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**THE ROLE OF BUSINESS IN PUBLIC AFFAIRS:
SOME NEW ZEALAND PERSPECTIVES**

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1 Introduction

In this talk I want to explore the tensions between two ideas.

The first idea is that because the only role of business is to meet consumer needs, the long-run interests of the business sector as a whole are largely consistent with those of most consumers. Consumers' interests are best served by an efficient economy which delivers them the goods and services that they want with the most economic use of available resources. From this perspective, the size and growth of the economy and the opportunities for business will be maximised by policies which encourage economic efficiency, such as open and competitive markets and smaller rather than larger government. It is therefore in the interests of business at large to promote such policies. They focus on expanding the overall size of the cake and are in the general public interest.

The second idea is that democratic politics is strongly influenced by special-interest groups, including business firms and industries which favour government programmes that confer substantial benefits on them while imposing smaller costs on a larger number of citizens. Governments are susceptible to lobbying by specific producer interests for protection, subsidies, regulation and other favours at the expense of the mass of unorganised consumers, taxpayers and other producers. From this perspective, individual businesses or industries have strong incentives to engage in rent-seeking behaviour to promote their private interests. While this results in a cake of smaller size, they obtain a larger slice of it if successful. Adam Smith wrote of the tendency of firms to conspire against the public interest and the idea has been greatly refined and developed in modern public choice theory.

In recent decades the private-interest view of business and the political process has been in the ascendancy. Those of a market-liberal persuasion have often seemed pessimistic about defeating what Milton Friedman has called the "iron triangle" of special-interest groups, politicians and bureaucrats. Certainly there has been a great deal of evidence in support of the view that there are strong political incentives for ever-increasing growth in government spending, taxation and regulation. On the other hand, there are countervailing influences, including ones that can be mobilised within the business community, as I propose to show.

I want first to discuss in a little more detail some aspects of the conventional views about politics and interest groups, and their implications for public policies and economic performance. Next I shall touch on some other general features of business-government relationships that various writers have rightly criticised. I shall then consider these elements of theory and practice with reference to recent New Zealand experience. Finally, I shall give some reasons for questioning a narrow or fatalistic interpretation of public choice theory and argue that business interests can be joined with those of think tanks and others in promoting market-liberal causes.

2 Special interests and the public interest

Only a generation or so ago, courses in political science reflected a more benign view of interest-group politics than is the case today. Interest groups were often regarded as a necessary and useful feature of the political process. In large, modern democracies, politicians were seen as incapable of ascertaining the views of unorganised, individual electors. Representative interest groups were the means of filtering their views to politicians. The job of politicians was to mediate these views, resolve any conflicts and translate them into policies.

There was at least a weak assumption that the representations of major interest groups were in the public interest – as their spokespersons typically maintained they were. Representatives of corporations could argue that "What's good for General Motors is good for America" in a way that would not be possible today without courting scepticism or outright mockery. Beer and sandwiches in Downing Street with trade union and employer representatives were one manifestation of this climate of opinion. The growth of organised interest groups was part of the ever-increasing dominance of government in the economy, and corporatist approaches to economic management were viewed favourably by many. Today we would be more likely to label such approaches, as manifested in Russia and some Asian countries, as 'crony capitalism'.

Such theories of interest-group politics were naïve, and were exploded by the public choice analysis associated with names such as James Buchanan, Gordon Tullock and George Stigler. This body of scholarship emphasised the incentives of business and other groups to lobby for self-interested purposes. On the other side of the bargain, it exposed the tendency of politicians to govern not in the public interest but in the interests of constituencies to which they were beholden. Politicians were seen as rational maximisers of voter support, seeking to increase their popularity and chances of being re-elected. They would therefore yield to pressures from organised groups with political clout, favour special interests rather than the general interest, and support policies which promised expedient 'quick fixes' rather than durable but less popular solutions.

Other writers like Mancur Olson developed these ideas, noting that the accumulation of interest group-driven policies distorted economic decision-making, fossilised institutional arrangements, sapped wealth creation and undermined economic growth. Olson observed that interest-group politics tend to develop a stranglehold in countries that experience long periods of stability and are broken in times of great upheaval: this helps explain, in his view, the post-war success of countries like Germany and Japan. New Zealand's isolation from world disturbances and the stable and intimate nature of its politics were conducive to interest-group sclerosis. Its long period of relative economic decline this century – after achieving one of the world's highest levels of average income per capita – fits Olson's hypothesis well, as does the reappraisal of its economic directions which followed the debt-induced economic crisis of 1984.

