ECONOMIC AND SOCIAL POLICY

NEW ZEALAND BUSINESS ROUNDTABLE

SEPTEMBER 1989

FOREWORD

In addition to the publication of a series of research studies and submissions to official inquiries undertaken by the New Zealand Business Roundtable, its analysis and views on a number of issues have been presented in speeches, papers and articles given by representatives of the organisation.

This volume is a collection of such material on a range of economic and social policy issues. Topics covered include the economy, privatisation, education, retirement income support, occupational safety and health, the labour market, employment equity and commercial law. There is also an address which describes the Business Roundtable and its aims and interests.

The volume contains a paper on labour market issues by Professor Michael Porter of Monash University, Melbourne, Australia. Professor Porter has been a consultant to the Business Roundtable on this subject.

A full list of current publications is also included.

R L Kerr
EXECUTIVE DIRECTOR

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BACK TO THE BRINK?

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BACK TO THE BRINK?

It is a pleasure to be here with you in Hamilton today and to share with you some thoughts on economic directions in New Zealand in 1989.

To see where we might be going, it is useful to take a look at where we have been. Let me begin by quoting from a survey of New Zealand by the international financial journal, Euromoney.

> "This survey", it wrote, "is a story of rapid change suddenly imposed after generations of stability. No wonder that it has induced an acute attack of inner insecurity among New Zealanders, blinking in the strong sunlight following their expulsion from the sheltered life to which they had become accustomed. This uncertainty is inevitable under the circumstances... The speed and thoroughness of the response from concentration on a totally protected home market to the reality of the world trading markets has been startling."

What was Euromoney talking about? Obviously, you will be saying, the economic changes introduced since 1984 by the Lange Government. You would be wrong. The survey was written in September 1980. Its timing marked the high point of the previous Government's erratic efforts to abandon the unsuccessful economic policies that had held the country back for so long and join the real world.

New Zealand's economic problems are of very long standing. The 1962 report of the Monetary and Economic Council pointed out that during the period 1949-1960, "the New Zealand economy has earned the unfortunate distinction of having one of the slowest annual rates of growth of productivity among all the advanced countries of the world." This record continued. Over the period 1960-84, New Zealand had the slowest rate of productivity growth in the OECD area. In the 1970s, with the two oil price shocks and international stagflation, the chronic weakness of the economy was exposed with a vengeance.

The Muldoon administration attempted on two occasions to get to grips with the problem in an orthodox way. When it came to office in 1975, it reversed the reckless attempts of the Kirk/Rowling government to counter the impact of declining terms of trade by monetary and fiscal expansion. The budget deficit was cut from 8.6 percent of GDP in 1975/76 to 3.6 percent in 1976/77. Interest rate controls were liberalised and money and credit growth slowed appreciably.

So, of course, did the economy. Real output fell by 5 percent in 1977/78, a far steeper recession than the one New Zealand has recently been experiencing. Unemployment climbed dramatically. The Government lost its nerve. By 1978/79 the budget deficit was up to 8.3 percent of GDP again and inflation was on the rise.

After the 1978 election, the Government made its second and temporarily more successful attempt to lift New Zealand out of its economic hole. For 18 months to mid-1980 it did many of the right things. Fiscal and monetary policy was tightened, a start was made in relaxing import licensing and other regulatory controls, and the foundations for CER were laid. The 1980 Budget has much in common with the policy framework of more recent years.

By the time of the Euromoney survey, the benefits of sounder policies were showing up. Inflation was down to 10 percent. But inevitably the economy was slowing, and the 1979 oil price increase was affecting New Zealand along with other OECD countries. With the loss of the by-election in East Coast Bays, the Government's nerve snapped again. A mini-Budget to boost activity followed in November 1980, and from that point on the Government never got back to a sound policy course.

What followed in the next three years is well known. Public works and job creation schemes mushroomed, SMPs were raised to economically absurd levels and the Government embarked on a massive programme of picking industrial winners with the Think Big projects. In the face of a growing fiscal deficit and inflation, it first tried to jawbone interest rates down and then imposed controls. It attempted to negotiate a kind of 'compact' with the trade union movement, and when that failed it froze prices and wages. Between 1981 and 1984 the public debt rose from 26 percent of GDP to 41 percent. By 1984 New Zealand looked more like Albania than a market economy. With the departure of Derek Quigley, the last forceful voice for economic sanity was removed from the Cabinet. Fittingly, towards the end of its time in office, the Muldoon Government was given the wooden spoon award by Euromoney for economic management.

It is noteworthy that at no time during this latter period did the Government announce that it was doing a policy U-turn. Instead it talked about shifting the emphasis of policy and concentrating on new targets. The increase in the marginal income tax rate (to 66 percent) was a 'temporary surcharge'. We would just have to allow some of our ratios to 'get a little bit out of line' for a while. In any case, Sir Robert told us, New Zealanders 'would not recognise a budget deficit if they fell over it'.

The verdict by New Zealanders on these insults to their common sense was given at the 1984 election, but not before there was a massive run on our foreign exchange reserves which brought the country to the brink of default. At the Economic Summit that followed, there was a broad-based consensus that New Zealand had been on a road to nowhere and had to change direction.

The direction that New Zealand has since taken has been firmly towards the international mainstream. One of the most remarkable phenomena in politics in the 1980s has been the growing international consensus on economic policy. In the words of a former editor of the Australian Financial Review:

> "This agrees on the need for a more liberal economic regime in which government ownership and regulation are not oppressive, in which individual economic activity is not discouraged by excessive taxation or direction, in which the reality of the market is incorporated into the policy objectives of governments, and in which welfare and social policy measures are judged by their efficacy, not their ideological purity...
>
> "It punctures the myths of regulation, rejects the myths of the 'New Right', and lays the basis for a modus vivendi between free markets and effective government."

The same point was recently made by The Economist. It noted that:

> "All British governments that do not want to pauperise the country are now obliged to run an economy that is open to the world, and within which the market determines what goods are produced, where and how... This does not mean that economics has disappeared from politics. But the debate on economic policy has been squeezed into a narrower channel than seemed possible ten years ago."

To an increasing extent, good government is about good economic management.

Many of the Lange-Douglas economic initiatives were consistent with this policy consensus. Despite the upheavals involved for them, the farming community, much of the business sector and many other groups have stood by the agreement reached at the Summit and broadly supported the Government's actions. The 1987 election was a referendum on the economic policies that had been adopted. The electorate supported an administration which, unlike previous ones, did not appear about to throw in the towel as the going got tough.

However, the inevitable short term adjustment costs, which were aggravated by the growing imbalances and flaws in the Government's own policies, were clearly creating political tensions within its own ranks. That cracks and fissures appeared should not be a matter for surprise. Speaking of a far more ambitious attempt at economic reform in the Soviet Union, The Economist recently wrote:

> "In any great endeavour there comes a moment when the will to press ahead falters in the face of the enormity of what has to be done... Three and a half years into its 'second revolution', Russia may have reached faltering point... Ten years from now, the Gorbachev era could seem no more than a brief interlude in Russia's steady decline. Its fate hangs on how he copes with this crisis of confidence."

As in the Soviet Union, the main opposition the Government has had to contend with in gaining acceptance for the necessary changes has come from the most conservative quarters, in New Zealand's case the unions and the hard left. A spokeswoman for Labour Youth called for a U-turn in government policy at the 1987 party conference, arguing that 'Stalin had achieved in 20 years what the West has taken 200 years to achieve'. Bill Andersen, a leading trade unionist in Auckland, recently declared on radio that for him the model society was East Germany. East Germany is a country where living standards have not increased since 1975, where 90 percent of the trees are sick, dead or dying, and where the population is kept in by a wall. More generally, the trade union movement has not adhered to the Summit consensus. As the President of Federated Farmers put it recently:

> "It is quite obvious that the union movement does not believe in a competitive economy. They are calling for a regulated economy."

The debate over asset sales is an illustration of just how far out of touch elements of Labour Party thinking are with developments in the rest of the world. The failure of state enterprise has been recognised worldwide, by governments of all ideological persuasions. An article that recently caught my eye in the New York Times reported calls by leading economic advisers in China for an abandonment of state ownership of industry. They argued that 'public ownership is no longer the premise of socialism' and pointed out that:

> "... when companies are owned by the state, the Government interferes with running them efficiently and the companies themselves try to maximise benefits to employees rather than profits and productivity."

The Chinese officials argued for privatisation and the creation of a share economy, including the emergence of large institutionalised shareholders who would oversee managers and replace them if they did not aggressively pursue profits. Unlike our National Party, they also strongly favoured allowing foreigners to buy shares.

Contrary to the tide of opinion in China, the Government's policy on state enterprises appears to be increasingly compromised. The abortive sale of the Bank of New Zealand was an early development. More recently, the prospects of political interference with the running of SOEs have re-emerged with the debate over the remuneration of top executives.

It is a sorry commentary on the National Party's performance in this area that they have picked up the same populist theme. The point they should be making is that with the half-way house SOE model, such political interference will always be irresistible for politicians, and is yet another illustration of why the state should not be involved in running businesses.

I believe the hard-line opposition to privatisation and other internationally accepted policies represents a tiny fraction of public opinion in New Zealand, and I shall give more evidence for that viewpoint shortly. While the Government was unified, the tensions within the party ranks were successfully managed. A crucial factor was leadership. The Conservative government in the United Kingdom is widely credited with saving Britain from third world status, but Thatcherism without Mrs Thatcher would have been inconceivable. The current lack of investor and business confidence is due in large part to uncertainties about the directions that will be charted from the top. If 1988 was 'boringly predictable', many people are asking what we are in for this year.

On this score there are grounds for real concern. It has become increasingly apparent over the last two years that there are three issues that the Government has not come to grips with which are undermining the good work it has done. These are the labour market, government expenditure and social policy. In each case the basic problem has been an unwillingness to face up to the minority vested interests to which I referred.

In retrospect, I believe the turning point for the Labour Government will be seen not as the ill-fated economic package of December 1987 but as the failure to agree on fundamental reform to the labour market in late 1986. As two National Bank economists recently argued in an excellent article in the National Business Review, the rise in unemployment is not some sort of accident that has hit the Government out of the blue. It is the inevitable result of the unbalanced mix of policies it has been pursuing since 1984.

The Business Roundtable, other employer groups, the Treasury, the Reserve Bank and many independent observers warned the Government from the beginning that the policy mix it was choosing would lead to that result. The Cabinet-Caucus committee on labour relations, headed by Geoffrey Palmer with Margaret Wilson as the party representative, chose to disregard that warning. They were also warned that the changes made to the Labour Relations Act were a Clayton's reform which would see minimal changes in bargaining behaviour, but they maintained otherwise. Two wage rounds and 150,000 unemployed later, the evidence is clear. The system has not changed, and it is a machine for job destruction.

The Australian Treasurer, Paul Keating, told the officials of the metalworkers' union in Australia, who instigated the wage push of 1981, that they carried 100,000 dead men around their necks. The architects of the Labour Relations Act bear the same responsibility.

The National Bank economists pointed out that approaches to unemployment currently being canvassed - such as an expansionary monetary policy, government work schemes, a general recovery in the economy or a compact - are all based on fallacies. In their words:

> "The Cabinet has only one option if it wishes to make quick inroads into the unemployment problem. It should deregulate the labour market without delay."

Other recent articles on the same theme are a hopeful sign of changing public perceptions. Talk of a freer labour market meaning Ethiopian-level wages is now recognised as being as ridiculous as earlier talk about Hongkong-style coolie wage levels. With one of the freest labour markets in the world, Hongkong not only has full employment but also wage levels that are now as high as New Zealand's and could be 50 percent higher a decade hence.

There is no doubt that there is a large public constituency for labour market deregulation. Two public opinion surveys commissioned by the Business Roundtable showed New Zealanders want increased freedom and choice in their employment relationships. They want to negotiate directly with their own employers rather than be covered by blanket national awards. They want employees to have a free choice on whether or not to join a union and the ability to decide which union to join.

Yet all these aspirations have been opposed by the leaders of the CTU, whose interests are served by compulsory, monopoly unionism, and the Government has preserved their privileged status. As yet there is no sign in government circles that the lessons have been learned. To the contrary, Geoffrey Palmer and Margaret Wilson are the leading supporters of yet more intervention in the labour market in the form of so-called 'pay equity' legislation - the idea that, for example, a female clothing workers' pay should be related to that of a waterside worker. Once again their approach is not based on the overall interests of New Zealanders. Mr Palmer's comments on a recent television programme were tantamount to an admission that a prime motivation was to buy women's votes. The Prime Minister added that if companies couldn't afford it, they deserved to go broke - a strange recipe for helping the most marginal and disadvantaged workers.

The second crucial policy failure has been the uncontrolled surge in government spending. It is extraordinary that more people have not challenged the Government's rhetorical claims that it will not tolerate a 'blow out' of government spending or the deficit.

On government spending, last year's Budget tables showed that outlays have blown out on some measures by up to 5 percentage points of GDP in only four years. Total expenditure has risen from $15.3 billion in 1984/85 to $25.6 billion this year. This is the largest blow-out in government spending in any comparable period. In Australia over the same period, the Hawke Government has reduced government spending by 4 percentage points of GDP. The difference goes a long way to explaining the relative health and job creation performance of the two economies. Increases in government spending will always crowd out the employment-creating potential of the private sector.

As for the deficit, the issue is not whether a blow-out has been prevented, but whether the deficit has been sufficiently 'blown-in'. Clearly it has not. Since 1986, progress in reducing the deficit has stalled in spite of substantial increases in average tax rates. Financial deficits have continued to add to the debt burden. Given the slippage that has already occurred, a financial deficit objective of 1 percent of GDP or $600-700 million in 1989/90 is not an adequate target. Moreover, the quality of decisions made to reduce the deficit will warrant careful scrutiny. Market reaction to the 1988 Budget was adverse because it incorporated ad hoc and once-off measures which left the medium term fiscal position in its present precarious state.

With Roger Douglas's departure, there are real fears that the Government will go still further down the high spending - high taxing path. Some in the Government appear to be admirers of Sweden which has the highest levels of spending and taxing in the developed world. They would do well to examine the facts of Sweden's performance over the past 20 years.

Up to the late 1960s, Sweden prospered due to policies which were remarkably like Rogernomics, including a public sector share in the economy well below New Zealand's present level. Since then it has stagnated under the burden of high inflation, a bloated public sector and a growing body of labour market regulation. Between 1970 and 1985 its average annual rate of growth was 2.2 percent, even lower than New Zealand's meagre 2.3 percent in that period. Unemployment has been kept low largely by putting 40 percent of the workforce on the public payroll. Taxes are astronomical, and estimates of the cost of raising an additional dollar of revenue go as high as $7.00.

It is because of this sacrifice of potential national income that sound fiscal planning is not simply a matter of deciding on a level of government spending and independently using the coercive power of taxation to raise the necessary revenue. The benefits of government spending programmes need to be weighed against the marginal costs of financing them with mounting disincentives to work, save and invest.

In the 1980s, OECD countries have recognised that high spending and taxing policies are a drag on economic performance. Most of them have moved to contain or reduce the public sector share in their economies. Even Sweden has made a start in that direction, and is proposing to flatten its income tax scale. The blow-out in government spending in New Zealand is a quite exceptional case.

Any move to deal with the fiscal problem by reversing the income tax changes that have been made would have a devastating effect. The successive tax packages have represented a clear-cut deal : a more level playing field without loopholes and concessions, in exchange for lower rates. Overseas financiers are appalled that there is talk of changing the October 1988 tax scale only four months after it was introduced. Such a return to Muldoonist ad hocery and uncertainty would seal any hopes for an early return of business and investor confidence. The overriding priority must be to reverse the spending blow-out.

The third serious failure is social policy. After four and a half years, we have had little clarification of the Government's thinking in this area. The debate seems to be between those who regard social policy as about spending more taxpayers' money and those who understand that social benefits come from a well-performing economy and efficient welfare systems. There seems little recognition, for example, that the main cause of poverty and widening income differentials is the unemployment that results from an over-regulated labour market.

In a well-publicised outburst last year, the Business Roundtable was accused by the Prime Minister of wanting to slash social spending and having no concern for widows, pregnant women or sons of poor families. The statement was nonsense, as anyone who cared to read what we have had to say on the subject would discover.

What we have argued is that many of the present social welfare systems that were meant to help people get back on their feet have in fact had the opposite effect and are keeping them dependent on the state. Many bureaucratic institutions which were set up to provide social services have become inflexible and unwieldy. We have argued that a more streamlined, responsive system is needed to deliver help to those who need it most and to enable people to help themselves. We have said that more accountability has to be brought to our social spending, and that there is substantial evidence of low quality policies in this area. All this is exactly in line with Government statements, for example in the 1987 Budget.

One of the ultimate yardsticks, surely, for judging a nation is the success it has in protecting and helping the weakest and most unfortunate citizens. By that standard our present performance is inadequate.

It is ludicrous to suggest that people from the business sector have been involved in the social policy debate out of self-interest. Alan Gibbs gave a year of his life, at no cost to the taxpayer, to the inquiry into ways of reducing the gross inefficiencies in our public hospitals. The conclusions reached by the Hospitals Task Force are similar to the internal market arrangements currently being proposed for the National Health Service in the United Kingdom. It is astonishing that so little has yet been achieved, or even attempted, by the Government in this area. I would confidently predict that the Gibbs report will ultimately prove to be of far greater value for decision-making than the $5 million report of the Royal Commission on Social Policy.

The most puzzling thing of all is that the people that are hurt most by the present lack of direction are the people the Government professes to care about. In the final analysis, businesses and investors can cope with economic mismanagement in an open economy - they can put their money elsewhere. Those hurt are the people who have to pay high real interest rates on mortgages, have their wages reduced because of a wasteful accident compensation scheme, or are denied the chance to get on to the first rung of the employment ladder by rules that protect people in privileged positions.

These policy failures - a hyper-regulated labour market, ballooning government expenditure and an inefficient welfare state - are inter-related and are now seriously handicapping New Zealand's prospects. With the rigid labour market there is every likelihood that unemployment will continue to rise and no chance that it will recede far from high levels. This will put intolerable pressures on social services and give rise to mounting fiscal costs. For an economy in the fifth year of an adjustment process, the outlook remains poor.

There is not a lot that the Government could do to improve the economic statistics between now and the next election. The major trends in an economy do not change quickly. The important gains that have been made - for example in inflation, the balance of payments, and improved industrial efficiency - are the results of decisions made many quarters ago. Policies now in place, or decisions already taken, will have by far the most important influence on the economy in the next 18 months, at least in a positive sense.

What the future course of policy can do is determine New Zealand's economic fate two or three years hence, and carry significant downside potential in the meantime. Last year the Prime Minister said that he did not need to enjoy the confidence of New Zealand business leaders. Such an attitude is in marked contrast to that of leaders of successful countries. The other side of that particular coin is that the business community does not have to have confidence in the Government. At present it is not just organisations in the Business Roundtable - which account for 80 percent of the market capitalisation of the stock exchange - but the business community in general that does not have that confidence. The consequences are high interest rates and a weak outlook for investment and job creation.

Recently there has been much speculation about a U-turn in government policy. I believe such talk is largely wide of the mark. In an increasingly open international economic environment, any New Zealand government now has narrow options, unless it is bent on economic sabotage. Moreover, as our earlier attempts to get out of the economic hole illustrate, the real danger is not U-turns but shifting and inconsistent policies, slippage in key areas and a failure to maintain credibility and confidence.

At present the danger signals are surely flashing. The evident desire to slow down the pace of change could herald a return to the timid gradualism of earlier years. Recent attempts to talk down interest rates could easily lead us back down the path to interest rate controls - even though the idea may be as remote from the mind of the Minister of Finance at this stage as it was from his predecessor's in 1980. Economic analysts are already raising their inflation forecasts. Any preoccupation with a compact at the expense of the substance of labour market deregulation will worsen the unemployment outlook. New Zealand's credit rating has been marked down since 1984 and on present performance is unlikely to be restored; a deterioration in fiscal policy could see it slip further.

Developments of this sort could do great damage to what remains a debt-ridden and very fragile economy. Public debt has climbed in the last four years to a peak of 80 percent of GDP. Much of the necessary restructuring still has to be tackled. It is not beyond the bounds of possibility that an incoming government in 1990 could inherit an economic situation which is even worse than in 1984.

Last year the Prime Minister advised business leaders to get on with running their breweries and construction companies and let the Government get on with running the economy. I recall Mr Bolger gave similar advice to Federated Farmers on an earlier occasion. They ignored the advice and so have we. Memories are still fresh of an earlier era when the national sport was to play the man rather than the ball. In that economy of fear and counter-punching, too many New Zealanders were silent as their country slid towards the abyss.

In the months ahead it is vital that ordinary New Zealanders speak out about the sort of country they want to live in. If I am right, the advocates of the East German model, the regulated economy and the state-run business sector are a tiny minority, given massive media exposure because they are neither too afraid nor too lazy to state their views. By contrast, I believe there is broad public support for the kind of economic directions that middle-of-the-road politicians in both the National and Labour Parties have been trying to steer the country in for over a decade.

Certainly major business leaders in New Zealand have not changed their views. They supported the excellence and consistency of the reforming thrust of the Government's first term. The criticisms of the last 18 months have been about the loss of direction and momentum. Business remains supportive of those who understand the need to regain direction and urgently address the outstanding weaknesses.

