EMBARGOED UNTIL 2.00 PM WEDNESDAY 25 NOVEMBER 1998

WELLINGTON REGIONAL CHAMBER OF COMMERCE

TURNING GAIN INTO PAIN

DOUGLAS MYERS CHAIRMAN LION NATHAN LIMITED MEMBER NEW ZEALAND BUSINESS ROUNDTABLE	WELLINGTON 25 NOVEMBER 1998

TURNING GAIN INTO PAIN

Remember 1994? That was the year that marked a decade of economic reforms in New Zealand. Pain had been turned into gain. The economy grew that year by 6 percent, having grown by 5 percent the previous year. Unemployment was dropping like a stone, inflation was down and out, the current account deficit was 1 percent of gross domestic product (GDP) and the budget was in surplus. New Zealand's achievements were getting due recognition around the world. As an editorial in *the Wall Street Journal* put it:

> Under finance minister Roger Douglas, this tiny, faraway democracy began its break from limp socialism. It was the most ambitious assault of any Western nation on the system of entrenched privileges that had made an elite rich and resulted in reduced opportunities for everyone else.

But New Zealand's socialistic past casts a long shadow, as Michael Bassett's recent excellent book about the state in New Zealand reminds us. It has turned out that 1994 was a turning point. That year I received a letter from a major investment fund manager after a visit here. He too was enormously impressed by New Zealand's economic renaissance after what he described as "decades of socialism which [had] left the country bankrupt and desperate in the 1980s." Like any prudent investor, however, his concerns were forward-looking. "Now that most of the damage has been repaired and things are going well", he said, the country appeared to be lapsing back into its old habits. "For that reason … we are reducing our exposure to New Zealand."

By 1994 Ruth Richardson had been dumped. Like David Lange before him, Jim Bolger had decided that staying in the competitive race was too hard. He stopped rowing and opted for the job of helmsman, but sadly his steering skills were no better. New Zealand has been drifting ever since, and is now dangerously close to the rocks again.

Nineteen ninety-four was the year in which economic growth and business confidence both peaked. Soon after the public sensed that things were on the wrong track. In the regular *Insight* poll those who believed New Zealand was heading in the right direction peaked at 57 percent in August 1995. The number has fallen steadily to 25 percent today.

It's not hard to see why New Zealand is again in deep trouble. Key failures of Sir Robert Muldoon – the Great Spendthrift and Timid Gradualist – were repeated by his National Party successor. The massive blow-out in government spending began in 1994 and was exacerbated by the coalition agreement. Policy paralysis set in that year and was made worse by MMP. Even our near neighbour, Australia – second only to New Zealand as an economic under-performer – has moved ahead with deregulation, privatisation, tax reform, central bank independence and government spending restraint which has yielded a budget surplus. The consequences for New Zealand of four years of economic mismanagement, combined with a difficult external environment, are an economy in recession, unemployment on a rising trend, a weak external account, a credit rating downgrade, a steep fall in the currency, a budget that is back in deficit again, and, most telling of all, a big outflow of talented people.

What is extraordinary is that many New Zealanders have not figured out that the story of our economic life since 1984 has been one of two waves of reform, followed respectively by a teabreak and a long lunch. Jim Anderton, for example, thinks it's a story of "15 years of failed policies" and would take us back to the pre-1984 era. What this view completely overlooks is Jim Bolger's departure from a disciplined economic framework, partly in response to the Alliance's success in the 1993 election, and the further departure under the coalition with Winston Peters, whose explicit goal was to 'moderate' what he maintained were 'harsh', 'uncaring' policies. He manipulated a gullible electorate, got what he wanted, and his $5 billion spending package was the final straw in 'moderating' the economy to a standstill.

A couple of other issues need to be put in perspective.

First, the idea that New Zealand's reform programme has 'failed' is ludicrous. By any standards it was a remarkable achievement. Prior to this year New Zealand enjoyed 20 out of 21 quarters of continuous expansion. From the end of 1991 until last year the economy grew by around a quarter. Even with the recent drop in employment there are now 268,000 more jobs than at the end of 1991 – an increase equivalent to two thirds of the jobs in the whole of the South Island. Net government debt has been halved to under 25 percent of GDP and net official foreign currency debt has been totally repaid. Company balance sheets are much stronger. Despite the recent slippage, the results of nearly a decade and a half of reform have enabled New Zealand to weather the present international financial turmoil. Without them we would be looking like Thailand today.

Secondly, the rhetoric since 1994 about 'softer' policies has been economic rubbish and political humbug. We should judge policies by their results not their labels. The results have been a setback to the prospects of the least well off, rising unemployment and few benefits from pouring billions of extra dollars into dysfunctional health and education systems. Moreover, when it came to New Zealand First there was not even any pretence about helping the poor – the vast majority of the benefits of its spending initiatives went to wealthy superannuitants and other better-off groups in a naked vote-buying exercise. So much for MMP and its incentives to pander to interest-group politics.