Public choice theory has been shown to have great predictive power. In the business sector, it helps explain the prevalence of policies such as protection against foreign competition, farm subsidies, industry licensing, handouts to both 'sunrise' and 'sunset' industries, restrictions on company takeovers and much else. Outside business the same incentives – to favour narrow interests at the expense of the general interest – can be seen at work in areas as diverse as occupational regulation, subsidies to higher education, arts funding, state pensions and minimum wages.

Public choice analysis also offers insights on the likely behaviour of different parts of the business sector.

Firstly, it suggests that the large numbers of small businesses, like the large numbers of consumers and taxpayers, are less likely to be able to organise effectively, engage politicians' attention and obtain government favours. They are therefore more likely to support free-market rather than interventionist policies. The Federation of Small Businesses in the United Kingdom fits this mould, as does its counterpart in the United States. When I worked in the New Zealand Treasury a popular in-joke was that the best way to help small business was to keep representatives of big business out of politicians' offices.

Secondly, in terms of public choice theory, organisations with broad sectoral representation may be more likely to adopt a national-interest perspective than those that represent specific industries or groups. In a paper that I wrote as a Treasury official, I suggested that:

... interest groups with broad representation, which are thus forced to take a more economy-wide view, may be a source of influence that is more coincident with the interests of the community at large.¹

In similar vein, William Niskanen, president of the Cato Institute and a former member of the US Council of Economic Advisers, recently made the point to a Japanese business audience that:

Firms and industries that seek special favours ... encourage other firms to seek similar favours, corrupt the political process, and undermine political support for capitalism.

In this sense, every firm that seeks a special favour creates a public bad. ... Any one firm is torn between playing the game to gain a special favour and supporting a principle to preserve the system. That is why it is especially important for broad-based business organizations like the Keidandren to maintain their support for the principles that preserve capitalism and constitutional government.²

However, this proposition does not always seem to hold: the United States Business Roundtable and the Confederation of British Industries tend to adopt more statist positions than the organisation I now work for, the New Zealand Business Roundtable. One thinks, for example, of the former's record of lobbying for anti-takeover regulations – a management protection charter – and the call by Sir Terence Beckett as CBI president for a "bare-knuckle fight" against Mrs Thatcher's reforms.

3 Weaknesses in business lobbying

In an article in *The Wall Street Journal* entitled 'What's Wrong with Business Lobbyists', Fred Smith, president of the Competitive Enterprise Institute, wrote:

Firms and industry trade groups spend ever-greater sums successfully purchasing "access" and "influence" in Washington, but still manage to lose ground over the long run. Despite some notable gains in

¹ Republished as *Ideas, Interests and Experience*, Centre for Independent Studies, Sydney, 1988.

² William A Niskanen, 'Deregulating the Japanese Economy', Cato Policy Report, July/August 1998.

deregulating a few markets, the competitive economy on which business prosperity ultimately rests is gradually being eroded.³

One of the problems identified by Smith is that, to many firms, principled defence of business interests appears ideological, "which indeed it is". "Ideas, however, do matter," he argued, "and it is important that business realizes this".

The best response to any criticism that a position is ideological is to point out that any alternative position is ideological also. The term evokes the notions of ideas and logic, and the debate must be about the quality of both. The case for free trade, for example, is based on certain ideas and logic, just as is the case for protection. It so happens that the 'ideas' and 'logic' justifying protection are wrong and those justifying free trade are right – at least according to the theoretical and empirical findings of the overwhelming majority of economists.

A country is not a company, and the body of knowledge needed to understand how an economic system operates is quite different from that required to run a business enterprise. Business people often fall into the trap of thinking that running the economy is like running a firm, hence the common attachment to corporatist approaches. Moreover, they tend to regard themselves as pragmatic rather than 'into' ideas, and are often not well informed about issues outside their own professional experience – which is surely true of most of us. But successful business people do understand the importance of expertise and professionalism in business affairs and can readily grasp the need for the same attributes for successful engagement in public affairs. Persuading them that they will not win without such capabilities, and without developing strategies on the same fundamental basis as they develop their business strategies, is not necessarily a difficult challenge.

The converse of not taking a principled stand is to engage in the tactics of accommodation and compromise. Joseph Schumpeter criticised the habits of business representatives when attacked by opponents in the following terms in his pessimistic book, *Capitalism, Socialism and Democracy*, written in 1942:

They talk and plead – or hire people to do it for them; they snatch at every chance of compromise; they are ever ready to give in; they never put up a fight under the flag of their own ideals and interests – in this country there was no real resistance anywhere against the imposition of crushing financial burdens during the last decade or against labor legislation incompatible with the effective management of industry.