Even economies as large as the United States have recognised that to restore their economic vitality they have to adapt to an open, rapidly changing world economy. As a recent New York Times article pointed out, they have to learn to compete, save, innovate and persist. In a small economy with a long history of economic mismanagement, it is futile to believe that anything can be achieved by attempts to jawbone down interest rates or jawbone up confidence. Every such attempt merely delays the prospect of improving trends. The only things that will work are sound policy directions, unity and consistency, and a willingness to keep on taking the hard decisions.

At present, New Zealand politics is surely at a critical watershed. Between now and the next election, the confusion in both political parties could be resolved in favour of a recommitment to a policy of joining the real world with the challenges, rewards and occasional discomforts that would bring. I agree with the deputy-editor of The Economist who recently suggested in a valedictory article that:

> "Mankind as a whole, in the last eleven years of the twentieth century, is almost certainly on the foreshore of the fastest period of market-driven economic development it has ever seen."

On that scenario New Zealand could, for the first time in decades, be an exciting place in which to live, work and do business.

Alternatively, elements in both parties could lead us back to the policies of timid gradualism, mediocrity and compromise that have debilitated the country for so long. We could decide once again that the sunlight is too bright and slide back down the slippery slope. On that scenario, a Latin American future would be in store for us. The difficulties of trying to extricate ourselves from an even deeper hole do not bear thinking about.

I have to admit that I am more pessimistic than I have been for some time that our politicians may choose a path that takes New Zealand back to the brink.

ADDRESS TO THE NAPIER CHAMBER OF COMMERCE

THE NEW ECONOMY

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NEW ZEALAND BUSINESS ROUNDTABLE

NAPIER
23 NOVEMBER 1988

THE NEW ECONOMY

At the information centre in the Lake Rotoiti National Park, there is a description of the regeneration cycle in New Zealand's native forests. It reads as follows:

> "Beech forests revel in catastrophes. This is because under normal forest conditions the adult trees form such a tight canopy that little light gets through to the forest floor. Here beech seedlings either fail or develop only a few metres in height, where they maintain themselves in a state of 'dormancy' awaiting the additional light necessary for further growth.
>
> This state of suspended animation is only changed when an old tree dies and falls or is blown over, allowing sunlight to penetrate through to the young saplings which then compete frantically with each other to fill the new space in the sky. Often patches of the canopy are destroyed by avalanche, snowfalls or gales allowing a whole new generation to develop."

The parallels with the regeneration cycle of an economy are striking. Economic progress has been described as a gale of creative destruction. Old industries and firms die and new ones are born. Skills become obsolescent and new ones must be acquired. Businesses must adapt to changes in technology and consumer demands. Without such changes, an economy cannot grow and prosper.

In the old New Zealand economy, the tight canopy of regulations and controls stifled initiative and growth. Instead of allowing old activities to die, we kept them alive on artificial life support systems. New industries could not compete effectively for resources. The result, as we all know, was economic stagnation.

Lester Thurow, a United States economist who recently visited New Zealand at the invitation of Mike Moore, has emphasised the importance of disinvestment in a healthy economy.

> "While there are many voices calling for more investment," Thurow writes, "the process of disinvestment is even more important. Eliminating a low productivity plant raises productivity just as much as opening a high productivity plant... To close a low productivity plant also makes it possible to move the workers and capital that have been tied up in this activity into new, high productivity activities... Paradoxically the essence of investment is disinvestment."

Thurow goes on to say that some economies have not been very good at accomplishing disinvestment. The basic problem is the desire that everybody has to avoid the economic pain that is endemic wherever disinvestment occurs. Governments are asked to stop or slow down the process. Subsidies are used to keep inefficient industries in business. Instead of shrinking with declining enrolments, schools discover special education and the need for more teachers. It is easy to recognise that Thurow is not only speaking about the United States.

New Zealand is currently experiencing a major economic upheaval as it works off a backlog of long-postponed adjustment. The extent of previously hidden unemployment on the payrolls of state-owned enterprises and private sector firms has been exposed in the sharp rise in registered unemployment. For many people in regions like Hawke's Bay, it is easier to see the effects of the avalanches than the signs of new saplings.

Understandably in such circumstances, people ask the question: "where will the new jobs come from?" The question is not an easy one to answer in detail in 1988, but it is no harder to answer this year than it was in 1978, 1968 or any previous decade. Nor would it have been any easier to answer if the economic changes had not been made.

The truth is, as one of Shakespeare's characters put it, that we cannot:

"...look into the seeds of time,
And say which grain will grow and which will not."

If we could, we would all be living in the south of France with our feet in a bucket of champagne.

A vision of the future based on known alternatives and certainty is the vision of the bureaucratic planner. But the future is not like that. It is not a matter of obtaining the perfect crystal ball which can reveal to us some predetermined scenario. The future is uncertain and unknowable; it is there to be discovered and created. And the task of discovery and creation in an open, free enterprise economy is preeminently the role of the entrepreneur.

We should have no lack of confidence that entrepreneurs in New Zealand can find profitable ventures and employment opportunities in the new economy. They have done so for 150 years. Their counterparts in high productivity, high employment, small economies like Switzerland, Finland, Hongkong and Singapore are continuing to set the pace for the rest of the world. New Zealand has no serious handicaps in footing it in the global economy, other than self-imposed ones.

In Fletcher Challenge, we like to think we have some vision, but I would be less than honest with you if I said that twelve years ago any of us foresaw the shape of the company in 1988. Twelve years ago the merger with Tasman had not taken place, Fletcher Challenge did not even exist, and the thought of entering into North America had not occurred to us. If anyone had suggested to me then that in 1988 we would be the world's second largest forestry company and have a major stake in New Zealand's petroleum industry, I would probably have dismissed the idea out of hand.

By the same token, there is no way we can know the shape of the company in the year 2000, only 12 years from now, still less that of the economy. What I do know is that if we stick to some sound, basic principles of business and economic management, both will flourish.

In Fletcher Challenge our vision is to be a great international New Zealand company. A company that adds value, that strives for growth and excellence in all it does. A company that will be measured by its achievement of a superior financial performance and an impeccable public reputation. Our purpose requires us to focus on our customers, to manage with an open style and to act with integrity.

We believe in commitment, to innovation and to change. We cannot be certain where our growth will come from but we search for opportunities and we take them when the time is right. These are the sort of visions that create an entrepreneurial company.

In respect of the future economy, it possible to hazard a few general propositions. It is likely , for example, that we shall see relatively more rapid growth of the unprotected activities that have been handicapped in competing for resources in the past. With good management, we should see significant growth in industries based on the natural resources of many of our regional areas. As in most western economies, there will probably be a relative expansion of the services sector. Activities benefiting from the rapid development of telecommunications and information technology should thrive. People will probably continue to shift away from harsher parts of the country, but it would not surprise me if many of them went to provincial towns rather than the main metropolitan areas.

In all of this, I believe there will be a large role for New Zealand's agricultural and manufacturing industries. Certainly their composition will be greatly altered as the distortions that have warped their development in past years are removed. They will become much more specialised and driven by market demands rather than tax and subsidy policies. We should not attempt to compete in the range of manufactured products that the next generation of newly industrialising countries like Malaysia, Indonesia, Thailand and

China will produce. But there will still be great opportunities even in industries like textiles and apparel, as producers of these products in high income countries like Japan, Germany and Switzerland continue to demonstrate.

I would be astounded if, by the year 2000, our agriculture and manufacturing sectors are not significantly larger in absolute size than they are now. Over that period of time, we ought to be able to increase real national output, and hence national income, by at least 50 percent. That would only require an average annual growth rate of 4 percent. Countries at a similar level of income such as Korea, Taiwan and Hongkong are growing at twice that rate. The new British economy is recording growth rates of around 4 percent a year, and should be able to do so for many years as it narrows the productivity gap with its European neighbours.

The economic policy changes of the 1980s, starting with initiatives like CER, have taken us a long way down the road to a better economic performance. The policies are working and many of the benefits are becoming apparent.

Perhaps the most surprising thing about the adjustment process is how strong the economy has remained despite the disinflationary squeeze and massive restructuring. Whereas other countries that had to undertake a much smaller adjustment task experienced real falls in output, production in New Zealand has remained higher than it was in 1984. What that means is that for every activity that has had to be scaled back, something else has already taken its place.

Over the next couple of years, I would expect to see an improving economic performance. Inflation should continue to fall, and interest rates should follow. Many firms have achieved lower break-even points and are well-placed to benefit from economic recovery. Export growth is likely to be strong, and the balance of payments should continue to improve.

However, the progress to date needs to be kept in sharp perspective. New Zealand was, and remains, one of the OECD's most distorted and debt-ridden economies. We remain extremely vulnerable to adverse economic developments abroad and political uncertainty at home.

My guess would be that the measures that have so far been taken might move New Zealand to an average annual growth path of around 2 percent. This would be a significant improvement on the near-stagnation of the past but well short of the 4 percent rate which I suggested should be achievable. In other words, we are likely to underperform relative to our potential. And there is no action in sight which offers any prospect of dealing effectively with the high rate of unemployment that has accompanied the economic shake-out.

If we are to complete the task, New Zealand governments have to make progress on the areas of outstanding weakness, and quickly. Every investor and businessman knows that the Government will face major difficulties with its fiscal policy next year. Spending on social programmes is mushrooming at unsustainable rates, and revenues will be reduced by the amount of the October tax cuts. Uncertainty about how this problem will be resolved is a major reason why real interest rates remain at high levels.

The Minister of Finance's response, as announced in the Budget, was to conduct a major expenditure review in the second half of this year. Indications of progress with this review, which can presumably be expected shortly, will be a key litmus test of the necessary commitment to maintain a sound economic strategy. The recent setbacks to confidence will only be overcome by solid policy decisions in the period ahead on issues such as the tertiary education review, income maintenance, the future of the asset sales programme and national superannuation.

After fiscal policy, the second major area desperately in need of attention is the labour market. As the Government's own advisors, the OECD, employer organisations and many other commentators predicted, the consequence of the Government's decision to put this topic in the 'too hard' basket is a rate of unemployment which may turn out to be as high as other countries experienced during their difficult economic adjustments. And whereas a country like the United Kingdom moved early to reform the regulations governing trade union organisations and wage bargaining, and has seen the benefits in the past 2 years in the sharp fall in unemployment, reforms in New Zealand are lagging well behind their logical place in any coherent liberalisation programme.

The present wage round is once again showing how detached from reality New Zealand's labour relations system really is. Wage claims of 6, 8 and 10 percent are being made at a time of record unemployment and when inflation is running at below 4 percent and the economy is not growing. If they are conceded, thousands more New Zealanders will be thrown out of work. Negotiations are breaking down and strike action is spreading. In successful economies like Japan and Switzerland, strike action is a rarity. Even in the United Kingdom, the number of strikes has fallen massively in recent years.

The rhetoric of some union leaders in denying, for example, the relationship between wage increases and jobs, underlines the detachment from reality. In Australia, after years of similar debate, it is now common ground that in circumstances such as New Zealand currently faces, one worker's pay rise is another worker's job. The argument that wage rises are needed to maintain purchasing power and jobs is also flatly contradicted by Australia's experience. While real wages in New Zealand have increased in recent years as a cost to employers, they have fallen in Australia by around 5 percent and employment has been growing more rapidly across the Tasman than in any other OECD country. The evidence suggests that the Accord has played little part in this outcome, and that even better results would have been possible with a more flexible labour market.

Similarly, in the wider labour relations debate, the claim that a deregulated labour market would mean depressed wages and exploitation is simply contradicted by the facts. In countries such as Japan and Switzerland, where employment relations are much freer, wages and employment levels are far higher than in New Zealand. The reason is that wages are fundamentally maintained by competition for labour and not by union power. Non-union wages have risen faster than union wages in the United States in recent years.

Lester Thurow, whom I quoted earlier, has argued that "American unions like dinosaurs will disappear if they do not adjust to the new competitive environment and realise the need for flexible labour forces". He has argued for a union and wage determination system on the lines of the Japanese model which is voluntary, decentralised and closely related to the fortunes of the firms in which workers are employed.

I have no doubt that New Zealand will move in that direction. As a recent New Zealand Herald editorial observed:

> "Every unionist knows that compulsory unionism will go; the 1000 minimum membership rule is likely to be scrapped as well; so, probably, will statutory provisions binding employers to national awards and binding staff in any workplace to the will of external organisations".

But the longer we delay making those changes, the longer we will have to endure 10 percent rates of unemployment or more in the weakest areas of the labour market, particularly among school leavers, low-skilled groups, Maoris and regions like Hawke's Bay.

One reason why I believe these changes are coming is that there is strong public support for them. An opinion survey commissioned by the Business Roundtable late last year revealed overwhelming support for voluntary and contestable unionism, enterprise bargaining and individual contracting. Recent research which we shall shortly be releasing has strongly confirmed these findings. New Zealanders are sympathetic to trade unions and their role, but very dissatisfied with the system that governs their activities. Ken Douglas has made the valid observation that the trade union case will only prevail if it is supported at the bar of public opinion. The verdict of the public is very clear.

More generally, what comes through yet again in this survey, and what makes me optimistic for the future, is the basic commonsense of the ordinary New Zealander. For example, most New Zealanders feel, correctly I believe, that women are discriminated against in the workforce, but only a tiny minority, 11 percent, supported the kind of affirmative action policies that have recently been proposed. Women were more opposed to such policies than men. They do not share the collectivist attitudes of feminist politics. I am reminded of a recent article in the London Financial Times which began:

> "The class struggle is over. The politics of the next century will be about the individual and her place in the community".

I believe that for 20 years or more, ordinary New Zealanders have seen the need for change and wanted their political representatives to bring it about. They have become fed up with a third rate economy and a confrontational society. If last year's election was about anything, it was a referendum on economic directions. It showed that New Zealanders were prepared to support necessary and uncomfortable changes.

I am convinced that the changes that have been made are irreversible. Policies for a better yesterday are no longer saleable. A recent meeting between representatives of our organisation and the full front bench of the National Party gave us increased confidence that they accept that and are focusing more clearly on what needs to be done. Any party that does not absorb those lessons will quickly become unelectable.

The tasks ahead like cutting back government expenditure and freeing up the labour market are difficult, but not impossible. The Hawke Government in Australia has cut back government spending further than any other OECD country and is set to do so again next year. The Australian economy has benefited, and the Government has been given credit for its action. Changes are happening in the New Zealand labour market, and the constituency for wider reforms is large. Provided political parties govern in the interests of all New Zealanders and resist capture by sectional and privileged groups, I am confident they will get electoral support.

My favourite magazine, *The Economist,* recently discussed the programme that a British government now needed to pursue in order to build on the new sense of economic success, entrepreneurship and individual responsibility in that country.

> "As people get richer," it wrote, "they will want to take more responsibility for their health, their children's education, their pensions. Even so, the state cannot withdraw from these things. Instead, it needs to change its ways, by opening itself up to competition or creating some internally, so that it has to respond to what individuals show they want rather than what bureaucrats find it convenient to provide. There is still much to do in shrinking the state via privatisation; what is left of the state after that, and it will still be large, should be made efficient via competition."

If we can follow that prescription in the next few years, and make the other breakthroughs I have mentioned, we shall be well on the way to completing the regeneration cycle.

I have confidence in the future and faith in the commonsense of New Zealanders to complete the course of economic medicine that has been started. What we must ensure is that our politicians have the courage to administer the necessary doses swiftly and to all.

ISSUES FOR BUSINESS IN THE CURRENT ECONOMIC ENVIRONMENT

CONFERENCE OF THE NEW ZEALAND SOCIETY OF ACCOUNTANTS
WAIKATO/BAY OF PLENTY BRANCH

ALAN GIBBS
CHAIRMAN
GIBBS SECURITIES LIMITED

ROTORUA
15 APRIL 1989

ISSUES FOR BUSINESS IN THE CURRENT ECONOMIC ENVIRONMENT

I guess a standard speech from a businessman on "issues for business in the current economic environment" could be expected to focus on interest rates, low productivity, unemployment or a similar list of things that are currently bad for business and the economy.

I propose not to give you a standard speech for two reasons. One is that by this stage of your conference much of this ground will have been covered by other speakers. The other is that the things I mentioned are, by and large, symptoms of underlying problems that have been with us for a long time. To understand and deal with them more effectively, we have to look at the policies and mindsets in this country which have created them and which we have only recently started to change.

In thinking about my topic, it struck me that it would be interesting to reflect on how someone might have approached it five years ago.

I recalled that a friend of mine had a similar task in early 1984. He had been asked to propose a toast to the market system at a professional conference. He had to begin by acknowledging that that great unmentionable, the market system, was a subject last heard of in New Zealand many years before. For that reason it had been extremely difficult to locate any worthwhile research on the topic.

Can you remember the environment for business in New Zealand in 1984? It was a place where businessmen spent half their lives in Ministers' offices seeking favours or second-guessing what the government was going to do. To import most consumer goods you had to get a permit from a bureaucrat. Unless you had foreign exchange, you had to get funds at a premium through a depository at the Reserve Bank if you wanted to buy Australian shares. The top personal tax rate was 66 cents in the dollar at just over twice the average wage. We had a sales tax with 17 different rates.

By early 1984, white elephant industrial projects were going up all around us. Farmers were growing sheep which produced negative value added. Virtually every key price in the economy was frozen. Japanese deaf mute mountain climbers were being ordered off Mount Cook by prime ministerial decree. We were a combination of a Polish shipyard in economic and business terms and a banana republic in our politics.

What has happened since 1984 is starting to change the face of New Zealand. It is hardly a revolution and it is certainly not an experiment. All we have done is to get somewhat closer to the real world and the mainstream policies of successful OECD countries.

We should not underestimate how far we have to go if we want the prosperity, security and employment opportunities that other countries enjoy. At a time when the British government is privatising the water supply, it looks as though we will continue to argue for a couple of years over whether the state should sell a bank. Our railways have been operating as a state-owned enterprise for most of the 1980s but are still making huge losses. They are a classic example of why public enterprise doesn't work, or doesn't work for long. New Zealand is still lagging far behind the rest of the world in getting the state out of business.

We have an archaic labour relations system of a type that has long since been discarded in the successful economies. Among the OECD countries only Australia, another of the worst economic performers, has a comparable system of compulsory union membership. We have so-called 'free' tertiary education, a superannuation scheme which pays a generous universal benefit at age 60 and a no-fault accident insurance scheme run by a state monopoly. We pay an unemployment benefit to school leavers. Try to explain these things to an American, a Swiss, a German, a Japanese or even a Swede and you will be met by stares of disbelief.

One of the prevailing myths is that the main beneficiaries to date of Roger Douglas's economic reforms have been major businesses in New Zealand. The truth is that during the adjustment process most of the moves to free up the economy have been very costly to organisations like the members of the Business Roundtable. In the case of companies that I have been involved with, deregulation of the transport industry and the opening up of the economy have cost us megabucks.

Under import licensing, for example, Ceramco was guaranteed 80 percent of the market for tableware and 90 percent for bricks and bras. In TV manufacture, we were one of the few with an unfettered licence to pass our excessive costs on to consumers. We used to pay 10 percent more for the parts to assemble a Japanese TV set than the finished product, ready to go on the retailers' shelves, would cost. The result was that we added negative value but doubled the retail price of TV and audio systems. The costs of shaping up and scaling down such operations have amounted to tens of millions of dollars of capitalisation, not just for us but for companies like Brierleys, Fletcher Challenge and a whole raft of others.

Not only has Roger Douglas imposed these costs, but in many ways he has made life more difficult for major businesses in the future. In the pre-Rogernomics New Zealand, businesses only had to outwit the regulations to be successful. Now we really have to perform for the customers. If we want to grow, we must now expand outwards into the tough export markets of the world. In the domestic market, we now have to compete with the world's best.

Yet despite all this, most major business leaders in New Zealand have supported the broad thrust of the Lange-Douglas reforms. The reality is that they had to happen, and that they have to go on.

At the last meeting of the Business Roundtable, I suggested that not one New Zealand business had fallen over in recent years that hadn't deserved to. Nobody disagreed with me. Most such businesses never made sense for New Zealand. Many were the victims of the removal of the artificial policies that had created them. Others were businesses that, if exposed to competition from their formation, could have developed internationally excellent skills. Unfortunately, due to mollycoddling through protection, management became lazy and rigid with the result that they could not adapt to the new environment. It would be easier to start from scratch than reinvigorate them.

However, it would also be fair to add that we have had unnecessary contraction of businesses because the government's policies have become more and more unbalanced and less and less certain, and because some of the major obstacles to wealth creation have not been removed.

We have certainly not reached the end of restructuring. In areas like the meat industry and the motor vehicle industry, we have a long way to go. In others like public hospitals we have not even started.

Hospitals are the largest industry in New Zealand and are the largest employers in most towns. By comparison with the waste and inefficiency that has been revealed in most state-owned enterprises, the situation in public hospitals was described in the Hospitals Task Force report as "scandalous". Despite the fact that we showed 50 percent more services could be provided for the same money, nothing effective has yet been done or even attempted in this area. The result is a lousy deal for patients and taxpayers, and a drag on living standards which is no different to what happens when resources are wasted in inefficient farming or manufacturing activities. Interestingly, the British government has adopted our model for transforming the National Health Service.