In October last year Jim Bolger finally seemed to hear the wake-up calls and responded with his 'Springtime' speech. But he was still in dreamtime – even though the Asian crisis had struck several months earlier and the policy framework was falling apart, he thought New Zealand would achieve 4 percent growth this year whereas we will be lucky to see any growth at all.

Twelve months down the track the government and the Reserve Bank are still telling us – for the third year in succession – that a recovery is just around the corner. This time the upturn is supposed to be driven not by tax cuts and the AMP demutualisation but by lower interest rates and a pick-up in exports. This could again be illusory: the worst of the international turbulence may not be over, policy directions remain confused, and election uncertainties may soon be upon us.

No coherent programme to put the economy back on track has materialised since Jenny Shipley took over. Some initiatives which were in the pipeline, like the decisions on tariffs and ACC have gone forward, and the proposed sale of Contact Energy is welcome. But much of the rest of the agenda in the prime minister's February statement has gone nowhere: the Code of Social and Family Responsibility is in tatters, efforts to fix the Employment Contracts Act were abandoned, hospital reform has been put on hold for three years, the Auckland Regional Services Trust exercise was a fiasco, and nothing has been heard about a Regulatory Responsibility Act. Next month's Budget Policy Statement is likely to show the government spending ratio rising instead of falling towards the government's goal of 30 percent of GDP. Good tax policy principles are being abandoned with the decision to fund the ACC 'tail' with a payroll tax to make the government's battered accounts look better. Another spring has come and gone and the economy's plight reminds me of the banal words attributed to the Victorian poet laureate, Alfred Austin, written at the time of the illness of the Prince of Wales:

> Across the wires the electric letters came
> 'He is not better, he is much the same.'

Now the government is talking about easing the pace of reform with next year's election coming up. How it can go much slower is surely a mystery to most of us in business. A symbol of its work rate is that a minor initiative which it announced as one of the highlights of its 1997 budget 18 months ago, the sale of its vehicle testing stations, has still not gone through. Lacking a strategy, it has become an easy prey to any interest group that decides to challenge it. Backing off roading and producer board reform certainly won't help the economy. Experience seems to show that governments which capitulate to interest groups and lack principle and commitment don't help their political fortunes either.

On the other side of politics there has been much talk recently of a swing to centre-left governments in a number of countries, of a reaction against economic liberalisation (for example in Asia), and of yet another search for a so-called third way. There is a lot of confusion in my view in such interpretations.

For a start, the idea that the election of centre-left governments in Britain and several European countries means a reversal of the policy directions of the past two decades seems to me totally misconceived. Tony Blair positively embraces the Thatcher legacy: 90 percent of Blairism seems, so far, to be Thatcherism with a smile instead of a handbag. The new German government is talking about labour market and welfare reforms and tighter fiscal policy, and an ex-communist prime minister in Italy is pressing ahead with privatisation, as is the socialist government in France. President Clinton has carried on where Ronald Reagan left off, and has presided over welfare reforms that Reagan never contemplated. Many of these countries are still attached to dubious economic policies but none is talking about going backwards. Both Blair and Clinton are strongly and visibly pro-market and pro-business.

By contrast, the centre-left parties in New Zealand display no such instincts: their inclinations are to disown the legacies of the 1980s, embrace a backward-looking programme, abandon privatisation and emphasise taxation and income redistribution rather than enterprise and wealth creation. It would simply not be credible for the present Labour Party to try to brand itself as 'New Labour': it has failed 'Old Labour' written all over it.

As far as Asia is concerned, I believe the lessons are also being read wrongly in the same quarters. The problems in Asia are not a failure of economic liberalisation: to the contrary they revolve around policy failures with regulated exchange rates and financial market controls, political cronyism and serious weaknesses in banking systems and corporate governance. At the Pacific Rim Forum I attended last month in Shanghai, attended by some 500 heavy hitters from around the region, there was no inclination whatsoever to retreat from a globalised and integrated world economy, despite its strains and challenges. To the contrary, the strong message was that efforts to free up trade and liberalise markets must continue: there is no place to hide. Japan was seen as being in chronic need of deregulation and the view was that Malaysia's agony would get worse if it tries to swim against the tide for long.

It is true that in Australia we saw a Labour Party going into an election last month with a protectionist, high spending and backward-looking programme. But the soft options it offered were rejected by the electorate in favour of a government that campaigned explicitly on a pro-reform agenda, including the politically difficult issue of tax reform. As one commentator saw the result, the argument of Pauline Hanson and others that:

> … the Australian electorate is tired and frightened of reform … is dead and finished and should never be mentioned again.