³ Wall Street Journal, 16 January 1987.

Thus business representatives faced, for example, with a proposed hike in the minimum wage from, say, \$5 to \$6 are often inclined to bargain for a lesser increase, rather than to argue that minimum wages are fundamentally harmful, especially to the interests of young and unskilled workers – a position that attracts almost as much support amongst economists as the case for free trade. Usually they lose, and at the same time they have conceded the legitimacy of their position.

Even worse, as Paul Weaver describes in his 1988 book, *The Suicidal Corporation: How Big Business Fails America*, corporations have often funded consumer, environmental and other groups that campaign for policies that would be highly damaging to their long-term interests and those of the wider community. Their chief executives seek to deflect the focus of such groups elsewhere, or to use the government's powers to impose penalties and regulations on their competitors. They are like the miserable figure Ronald Reagan described as the fellow who hoped the crocodile would eat him last.

A further failing on the part of business is timidity: often business representatives will not stand up and be counted even in the face of serious threats to their interests and the economy. They may be afraid of offending the government or another political party, of political retribution, of consumer boycotts or simply of the unpopularity of defending an unfashionable proposition. The problem for them is that their opponents have no such fears and scruples, and that arguments cannot be won without arguing them. Business associations have a role to play here, by reducing the exposure of individual businesses and their representatives, but public opinion is often swayed more effectively by someone prepared to take a personal stand.

4 Some New Zealand perspectives

New Zealand is a prime example of a country whose economy was shaped by government interventions that were usually motivated by the specific interests of a pressure group, as well as by a longstanding attachment to mistaken ideas. As Rolf Porter, an able and far-sighted businessman, put it in 1971:

New Zealand is possibly the most state socialistic country in the world outside the Iron Curtain and it is we, the industrialists, that have made it so by always running to the government

The most powerful business organisation in old New Zealand was the Manufacturers Federation. It used to be said that presidents of the Federation had to be buried six feet deep so that they couldn't get a handout. The former prime minister, Robert Muldoon, believed that Manfed's opposition to some tentative efforts by the National government to

free up import licensing cost it the 1972 election. National remains timid about free trade to this day, even though the majority of the business and farming communities now support it. Other powerful interests in old New Zealand included the unions, whose support for centralised wage controls was needed to offset the price-increasing effects of import restrictions, and the farmers, who were given subsidies in an ultimately fruitless effort to maintain their international competitiveness in the face of high domestic costs and inflationary policies. The whole economy became one huge interlocking grid of special interests, walking around with their hands in one another's pockets, and in the early 1980s the whole edifice fell over.

A key principle of the New Zealand reform programme that began in 1984 was that special interests should no longer be allowed to dominate the wider interests of the community. Every New Zealander is, ultimately, a consumer whose interests lie in having resources used in the most efficient manner. In the end, enough sector groups realised that everyone would benefit if we had an economy in which no one's special interest held the legitimate interests of others to ransom.

The New Zealand Business Roundtable (NZBR) was formally established in 1986 by a group of business leaders who had come to realise that the old ways had run the country into the ground. Today it is an organisation comprising 50-60 chief executives of our largest firms and its sole concern is with national policy issues – we provide no 'private good' services to members. Our founding document states that:

The NZBR is committed to contributing to the overall development of New Zealand and to promoting the interests of all New Zealanders concerned with achieving a more prosperous economy and fair society. ... In an open and free domestic and international market environment, the interests of the business sector are closely aligned with those of the community at large. As a broadly based organisation, the NZBR's focus is the general economy rather than particular sectors or industries. This requires it to take an objective, non-partisan and longer-term view, rather than to operate for the benefit of any one group at the expense of others.

One way of thinking about such a business organisation is that it is a response to the familiar prisoner's dilemma, the central model of constitutional political economy. Enough business leaders had realised that autonomous business groups organised around industry and sector interests were locked into promoting the non-cooperative outcome in which everyone was worse off. They formed the NZBR because they saw that everyone could be better off if there was enough support for the welfare-maximising cooperative solution to make a difference. They were not in any way acting against the long-term self-interest of the business sector at large; to the contrary they were pursuing it in a way which aimed to produce public goods rather than public bads. Expanding the size of the cake was seen

as a better strategy, even from a self-interested point of view, than scrambling for a larger share of a smaller cake. An interesting irony is that those who favour mandatory collectivist solutions to public policies attack the NZBR for being individualistic (which it is in the sense of fighting to preserve and enhance the scope of individual choice) but they fail to see that it also represents a voluntary cooperative response to a collectivist (public good) problem.