The tragedy of the present situation for New Zealand is that the job is only half done, and that we continue to labour under self-inflicted handicaps. New Zealand is the most isolated country with a significant population in the world, and if we are to close the gap with other successful countries we must get closer to them in every respect. Protectionist barriers increase the distance, not reduce it. They bias the economy away from export industries that can compete effectively in world trade. An inefficient waterfront industry increases the distance between us and world markets. The cost reductions that could be achieved by thoroughgoing ports and shipping reform would be equivalent to moving New Zealand half-way across the Pacific.

Regulation of our telecommunications and broadcasting industries has kept us insular and cut us off from much of what is happening in the world around us. Deregulation of these industries should provide exciting opportunities for New Zealanders to develop new technologies and businesses of an internationally competitive standard. Fortunately, the Australians and many others are still regulated, giving us a chance to jump ahead.

To understand the benefits of openness, it is instructive to look at Hongkong, perhaps the world's premier example of economic development in the last 30 years. I read with interest Ken Douglas's account in a recent interview of a visit to Hongkong in 1964.

> "The shock just about blew my mind," he said. "I couldn't get over the sheer mass of swarming humanity. In Hongkong, the filth and deprivation of the masses, just tearing out an existence, made me feel physically ill."

I first visited Hongkong in 1962. Ken Douglas is right. People were living in cardboard cartons on the sides of hills. Now, of course, Hongkong's per capita income is equal to ours. While we stagnated, Hongkong achieved real growth rates of 10 percent a year. It absorbed vast numbers of refugees while maintaining virtually full employment. Moreover, like other open economies, it has a relatively even distribution of income.

Hongkong is not alone of course. New Zealanders saw on their television screens last year the new South Korea, its modern capital comparable to any major city in North America or Europe. Korea, equally poor thirty years ago, is now a major economic power with a population half the size of Japan and a per capita income which may also surpass that of New Zealand by the turn of the century.

By contrast, in neighbouring mainland China many people are still living in caves. Prior to the recent moves to free up the economy, China's living standards stagnated for most of the last 30 years. Yet people like Ken Douglas still appear caught in a 1960s time warp. In the same interview he reaffirmed his belief in the Marxist ideologies that kept a billion Chinese impoverished and are now being comprehensively rejected around the world.

Closer to home, we can see the same centralist approaches being promoted by the Council of Trade Unions in seeking a "compact" with the government. Writing in the 20 March issue of the Socialist Unity Party *Tribune*, Ken Douglas said:

> "The issue of the compact has been correctly presented to us as a question of political influence... The struggle for the compact is in fact a question of a campaign for the re-regulation of the economy."

Despite the lip service paid to the Economic Summit consensus of 1984, the old guard in the New Zealand trade union movement have never accepted the need for change. They have consistently fought to retain their positions of power in a centralised economy at the expense of workers and the unemployed.

Corporatist and collectivist policies have been repeatedly tried and they have repeatedly failed. In Australia, the Accord has had to be modified several times in the face of economic pressures, and it is again under stress. Its alleged "achievement" of bringing about lower real wages is disputed by many, and it has done nothing to improve Australia's lousy productivity record. Australia is now learning that there is no substitute for sound monetary policies and market deregulation.

Collectivist rhetoric has it that the supporters of a liberal and open environment are narrowly individualistic and overlook cooperative and altruistic human instincts. This too is a myth. Altruism is strong within the family and towards close friends, and extends to wider groups through charitable giving and voluntary international aid. On an intimate scale, sympathy, solidarity, personal knowledge and information unite people and make for effective joint decision-making.

But the mistake social collectivists make is to transfer this successful model to a large modern nation and its infinitely more diverse and complex interests and needs. If cooperatives are indeed such a good model of organisation, why aren't there more of them? The reason is that, on a wider scale, decentralised market mechanisms are a far better means of coordinating economic activities and providing the goods and services and incomes that people need.

Those who support this analysis are then accused of being long on rationality and efficiency but very short on humanity. Milton and Rose Friedman were once told:

> "Your viewpoints (reminiscent of Marie Antoinette, Russian Tsars, Nero and worse) are the most animalistically inhuman I've ever heard."

They replied:

> "We reject utterly this criticism. It seems to us simply an example of the widespread tendency to take the will for the deed. Which is more inhumane? To tax the working classes of Britain in order to subsidize university education for the middle and upper classes?... To condemn thousands of patients to wait for years for life-saving or life-benefiting medical operations as is done under the British Health Service; or to urge reducing the tax burden now imposed to support the health service in order to enable individuals to buy their own health care? There are no such waiting periods for poor or rich in the United States mixed system and there would be none in a United Kingdom voluntary system... Welfare states are in deep trouble not because of the announced objectives of the programs that they have adopted, but because of the failure of those programs to serve the announced objectives. As Samuel Johnson put it, 'The road to hell is paved with good intentions'. If that is 'inhumanity' then so be it."

"What has all this got to do with the concerns of business in the current environment?" you may well ask. My answer is, "Everything". The big issues for New Zealand are not matters of technical economic policy. Around the world, successful countries have learned the lessons of sound economic management in the 1980s, and they are fairly simple.

To cure inflation, you stop printing money. To stop piling up debt, you balance your budget. If you want economic growth, you keep government spending and tax burdens low and your economy open and competitive. If you want full employment, you free up your labour market and make sure your welfare safety nets don't turn into hammocks for people to lie on. And as Bob Hawke has said:

> "There is no conflict between efficiency and equity. On the contrary in today's world, in today's economy, there can be no equity without efficiency."

Or to quote the present Swedish Finance Minister:

> "The market economy's facility for change and development and therefore growth has done more to eliminate poverty and the 'exploitation of the working class' than any political intervention in the market's system of distribution."

The contrast between the records of the Lange and Hawke governments on government spending was underlined in this week's economic statement in Australia. Australia will see another year of real spending cuts, which have brought Federal government spending down from about 30 percent of GDP a few years ago to nearer 25 percent. In New Zealand, government spending has shot up by a similar proportion, from around 36 percent of GDP to over 41 percent. Most other OECD countries have contained or reduced the public sector share of their economies in recent years, recognising the damage that high tax burdens cause to incentives and growth.

I think that perhaps the most lasting legacy of Roger Douglas's period as Minister of Finance will turn out to be the increase in economic literacy in New Zealand. There is now a far greater understanding that the economy is interconnected and that the interests of the community as a whole can differ from those of its individual parts. People in business now appreciate much more clearly, for example, that poorly designed policies in areas like health, education, superannuation or accident compensation affect companies and their workers as directly as, say, a high exchange rate. Organisations like Federated Farmers and the Business Roundtable share much the same diagnosis of current ailments, and the views of other business organisations are also far more in line than they were a few years ago.

Against this background, what concerns me as a businessman at the present time is the deteriorating quality of our political debate and the lack of understanding of how far we still have to go to make New Zealand the exciting, dynamic economy that it ought to be.

Lately we seem to have reverted to the New Zealand habit of playing the man rather than the ball. The Prime Minister dismisses his critics as designer jeans socialists, members of the New Right or people he would not want to be seen on a bus with. The media should be forcing him to address the issues that are being raised.

Last week in Australia Roger Douglas gave a thoughtful and courageous speech on labour market reform. The response in some quarters was calls to stop speaking out. Mr Douglas was underlining the unpalatable truth that by flunking labour market reform and hence the scope for more productive working arrangements which would lower labour costs, the government bore prime responsibility for the unemployment consequences. Media representatives should be asking the government to explain what is wrong with the arguments for the kind of voluntary, decentralised employment relationships which are the norm in the world's high wage, high employment economies.

I think it is a good thing that people like Roger Douglas, Winston Peters, Ruth Richardson, Ken Douglas and Jim Anderton are making their views known, and I hope others do likewise. We need competition in the market for ideas. New Zealanders are capable of understanding facts and evidence, and good currency will drive out bad. Ken Douglas made the very valid point a few years ago that the trade union viewpoint would only prevail if it was supported at the bar of public opinion. In respect of labour market reform, public opinion is now overwhelmingly in favour of moves towards greater choice and freedom and I believe it is only a matter of time before workers and voters demand action.

I am an optimist for New Zealand in the 1990s. I think we have a good chance of achieving the best economic performance we have seen for decades. In my view New Zealanders have become fed up with living in a third rate country and with politicians who would keep it in that state.

At present, however, the government is drifting aimlessly and the economy may get worse before the voters have the chance to express their views at the next election.

The recent economic statement reversed the trend of medium term tax reform only six months after the last changes were introduced. The review of government expenditure has produced nothing of significance apart from cuts in defence spending. The asset sales programme is foundering. Nonsensical proposals are being canvassed on "pay equity" which contradict the already too limited attempts to get away from centralised wage fixing. The decisions to drop or defer plans to deregulate postal services and passenger transport suggest interest group politics are again in the ascendancy.

Together these moves add up to a considerable shift in the thrust of economic policy. As in Australia, the emphasis seems to be moving away from the fundamental need to improve incentives to increase productivity and growth. There is no clear outlook for fiscal policy and no guarantee that tax rates will not rise further next year. The unstable climate can only inhibit job-generating and risk-taking investment.

Much has been done to put the economy back on its competitive feet. But as Mark Twain once said, it's all very well to be on the right track, but if you are lying down you will still be run over by the next train.

Most forecasters are predicting a slow recovery over the next 18 months, but none are expecting strong, sustainable growth. Further irrational decisions could tip the economy back into a recession. However, the consensus is probably best expressed by the authors of a recent National Bank article. They wrote:

> "We are... predicting sustained mediocrity. When the dust settles, the New Zealand economy will have failed to distinguish itself. We will simply meander along, with an average economic growth rate and an average unemployment rate."

Are New Zealanders prepared to settle for mediocrity? No one can be sure, but I think that the events of the last few years have changed for good our previous insular and inward-looking mentality and that things will never be the same again.

More people understand that the changes now going on in the rest of the world are dramatic. That world is not about to stop changing. If we want to be part of it, the last thing we need now is a breather or a cup of tea. What business and the public want, I believe, is political leaders who will get on with the job.

CORPORATISATION AND PRIVATISATION: A DISCUSSION OF THE ISSUES

NAPIER CHAMBER OF COMMERCE

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NAPIER
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Corporatisation and Privatisation: A Discussion of the Issues

Paper Presented to the Napier Chamber of Commerce on 31 May 1989
by Dr Roderick Deane, Chief Executive, Electricity Corporation of New Zealand Limited

1 Introduction

The gains achieved by the reform of a broad spectrum of state owned organisations and activities are already making a significant contribution to general economic performance and the Government's budgetary position. The benefits of corporatisation have generally been higher and achieved more quickly than initially anticipated. They have been achieved despite the scepticism and fears expressed by many at the early stages of the process.

The success of the corporatisation programme is no longer a matter of controversy; the gains from the reform process are obvious to all. The focus of the debate has instead moved on to consider whether further efficiency gains could be achieved by privatisation of SOEs.

This paper draws on the experience with corporatisation to assess whether further gains might be achieved by privatisation. The paper begins by briefly outlining the current state of the debate on privatisation. It argues that privatisation can be justified only if it improves the efficiency with which resources are used. The paper then moves on to review the process of corporatisation and discusses the implications for further reform that can be drawn from the experience to date. It sketches some of the gains achieved by specific SOEs, examines the reasons why the reforms have succeeded in improving SOE performance, and discusses reasons why there is the potential for achieving further benefits through privatisation.

2 The Privatisation Debate

The privatisation debate in New Zealand is currently poorly focused. People have been diverted by arguments that are peripheral to the main issue or are ideologically based. Two major arguments are confusing the debate. The first is whether repayment of national debt justifies privatisation and the second encompasses concerns that the quantity of subsidised social services provided by the Government will be reduced by privatisation. These issues are briefly examined before the paper focuses on the key objective of the privatisation programme - economic efficiency.

Repayment of government debt will improve the Government's position only if it receives more from a sale than it would receive from continued ownership of the asset. If the assets can be used more efficiently in the private sector, potential private owners will be prepared to pay more for the organisations than their value to the Government. If the proceeds are used to retire public debt, the Government's net worth would be improved by asset sales (the Government's debts will fall by more than the value to it of the assets sold).

If efficiency gains are not achieved by privatisation, the reduction in debt payments from debt retirement will merely be offset by a reduction in dividend and income streams and privatisation would not be justified.

The empirical evidence on the relative efficiency of private and public enterprise is fraught with methodological difficulties and is not fully conclusive. However, on balance it favours private ownership. Efficient performance by individual public enterprises for a period of time, for example as a result of superior management, cannot be ruled out. However, as the experience of the Eastern bloc has shown on a larger scale, performance over the longer haul is likely to be much inferior. This is the relevant perspective in framing policy.

The other major argument confusing the privatisation debate concerns the Government's role in providing social services. However, government provision of valued social services does not require government production of such services. In most cases, social objectives can be pursued more effectively through income transfers than through the direct provision of subsidised services. In situations where the Government wishes to provide subsidised services, it can contract for such services from the private sector. The issue of the role of the Government in providing social services can therefore be separated from the privatisation debate.

From an economic point of view, the potential to improve efficiency is the key justification for privatisation.

The efficiency of resource use is a valid objective because resources are scarce relative to people's demands for them. Because there are not enough resources to produce all of the outputs that people want, a choice must be made between them. The concept of efficiency describes the success with which resources are used to satisfy competing wants. More simply, improved efficiency benefits customers through lower prices as well as wider choices and better service.

Major gains in the efficiency of resource use have already been achieved by the Government's SOE reform programme. By changing the economic environment within which people operate, the Government has changed people's incentives to work in the overall interests of society. Since privatisation involves a further adjustment of the economic environment, the experience with corporatisation provides valuable insights into why privatisation might result in further efficiency gains. It indicates that for many SOEs privatisation is the next logical step.

3 Corporatisation

The SOE reform process has lead to a major improvement in the performance of a wide range of SOEs. Many SOEs have turned a position of loss to profitability. In most SOEs, output per employee has increased substantially, and costs of production are significantly lower. The organisations are more responsive to the needs of their consumers.

The success of SOE reform reflects the importance of the economic environment in influencing how people behave. SOE employees now have strong incentives to act in the interests of the company's owners (the taxpayer) and in the general interests of society. The overall change in the attitude and motivation of employees at all levels of SOE organisations has been dramatic.

The success of the corporatisation programme is illustrated by a number of different businesses.

CoalCorp was formed from the operation of State Coal Mines which made losses in 20 of its last 22 years of operation. Some miners were employed in uneconomic mines at an annual cost of around $122,000 per job. In its first full year of operation CoalCorp turned a loss of $23 million into a small profit without increasing its prices.

Despite reducing its staff numbers by half, CoalCorp's annual production is now higher than that achieved by the old State Coal Mines. CoalCorp expects that with a small increase in its employees it will be able to double production again over the next couple of years.

NZ Post was formed from the postal business of the former New Zealand Post Office. Although the postal business incurred losses of $38 million in 1986/87 and was expected to incur losses in the order of $50 million in 1987/88, NZ Post actually achieved a substantial profit in that year, its first year of operation. The profit was achieved without price increases for basic mail and with price reductions of 30 to 50 percent for unaddressed mail. Service delivery performance improved by 5 to 10 percent despite an increase in the volume of mail delivered.

Telecom has decentralised its operations into six major subsidiary companies each of which now has the freedom and flexibility to run cost-effectively. The new structure of the company has removed the costly controls imposed by the centralised bureaucratic structure of the past. The decentralisation of operations has allowed a reduction of head office staff from approximately 2000 staff to around 600 today; further reductions to around 200 will be achieved over the next few years. The total workforce has reduced from 25,000 to 19,000 and is expected to fall to 14,000 by the end of 1990.

More efficient pricing is being achieved by the removal of cross-subsidies between local and long distance calling. Benefits such as the recently announced 20 percent reduction in toll rates and business rental reductions have been passed on to customers.

Telecom has reduced costs in many areas by using sub-contractors for services previously provided within the company. (Telecom even built its own furniture at one stage.) In many cases, former Telecom staff are now sub-contracting to the company as well as to other clients. For example, former Telecom staff operating as contractors are now installing telephones for Telecom at up to four times the installation rates which were previously achieved. The waiting time for the installation of telephone lines has been reduced from around six weeks to less than 72 hours for 96 percent of customers.

In Auckland the PABX waiting list of 800 has been slashed and installation is now "on demand". A new directory service computer means that calls are answered in Auckland on average within 8 seconds, down from a 60 second average.

The Forestry Corporation in its first year of operation achieved a cash surplus of $53 million compared with the $70 million loss made by the Forest Service in the previous year. Output per employee rose by 18 percent during the year. The number of staff dropped from around 7000 to just over 2500.

The Electricity Corporation (ECNZ) has achieved a number of substantial improvements in performance. Electricity sales have increased despite the recession. Reduced real costs and increased volumes based on new marketing initiatives have enabled ECNZ to hold electricity prices in real terms. Over the first three years, ECNZ has reduced its unit costs in real terms by a total of 23 percent. Real costs per unit of electricity have fallen by 18 percent between 1987/88 and 1988/89. A further fall is anticipated in the current year. The output of electricity per employee has increased by 12 percent over the past year. A further increase of 6 percent is anticipated this year.

Despite the increase in the value of the organisation by $2 billion on corporatisation, ECNZ's prices have been held in real terms. Further significant reductions in real terms are anticipated, partly in response to the potential competition that is already evident.

In the same period, ECNZ has more than doubled its net profit after tax. The cashflow to the Government has increased from $641 million in the 1987 financial year to about $1640 million this year. A similar level of cash flow is anticipated in the next year. The dividend paid to the Government has increased from $60 million in 1987/88 to $183 million in 1988/89.

The efficiency improvements in all SOEs will contribute to a longer run increase in living standards. The primary motivation for the changes is the better use of the significant share of national resources absorbed by SOEs. While specific jobs have been lost and services curtailed, other jobs and services have been created elsewhere in the economy as reductions in costs and improvements in services have made other businesses viable. These benefits will accumulate over time.

4 Incentives for Performance

The experience with SOE reform illustrates how important the economic environment is in influencing people's behaviour. The economic environment sets the constraints within which people can enter into economic relationships; if the constraints are changed, people's decisions and behaviour change. They find new ways of making the most of the resources at their disposal. The nature of the constraints will determine the extent to which, in pursing their own goals, people promote the welfare of society as a whole.

The goal of the SOE reform process has been to provide managers and other employees of SOEs with incentives to maximise the value of their firms. In pursing this objective, they promote the objectives of taxpayers who own SOEs, and society in general which benefits from the more efficient use of resources. This link between the maximisation of a firm's value and the efficient use of resources may not be widely appreciated. Both economic efficiency and the firm's value will be maximised if, first, managers produce goods which people value more highly than their cost of production and, second, management minimises the cost of production.

The SOE model provides managers with a mutually reinforcing package of incentives to maximise the value of their firms. The key elements of the SOE reform process include clarifying the objectives of management; providing the degree of management autonomy and authority needed to make key resource use decisions; improving the monitoring and assessment of managers; instituting effective rewards and sanctions for managers; increasing the competitive neutrality of input markets; and increasing competitive pressures in output markets. Each of these factors is examined briefly below.

Objectives

SOE managers now have a single objective: maximisation of the commercial performance of the organisation. This clear and unambiguous objective provides a direct focus for managers. It facilitates monitoring of management performance by the Government, shareholders (the taxpayer) and customers. It improves management accountability.

SOE managers are no longer handicapped by the requirement to achieve poorly specified and contradictory objectives. They do not have to make difficult judgements on the trade-off between commercial and non-commercial objectives. They can no longer use the requirement to achieve multiple objectives as an excuse for poor management. Non-commercial objectives can be assessed, as they should be, by elected political representatives and pursued in a cost-effective way.

Managerial Authority

Managers have authority to make the key decisions required to achieve efficient commercial outcomes. They are responsible for major investment and strategic decisions. They are free to decide on recruitment, remuneration and dismissals, and procurement of inputs.

Key decisions are therefore made by managers who have a strong incentive to maximise firm value and who have the necessary specific knowledge of the firm. Responsibility for day-to-day decisions rests solely with SOE boards and managers.

Ministers are no longer involved in the day-to-day running of the organisation although they still have overall responsibility for the firm's performance. They have few incentives to hide inadequate performance from public scrutiny. They are no longer burdened by the need to make detailed management decisions using inadequate information.

Performance Monitoring

Management performance is closely monitored against the objectives established. Each SOE has a board of directors with primary responsibility for monitoring SOE managers. The overall performance of the company is monitored by Ministers, with Treasury providing advice and assistance. Additional monitoring of some SOEs is provided by independent expert analysts from private companies. Oversight is also provided by the SOE steering committee.

The approach is reinforced by strict reporting regimes. SOEs must prepare statements of corporate intent, quarterly and half-yearly company reports and business plans for the Government.

Rewards and Sanctions

The monitoring of managers is accompanied by an improved system of managerial rewards and sanctions to reinforce the incentives for management performance. In most cases, the reward and sanction system proxies the disciplines that motivate private sector companies. Salaries are linked to the performance of employees with bonuses sometimes being used to reward excellent performance. Sanctions for poor performance have also been strengthened. The practice of replacing board members and senior executives who consistently fail to measure up is becoming the norm rather than the exception.