The facts of life are that no country is going to prosper in the modern world if it doesn't embrace continuing change. Change is inexorable, and all growth depends on it. It is no use clinging to anachronistic producer board structures which may have made sense when New Zealand was exporting a handful of commodities to one market but make no sense when we are dealing with sophisticated food markets in all parts of the world. It is no use complaining about welfare dependency when 30 years of experience tells us that our present welfare system will continue generating more and more dependency if it isn't changed. We have to face up to such challenges if we want to make progress. And we must do so continuously: countries that, like the proverbial hare, just put on a spurt from time to time and then take time out for a nap still end up losers.

If New Zealand wants to succeed, it has to become a competitive nation whose diverse people are confident about doing business with the world and are well equipped to do so. It must accelerate the removal of obstacles to business enterprise and so improve the rewards from work, saving, investment and education. It must downsize all levels of government, which still appropriate 40 percent of national income, and lower taxes. The world will continue to change, with or without New Zealand. If New Zealand fails to meet these challenges, its people will not be secure, let alone be prosperous enough to provide the resources to look after those who genuinely need help.

We know that New Zealand has the potential to be a first class country. We proved that in the mid-1990s, when the economic framework finally became balanced and consistent. That period stands as a benchmark against which subsequent performance can be judged. Fortunately the reforms lasted long enough for New Zealanders to be able to see that pain could be turned into gain. The benefits were not just theoretical, and with falling unemployment, a start to real wage increases and then tax cuts targeted at low income earners, they were spreading widely. The tragedy is that the country has subsequently had to learn that through sheer mismanagement gain can equally be turned into pain.

In my business career I have discovered that there are two ways to arrive at a sound business strategy. One is to use your brains, think hard and logically, listen to good advice and go for the best quality decision. The other is to learn the hard way: don't do your homework, make mistakes, and then painfully remember never to repeat them. I have done both and I know which is less costly.

New Zealand now faces similar choices. Over the past few months I have been struck by the number of business colleagues who feel as frustrated as I do about the country's slide back into mediocrity. Many have begun to think that the only way out may be for New Zealanders to have to learn the hard lessons all over again. Personally I have not quite reached that position. Continued drift or, worse, a return to backward-looking policies would have huge costs. They would not fall primarily on investors, who have already been putting their money somewhere else, or on skilled and mobile people who can vote with their feet – as so many of them have recently been doing. They would fall instead on the unemployed, the unskilled, the elderly and others who don't have such options. Those people don't deserve that fate.

I believe we ought to have the wit to choose better. All political parties should be able to recognise the essentials of modern economic growth: providing a stable, neutral environment for savings and investment; reducing the size of government; opening markets to trade and competition; respecting property rights and the rule of law; not burdening the productive sector with unnecessary regulations and controls; and building human capital through flexible labour markets and sound education. The Business Roundtable and the Wellington Regional Chamber of Commerce set out such an agenda in the report *Moving into the Fast Lane* two and a half years ago. It is as valid today as it was then. We must continue to challenge political parties to take it up or tell us why they disagree with it.

Professor Michael Porter of Harvard University had similar advice when he was here earlier this month. He felt that New Zealand had made huge strides since his visit in 1991 – the economy was more stable, we had got rid of many unnecessary government activities, and businesses were better run and managed. But he observed that we seemed to have stalled, antiquated institutions like producer boards were still in place, and we needed a new vision and momentum.

Porter argued that there is – or should be – little political debate about most substantive policy issues and that there is no gap between economic and social policies. And he made another point which I think is very important. He suggested that what separates nations today is their ability to do things. By that he meant the quality of their political and business leadership, their ability to develop an achievement orientation, and their willingness to embrace ongoing change. He stressed the need for a vision, for political parties to spell out a framework for the electorate, to say what they believe in and what they want to achieve. I agree with him that the country desperately needs political and business leadership to show the way forward. And I know of no successful country where politicians and the business community are at odds.

But is anyone listening – to Porter or anybody else? I see little sign of it. How many people passionately want New Zealand to be an exciting, dynamic place, and are willing to strive to make it happen? Where is the concerned and articulate media alerting the country to the dangers it is facing? There is no reason why the country should drift on to the rocks – but where is the will to salvage the situation?

Like Russia, New Zealand seems to find it hard to escape its history – just listen to the arguments at any Grey Power rally. Many of the same generation that ran the country into the ground by the early 1980s push an agenda which would do the same again – and among other things lead to further cuts in pensions down the track. There is something in the Kiwi psyche that is uncomfortable with success – we would rather tear down achievers than applaud them and seek to emulate them. Unless that changes, mediocrity is likely to remain our fate. And unless the community comes to terms with the policy slippage and the paralysis of MMP and insists on change, my prognosis for New Zealand is bleak. Before we know it we could easily be facing an economic crisis again. In that event the process of turning gain into pain will not be at an end.