Having nailed our colours very publicly to the mast of a national-interest goal, we are condemned to operate accordingly or lose credibility. Roger Douglas, the initial architect of New Zealand's economic reforms, observed in a 1987 book that:

... [members of the NZBR] are prepared to go back to first principles and argue from there instead of presenting the usual parochial points of view. If they don't, they realise it is much easier for someone at some stage to knock over their case.⁴

Twelve years down the track I am prepared to claim that we have stuck firmly to those principles and have not engaged in special pleading, and there has been no serious pressure within the organisation to do otherwise. The committed leadership of a few individuals was one factor that made a difference. A handful of members who decided they did not fully share the organisation's perspectives simply resigned in the early days, because they saw the vast majority of members were committed to them. If we have unwittingly erred at any stage, the responsibility lies with me as chief executive for deficiencies in research and analysis, not with the membership. As a newspaper columnist put it recently:

Anyone who reads the material (as distinct from raising their very hackles at the mention) of the Treasury, the Reserve Bank or the Business Roundtable, knows national welfare is the goal.⁵

Of course it is one thing for an organisation to commit itself to a national-interest objective; it is quite another to achieve widespread public acceptance that it adheres to such a stand. As Fred Smith has put it:

The tendency of too many business groups over too many years to use free-market rhetoric to mask special-interest appeals has rendered their views suspect.⁶

⁴ Roger Douglas (1987), *Towards Prosperity*, David Bateman, Auckland, p79.

⁵ John Roughan, *New Zealand Herald*, 11 September 1998.

Especially given New Zealand's socialistic past and the stance of business organisations over the years, it is hardly surprising that we have encountered many accusations of narrow self-interest, greed and undue influence. The public is not used to interest groups which behave differently: in his book, *The Triumph of Politics*, David Stockman remarked that he did not encounter one group which lobbied for the general public good in his time as Ronald Reagan's budget director. Ultimately, however, politicians and others have to reckon with the message not the messenger, and there have been far fewer serious attempts to dispute our policy conclusions in a careful, academic manner. We rely for any influence we may have mainly on research and published material: the number of contacts we have with politicians is quite limited. Moreover, we have not been accused of timidity in persisting with arguments which initially encountered intense opposition from interest groups and others but which gradually became accepted and found their way into policy. Challenging sacred cows is never a recipe for popularity.

Of course, there have been many other politicians, organisations and individuals who have promoted similar ideas in New Zealand over the last 15 years or so, and they have been in line with worldwide trends. It is therefore impossible ultimately to fathom what contribution we may have made to the changes that have occurred. What is interesting to note is that, with the exception of a handful of individual voices, practically the whole of the business community as represented through national business organisations has moved to policy positions similar to our own. An illustration was the universal rejection last year by all the major business organisations of \$100 million of so-called business assistance included in the package negotiated by the coalition government partners after the last election. This stance, I believe, would find few parallels around the world. The consistency of business sector attitudes has been one of the more positive features of the New Zealand environment in recent years as governments have allowed economic policies to weaken and economic problems to accumulate again, and persistence with this stand offers the best hope of rebuilding a political constituency for policy improvements in the medium term. David Henderson, an experienced OECD observer, has said that nowhere else in the world have members of the business community been prepared to play such a role.

5 Conclusions

The articulation of public choice theory – the economics of politics – over the past 30 years or so has been an important achievement. It has shed much light on how politicians, under the influence of organised lobby groups, frequently work to advance private interests rather than the public interest. But the lessons to be drawn from public choice analysis do not need to be defeatist or even pessimistic. Were the strong-form versions of public choice to be taken literally, it is hard to see how the worldwide moves towards

⁶ Loc cit.

deregulation, privatisation and greater economic freedom over the past two decades could have happened. Many would argue that these changes have not gone far enough, but the fact that they have occurred at all suggests the need to look for other explanations.

A first explanation, I suggest, is that in a sense public choice theory has sown the seeds of its own demise. By that I mean there is now a heightened consciousness of the phenomenon of rent-seeking and greater scrutiny of the claims of distributional coalitions. The influence of 'iron-triangle' interest groups will only be maintained in the long run with the help of non-interested parties. When that support weakens, perhaps as a result of better-informed public opinion, rent-seeking becomes less profitable and less socially acceptable.