The more flexible reward systems ensure that SOEs can now compete both domestically and internationally to attract the high quality staff that organisations of their size and importance require.

Competitive Neutrality in Input Markets

SOEs are now required to raise their debt in capital markets rather than at subsidised rates from the Government. The Government has removed the explicit government guarantee on debt. In the case of ECNZ, there are also no ownership covenants. Despite this, ECNZ obtained as high an international credit rating as any other New Zealand organisation.

The SOEs are expected to earn a rate of return on equity capital in line with the relative risk of their business. The organisations must pay dividends and taxes to the Government.

Corporatisation has improved the flexibility of labour practices in the SOEs, removing some of the more restrictive practices existing in the past. For example, many employees in the major SOEs are now exempt from union coverage. Separate agreements for different parts of the business have been negotiated by some SOEs (including ECNZ).

Competitive Neutrality in Output Markets

Most SOEs no longer benefit from statutory monopoly protection or preferential access to government business and are therefore exposed to competition from private companies. Competition has increased pressures on SOEs to provide services at least cost. SOEs which are not successful at meeting competition will lose market share.

Special problems arise in attempting to establish competitive neutrality when firms have natural monopoly characteristics. Such firms may have significant cost advantages over competitors and as a result may not face tight market constraints in pricing. When firms have such advantages, their commercial performance may give a false impression of their achievements. Maximisation of the firm's value may not achieve the best outcome from the point of view of society.

The Government's review of the regulatory environment for electricity demonstrates that it is aware of the problems potentially created by the natural monopoly component of the business (essentially the line networks). The review is aimed at constraining the potential for abuse of monopoly power.

The constraints discussed above form a mutually reinforcing package which provides incentives for managers to behave in an efficiency-enhancing way. Each of the elements of the package is essential to its overall success. For example, the establishment of a level playing field validates the adoption of clear commercial objectives. The monitoring and assessment of comparative performance is facilitated by exposing SOEs to external market and regulatory constraints faced by others.

5 The Potential for Further Efficiency Gains

The dramatic gains from the SOE reform process have been achieved by changing the constraints facing SOE managers. This raises the issue of whether further changes in the constraints could achieve even greater gains or at least ensure that the gains achieved to date are not reversed in the future.

The constraints imposed on SOE managers are explicitly based on the mechanisms used to promote management performance in private sector "public" companies. The fact that this form of company has acquired its current dominance in competition with other forms of organisation indicates that it is a successful way of organising many kinds of economic activity. It allows management by specialists and risk-sharing by a diverse group of shareholders who, as owners, are not required to play an active role in the organisation's business affairs. Although the separation of ownership from control gives rise to potential incentive problems between shareholders and management, the problem is controlled by a series of market and organisational constraints which arise because of the transferability of ownership in public companies.

A similar problem of conflicting interests arises between the managers and owners of SOEs. The SOE constraints are intended to replicate as far as possible the mechanisms used in the private sector to align the interests of managers and shareholders.

However, not all of the constraints used in the private sector can be replicated in the SOEs. The absence or weakness of some of these mechanisms in the case of SOEs may have adverse implications for their performance and there are practical and conceptual problems with surrogate mechanisms that have been devised for SOEs. Public ownership itself introduces substantial risks that the gains achieved by corporatisation will not be sustained.

These problems would be reduced further by privatisation. Private firms can make bad investment decisions and perform poorly, but the market checks on sustained poor performance are the strongest available.

There are several key problems with the SOE model. Some of the most important are that it is not possible to replicate the private sector constraints which arise from the transferability of ownership and the development of the sharemarket; competitive neutrality cannot be achieved as long as government debt carries an implicit guarantee; and the scope for efficiency-reducing political intervention is higher while public ownership is retained. These are discussed in more detail below.

The Sharemarket

Monitoring by Sharemarket Participants

The ability to transfer ownership in a company by means of the sharemarket acts as a powerful constraint on management performance. The sharemarket aggregates the collective views of investors about the relative performance of different companies and their management teams. Share prices tend to reflect all available information held by market participants on the current and future performance of companies. This in turn reflects the quality of the decisions made by their managers.

People can profit from superior information about a firm's future earnings by buying or selling shares. This provides an incentive for professional analysts, institutional investors and others to study management performance closely.

Because of the non-transferability of SOE shares their commercial performance is not directly monitored by the sharemarket. The incentives for owners to monitor management performance may be weaker in relative terms because the monitors cannot profit from their superior information. The non-tradeability of equity has given rise to the acute difficulties of valuing the businesses and the consequent problems of establishing appropriate capital structures for firms. The sale of SOE shares to the public would enable some of the benefits of the sharemarket to be realised.

Threat of takeover

The gains from replacing poor managers and directors may motivate a takeover of a company. When a company's performance is poor, or its managers and directors are missing important opportunities to use resources efficiently, the company's expected future cash flows are reduced and its share price depressed relative to what it would otherwise be. An improvement in performance will result in higher share prices (arising from changes in expected future cash flows) and hence capital gains for current shareholders. · The capital gains provide the motivation and reward for changing control and replacing management. Because of the vast size of the assets controlled by publicly listed companies, the market for corporate control is one of the most important markets in the economy.

As SOEs do not have transferable shares, it is not possible for an SOE to be taken over and the management team replaced. Its management team is not therefore threatened by this possibility. The inability to take over the company reduces the incentives for investment companies or rival management teams to monitor management performance.

Board of Directors

There are a number of factors which affect the incentives of directors to monitor managers. First, directors' reputations will be directly linked to the performance of the company and will be strongly affected by the information generated by the sharemarket. Poor company performance creates a negative signal about the ability of incumbent directors, thereby affecting their future employment opportunities and expected remuneration.

Secondly, if they hold shares in the company, which is generally the case, their wealth is directly affected by poor managers.

Thirdly, if managers, and therefore directors are under-achieving, shareholders can replace directors by a takeover or proxy battle. The replacement of directors by existing or new shareholders will also adversely impact on the directors' reputations. The threat of takeover or proxy battle itself places pressure on incumbent directors to maximise the value of the firm.

The important incentives created by the second and third constraints do not apply in the case of SOEs. Because ownership is not tradeable, the offer of an equity stake in the business cannot be used to attract managers or directors to the business or act as an incentive for performance. Directors and managers are not threatened by the takeover market.

Market for Managers

The market for managers plays an important role in controlling managerial agency problems. The performance of individual managers and of the management team as a whole provides information to the market that affects the future income and employment opportunities of team members.

The market for managers relies heavily on the information provided by the capital market. The market for corporate control can be viewed as a major component of the managerial labour market. It is the arena in which alternative management teams compete for the rights to manage corporate resources. The information provided by the sharemarket is not available to those monitoring SOEs' managers.

Implicit Government Guarantee

It is effectively impossible to establish a competitively neutral environment while a firm remains in government ownership. An implicit government guarantee will tend to remain on SOE debt even in the absence of an explicit government guarantee. The possibility of a major New Zealand SOE defaulting on its debt is often considered remote because of the undesirable political consequences of such an event for the Government.

The threat of bankruptcy sets the ultimate limit on the amount of value that can be destroyed by unsatisfactory management performance. The market's view of the bankruptcy risk will be reflected in the cost of its debt capital (its interest costs) and the cost of its equity (the rate of return required by its shareholders). The level of these costs affects the firm's ability to survive and expand.

A proportion of the human capital of managers is specific to their existing enterprise. It will be destroyed by bankruptcy or impaired by inadequate financial performance. Bankruptcy or other financial difficulties also send negative signals to the markets for managerial labour regarding the performance of management teams. These constraints are absent in SOEs.

Privatisation would remove the distortions resulting from any implicit government guarantees. It would increase the discipline imposed by the threat of bankruptcy and help to ensure that the cost of funds to enterprises reflected their underlying risk characteristics and business performance.

Political Interaction

Many of the efficiency gains achieved to date can be attributed to the current Government's determination to push ahead with reform despite opposition from many quarters and the political costs involved. The Government has been able to attract considerable talent to serve on the boards of SOEs. The environment has provided the necessary challenge for highly motivated chief executive officers to achieve the dramatic improvements in performance recorded to date. However, experience suggests that none of these conditions is likely to persist indefinitely.

Statements by various spokespersons for the Parliamentary Opposition indicate that they do not see the functions of SOEs in the same light as currently serving Ministers. The possibility of a change in the monitoring procedures and operating environment for SOEs cannot be ruled out in the event of a change in government. The periodic changes in political office and uncertainties created by conflicting party policies may involve serious adjustment costs for SOE employees and the subsequent loss of motivation. The efficiency costs are substantial by comparison with private companies not subject to such changing policies.

In any event, government ownership of an organisation increases the likelihood that it will be used by politicians to confer benefits on particular interest groups. Because much of the income generated by an SOE is not clearly allocated to any particular individual (unlike a private firm where the rights to income are clearly specified), governments have the scope effectively to divert this income to politically favoured groups. This is achieved, for example, by requiring SOEs to provide subsidised services to favoured groups at the expense of overall profits.

Interest groups have incentives to lobby for special benefits and politicians have incentives to grant them provided the costs of such actions are not apparent to those who are disadvantaged. As long as SOEs remain in public ownership, governments will be tempted to use them to deliver benefits to such groups at the expense of overall community welfare. Interventions of this type will undermine the incentives provided by corporatisation.

Government ownership introduces the temptation for the Government to sacrifice agreed commercial objectives in the face of fiscal pressures through, for example, requiring the payment of excessive dividends.

If public ownership of SOEs is retained there is a substantial likelihood that the benefits of corporatisation will be lessened or even perhaps reversed. The United Kingdom experience emphasises this risk. A salient feature of experience with SOEs in the United Kingdom has been the extreme difficulty of making the economic and financial guidelines operative and maintaining the integrity of the arm's length concept (whereby the government is not involved in the day to day running of the organisation). G.W. Jones, a Professor of Government and Political Science at the London School of Economics, notes "[the SOE process] does not work. The half-way house is not viable. New Zealand, if benefiting from British experience, should regard the SOEs as a stage *en route* from the departmental form to full privatisation. SOEs offer no enduring model."[1]

6 Conclusion

The SOE reforms to date represent a consistent and self-reinforcing package. Managers and employees of SOEs have responded strongly to the change in their operating environment achieving appreciable improvements in the efficiency with which resources are used. The breadth of the reforms has ensured major gains in SOE performance.

However, the reforms do not alter the fact of state ownership and the problems that this creates in maximising management performance. Some of the important constraints on managers which exist in the private sector mechanisms cannot be replicated in the public sector. The absence or weakness of these mechanisms in the case of SOEs has adverse implications for their performance. Continued public ownership of SOEs increases the likelihood that the gains achieved to date will be eroded or reversed because of the temptation for politicians, in the face of interest group pressures, to use these organisations to deliver special benefits to the politically powerful.

Privatisation of SOEs will generally ensure that the gains achieved to date by corporatisation are not reversed and that further improvements are achieved.

Where organisations do have significant market power, the Government should consider the issue of ownership of the firm in conjunction with alternative regulatory solutions to the problems of market power. Its central concern must be that the privatisation process itself - including the determination of the regulatory environment for newly-privatised SOEs - should be consistent with the ultimate goal of privatisation: an improvement in the efficiency with which scarce resources are used, and thus an improvement in the overall welfare of New Zealanders.

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1 Jones, G.W., *Privatisation: Reflections on the British Experience,* Paper delivered at the Institute of Policy Studies Seminar "Corporatisation and Privatisation: Completing the Revolution?", 1987, Wellington.

SOCIAL POLICY

WORLD EXPO CELEBRITY SPEAKERS FORUM

THE SOCIAL DIMENSION

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PERFORMING ARTS CENTRE
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THE SOCIAL DIMENSION

My allocated topic is social aspects of economic policy formation and management. I want to relate it to developments in our region, with special reference to Australia and New Zealand.

Both countries have been prosperous for longer than most and were at the forefront in considering the social dimension. Technology, the theme of this forum, accelerates the rate of change and the opportunities for economic growth. It enhances the need for more rapid social adaptation and better education. The lesson our countries demonstrate is that excessive intervention by the state leads to resistance to change and poorer economic and social performance. The answer lies in policies that allow individuals to make the decisions that affect them and permit them to control their own destinies.

Events in Australia and New Zealand in the last few years have made them interesting countries in an exciting part of the world. Tired of being perennial economic losers, their electorates voted for change. They are midway through a difficult period of economic and social adjustment. The jury is still out on whether the two countries will complete the transition to being part of the dynamic economic region of the Pacific basin.

It only gradually dawned on Australians and New Zealanders that they were losing ground. A century ago, their per capita incomes were over 50 percent higher than those in the United States. New Zealand incomes per head are now half North American levels and two thirds those of Australia.

But our countries have also lost ground relative to the Asian region. In the space of a generation, the free market economies of Asia, with few natural advantages, have made spectacular advances. Japan is now an immense force in the world economy. Singapore and Hong Kong have reached New Zealand standards of living. Korea and Taiwan look set to surpass us before the turn of the century. In recent years, India and Thailand have been quiet achievers. The most fascinating development of all, of course, is the capitalist revolution in China.

Australia and New Zealand have started to dismantle some of the mechanisms which shut us off from economic reality for so long. But the process still has a long way to go, and the base of public understanding on which it rests is still rickety. As one Australian commentator recently put it:

> "It is true that, in recent times, the Australian Government has taken some steps towards the real world, such as the deregulation of the exchange rate. It has to be said, however, that there is little evidence that such steps have been taken in response to any pressing public demand for them. Moreover, we have been unwilling to take other necessary measures - such as the freeing up of the labour market and the reduction of penalties on success - without which the first kind of change simply makes us more vulnerable."

Why is it that Australians and New Zealanders have had such difficulties in coming to terms with changes afoot in the world? What explains the lack of confidence and the congenital pessimism that so frequently surfaces in our societies?

An examination of these questions by a distinguished Australian academic, Professor Ray Ball, seems to me illuminating. He suggests that Australians - and the same is true of New Zealanders - have been unusually sheltered through much of their recent history from primary responsibility for their own economic futures.

Paternalism, Ball argues, has led to a self-reinforcing cycle of dependence. If people don't accept full responsibility for their own future, they become dependent on others. If entrepreneurship is directed away from markets, it begins to create more and more effective mechanisms of state direction and control. A habit of avoiding responsibility becomes endemic in families, schools, universities, churches and other formative institutions, in the training, practices and attitudes of employers and employees, in the role of the government and in the social fabric in general.

It was not always so. The early success of our two countries appears to be due, at least in part, to values and habits such as self-reliance, hard work, thrift and a readiness to help one's neighbours and others in need. In their quest for the good society in new lands, our forebears were among the first to introduce elements of social security, but they also understood the importance of other mechanisms that upheld the social fabric. There was a large role in their world for church and family, for friendly societies and cooperatives, and for other forms of mutual aid. They understood less well, regrettably, the importance of similar social institutions, and economic property rights, for the welfare of the Maori and Aboriginal communities.

What seems to have happened is that, decade by decade, we forgot the lessons of our early prosperity. I believe it is wrong to view this process as essentially a product of the 1930s in the aftermath of the depression. The record shows that the political climate of that time was in many ways quite conservative, that Keynesianism had little influence, that the welfare initiatives taken were quite modest, and that political leaders realised that job creation schemes could only be a temporary expedient. They were also aware of the risks of people becoming dependent on the state and of undermining other valuable social institutions.

Rather the process was a more cumulative one. The necessary wartime resort to government planning and controls was mistakenly continued at a time when other countries moved to liberalise their economies. Fashionable economic doctrines led governments to try to manage and manipulate economic activity. Political auctions developed for the support of pensioners and an increasing number of welfare categories, who often received the wrong signals with respect to employment and savings. Not just needy individuals and families but farmers and manufacturers became wards of the state. Policies that were established with the best of intentions often proved to have perverse and unintended consequences that far outweighed the originally perceived benefits.

In New Zealand all of our citizens are now welfare beneficiaries at some time in their lives, regardless of their need. For example, we provide universal superannuation at age 60, a mandated accident compensation scheme run by a state monopoly, universal family benefit, free - or nearly free - health benefits and public hospitals (when you can get a bed) and virtually free tertiary education (when you can get access to the course of your choice).

Despite the growing awareness of the problems inherent in such arrangements, a recent Royal Commission on Social Policy in New Zealand generally favoured a continuation of such universality rather than the option of targeting those in real need. They seemed to be saying that it would be unacceptable to take $1 from me to give it to you to meet real needs, but it would be acceptable to take $2 from me to give $1 to you and give me back $1 - less the enormous costs of churning the money through the tax and welfare systems.

Not surprisingly, given the unreality of this economic culture, Australians and New Zealanders have had difficulty in confronting the long run consequences of their own decisions. These have been not just relative economic decline but also a recognition that many well-intended social programmes have actually made many social problems worse. Many in our communities are bewildered by the actions taken by our governments to withdraw arrangements which have sheltered them from responsibility for so long.

There is widespread confusion in New Zealand, for example, about the implications for social well-being of a greater degree of economic freedom. Some domestic critics suggest that a more open and competitive economy benefits the rich and greedy at the expense of the poor and disadvantaged. The market is portrayed as a jungle where only the fittest survive and where the strong prosper by exploiting the weak.

As Hugh Morgan, one of Australia's leading businessmen, recently observed, the response of many thinkers who have sought to deflect such accusations has been that a free enterprise system is based not on greed but on self-interest, broadly defined, and that, because self-interest includes a deep concern for one's family and community, there is no conflict between the basis of capitalism, free markets and private property, and the good of society.

Morgan noted that the argument is reasonable, and in accord with our observations of human behaviour both domestically and socially. But it does not have the power to bind people with strong loyalties and deep commitment. It is too reasonable to inspire passionate conviction.

That is why George Gilder's book, *Wealth and Poverty*, published in 1981, caused such a furore. Morgan quoted from the pivotal chapter where Gilder argued flatly:

> "Capitalism begins with giving."
>
> "Capitalism consists of providing first and getting later."
>
> "Capitalism entails faith - in one's neighbours, in one's society."

Elsewhere Gilder has pointed out that:

> "One of the most impoverishing illusions in the world today is the bizarre concept that wealth creates poverty, that somehow some people are poor because others are rich. The idea itself creates more poverty than almost any other concept in the canons of Marx."

We in New Zealand and Australia are only slowly coming to appreciate that an open and decentralised economy is the land of opportunity for the disadvantaged and those on low incomes. The reason is that competitive markets are remarkably indifferent to status. An employer finds two unskilled workers receiving $5 per hour an excellent substitute for a semi-skilled worker receiving $10 per hour - provided he or she is allowed to hire them. A shopkeeper finds ten $1 purchases by the poor more profitable than a $7 purchase by a prosperous buyer.

What the competitive economy is not a friend of is privilege. It is irksome as a businessman to have to satisfy your customers or lose them to a competitor; far easier that they did not have the choice. It is uncomfortable for unionists to have to serve workers' interests or lose their membership, which is why so many detest the removal of their monopoly privileges. Teachers often oppose the elimination of school zoning. Competition is typically resisted by privileged groups rather than the less well off. The latter know that not many regulatory policies work to their benefit.

The logic of the argument is supported by the facts of history in our region. The free economy of Hongkong has been a mecca for destitute immigrants in the post-war period, just as the United States was a hundred years earlier. With its decentralised and largely unregulated labour market, Japan has enjoyed virtually full employment through the oil shocks of the 1970s and their aftermath, and it has one of the world's most even distributions of income. South Korea saw a progressive reduction in income inequalities as it liberalised its economy in the 1960s. This trend was interrupted during the 1970s when it reverted to government intervention and resumed in the 1980s when it switched policies again. Chairman Mao's China was supposed to aim at eliminating class differences, yet there were few societies in which the classes were more clearly segregated. The beneficiaries of the enormous disparities of wealth and status that developed in Mao's time remain the main source of resistance to Deng and his successors.

Although Australia is some distance down the track, New Zealand has barely started the process of reviewing specific social policies in the fundamental way in which it has approached economic reforms. Yet to an outside observer, many of the arrangements it has adopted are as bizarre as its former economic policies and have been equally unfair and inefficient.

Just as economic reforms such as the introduction of a broad-based consumption tax in New Zealand attracted opposition, there will be resistance to the further changes that are necessary. Advocates of change will be branded extremists, in the same way that Pythagorus was when he produced evidence that the world was not flat. The truth, it will be argued, lies neither with the defenders of the status quo nor with those who propose changes to which logic and evidence lead them. Extraordinary as the notion sounds, it will be claimed that the truth rests somewhere in the middle. The world is neither flat nor round, but somewhere in between.

But the new consensus on economic and social management that has developed around the world is backed by an increasing body of analysis and evidence, which requires its critics to produce their own analysis and evidence rather than resort to abuse and labels. Those who have advocated systems which have trapped large numbers of people into dependent situations, produced ever-increasing hospital waiting lists and restricted entry into tertiary institutions, now have a case to answer. It is not easy, for example, to ignore the fact that tertiary education enrolments in North America are far higher than in New Zealand despite the absence of 'free' tuition, nor that the chances of a Japanese shop floor worker's son entering the predominantly private and fee-paying senior high schools in Japan are 5 times higher than his British counterpart.

In the final chapter of his recently published book, New Zealand's Minister of Finance, Roger Douglas, identified the contemporary debate as being not about the ends of a good society but the means of achieving them.

> "At the end of the 1930s," he wrote, "we established a welfare system to act both as a safety net and a base from which people could re-enter productive society... But something has gone terribly wrong with the system, and the institutions, as society has changed around them."

Having a true social conscience - being truly caring - involves facing facts and finding better solutions.

The new approaches to social policy accept that there is an important role for the government, especially in defence of the weak, poor and discriminated-against. However, their forms are very different from the welfare state or 'Great Society' programmes of the past. Emphasis is placed, for example, not on funding institutions in the hope that money or services might 'trickle down' to the right places - only to have it diverted in many instances - but on the 'trickle up' strategy of vouchers or consumer-based funding which gives direct assistance to those in need. As in the economic domain, features such as competition among providers and choice among consumers, assisted where necessary in a targeted way, are likely to characterise many new initiatives.

At the same time, we shall have to recognise the limitations of state action in solving social problems. As Mrs Thatcher recently told critics in the church:

> "Any set of social and economic arrangements which is not founded on the acceptance of individual responsibility will do nothing but harm. We are all responsible for our own actions. We cannot blame society if we disobey the law. We simply cannot delegate the exercise of mercy and generosity to others... [I]ntervention by the state must never become so great that it effectively removes personal responsibility."

We have to be concerned that by abrogating too many responsibilities to the state we have depersonalised caring and crowded out much voluntary initiative. By extending assistance on a universal basis to large sections of the population, we have ended up recycling funds, reducing our overall wealth, and doing a poorer job of helping people in real need.

Many in the intellectual classes, whose self-interest often lies in the expanding the scope of governmental activity, remain hostile to Mrs Thatcher's message. But a source of optimism for the future is that on many topical issues, the opinion of the general public, and in particular of so-called 'lower' socio-economic groups, younger age brackets and minorities, appears to differ in interesting ways.

A recent opinion survey showed 72 percent of Australians supported proposals for student contributions to higher education. A poll conducted in New Zealand last month revealed that notions of a general community preference for public hospitals are outdated, and that the groups most strongly in favour of private hospitals included younger age groups, residents of major cities and Maoris. In both Australia and New Zealand, polls have indicated strong support for a voluntary, decentralised industrial relations system. There is international evidence that the most poorly paid workers are aware of the adverse effects of minimum wage laws, and their representatives vote against such measures. There are thus some grounds for hope that the democratic process will push our countries towards more successful means of achieving widely shared goals.

But progress is not assured; Argentina, which was the world's 8th largest economy immediately after the second world war, is now in 58th position. Australian and New Zealand societies still have a long way to go to overcome the dependency habits, pessimism and lack of confidence of which Professor Ball spoke. To succeed we need to teach opportunity and responsibility rather than dependence in our families, schools, universities and churches. We need changes in attitudes and practices among businessmen, trade unionists, politicians, regulators, professionals and the media. I share Ball's view that as the rest of the world - and notably the Pacific rim - continues to develop its capabilities, Australians and New Zealanders will experience a near-term slide in well-being if they do not quickly learn to adapt to a world without a parent.

LINCOLN COLLEGE OLD STUDENTS ASSOCIATION

ANNUAL GENERAL MEETING

EDUCATION

SIR RONALD TROTTER
CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

CHRISTCHURCH
5 MAY 1988

EDUCATION

I am pleased to be here this evening and to respond to an invitation to share with you some thoughts on education. We are going to hear a good deal more about that subject in the debate on social policy over the next few months.

It is absolutely imperative that this debate is set in the context of where New Zealand has been as a country and the fundamental stocktaking that has been occurring in recent years.

Our poor economic performance has been a major cause of the social stresses - in forms such as unemployment, housing and our capacity to care for the sick and the needy - which the country has been experiencing. But the performance of our social services, such as health and education, and the incentives of many of our welfare programmes have in turn undermined our capacity to generate wealth and jobs. Economic and social policies are totally intertwined.

Consider, for example, how three major issues in economic policy - inflation, unemployment, and public debt - affect social well-being. They should be at the centre of the report which the Royal Commission on Social Policy is presenting tomorrow.

Years of double digit inflation ravaged the lifetime savings of a generation of New Zealanders by decimating the value of their fixed interest investments. Recent generations voted for economic policies which cleaned out their parents. National Superannuation should be seen as a weak countervailing offset to monetary and fiscal profligacy. Unless we eradicate inflation permanently we shall never be able to solve the social problem of post-retirement incomes in a satisfactory way.

A key statement on employment was made by the Royal Commission in its initial report. "We believe", it said, "that the primary instrument for achieving a fairer society must be economic and social policies designed to provide wide employment opportunities".

Their initial report said little about how wider employment opportunities should be promoted. By far the most important step is to free up our malfunctioning labour market. If this issue is not faced up to squarely in the Royal Commission's report, the exercise will have been in vain.

A theme that does emerge clearly in the Royal Commission's first report is a concern for children in society. So far, however, there is little sign that it has grasped the point that the single most important impediment to our children's welfare is the mountain of public debt which we have bestowed upon them.

I saw an American cartoon recently which featured a group of politicians having a meal in a restaurant. The waiter brought the bill and they told him: "Stick it on the kid's tab". That is what New Zealanders have done for the last 15 years - we have stuck it on the kid's tab. We cleaned out our parents, and simultaneously we committed fiscal child abuse on an unimaginable scale.

What right do we have to live this way? If the Royal Commission is serious in its concern for the future of our children, the debt problem must be at the centre of its analysis. The solution to it must include reductions in wasteful spending on social services and on transfers to those who are not in genuine need.

In this process health and education cannot escape scrutiny. They are huge industries, accounting for over 10 percent of gross domestic product. The recent Gibbs Task Force report has exposed a degree of waste in our public hospitals which it described as scandalous. People genuinely concerned about those on waiting lists should be calling from the rooftops for action, and politicians should be held accountable if they fail to respond.

There is little doubt that the Picot Committee will reveal a similar malaise in our education system. Richard Prebble has argued that New Zealand's failure economically has been mirrored by its performance in education. Statistics suggest that in some areas New Zealand has gone backwards educationally while other countries like Germany and Japan have improved by a massive margin. Mr Prebble expressed amazement that this failure has not caused a greater business outcry and public debate.

I can tell you tonight that the business sector has become much more conscious of the performance of the education system, and will be expecting the Government to produce results. This is partly because of a recognition that the human resources we need to meet international competition must be the products of a world class education system. But the interest is more a reflection of the point I made earlier, namely that all aspects of economic and social policy profoundly affect the environment in which New Zealanders live, work and do business.

The malaise New Zealanders have been expressing about education is not unique. The 1982 report on American education, *A Nation at Risk*, stated:

> "For the first time in the history of our society the educational skills of one generation will not surpass, will not equal, will not even approach those of their parents."

As one business magazine commented, it is:

> "Little wonder that many executives are joining the education reform movement sweeping America. They fear that if the United States can't count on public schools to produce workers who can read, think, calculate and communicate, it can kiss its economic preeminence goodbye."

The Business Roundtable has not considered the area of compulsory education in any depth, and what I have to say on that subject represents my personal views. We have undertaken a major study on tertiary education, and I shall refer to that a little later.

As far as schools are concerned, my personal belief is that the head of a leading Wellington secondary school identified the anxieties of many parents very accurately in a recent article. He noted that there had been a decline in confidence in the state schools, for any or all of the following reasons:

" * Fear of political lobby groups having too much say in schools.

* A sense that traditional values have been lost and that schools actually pose a threat to the desired expectations of the family.

* A suspicion that schools are becoming places for social engineering.

* Concern that the academic disciplines are to be supplanted by such curriculum topics as peace studies, trade unionism and taha Maori.

* A belief that standards are declining, particularly in mathematics and English.

* Lack of discipline in and out of school."

The article expressed a belief in good private education, but also argued, rightly in my view, that the state education system should provide its counterpart with the best possible competition. At present it suggested the state could not provide an education which parents would choose over private schooling.

Curiously, given these beliefs, the school principal who wrote the article and a number of others argued stridently, and in my view irrationally, against the Government's moves to introduce performance-based pay for teachers. The link between better reward mechanisms and the accountability and responsiveness of the system seemed to be completely missing in their criticisms. It is to the credit of the Minister of Education that he appears concerned to put the interests of parents and children first, and to promote the same kind of arrangements that make for cooperative, high-performing teams in business organisations.

I am aware that there is debate over whether or not education standards in New Zealand have actually declined. That such a debate exists is in itself a damaging commentary on our education administration, including the virtual non-existence of reliable education research, that we do not have precise information on education performance.

Second, and more important, supposing it is the case that education standards have at least been maintained, I am amazed that people have not asked an awkward question. Over the last couple of decades, there has been a very large increase in the resources devoted to education. If, despite this massive increase in inputs, we have achieved little or nothing in the way of improved standards, what does that say about education productivity?

In my view, productivity in the educational services industry must be the central policy issue, as it must be in all other areas of New Zealand life. Studies have indicated that better academic and more sophisticated disciplinary results have been achieved in Japan even though Japanese teachers take classes twice as large as the British average and though government expenditure per school child is lower. The explanation given is that education and teachers in Japan are much more competitive and productive.

To my knowledge, most educational research casts strong doubt on the educational benefits of across-the-board reductions in student/teacher ratios, which would involve major increases in education spending. Teacher quality is typically found to be a much more important factor in student performance. With falling school rolls, there should be significant scope for savings to the taxpayer, consistent with maintaining and indeed improving standards.

In New Zealand there has been an increase of around 50 percent in spending on education, or 20 percent in real terms, over the past 3 years. It is not easy to see what we have got for that massive additional outlay, apart from an increase in teachers' remuneration. On the other hand, we can see clearly that this transfer to one of the more sheltered sectors of the economy, and a similar increase on health services, have been directly at the expense of incomes in exposed industries like farming. I am far from convinced that there is a case for throwing more money at the present education system as some are arguing especially if, as I say, we are genuinely concerned about the future of our children and the debt burden they face.

At the tertiary level, the study which the Business Roundtable will be releasing next month suggests that the case for greater competition among the providers of educational services and for greater choice among consumers is even stronger than in the schools. Properly informed school leavers are generally able to make sensible choices between work and further education, and between the forms of education or training to which they are most suited. Nor is there any obvious reason why public institutions should retain a virtual monopoly on tertiary education services. The implications for policy are to create an environment which permits more decentralised competition within and between public and private institutions, and rewards universities and polytechnics for what they produce, not what they spend.

The study suggests that a clear distinction should be made between the functions of providing tertiary education services and paying for their provision. A striking feature of "free" university education in particular is that it represents a massive redistribution of income from poorer to richer members of society, since most students come from better off families and graduates typically earn incomes well above the average. In Britain tertiary education has been estimated to represent a transfer of $5 to the rich for every $1 to the poor. There is a strong case, on both efficiency and equity grounds, for relying on loans rather than grants as a general means of financing tertiary education, with scholarships being made available on a generous basis to ensure that access is not denied to any capable student.

A further crucial factor identified in the study is the relationship between formal education and the labour market, particularly with respect to skill development. By and large training outside the workplace does not create jobs; jobs create training. But to provide the incentives for employers and employees to undertake training, a freer labour market is necessary. At present both the subsidies to formal education and the compression of earnings differentials under rigid awards operate to discourage skill acquisition in the workplace.

Some of the recent political rhetoric on the idea of a competitive, decentralised, client-driven market for education, and of a counterpart system for health services, is not encouraging. It has echoes of Edward Heath's dismissive criticism:

> "This is a crackpot scheme by those who think they can sell education like canned spuds in a supermarket."

As one commentator responded:

> "A moment's thought should reveal that what would indeed be crazy is a proposal to distribute groceries as we now distribute secondary schooling ... No grocery store serving customers who are free to take their business elsewhere could long survive while giving only half or a third of the value for the same money."

It is precisely because education is such a basic requirement, like food, that we need to strive to find the best ways of supplying it. Imagine what would happen if we had to rely for our food on a government supermarket or soup kitchen! Any Polish housewife could describe the result.

I hope it is a promising sign that the Government appointed the former chief executive of a progressive supermarket chain to head its review of education administration.

In a much-quoted article surveying educational performance in a number of countries, Norman Macrae, deputy editor of *The Economist*, proposed that progressives in the educational battle should have one guiding principle: "Where you find a place where education is awful, throw more competition (not money) at it". Schools should be paid according to the students they attracted, he argued, and progressives should argue for the largest capitation fee for the most disadvantaged child. Comparing Britain and Japan, he found that the chances of a Japanese shop floor worker's son getting on the escalator to the predominantly private and fee-paying senior high schools in Japan were 5 times higher than his British counterpart. "Fees-plus-scholarships work egalitarianly", Macrae concluded.

My purpose in these remarks has been not so much to endorse any particular line of approach to education as to argue that it deserves to be subject to the same kind of fundamental stocktaking as has been applied to other areas of national life. There is no reason to be starry-eyed about education. In many respects it is a professional or business service like many others, and should be managed in an efficient and business-like way.

With your Lincoln College backgrounds, and notwithstanding New Zealand's strong record in agricultural studies, you will be well aware that the agricultural sector, the country's largest export industry, would have to be seen, at least in formal terms, as an industry that overall does not have a high level of academic education. The government sector, by contrast, is very well educated academically. Given my rural origins I may be biased, but it seems to me that the rural sector has done better in terms of service to the country than has the government sector. If this insight were more widely shared, we might be spared much of the pretentious rhetoric that we hear on education.

Let me leave you with one concluding thought. If there is one thing that we have learned in New Zealand in recent years it is not to blame people in organisations for the things that have gone wrong. There is no point in blaming protected manufacturers or their workers for the fact that their products were too dear or of poor quality. There is no point in blaming employers or unions for confrontational "them and us" attitudes to industrial relations. There is no point in blaming doctors for waiting lists or academics for queues for tertiary places. There is no point in blaming farmers for exploiting Livestock Development Schemes. The blame lies squarely on the policies, the environment and the incentives which affect these organisations and the people in them. They have been prisoners of systems which must be changed if we want to change behaviour and performance.

It is ludicrous to suggest that New Zealand teachers and academics are genetically inferior to their counterparts in Germany or Japan. Teaching should be a profession with high standing in the community. Good teachers should be well rewarded, and should not be frustrated in their work by poorly performing colleagues. It is the worst performers who should be dropping out of the system, if remedial efforts have failed, not the best as is too often the case at present. It is to the best teachers that the Government owes changes in the education system, but even more it owes them to the consumer of their services who, in this area as in any other, should be king.

I am aware that, like many business organisations, Lincoln College is facing a difficult adjustment task right now. However, it has already shown much more flexibility than many other tertiary institutions in adapting to the changed circumstances of the rural sector, and moving into new areas like recreational and environmental studies. It has been a leader in assessing individual teaching abilities and on questioning the system of tenure. If it were to be freed of the constraints and bureaucracy of the present system, and be given the opportunity to extend these entrepreneurial initiatives in the education market, I would have every confidence that Lincoln has a bright future.

TERTIARY EDUCATION REFORM IN NEW ZEALAND

- A BUSINESS SECTOR PERSPECTIVE

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TERTIARY EDUCATION REFORM IN NEW ZEALAND - A BUSINESS SECTOR PERSPECTIVE

INTRODUCTION

In recent years governments in New Zealand have been responding to a widespread recognition that the country's economic and social performance has been perhaps the least impressive in the OECD area. There has been a searching re-examination of the policies, systems and institutions that have been responsible for this performance. Many of them have been found not to conform with what modern theory and evidence suggest are best practice models, and some quite far-reaching changes have been set in train.

An important part of this re-examination has focused on the public sector, which absorbs some 25 percent of national resources in the direct production of goods and services. Some of the worst cases of waste in the use of resources have been identified in this sector. A policy of establishing state trading departments as business enterprises with straightforward commercial goals has already yielded significant improvements in efficiency, and moves to privatise many of them are now underway. Policies of full or partial cost recovery have been introduced for many publicly provided goods and services, there is an ongoing process of reorganisation of policy and regulatory agencies to better reflect their appropriate objectives, a new system of appointments and contracts for chief executives of government agencies is being introduced, and pay-fixing arrangements in the state sector have been changed to relate them more closely to performance and market conditions.

In this process, it is not surprising that attention has now turned to a number of public sector institutions which have been among the most sheltered and least subject to change. These include the education sector, health (in particular public hospitals, which account for around 75 percent of public health spending) and local government. Tertiary education alone is a massive industry with expenditures of around $0.75 billion annually. Clearly inappropriate policies for tertiary education have the potential for undermining national social and economic goals.

The business sector in New Zealand is taking an active interest in the debate on tertiary education reform. This reflects a broadening of business perspectives in recent years to recognise that all major areas of economic and social policy affect the environment in which New Zealanders live, work and do business. The business sector's preoccupation with tertiary education is not primarily with narrow vocational aspects, as is sometimes alleged, even though the rigidities of the system in responding to the new skill requirements of the private sector are a source of frequent complaints. It is partly a recognition that in order to be able to foot it in an open trading environment with the world's more successful economies, our industries must have access to the products of a world class education system. But the main motivation for a business sector interest is the realisation that national goals of high productivity, social opportunity and democratic values will not be sustained unless institutional arrangements within our tertiary education sector provide the right incentives to both the producers and consumers of its services.

To illustrate these perspectives, this paper reviews two recent contributions to the debate on tertiary education reform in New Zealand. The first is the report of the Universities Review Committee (Watts Committee) appointed by the Vice-Chancellors of the New Zealand universities. The second is a study undertaken for the Business Roundtable by Professor Richard Blandy of the National Institute of Labour Studies in Adelaide. While much of the discussion of this topic, as reflected in the scheme of the Watts Committee report, concentrates on the formal institutions of tertiary education, I also wish to bring out the crucial role of the labour market and informal employee training in the development and utilisation of human resources.

REPORT OF THE UNIVERSITIES REVIEW COMMITTEE

The task of the Watts Committee was to review the development of New Zealand universities over the past 25 years, to assess their current international standing and potential and to make recommendations for their future development.

Part of the requirement to assess the standing of the universities was carried out by an examination of six selected subject areas. A glance at one of these, economics, provides an illustration of the weaknesses of the Committee's method of operation and the limited critical scrutiny which characterises the report.

The performance of economics departments can be examined by some quite tangible yardsticks with respect to such matters as course content and quality, research output and contributions to public policy. Even a cursory look at undergraduate programmes would have revealed that much of what is taught reflects the state of economic science 20 years ago. Major developments in the discipline such as public choice, financial economics and law and economics are barely represented in many New Zealand economics department programmes[1] .

There has been little infusion of new blood into economics departments for many years. Senior incumbents have held positions since the expansionary era of the late 1960s and early 1970s, promotions have been largely from within and little international talent has been recruited. The most distinguished New Zealand academic economists are now almost all working overseas. Few PhDs in economics are undertaken in New Zealand, and first-class overseas students are seldom attracted to New Zealand to undertake post-graduate study.

A recent Australian study has estimated that the average rate of publication of top rank equivalent articles per member of the Australian university economics departments is less than half an article per year (Harris, 1987, p.7). Some 20-25 percent of staff are "non-researchers". A comparable New Zealand study would undoubtedly show an even worse picture. Only a handful of articles in leading economic journals has been produced by academics working in New Zealand in recent years. Although public and private sector funding of economic research has burgeoned in New Zealand, little has been attracted by university researchers.

With a few notable exceptions, the contribution of academic economists in New Zealand to public policy has been non-existent or of a standard that has been regarded as embarrassing by their overseas counterparts. The present Minister of Finance has been especially critical of this role of academic economists (Douglas, 1987, p.30).

In a discussion with the Business Roundtable, members of the Watts Committee indicated that in their opinion economics was the weakest of the subject areas they examined, but there is barely a trace of this assessment in the report. For a discipline that is as important to national and commercial life as economics, this is a sorry state of affairs. Yet it is no accident: a systematic feature of the New Zealand university sector is that performance is typically weakest in important areas, for the reason that the demand for talent is high elsewhere and attracts a premium which rigid contractual arrangements in universities cannot match.

The non-evaluative and bland treatment of the international standing of the universities is unfortunately typical of the Review Committee's report more generally. For the work of an academic group, it is a strangely unscholarly document. There is no framework or methodological approach that is developed to assess the provision and financing of university services; the large body of relevant research on the subject is not utilised; and much of the discussion lacks analytical rigour.

The basic thrust of the report is that "more is better". It is asserted that enrolment is low by international standards and participation should be doubled over the next two decades.

1 Interestingly, financial economics and law and economics studies have been introduced in the more innovative accountancy and law departments.

Research is under-resourced and should be expanded. Input levels (staff/student ratios and other resource inputs) are said to be low and international norms are recommended as a goal over a twenty year planning period.

The assumptions underlying these recommendations do not stand up to scrutiny. No automatic conclusions for policy arise from such international comparisons. Low enrolment rates could, for example, be due to the structure of an economy's labour market or the poor quality of its university system. Very little of a prescriptive nature can be said about the extent of a country's involvement in tertiary education, any more than about the extent of its involvement in science, or the level of its saving and investment. More is not necessarily better in education just as less is not obviously better in health. The absurdity of the view that a low ratio of health or a high ratio of education spending to national income is desirable is revealed by asking whether a zero or 100 percent level of spending respectively would be best of all. It is possible to over-invest in education or science just as it is in any other activity, as the number of unemployed graduates in India (or working on the London underground) clearly indicates. The Beattie committee on science and technology missed this same basic point, and did not investigate in a rigorous way the criteria justifying government involvement in R and D.