In the business community in New Zealand, it is now almost bad form to lobby for government handouts, and there is greater awareness of 'provider capture' in areas such as health and education. Producer interests came to accept that economic output would be higher, and all sectors considered jointly would be better off, if some force other than immediate self-interest induced all groups to forgo rent-seeking activity. The dynamic that developed was that one group was prepared to accept the loss of its privileges provided others were treated likewise. Moreover, industry groups had come to realise that privileges could be 'rented' but never 'owned', and the costs of paying the 'rent' – in the form of expenditures on lobbying – were a deadweight loss to them as well as the economy. Outside the producing sectors in New Zealand, however, there has been little sign that rent-seeking has diminished among welfare, cultural, environmental and ethnic lobbies.

Secondly, as I have argued, there is scope for voluntary, cooperative solutions to some of the 'public good' problems associated with promoting better public policies. These relate essentially to the fact that the benefits of successful efforts to promote better policies accrue to all, and others can free-ride on those who make them. New Zealand's experience suggests, however, that many in business may come to recognise that it is not in their interests to spend their careers struggling to run their firms in a third-rate economy, and that they are prepared to take a broader and longer-term view even though a shift to better policies may harm their firms in the short run. There have been free-riders in New Zealand who have not contributed to the business community's collective efforts, but they have not made them unviable. As I read it, at least the Virginia school of public choice theory does not deny the possibility of spontaneous, voluntary solutions to the public good problem. Only hardline Marxists see the world as composed of conflicting groups, the inevitable activity of each of which is to pursue its own interests at the expense of others, and deny the possibility of cooperative solutions.

Finally, too literal an interpretation of public choice theory overlooks the power of ideas. Ideas about economics and politics ultimately influence the political process irrespective of

group pressure. Otherwise how would change occur? One of Keynes's insights in the *General Theory* that was unquestionably right was that "the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas."

It was mistaken ideas about policy – essentially the adoption of "socialism without doctrine" as a European visitor to the country early this century put it – that accounted as much as interest group lobbying for New Zealand's long-term economic decline. An important insight of David Henderson's, which he has revisited in a forthcoming paper to be published by the Institute of Economic Affairs (IEA) and the NZBR, is that influential ideas are not confined to academic circles. Even educated public opinion is clearly influenced by strongly held intuitive notions about economic issues, relationships and events. The notions of what Henderson has called 'do-it-yourself-economics' are characteristically centralist and anti-market. These have influenced the course of policies in many countries, including New Zealand. The progress of economic liberalism over the past two decades suggests that opinion is shifting, but support for it is still far from conclusive. However, the potential for good ideas to drive out bad over time is arguably the best hope for overcoming both the continuing influence of pre-economic thinking and the power of vested interests. Better policy making might also be encouraged by well-conceived constitutional rules such as those embodied in New Zealand's Reserve Bank Act 1989 and Fiscal Responsibility Act 1994.

In an IEA address, the former GATT economist, Jan Tumlir, referring to government attempts to mobilise service industries and consumers to lobby for liberal trade, remarked:

What an absurd system it would be where an obviously reasonable policy could be sustained only if these two large masses of citizens could be organised in active support of it. ... If the issues of liberal trade and protection were presented to them in their capacity as voters and electors, fully, simply and intelligently, why should any politician doubt that their response would be equally intelligent?⁷

And it is here, it seems to me, that there is scope for stronger alliances between the purveyors of ideas in the market-liberal think tanks and the entrepreneurial class in business. Such alliances are not always seen by many in the think tank community as natural – and often for good reason, given the public policy stance of many business organisations. But I have argued that malign stances by business are not inevitable and indeed that is in the larger interests of business, properly conceived, to make the case for a liberal economy and society. If business will not make the case for free enterprise, who will? Like-minded think tanks – which of course have often been endowed by individual

⁷ Jan Tumlir (1984), 'Economic policy as a constitutional problem', Harold Wincott Memorial Lecture, Institute of Economic Affairs, London.

business people – are one of businesses' few allies in this role. In my view the best strategies for both parties are similar; as Fred Smith has argued:

If business is to defend its long-run interests successfully, it must ensure an adequate defense of the free market. It should adopt the approach pioneered by liberal public-interest groups: find areas where a difference can be made, create rather than respond to an agenda, marshal intellectual and political forces, and seize the moral high ground.⁸

New Zealand's experience offers some grounds for hope that this can be done.

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Loc.cit.