There is no close correlation and certainly no clear causal link between university education and economic growth. For example in the 1970s the proportion of the Australian workforce with post-school qualifications doubled and the proportion with degrees more than doubled. Yet in this period growth rates showed no discernible upward trend and, if anything, productivity growth slowed. Nor was there a correspondingly greater equality in overall distribution of income. Clearly a much more secure foundation needs to be identified for determining an appropriate allocation of resources to university education.

Similarly what might be called the Frank Spencer "Some mothers do 'ave 'em" approach to determining input levels begs all relevant questions. The main comparisons made are with Australia and the United Kingdom, both of which share with New Zealand an unenviable record of economic performance. Even so, they are considerably wealthier countries than New Zealand and are capable of financing a greater resource input. Low staff/student ratios may well be an indicator of poor academic productivity; they tell us little about the quality of educational output. Research suggests that teacher quality is likely to be much more important in this regard.

The Committee establishes a sound principle in stating that, "It is appropriate that the private and public contributions [to university education and research] should match the private and public benefits that are derived". However, the application of this principle is badly flawed, in particular in its assumption that forgone earnings should be regarded as a private contribution in assessing the justifiable proportion of taxpayer subsidy. Many individuals forgo income to engage in leisure, take an overseas trip or raise a family, yet these activities are not generally regarded as a justification for taxpayer assistance. Moreover, a good deal of evidence (e.g. Fane, 1984) of which the Committee seems unaware suggests that the majority of the benefits of tertiary education are captured by students themselves, and that it is not clear whether the net external benefits are positive or negative. Similarly, only research which generates non-appropriable benefits (which would not be financed by identifiable beneficiaries) justifies public funding. The Committee suggests that a maximum of 20 percent of total tuition costs should be borne by students, but if appropriate corrections are made to the application of its own principles - that private contributions should match private benefits - a much higher student contribution is clearly warranted.

The Committee makes a further error in rejecting differential tuition fees reflecting the varying costs of courses on the grounds that these are not necessarily reflected in possible future earnings. This criterion is in conflict with the previous (correct) proposition that , on efficiency grounds, private and social costs and benefits should be matched in financing. As Blandy points out:

> "Science-based courses are more expensive than humanities-based courses, but fees are uniform, so that the subsidy to the former is greater. We know of no evidence which

would support the proposition that the benefit spillovers to society are greater for courses in sciences than for courses in humanities. As a result, the rate of production of tertiary education services may be ... especially excessive in science-based fields, such as medicine and engineering" (Blandy, 1988, p.35).

In its general "boosterism" the report does not refer to the problem of credentialism, which is extraordinary as it is widely assumed to be a fact of modern educational life and one that has a high cost and little productivity effect. Its recommendations, if adopted, could greatly accelerate the "paper chase". Nor does it analyse the most striking equity aspect of university education, which is that it accounts for a massive redistribution of income from poorer to richer members of society. In Britain tertiary education has been estimated to represent a transfer of $5 to the rich for every $1 to the poor (Treasury, 1984, p.259).

In summary, the Review Committee's report appears to be very much an "establishment" document, defensive of a status quo which it does not question too deeply. As such, it is unlikely to be a useful basis for policy makers or university administrators confronting the problems of university development. Its attachment to long-term planning of enrolments is reminiscent of manpower planning approaches of the 1950s and 1960s (Robbins et al.) which have been generally discarded elsewhere. The nature of the universities' contract to the taxpayers for a planning commitment extending over 20 years is not specified. No basic questions are asked about the best operating environment for universities, their form of incorporation, whether the government should remain the exclusive provider of university services, or the incentive structures for performance within universities. The continued reliance on block grants, national pay scales (albeit with some built-in flexibilities), and tenure does not seem to constitute a convincing response to contemporary requirements.

"REFORMING TERTIARY EDUCATION IN NEW ZEALAND"

This study by Professor Richard Blandy was commissioned by the Business Roundtable as an input into the Government's review of tertiary education. Its terms of reference required the development of a policy framework for the provision and financing of tertiary education services characterised by excellence and accessibility, on the basis of relevant criteria for government involvement. The study discusses post-compulsory education and training in general.

A starting point of the analysis is to consider the objectives and functions of education. These can be described and classified in various ways. The New Zealand Treasury (Treasury, 1987, pp24-26) classifies the functions under four headings relating to the individual, the society, the economy and the parent-child relationship. The corresponding functions are, respectively, *fulfilment, integration, skill formation and certification,* and *custody*. Parish (1987, pp95-101) proposes a three-function categorisation: *cognitive, socialisation* and *screening* (i.e. certifying attainments). Clearly the nature of these functions differs as between the tertiary level of education and earlier stages. The custodial role (protecting and caring for the upbringing of the young) has little obvious relevance in higher education where students are adult or near adult. Whereas children at an earlier age are dependent on agents (parents or educational institutions) to make educational choices for them, properly informed school leavers are generally able to exercise rational choices between work and further education, and the forms of education or training to which they are best suited. The benefits of the fulfilment and integration functions at the tertiary level will be largely captured by the individuals concerned. It follows that government involvement at the tertiary level can focus more directly on creating an environment for the efficient supply of a diverse range of educational services and on ensuring access is not denied (because of resources, attitudes or social background) to individuals who are capable of developing their educational potential.

On this basis, Blandy concludes that the appropriate criteria for assessing the performance of tertiary education are:

- the effectiveness of freedom of choice,

- the effectiveness of skill formation systems,
- the degree of emphasis on values consistent with socialisation into a liberal and diverse society,
- the efficiency of the system, and
- the equity of the system.

By these criteria, the New Zealand system of tertiary education does not rate very well. The reason for this is the inappropriate incentive structure flowing from centralised funding and its associated management system.

Freedom of choice has been restricted by quota rationing of places, on the demand side, and resource inflexibilities on the supply side. Excess capacities sit, persistently, side by side with excess demands. New courses take many years to be set in place, in a process in which student demand is often secondary to other pressures.

The **effectiveness of skill formation** is low notwithstanding the claim of technical competence of those graduating. Non-completion rates are high. Tenure, and inflexible salary-setting processes, have combined to starve skill formation processes precisely in those areas on which the labour market is setting a premium. Incentives for teaching units to economise or innovate are weak or non-existent because of centralised funding arrangements.

Tolerance of **diversity** has been partly met by the present system, principally because of the inherently liberal content of traditional curricula in tertiary education. The claims of the humanities for a major continuing place in New Zealand's tertiary education are valid. Blandy argues that the present tendency towards vocational narrowness in course content should be resisted in favour of the free expression of ideas, however unconventional, in our tertiary institutions. In the business sector, for example, the demand is often for graduates with the ability to think in analytical and strategic terms, rather than for narrowly trained professionals. Increased institutional responsiveness to the diversity of student wants is likely to be an important means by which disadvantages can be addressed and overcome. Appropriate, decentralised incentives are likely to be effective in this respect.

The **efficiency** of the tertiary education system is low. It is quite implausible to believe that the system operates at least cost. The planning "norms" used to provide resources to the system are arbitrary and the process of allocation creates incentives to maximise claims. Incentives for innovation are weak, reducing the system's dynamic efficiency. Innovation in the system emerges from "big" initiatives at the top rather than incremental initiatives from below. Diffusion of innovations is also delayed by the red tape of the committee processes involved in their adoption.

The **equity** of the system is very doubtful. Subsidies to students on equity grounds involve regarding them as "poor" or disadvantaged. The low incomes of students while studying are simply a stage in their life-cycle, however. In later years, these initially low incomes are recouped by the earning of higher incomes than average. The taxation system would have to be altered to tax former students at a higher rate than other citizens if it were to be used to recoup these subsidies in an equitable way.

Access to the system by disadvantaged groups has not been promoted by high subsidy arrangements. A particularly bizarre result is that quota restrictions (denying access) operate at the same time as the subsidy arrangements intended to "promote access". Selective scholarships and loans could be used instead to provide access more equitably than occurs in the present system.

This analysis leads to a proposed reform package which draws on a number of emerging Government policy directions, including the ACCESS scheme which is aimed at lower skilled groups, corporatisation initiatives and the state sector pay-fixing proposals.

Essentially, the study suggests that the best strategy for reform is one which subjects the whole range of tertiary education institutions to the opportunities and constraints provided by a decentralised, competitive market for their services, while funding users of these services (to whatever extent desired) by a system of targeted entitlements financed by the government. A clear distinction would be made between the functions of providing tertiary education services and paying for their provision.

Advice on education policy at all levels would be integrated within an agency which was less vulnerable to sectional pressures, such as a Ministry for Social Policy. The administration and monitoring of centrally determined funding would be the responsibility of a separate Education Commission.

At the tertiary level, the existing universities, polytechnics and teachers colleges would become autonomous state corporations funded by tuition fees, research funds, capital raisings and the sale of goods and services generally, including training and research services. Private ownership of some of the existing entities, as well as new private entrants, would be feasible.

A branch of the Education Commission would provide entitlements to New Zealanders towards the costs of tertiary study. These entitlements could be targeted towards particular groups, courses or institutions and could take the form of scholarships, loans and loan guarantees.

There would be competition between providers in the universities, public sector science agencies and the private sector for funds for non-appropriable or public goods research. On the basis of a centrally determined budget and appropriate criteria, funds would be granted to a number of research agencies to contract for research services on a competitive basis. The budget would comprise, at a minimum, that part of the present salaries bill for academic staff in the universities which can be attributed to non-appropriable research not associated with teaching, together with the relevant part of the budgets of other government agencies undertaking public goods research. Public sector researchers would be subject to the stimulus of private sector competition, which would enhance research performance.

No restrictions would be placed on the services that the tertiary education institutions could offer, the terms under which the services could be offered, the terms under which staff could be employed or the structuring of the institutions themselves. New institutions could enter the field of tertiary education services and be eligible to receive entitlements and research funds.

As with other corporatisation initiatives, a complete reappointment process should be undertaken in each institution starting with the councils and the chief executives. Those staff not reappointed should be offered the same sort of severance package as has been offered in the corporatisation process elsewhere.

These reforms would rejuvenate performance in tertiary education institutions by altering incentives to emphasise client-driven outcomes, while retaining as large or small a role for state funding as the Government decided.

A further crucial factor emphasised by Blandy is the relationship between formal tertiary education on the one hand and the informal sector (on-the-job training and learning) and the labour market on the other, particularly with respect to skill development. He notes that in New Zealand the informal sector is quite large but not as large as in the United States or, probably, Japan, relative to the formal sector. Econometric studies have consistently shown that only 15 percent of the variation in income among Americans can be accounted for by formal education. As one article has put it:

> "Public education and job training programs outside the workplace do not have appreciable effects on individual earnings or on institutional performance. Training outside the workplace does not create jobs; jobs create training" (Carnevale, p.18).

The reason for the smaller size of the informal sector in New Zealand is the lower incentive for skill acquisition because of the compression of earnings related to skill and experience compared with other countries. The reduced returns to skill acquisition have induced compensating subsidies to formal sector education and training in order to maintain the flow of skills. Without receipt of such subsidies, the informal sector has tended to be "crowded out" of tertiary education in New Zealand.

A full reform of the tertiary education system will only be fully effective, therefore, if implemented in the framework of a freer labour market which permits more appropriate incentives to emerge for skill formation. Steps need to be taken to restructure awards to provide for better-delineated career structures, with provision for lower starting pay and higher finishing pay. Unless this occurs, removing subsidies could result in a reduction of enrolments in tertiary education. Such a restructuring would provide a desirable extension of the "career" philosophy from salaried staff to the whole of the workforce in each enterprise.

CONCLUSION

The vision of a competitive, decentralised, client-driven market for tertiary education services, with appropriate forms of community assistance to ensure equal opportunity on merit for financially disadvantaged students, is significantly at variance with the "establishment" vision of the Universities Review Committee. Which vision is likely to prevail in New Zealand?

No conclusive answer can be given at this stage. However, there are many indications of trends of thinking in the direction of the former model in both New Zealand and Australia. The recent Gibbs Task Force report on public hospitals proposes a policy framework based on a separation of provider and financing roles, and the establishment of a level playing field for the provision of services between profit-oriented public hospital corporations and private suppliers. It leaves for subsequent examination the question of who should pay for hospital services. The New Zealand Treasury points out in its discussion of tertiary education that:

> "... developments in freeing up either the demand side or supply side in tertiary education in isolation from the other will also produce significant efficiency or equity costs or both. If the demand side is freed up but the supply side is not, inequities will result. At present, universities cannot meet the demand for accountancy studies because they cannot pay a market wage for accountancy lecturers. A freer demand side would respond to such an artificial shortage by bidding up the price for such courses which would increase inequity in access to them. On the other hand if the supply side is freed up but the demand side is not, inefficiencies will result as some providers are enabled to exploit the surplus demand created by extensive state subsidy to create benefits for themselves. If, by virtue of state subsidy, all courses cost much the same low amount to students there will tend to be a preponderance entering those perceived to offer the best job prospects. Differentials in academic salaries will widen considerably as will the rates of return for students taking different courses (hence the drift away from non-commercial ones). Because of the lack of feedback through changing course costs, there will tend to be over-response to perceived changes in the labour market - with students cramming into the currently fashionable commercial courses at the expense of less fashionable courses. Perverse incentives will be created for academics and recruitment officers for specialist employers to create fashions. The result: growing inefficiency."

Within the tertiary education sector itself, there are divergent attitudes towards change. New Zealand student union leaders appear as determined as their counterparts elsewhere to cling to their privileged middle class status. (The unrepresentative nature of student unionism has been well documented by the Australian Institute of Public Policy in its publication *Compulsory Student Unions: Australia's Forgotten Closed Shop*.) On the other hand the ACTU in Australia, representing lower paid groups, has promoted the concept of payment of fees upon the completion of a tertiary course. A number of university administrators have taken a positive attitude towards change. In a recent newsletter the Chairman of the New Zealand Vice-Chancellor's Committee, Dr Wilf Malcolm, expressed the belief that:

> "... the Teachers Colleges will not continue as stand alone institutions, but be linked, probably to the universities as schools of education or, possibly, as some suggest to the polytechnics", and added:
>
> "I think it is likely that the general cost of a university education will increase substantially to those seeking it, with targeted support being the means of implementing goals of access and social equity."

The heads of a number of New Zealand polytechnics are known to be enthusiastic about the concept of a more autonomous and competitive role for their institutions. The Parliamentary Opposition in New Zealand put forward an innovative, consumer-oriented approach to education in its 1987 election policy.

At the present time, upwards of a dozen proposals for private universities appear to be under consideration in New Zealand and Australia. The New Zealand Market Development Board has promoted the idea of the export of educational services to fee-paying overseas students, and policy in this area in Australia is further advanced. A number of universities have extended their consultancy services and introduced graduate programmes on a full-cost basis. The long-run trends seem clear. Many in the business sector hope that they will be promoted by policy changes which positively encourage the expansion of innovative programmes and reward high quality staff, rather than be forced upon the tertiary sector by the rigid funding and management constraints which would inevitably be maintained in the existing structures. These can only lead to a continuing loss of the best and brightest academic talent and a further erosion of open entry opportunities for New Zealand students.

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RETIREMENT INCOME POLICIES FOR A DYNAMIC ECONOMY

ASSOCIATION OF SUPERANNUATION FUNDS OF NEW ZEALAND

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Retirement Income Policies for a Dynamic Economy

Paper presented to a meeting of the Association of Superannuation Funds of New Zealand, Wellington, 22 June 1989 by Roger Kerr, Executive Director of the New Zealand Business Roundtable.

1 Introduction

A recent study of the retirement income problem begins as follows:

> "The rapid aging of the populations of all industrial countries over the next 40 years will be an economic and social transformation of vastly greater magnitude than the 1970s oil shock or the 1980s recession"[1].

This statement highlights the fundamental economic dimension of the problem. Its ramifications are far broader than the design of tax and benefit policies. Providing adequate income security for the present and future elderly is basically dependent on future economic performance.

Against the background of deteriorating economic performance in the 1970s and the prospect of aging populations, most Western governments have been struggling with some success to restructure and revitalise their economies. As part of this process, many are starting to look again at their pension schemes. Some countries, including Britain, Japan and the United States, have already introduced reforms to reduce the future cost of pensions, and others are likely to follow.

New Zealand is faced with similar problems and we have seen similar responses. Up to and including the mid-1970s, New Zealand governments were responding to pressures for more generous retirement income arrangements. Over the last decade or so they have been making efforts to draw back. Nevertheless, as the OECD recently observed in its report on New Zealand, "the state pension system remains unusually generous by the standards of most OECD countries"[2]. Yet New Zealand is one of the worst performers in the OECD. There is widespread agreement that current policy is unsustainable and it is appropriate that it is currently under review.

Various approaches to reform are currently being canvassed, and the Business Roundtable made a contribution to the debate in a recent study[3]. This paper discusses the economic management requirements that are fundamental to our ability to cater for the needs of retired people, outlines the scope for greater self-provision for retirement, and considers the government's role in providing income support for the elderly. There is also some discussion of alternative approaches that have been put forward.

2 The Economic Dimension

The economic and social problems which New Zealand has been grappling with in recent years remain acute. The poor long run performance of the economy has meant that it has not been possible to meet the aspirations of many groups, including the dependent elderly, for better living standards. Over the past 15 years, a massive burden of public debt, unsupported by equivalent assets, has been accumulated and will be a burden on the next generation. Unfunded national superannuation liabilities are an addition to this burden.

The combination of a low performing, debt ridden economy and the demographic prospect of a declining ratio of people active in the workforce to the total population - even on the most optimistic assumptions regarding future trends in immigration, mortality and birth rates - amounts to a disturbing scenario for New Zealand. Without change, tax burdens will become even more oppressive, forcing a poorer economic performance and a migratory response on the part of productive and enterprising New Zealanders. The real prospect of a society in which the old find fewer and fewer producers to share future income with them and to care for them is not an attractive scenario for those who are left behind.

The only way in which New Zealand will be able to ensure that the growing proportion of the population that is elderly has access to an adequate supply of goods and services is for the economy to perform well enough to provide a decent standard of living for everyone. If the economy performs as poorly as it has over the last few decades, the prospects for the future elderly are dim. That is true irrespective of how generous present governments may appear in promising future state benefits for the retired. A focus in the retirement income policy debate on income transfers and financial claims rather than the availability of real resources is far too narrow.

In discussing retirement income in its report on income maintenance and taxation, the Royal Commission on Social Policy briefly recognised that "the greatest contribution that any government can make in this regard is to provide a stable economic environment in which individuals are able and encouraged to make their own provision for retirement as far as possible"[4]. However, it gave little further attention to this basic economic requirement, and indeed proposed an extension of redistributive policies which would risk further impairing economic performance. The centrality of sound economic management was, however, recognised in a recent study by the Centre of Policy Studies at Monash University:

> "The key to providing high incomes in retirement is the pursuit of policies promoting high economic growth. Policies to this end rarely are focused just on retirement and superannuation issues but cover taxation, government spending, government regulations, labour market arrangements, and the incentive and reward structures facing individuals, private business enterprises and governments. With an expanding economy, most people should be able to self-provide for their retirement income, and should face incentives to save and to consume which are level and fair across their lifetime; the basic role of a government pension is to provide a bottom safety net against the problem of aged poverty."

The authors went on to note:

> "Countries pursuing heavily redistributive social security policies, for example countries with generous government pensions, may not always be those which do the best for their retirees, particularly if they compromise economic growth in the process"[5].

The most important set of policies which would enable people to provide for their old age would comprise:

- monetary and fiscal policies which ensure zero or minimal levels of inflation and so protect the value of retirement savings

- reductions in government expenditure which would allow a lowering of the tax burden

- lower rates of tax on income in particular, which would increase the ability and incentives for people to save

- a free and efficient financial sector without interest rate ceilings or other distortions to financial intermediation

- flexible labour markets which ensure that people have access to employment and which do not force people out of the workforce before they wish to leave.

An expanded immigration programme would also ease the demographic problem, as well as foster entrepreneurship and innovation and assist the transformation to a more outward-looking economy.

These are the same policies which, maintained on a stable, consistent basis, would promote general economic welfare. In the longer run, the interests of those saving for their retirement, the elderly and the rest of the population are all therefore best protected by the same set of policies. Naturally transition issues arise for the category of currently retired people who have little alternative but to continue to rely on government support.

The high fiscal cost of national superannuation as it is presently structured, and particularly the projected future fiscal costs, would make the achievement of a desirable set of economic policies difficult. There has been an increasing awareness by economists in the last 20 years of the impact on growth and economic performance of high levels of government spending and associated tax burdens. Redistributive polices do not just involve a transfer of a dollar of income from Peter to Paul; they sacrifice potential community income in the process through the effects of taxes on incentives to work, save and invest. On the basis of a conservative estimate of the marginal cost of public funds, the Business Roundtable study estimated that the welfare sacrifice occasioned by national superannuation was some $675 million per annum, or around $6-7 billion in net present value terms. This is far beyond the probable total economic loss arising from the misinvestment in the Think Big projects. While some level of sacrifice of potential income is clearly justified in order to meet social objectives, it is apparent that constraining the cost of national superannuation will be an important foundation for achieving the economic policies which would enable the elderly of the future to obtain a desirable standard of living.

Greater reliance on private retirement provision, the alternative to state provision, would be more consistent with the income, wealth and work profile of tomorrow's elderly, and with the sort of economic policies needed to sustain a relatively large elderly population. It is a viable option provided general policies are more conducive to savings and to labour market opportunities. In addition, reduced public provision will provide the incentives for people to save for their retirement in the same way that they save for other future events. Our study considered a number of contrary arguments that have been advanced in respect of the scope for self-provision and concluded they are not well-founded[6]. While the approach we favour is dependent on sound general policies being pursued, especially low inflation and a lower tax burden on savings, without such policies no alternative approach to retirement income can hope to succeed.

3 Specific government policies to provide income for the elderly

Even if greater reliance were to be placed on private retirement provision, there would still be a continuing requirement for a programme providing some form of state provision for retirement income. The alternative would be to accept the likelihood of a degree of elderly destitution, an outcome which New Zealanders are unlikely to find acceptable.

The issue is what the objective of such a programme might be. Our conclusion is that the government's role should be one of income support (not the maintenance of people's past income levels in retirement) to prevent those without alternative means from falling into unacceptable poverty. The key issues in the design of an income support programme for the elderly are the level of benefit, the age of eligibility, the question of targeting, and the transitional arrangements for any changes.

- **The level of benefit**

The recent OECD economic survey of New Zealand noted that the New Zealand pension system is generous by international standards. It pointed out that income replacement ratios are higher than in other OECD countries and probably exceeded only in Sweden, and reported that perhaps 90 percent of national superannuation recipients have incomes or receive transfers in excess of the average national wage. If the role of the government is income support, there would appear to be a sound logic in aligning superannuation benefit rates more closely to other income support benefits and to reduce, over time, the real level of benefits relative to wages. This is not an argument for cutting the purchasing power of present retirees who are currently wholly dependent on national superannuation. Provided a superior economic performance can be achieved, it would be desirable to avoid this outcome if at all possible.

The government's recent benefit reforms involve a reduction in the relative generosity of national superannuation and a compression in the differentials between different benefits. This appeared to be overlooked in some media reports that chose to portray our approach as "cutting superannuation benefits to the level of the dole". The basic level of benefit proposed by the Royal Commission for each of the retirement income options it outlined was also the same as for other social security benefits. It commented that:

> "While this may seem to indicate a significant reduction in the level of payment to superannuitants in fact this is not the case. The basic level of national superannuation is already so close to the level of other benefits, it simply implies a slightly smaller periodic adjustment than would otherwise have been granted."

- **The age of eligibility**

An increase in the eligibility age would be a critical move in any redesign of public retirement income provision. As a recent article in *The Economist* argued:

> "The best reform would be to encourage the old to stay longer at work. That helps in two ways: it increases the number of workers, and it cuts the number of pensioners"[7].

It added that in Britain activity rates among older people (including the over-70s) have been creeping up since the mid-1980s.

The most controversial element in our study was the suggestion that the qualifying age, for those who meet targeting criteria, could be raised to around 70 years. This proposal was made in the context of an approach which would rely primarily on private provision for retirement income, and provide other forms of income support (such as sickness or unemployment benefits) at similar rates to those below the age of eligibility with inadequate means who were unable to work or find a job. As part of this integrated approach, it might be appropriate, as the Royal Commission suggested, for any older unemployed to be relieved of the obligation actively to seek work after having been unemployed for, say, 12 months.

The age at which qualification for income support without specific tests is available is a matter of judgment. With later school leaving ages, increasing life expectancy and health standards, and improved working conditions, people should not be forced artificially into retirement but should have the choice of extending their working lives, perhaps on a part-time basis. They may of course choose to retire before pension age. The typical age of eligibility (for males at least) in other OECD countries is 65. Some OECD calculations suggest that, if 65 was the right age for an American man to retire in 1940, and if the rise in life expectancy since then were used purely to extend working life, a man retiring now ought to do so at the age of 73, rising to 75 in 2025.

The Economist noted that "a few governments have begun to consider raising the age at which pensions are paid, although only in America and (in disguised form) in Japan have they bravely decided on a change". Denmark and Norway, both considerably wealthier countries than New Zealand, have pension ages of 67. The Royal Commission recommended an eligibility age of 68 for a universally available pension (at half the rate of an income tested benefit available at age 65). While the precise level of a qualifying age can be fairly debated, there are reasonable grounds for considering an increase beyond the age of 65 which appears to be favoured in many submissions to the government's review.

- **Targeting the benefit**

The existing national superannuation scheme is very loosely targeted. Closer targeting would reduce the extent to which the scheme became a supplement for private provision. It would be a corollary of the view that primary reliance for retirement income should be on private provision and that the benefit should be payable only to those who most need it.

Of all the feasible reform options, closer targeting offers the most scope for reasonably rapid fiscal savings, consistent with the equity objectives of income support. It has been estimated that income testing without a threshold could reduce the cost of national superannuation by about 8 percent at a 20 percent abatement rate and by over 25 percent at a 70 percent abatement rate. We concluded that the potential reductions in fiscal costs, with their positive consequences for economic growth, outweigh the trade-offs associated with targeting, in particular the higher administration costs and the high effective marginal tax rates for those receiving the benefit.

In addition to supporting closer targeting via an income test, we proposed that an assets test should also be applied. This would reflect the fact that consumption needs, which are the basis of an income support programme, can be financed out of accumulated wealth as well as income and that narrow income tests can be evaded by a build-up of non-income earning assets. An assets test was applied in New Zealand up to 1960 and has recently been reintroduced in Australia. It has significantly reduced pension expenditure there and now appears to enjoy bipartisan support.

The use of an assets test in combination with an income test would ease somewhat the problem of high effective marginal tax rates over the benefit abatement range. This problem would also be reduced in scale under an approach in which benefits were restrained and paid at a later age. A wider solution to the problem must depend on reversing the blow-out in government spending of recent years and achieving general reductions in income tax rates.

Most OECD countries have been trying to shrink their public sectors in the 1980s, some - like Australia - with notable success. It would be surprising if New Zealand did not follow suit in the 1990s.

One form of targeting which has sometimes been suggested, for example by the Council of Trade Unions, is to restrict benefits to those who are no longer in the workforce. Our study rejected that approach on both economic efficiency and equity grounds. It would discourage workforce participation and result in benefits being received by wealthy capital income earners but not by poorer labour income earners.

- **Transitional issues**

An approach to retirement income provision based on a less generous level of benefit relative to prevailing wage rates, a higher age of eligibility and one more tightly targeted to those in need could not be introduced overnight. The retired elderly who are wholly or largely dependent on income support are in no position to make significant adjustments to a change in policy.

The objective of transitional measures should be to balance the need to phase in changes over a period of time, so that the burden of adjustment is minimised for those in or near retirement, with the desirability of bringing forward, to the earliest possible date, the efficiency gains from the reforms.

A move to closer targeting of benefits would require a shorter phase-in period than other changes (and be accompanied by a removal of the national superannuation surcharge). A reduction in benefit levels relative to wage levels should preferably occur over a period of time in which real wage rates rise, an outcome which will be dependent on the soundness of general economic policies. An increase in the qualifying age would need to be phased in over a number of years e.g. by increasing this age by one year every two years. The Royal Commission envisaged that the changes it proposed would be phased in over a 10-12 year period from about 1995 to 2007.

4 Alternative retirement programmes

The framework for a government pension scheme that has been outlined is simple and familiar and indeed has many similarities with old age pension arrangements that were stable and widely accepted in New Zealand until they were undermined by inflation and electoral vote-catching in the 1970s. The main alternative model being promoted, a social insurance scheme, would be a radically different concept whose only precedent in New Zealand or Australia was the New Zealand Superannuation Scheme of the third Labour Government.

The social insurance approach which has been promoted by the Minister of Social Welfare is based on an income maintenance concept rather than income support, would not be targeted and would provide more generous benefit levels than existing arrangements. Earners would pay a fixed percentage of annual income either to the state scheme or to an approved private scheme, and part of the "contributions" might also be paid by employers.

Our study analyses this approach in some detail. In brief, we argue that it appears to be based on a misconception of the free-rider problem associated with a state safety net; it would involve a sharp increase (of about 16 percentage points) in effective marginal tax rates; it would greatly distort the form, manner and timing of voluntary savings decisions; the increased cost to employers would risk worsening the unemployment problem; the administrative arrangements, which would include a means-tested top-up, would be very complex and extend over a generation; and during that period present income earners would be financing both their own superannuation and that of former retirees[8].

In a recent article Susan St John added that the scheme would disadvantage women who may have considerable periods out of the paid workforce and went on to say:

> "The most serious aspect of this option is that it perpetuates the myth that somehow it means we have overcome the problem created by the aging of the population. The truth is that as a nation, we cannot save up most of the things the retired will need for their everyday living next century. Such things as medical services, food, personal services and travel must be provided by current workers. The more current output used by the elderly, the less for future workers and their families... We may think we are saving for the future but in terms of improving the prospects for the future, nothing has changed"[9].

St John counsels an examination of the problems of the American social insurance system by those who think this is a suitable path for New Zealand. Contrary to the perception that there is more security in funded schemes, there have been frequent changes in benefits, indexation provisions and the age of eligibility in social insurance schemes overseas, despite their apparent contractual nature. The same is true of schemes financed from earmarked taxes, as New Zealand's experience with the former social security tax demonstrates. An income tax dressed up as a compulsory superannuation contribution imposes similar economic costs through the distortion of savings and work decisions. As one leading United States authority has commented:

> "If Social Security were to go only to the elderly poor, Social Security taxes could be folded into the income tax system. When all pretense is dropped that Social Security is an annuity system, separate taxes to finance benefits make as little sense as separate taxes to finance the food stamp programme"[10].

Becker adds:

> "Sooner or later budgetary deficits and tax burdens will force the United States and other countries to do what has been until now politically unthinkable - replace Social Security systems in their present form with systems of benefits only for the needy elderly."

On this analysis, a radical departure from a system which could be more easily modified in the direction advocated by Becker would be a backward step. It would create a high financing burden and would ultimately be even less sustainable than the existing programme.

An alternative to compulsory arrangements that has been canvassed is some form of subsidy to private superannuation plans. Neither of the two recent official inquiries supported this option. The Royal Commission reported that it was not convinced that a return to preferential tax treatment was justified and the Consultative Committee on Superannuation and Life Insurance also favoured a neutral tax regime, although in a modified form from the pure income tax treatment adopted by the government.

It is certainly the case that the success of an approach which places primary reliance on private savings for retirement is dependent on moderate rates of tax on income and savings. The environment for savings has improved in New Zealand in recent years with lower inflation, the removal of constraints on interest rates and the financial sector, the reduction in public sector dissavings and the lowering of income tax rates, although the rise in government spending and tax collections has offset these moves to some extent. Arguably the further improvement of this environment for savings is best pursued by similar broad policies, especially government expenditure and income tax reductions, rather than by tax preferences which would require compensating tax increases elsewhere.

Similarly the tax regime favoured by the Brash committee would not appear to sit comfortably with a tax reform strategy based on structuring the tax system on the twin pillars of a broad income and consumption tax base. It is a hybrid scheme with elements of both income tax (the taxation of superannuation scheme investment income) and consumption tax (the non-taxation of superannuation contributions but the taxation of benefits). Its adoption could be even more disruptive of existing superannuation arrangements than the taxation reforms adopted since it could involve severe reductions in existing benefit levels. Moreover, to retain neutrality and not favour one form of retirement savings over another, that tax treatment would need to be applied consistently across other forms of retirement savings, such as bank deposits, government bonds and farm and business investment. The resulting reductions in current tax revenue would be dramatic. Even if they were to be compensated for by higher future tax revenue, the government would find it difficult to convince financial markets of its fiscal rectitude without corresponding expenditure reductions or tax increases. If the fiscal costs were to be limited by limiting the quantum amount that could be saved in such ways, the result would be a penal tax regime and artificial limitations on such savings vehicles. Finally, the need to accomodate such unconventional tax treatment within ordinary income tax rules would require the maintenance or even extension of a number of regulatory controls. That would further disadvantage such forms of retirement savings.

5 Conclusion

New Zealand's economic position remains weak, and it is poorly placed to handle the adjustment required by an aging population with its present retirement income policies. Recent polling suggests that a majority of New Zealanders consider the national superannuation scheme needs to be changed to keep it affordable. Almost 50 percent appear tobe already saving for their retirement in various ways. However, policy in this area has been plagued by changes and uncertainty, with damaging consequences for individuals, institutions and capital markets. There seems to be widespread community agreement that priority should be given to re-establishing a sound, sustainable environment for long-term retirement planning.

While the specific parameters proposed differ - and supplementary measures are suggested in some cases - the elements of a gradual lowering of the rate of national superannuation relative to wages, an increase in the age of eligibility and some moves away from a wholly universal basis of payment are common to a number of reform proposals that have been made. These include the proposals of the Royal Commission on Social Policy, the Life Offices Association and the Council of Trade Unions. An income support approach seems closer to current National Party thinking than an approach based on social insurance. Such a retirement income policy would be compatible with the evolution of policy in Australia, an advantage with the common labour market. It would make the greatest contribution to an economic growth scenario and pose the fewest transitional problems. It may therefore be argued that as a cost-effective means of meeting widely-shared equity objectives, it also holds out the best prospects of sustained political support and long-term stability.

A popular view is that governments are too frightened of grey power to make economically responsible decisions on pension policies. The analysis of this paper suggests that view may be too pessimistic. Both present and future retirees have a large stake in decisions that will make New Zealand a more dynamic economy. Recent experience indicates the existence of community support for well-conceived, properly communicated decisions that take the longer term view. At this juncture there is a premium on high quality decisions on superannuation. The proposals of the Royal Commission on Social Policy are likely to be the minimum standard against which decisions will be judged. After the changes and uncertainties surrounding retirement income policies in recent years, the worst possible outcome would be one that did not face the issues squarely, was not perceived to be sustainable, and hence perpetuated uncertainty in personal decisions about long-term saving.

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SAFETY AND HEALTH WITHIN A DEREGULATED SOCIETY: THE CASE FOR A UNIFIED APPROACH

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SAFETY AND HEALTH WITHIN A DEREGULATED SOCIETY: THE CASE FOR A UNIFIED APPROACH

The economic reforms of the 1980s have been significant not so much for their scale and scope as for the philosophy of public policy that has underpinned them. The history of government in New Zealand is a history of legislative activism, of writing and rewriting the statute book. What sets the recent reforms apart from the broad thrust of policy in the preceding 30 to 40 years is rather a change in focus: a shift from an emphasis on achieving particular outcomes or endstates to an emphasis on the incentives that shape economic and social activity. This has led to a concern with reforming the legislative groundrules on which such activity is based.

Most simply, this approach draws on the evidence that economies perform best when they capitalise on the diverse abilities and knowledge of individual citizens, who may voluntarily enter such economic, political and social relationships as best serve their own interests and the interests of those that they care for. The role of the government in this context is not to direct activity, legislating for outcomes according to some vision of utopia, but rather to provide a constitutional and legislative environment that protects individual rights and provides people, singly and in communities, with the incentives to exercise these rights fully and responsibly. In terms of policy, this view is not anti-regulation; the reforms that have taken place in New Zealand have not been about deregulation so much as regulatory reform - the emphasis being on quality, rather than quantity.

I would therefore like to suggest that the title of this part of the seminar is something of a misnomer. My focus in this paper will be less on *deregulation* than on the impact of regulatory change - changing groundrules - on the way in which decisions about occupational health and safety are made.

The most significant effect of the reform process has been the redistribution of the right to make decisions about how resources should be used away from bureaucrats and their lobbyists, in favour of consumers. It is now far more clearly consumers who are ultimately sovereign, consumers who create jobs, and consumers who determine how resources will be rewarded and what practices can survive in the workplace. But there is a notable lack of consensus about what this actually means for workers, whether in general or in particular areas such as occupational safety and health.

A commonly held view is that when firms are obliged to compete for consumer dollars, the vulnerability of workers must increase. This frequently leads to a belief that formal mechanisms for providing workers with a "voice" must be reinforced. This kind of argument underlies the idea of a "Compact", designed to permit a dialogue between unions and the government on matters of policy, and the Minister of Labour's Committee of Inquiry into Industrial Democracy, which has been charged with finding ways of promoting "meaningful participation" by workers at enterprise, industry and national levels. It also underlies ACOSH's[1] proposals for tripartite structures for promoting occupational safety and health.

An alternative view would be that, prior to the reform process, more and more New Zealanders were becoming economically vulnerable as a result of inferior economic performance, and that the current risks are mainly due to policy inconsistencies.

Whether regulatory reform *has* made workers more vulnerable, and whether, if it has, the proposed solutions are the appropriate ones, are therefore questions on which there is much

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1 Advisory Council for Occupational Safety and Health.

room for debate. However, I think that there would be near universal agreement that greater success in promoting communication and cooperation is needed in workplace relationships in New Zealand if firms are to be able to compete successfully, and workers' interests - and ultimately their jobs - are to be protected.

This is particularly relevant to the purposes of this seminar in that, within the broad field of employment relations, safety and health is an area in which we can perhaps least afford to underperform. It is also an area in which a cooperative approach to problem-solving, drawing on the experience and initiative of all participants in the workplace, is crucial; where we can ill afford the kind of adversarial approch that has tended to permeate labour relations in New Zealand. Only by recognising a common interest between employers and workers can satisfactory health and safety processes and outcomes be achieved - and the "national" interest be served.

The Implications of Regulatory Reform for Occupational Safety and Health

The implications of regulatory reform for the performance of New Zealand firms in terms of workplace health and safety can be understood most clearly by considering the effects of an increased pressure to compete. This pressure has come from two main directions: from increased access by foreign suppliers in markets for goods and services, and from increased competition in finance markets, with savers enjoying greatly expanded options for investment.

In both cases, the result has been a heightened need to pay attention to productivity and innovation - not only in a technological sense, but also in terms of how the activities of firms are arranged and managed. This in turn has implied a need to reconsider how relationships within the workplace are to be approached - how they can be developed so as to elicit cooperation, to draw on and reward the diverse skills of all participants in the workplace, and to promote trust and a sense of mutual reliance. It is not surprising that such developments have been most marked in companies facing dramatic reductions in protection.

Thus the ability to compete successfully in the long run depends not, as is often claimed, on an ability to screw down wages and conditions to a subsistence level, dehumanising and marginalising workers in the process, but on an ability to raise productivity - and thus remuneration - through a combination of good employment conditions and good management practices. (The New Zealand preoccupation with wages at the expense of other aspects of the employment relationship - the very fact that we refer to the renegotiation of employment packages as "The Wage Round" - reflects the narrowness of bargaining in a centralised labour relations system.)

You will all be aware of the practical returns to good performance in occupational safety and health - that health and safety practices affect productivity not only directly through lower absenteeism, downtime or labour turnover, but also indirectly as a result of improved employee morale - of the recognition by workers that their wellbeing is taken seriously and that their ongoing contribution to the firm is valued. Health and safety programmes are not charity, but a prudent investment.

It has long been fashionable to recite this kind of argument. The reinforcement of competition as a result of economic restructuring may be seen as transforming it from an article of faith to a practical necessity. However, how successful New Zealand companies can be in meeting this necessity depends critically on the quality of regulations that surround the setting and pursuit of health and safety objectives. Standard-setting for occupational health and safety is not the only kind of regulation that is relevant here. To get a broad picture of how incentives and constraints are created for decisions affecting occupational injury and illness rates it is also necessary to look at such institutions as the Accident Compensation Scheme, public health provision, and the way in which labour relations legislation shapes employment relationships.

Regulating for Occupational Safety and Health

Legislation setting health and safety standards is typically motivated by a belief that individual workers - or their representatives in unions - are either chronically under-informed about the risks that they face, or powerless to reduce these risks or moderate their effects. There is an implicit assumption that the government can be better informed than workers about occupational hazards, and enforce solutions that workers or unions could not negotiate directly with employers. However, international experience in health and safety regulation suggests that in most, though not all, cases there are strong doubts as to the ability of government agencies to improve on the solutions that could be negotiated voluntarily by employers and workers or their unions[2].

In particular, there is a danger that legislative solutions will seek to reduce risk too much, because of a failure to weigh the benefits of risk reduction against its costs. The costs of some of the OSHA regulations in the United States afford evidence of this. Regulations implemented up to 1986 had a cost per life saved of as much as $US 92 million. The expected cost per life saved under provisional OSHA regulations was even higher - in the case of formaldehyde regulations it has been estimated at $US 72 *billion*[3].

Cold-hearted though it may appear to be to raise questions about the value that can be placed on a human life, the implications of such regulations are enormous. Studies of their effects in the United States document reduced productivity growth, disproportionate failure rates among small firms, particularly in the relatively depressed "Sunbelt", and job losses. At the same time, some of these regulations appear to be having minimal impact on occupationalinjury and illness - not so much because of non-compliance as because of their basic inefficacy[4]. But so long as OSHA regulators are not made accountable either for the efficacy of their policies or the costs they impose, it is hard to imagine them coming up with a less harmful approach to health and safety management.

Abstaining from all risky activities has a high cost in terms of the benefits of those activities that are forgone (as Howard Hughes may have discovered). We recognise this when we choose to do such inherently risky things as driving in cars, which is far riskier than most employment activities. Instead of passing up the benefits of driving, we typically seek to reduce the risks associated with it, for example by wearing seatbelts or taking defensive driving courses. We may also seek to reduce the adverse implications of accidents, for example by taking out insurance. Preventive activities directly reduce the risks that we face; insurance helps us to spread those risks.

However, risk reduction and risk spreading also come at a cost, and we typically undertake them only to the extent that we value tempering risk more that we value other goods and services. Because these kinds of trade-offs are inevitable, in the workplace as well as at home, it is seldom if ever desirable to seek to eliminate risk completely. This makes it all the more important to create a regulatory framework in which the costs of handling risk can be minimised - where there are no barriers to efficient means of accident or illness prevention or insurance. This will generally be a framework in which it is as simple and inexpensive as

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2 These arguments are examined at greater length in New Zealand Business Roundtable (1988), *Regulating for Occupational Safety and Health*, Wellington, New Zealand Business Roundtable.

3 See Morrall, J.F. (1986), "A Review of the Record", *Regulation*, November/December, pp 25-34.

4 See Bartel, A.P. and Thomas, L.G. (1985), "Direct and Indirect Effects of Regulation: A New Look at OSHA's Impact", *Journal of Law and Economics*, 28, pp 1-26.

possible for individuals or groups to make trade-offs between the costs and benefits of risk-taking, and of different ways of dealing with risk.

Workplace health and safety has traditionally been regarded as something delivered by the employer to his or her (mostly his) workforce. At its most simple, this is a view that emphasises the role of the physical work environment in determining health and safety outcomes. This has made for a rather paternalistic approach to health and safety management.

In practice, the capacity of workers to affect health and safety outcomes varies according to the kind of work in which they are engaged and the way in which that work is organised. In most, if not all, cases workers have some discretion over the riskiness of their activities. An effective health and safety regime will therefore be one that recognises that health and safety is not only of mutual interest but also a shared responsibility, and that draws on the differing capacities of, and information available to, workers and management. This means ensuring that all participants in the workplace are provided with incentives to deal with health and safety risks efficiently.

First and foremost, this requires a work environment in which employers and workers are able to negotiate constructively about how health and safety problems should be handled and who should be accountable for handling them. This involves a responsible sharing of information, recognising that both parties can contribute valuable information about what the problems are and how they can be resolved. To be successful, it must rest on an understanding that the efficient resolution of health and safety issues is a matter of mutual interest. And it must also be realised that the best ways of achieving health and safety objectives are neither uniform across firms nor unchanging over time.

The voluntary code of practice for workplace arrangements for the promotion of safety and health issued by ACOSH in 1987 may be seen as an attempt to reinforce the role of workplace solutions to what are effectively workplace problems. ACOSH's 1988 proposals for the streamlining of health and safety standards legislation and the promotion of "self-regulation" are an attempt to clarify the rules constraining these solutions.

There are indications that the voluntary code for workplace safety committees has not been widely adopted. However, non-compliance does not in itself indicate that workplace health and safety arrangements are insufficient. The nature of representation recommended under the code, and the way in which responsibilities of health and safety representatives are defined, are unlikely to be the best means of protecting employee interests in *all* workplaces. For example, some companies have found that much broader participation in resolving health and safety problems is more effective than a committee approach. But there are also disincentives in the broader regulatory environment - most importantly labour relations legislation - to workplace resolution of health and safety issues.

The more recent ACOSH proposals to bring all work-related hazards under one piece of legislation represent an advance over the present fragmented system of health and safety standards in that they involve some streamlining of procedures, and a shift from technologically-oriented "design" standards to outcome-oriented "performance" standards. The proposals reflect a recognition of the burden imposed on firms and workers by the proliferation of health and safety statutes and administrative bodies, by attempts to deal explicitly with all possible contingencies, and by concentration on work environments as determinants of occupational risk, at the expense of attention to work systems and work practices.

However, as the Business Roundtable argued in its response to the ACOSH report, the principles on which its analysis was based were deficient in a number of ways. The result was that it was biased in favour of health and safety minima, and centralisation of standard-setting and enforcement. It needs to be recognised that even performance guidelines are unlikely to be the best way of improving outcomes in all cases. There will be circumstances in which socially desirable health and safety outcomes can be promoted more effectively and directly by other means. For example, in the case of hazards with long latency periods or substantial spillover effects, performance guidelines may be rather ineffective, but outcomes could be improved relatively cost-effectively by the government taking a role in funding research and education on such hazards. Where there are groups of workers in particular need of protection, for example as a result of handicaps, the most appropriate course may be direct legal protections for these workers.

The principles adopted in the ACOSH report made for an emphasis on government involvement far beyond the information-enhancing role suggested by conventional economic analysis of health and safety issues. There was, however, little attempt to consider how government agencies might be held accountable for the potentially massive - and unjustified - costs their activities could impose on firms and workers.

Perhaps even more significantly, neither of the ACOSH documents attempted to deal with the complex and important interactions between health and safety standards and labour market law, the regulation of accident insurance, the domain of tort and the state's role in providing health services.

The benefits of reforming health and safety standards alone will not be large if other legislation plays a significant role in shaping workers' and employers' attitudes to health and safety risks. In New Zealand, for example, there is a strong case for arguing that health and safety performance is undermined by disincentives present in the Accident Compensation Scheme - both its no-fault approach and its internal structure. Performance is also constrained by barriers in the Labour Relations Act to the development of communication and cooperation within enterprises and workplaces, and thus to environments conducive to the negotiation of innovative solutions to workplace problems. If poor outcomes are rooted in these areas, rather than in "mere" ignorance, apathy or intransigence, health and safety standards may turn out to be a particularly costly and inappropriate form of intervention.

The main point to be made here is that a whole range of factors work together in determining how employees and employers make decisions about setting and achieving health and safety objectives. An important aspect of this is the extent to which they face the true costs of these decisions, rather than passing them on to society as a whole (for example through more expensive products or higher taxes), or on to other workers (where the decisions that they make have a cost in terms of jobs lost). Getting the groundrules right for health and safety means getting the groundrules right for all of the factors that affect decisions about health and safety, not just streamlining health and safety standards themselves.

For this reason, the Business Roundtable has recommended broadening the debate on occupational health and safety regulation. In particular, it has recommended removing the Accident Compensation Corporation's monopoly on basic accident insurance. "Corporatisation" - and ultimately privatisation - of the ACC would free it to innovate in providing the kind of insurance packages most suitable for widely differing work situations. Competition in the provision of insurance would promote not only efficient compensation when accidents did occur, but also an efficient balancing up of the benefits of prevention vis a vis compensation. It has also suggested that it could be worthwhile to reconsider the role of tort - of moving away from a completely no-fault regime - recognising as other OECD countries have that tort is a poor means of compensation, but that it can play a useful residual role in reinforcing incentives for accident or illness prevention.

The Business Roundtable has also argued for further reform of the Labour Relations Act, by removing barriers to enterprise and workplace bargaining and enhancing the protections available to those more vulnerable workers whose interests tend to be averaged out of existence where bargaining is centralised. This would both facilitate the kind of cooperative workplace environment necessary for effective negotiation on how health and safety objectives should be set and achieved, and reduce the likelihood that the solutions reached would involve uncalled for sacrifices in terms of job losses.

This does not, of course, mean that the Business Roundtable sees no role for the government in assisting and promoting occupational safety and health. Its objective is not deregulation as such, but reform of regulation. It recognises that in some situations the government may have a role in funding research on occupational hazards, or in intervening directly to protect the interests of particularly vulnerable groups of workers. However, in general it defines the government's role as a facilitative rather than directive one; as one of providing the groundrules for voluntary, cooperative solutions to health and safety problems rather than dictating the solutions to those problems. The notion that this, rather than heavy-handed protection, is what empowering workers is actually about may be a novel one. It perhaps demands more respect for the abilities and rights of *all* participants in the workplace than we have been accustomed to affording them. And this kind of respect is essential if we are to make progress in promoting truly healthy workplaces.

THE LABOUR MARKET

REFORMING NEW ZEALAND'S LABOUR MARKET: BACK TO BASICS

NEW ZEALAND INSTITUTE OF PUBLIC ADMINISTRATION

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REFORMING NEW ZEALAND'S LABOUR MARKET: BACK TO BASICS

New Zealand's system of labour market regulation has failed. And it is not just distant advisers in the OECD and editorialists in *The Economist* who are saying so. Opinion poll after opinion poll shows the disillusionment of New Zealanders, in work and unemployed, with such impositions as compulsory unionism and lack of choice about union representation, and with needless barriers to resolving workplace problems at the workplace level.

The failures that these polls point to are not just failures in individual employment relationships or in the answerability of individual unions. These failures, manifested in conflict and loss of morale, in poor productivity and loss of jobs, are bad enough. But the effects of an under-performing labour market are far more pervasive. With so much militating against the development of good employment relationships, restructuring is even harder work than it needs to be, investment suffers and thus productivity and growth suffer, and emigration becomes an increasingly attractive option for worker and entrepreneur alike. We have gone part of the way to creating an economy capable of holding its own in the world, but we will never make it if we insist on clinging to a system of labour law designed to undermine individual rights and individual initiative.

But it is always easier to point out what is wrong with a system - what restricts choice, what limits job opportunities, what holds back productivity and growth - than to construct a feasible alternative. A consequence of our insularity is that many New Zealanders have never had first-hand experience of systems in other countries, most of which have long since discarded the arbitration and conciliation framework that we have retained. Those with a vested interest in defending the current system tend to describe its critics as favouring a return to the real or imagined evils of the nineteenth century, to a "law of the jungle". This kind of assertion is of course inaccurate, and it is an inaccuracy carefully nurtured by those with an interest in resisting change. But it does serve to remind us of just how little serious public discussion there has yet been in New Zealand of what labour market reform should consist of. This conference offers an opportunity to clarify the issues on which such discussion should focus. In this paper, I would like to clarify some of the Business Roundtable's ideas on what these issues are, and how they might be resolved.

When seeking solutions for the problems which plague our labour market, it is easy to get lost in semantic debates over whether we are talking about deregulation or about regulatory reform, or over what might be meant by such terms as "flexibility". These are not the real issues, for all the heat that they generate. Instead, we must get back to the basics of what a sound body of employment law should look like.

This is a point that the Business Roundtable has been emphasising throughout its involvement in the debate on labour market reform in New Zealand. The proposals for reform which I will be discussing in this paper are a result of our attempts to give some shape to these "basics"; our attempts to return to common sense in labour law. As we said in a submission on the Green Paper on industrial relations in 1986, "labour and industrial relations law in New Zealand has gradually isolated labour market contracting arrangements from common law and common sense".

Put most simply, what I will be discussing is the abandoning of our legacy of statutory attempts to manipulate the outcomes of employment relationships, and a return to common-sensical employment contracts. This means recognising the fundamentally cooperative, not adversarial, nature of employment relationships. It means recognising that it is individual workers that matter, and that the interests of individual workers will be served best where their freedom to make the most of their labour is respected. It means adopting principles similar to those that have guided reform in other areas of economic activity. The great tragedy of the present government's economic policies is that these principles have not been applied to the legislation surrounding employment relationships.

The major economic reforms of the 1980s have been based on a recognition that governments function better - serve both public and private interests better - when they focus on providing good basic legal rules, and leave the details of economic relationships to be decided by the people affected by them. But this isn't a notion that has been embraced in the area of labour market reform - compare the 1984-85 reforms in finance markets with the ambivalence of the 1987 Labour Relations Act and with subsequent reversals in the direction of proposals for comparable worth and "industrial democracy" legislation. Deep down, the Government still seems to be hankering after a New Zealand version of the disastrous Australian Accord.

Various arguments are run to justify the divergent approaches of labour and other commercial law. For example, it is asserted that, left to their own devices, employers will oppress workers, an argument that has strictly limited credibility once you realise that both employers and workers depend for their livelihood on their ability to provide what consumers want - and that consumers are, after all, just workers in another guise. Or it is argued that employment relationships are too special and too complex to be left to the uncertainties of the "circuitous and uncontrolled" processes of the market. But this "market" is not some malevolent independent power, but rather an amalgam of thousands of voluntary exchanges between individuals, exchanges made with all the more care *because* they are complex and important. As the legal scholar Richard Epstein puts it:

> "With employment contracts we are not dealing with the widow who has sold her inheritance for a song to a man with a thin moustache. Instead we are dealing with the routine stuff of ordinary life; people who are competent enough to marry, vote, and pray are not unable to protect themselves in their day-to-day business transactions."

The question at the heart of regulatory reform must be how we can enable people to develop the kinds of employment relationships that best meet their needs and ambitions and that free them to determine what is best for them, while safeguarding them against abuses; how we can develop a system that fosters cooperation, productivity and innovation.

This is not a question about whether unions are "good" or "bad", about whether worker participation in decision-making processes is good or bad, or about whether or not there is a need to improve the position of disadvantaged groups in the workplace, or get more of our young people into jobs.

The question that we should be asking is how we can best achieve a system where individuals can exercise their own preferences in their employment relationships, where unions flourish if they serve workers well, where cooperation comes naturally, and where some workers are not denied opportunities just to protect the privileges of others who are already more advantaged.

The current system clearly does not deliver these outcomes. It fosters conflict - the myth of an enduring struggle between capital and labour - where the reality is that employers and workers have a shared interest in serving consumers, an interest that can only be fostered by cooperation. It protects the narrow interest of the officials of established unions at the expense of workers, whose interests and abilities can vary widely. In doing so, it effectively condones practices that close off workers' options. It abrogates the right of individual workers to enter into arrangements which suit them - whether with unions of their own choosing or directly with employers. It thus undermines the very important protection offered by freedom of choice: the protection of a well-functioning market.

The loss of this protection might be tolerated if the most vulnerable members of the workforce were offered a better deal as a result, *but they are not*. And no amount of special legislation aimed at enforcing union accountability or encouraging "industrial democracy" or "employment equity" can alter this. By sanctioning the monopoly power of unions over workers, our system of labour legislation ultimately condones not the redistribution of income away from "capital" in favour of "labour" but an overall *reduction* in income, and the redistribution of that income away from weaker members of the labour force and the unemployed in favour of those workers closest to the union elite.

We must thus turn around the conventional wisdom that reliance on the market is all right for the strong, but destruction for the weak. *Everyone* suffers, and *everyone* is made poorer, in a system strangled by regulation, but the weak suffer more - the strong will always find a way of turning even an impoverishing system to their own advantage. It is the most vulnerable - the lowly skilled, the inexperienced school leaver, the woman trying to combine work with raising a family, the Maori living in a depressed region - whose choice is most easily suppressed in the interest of others, and who is most in need of the freedoms that a well-functioning market can uniquely offer.

This does not mean that there will never be situations in which individual workers are vulnerable to mistreatment by their employers. But enforced collectivism is not a solution; indeed it's often part of the problem.

The benefits of a system based on the notion of freedom of contract are not, of course, limited to those workers excluded or oppressed by the current system. For all workers it is a matter of creating far greater scope than at present for the development of employment relationships based on mutual interest rather than conflict, and fostering the kind of commitment and trust on both sides that are essential to any productive, innovative enterprise. And this means far more effective protection of the interests of both workers and employers, whether through workplace negotiation, through variation in individual contractual terms, or through the emergence of a new and responsive breed of unionists.

That freedom of contract is an effective basis for laws guiding economic relationships is not a novel idea. We rely on law based on the principle of freedom of contract for just about all of our other economic relationships. We accept as a matter of course that there are situations in which modifications of that freedom by the government can make these relationships work better. Thus, for example, we recognise that a good basic company statute makes it easier for shareholders and their companies to develop a relationship that works in their mutual interest - that reduces the cost of funds to companies, and reduces the risks of investment to shareholders. At the same time, we recognise that ill-conceived law can impose needless costs, and make it more difficult for this kind of relationship to function. The reform of company law recently undertaken by the Law Commission should be seen in this light. The principle of freedom of contract underlies both the existing statute and the proposals for reform. The goal of the reform process is to make freedom of contract work better.

The same sorts of principles apply to employment relationships. Freedom of contract must be the basis, but this is only the beginning of the debate about what good employment law should consist of. Freedom of contract is not some mindless shibboleth that requires that any private contract be automatically acceptable in the courts. The question is not whether we should set rules for employment contracts, but with what justification, and how.

The long history of collective negotiation of employment contracts in New Zealand - as, to a lesser extent, in other Western economies - has limited discussion of what set of rules will be most supportive of fair, efficient contracting in a voluntary setting. But this does not mean that we are operating in a vacuum when it comes to establishing such a set of rules, or predicting its effects. To some extent, voluntary contracting has always survived alongside collective bargaining in New Zealand, if to a smaller extent than in most other Western nations. This contracting is essentially based on tried and tested rules that long predate the advent of collective bargaining - rules embodied in the common law of contract and of torts.

Of course, "the common law" isn't a precise notion - in effect it is the result of centuries of judicial refinement, of attempts to find private law rules that stand the test of time in handling the varied and complex relationships that people forge with each other. These rules lend a degree of certainty to these relationships without unduly repressing the participants.

The common law yields some very powerful principles with which to guide employment relationships. For example, the principles of tort have offered protections for both workers and employers against the threat of force - whether by each other or by unions. They also provide basic protections against fraud, and against deliberate attempts to force the other party to the relationship to breach their contract - thus providing important safeguards against, for example, unjust dismissals, or coercion of workers by unions.

Common law contract principles allow individuals to form such relationships as suit their particular interests and preferences. This doesn't just mean relationships between workers and employers. It also means relationships between workers and unions, and thus also between employers and unions. The essential difference from the current system is that under common law principles the existence of a union in such circumstances would not be a matter of unchallenged right, but a matter of how well it could serve the interests of workers in their relationship with their employer.

But freedom of contract is not unlimited in the common law. It is something that has been modified over time in an attempt to ensure that the relationships that people form with each other really do produce benefits for both, and don't impinge unduly on the interests of others. I noted that there are common law restrictions on duress or fraud in the formation of contracts. There are also provisions for dealing with the effects on third parties who have no immediate say in what a contract looks like.

These safeguards perform a dual function. In providing an assurance of fair treatment, they provide a protection for the socially, politically or economically weak - they condone not might, but social responsibility. But they also provide a basis for faith that the kind of relationships that they support are sustainable. They lend the certainty and sense of fairness essential to a thriving social and economic life.

One of the beauties of a system based on fairly straightforward notions of contract and tort is that it takes the vexed questions of what outcomes are fair, or what institutions are permissible, out of the court room and back to the people directly affected. It affirms that by and large the people directly involved in a relationship - whether it's a relationship between a worker and a union, or between a worker and an employer - are in a better position to see what is good for them, and to work out a way of getting it, than is a distant judge or bureaucracy. It doesn't deny the role of the courts, or even of some supportive bureaucracy, but it sets this role in perspective.

The essential role of the courts in such a system is not to comment on or redirect people's relationships with each other, or to foster an expanding market for litigation about what is and is not fair. Their role is to help people to resolve the problems that they can't resolve for themselves. I am not convinced that we need a separate labour court to do this for employment relationships - the law of contract, property and torts which should guide these relationships is the bread and butter of the existing civil court system.

The kind of collectivism that we have supported in labour markets is fundamentally incompatible with the emphasis placed on the individual in the rest of our legal system - government-sponsored collectivism is at odds with our whole legal tradition. New Zealand's separate Labour Court, the National Labor Relations Board in the United States and the extensive system of union immunities in the United Kingdom reflect different attempts to deal with the tensions that arise when the principles of labour law cut across the principles of other commercial law. But the "justification" for inconsistent bodies of law and separate courts disappears once we recognise that the application of different principles to labour law is unjustified; that the interests of employees are best served not by enforced collectivism but by legal protection of their individual freedom of contract.

The role of a good bureaucracy is not to dictate what can and cannot be done, but to provide such services as private individuals and organisations genuinely need to function well, but cannot provide for themselves. A labour department might be thought to have a legitimate role in funding the provision of information that will make employment relationships work better. For example, there may be some advantage in central funding of research into health and safety issues. But there is no reason for a bureaucracy to get involved in providing mediation services, or take upon itself the role of decreeing acceptable wage relativities through a Pay Equity Bureau as envisaged in the proposed comparable worth legislation.

If we look at corporate law, we can observe that the basic protections and encouragements provided by the common law have been modified by statute. Perhaps one of the most significant examples was the nineteenth century legislation which formalised the role of limited liability companies. This opened the way for the development of the modern corporation, able to draw on widely dispersed funds rather than family wealth, and able to plan and invest for the benefit of consumers far into the future - beyond the time horizon of any current manager.

And if we look at the best available modern company statutes - the kind of statutes that make a country a desirable place to invest - we see that they do such things as confirming the basic fiduciary duties of directors, or providing optional standard forms for contracts between shareholders and the company. These provisions make the relationship between investors and companies work better, because they make it less costly to ensure that it will be managed in a fair and efficient way.

For the same sorts of reasons, I would not argue that all that we want to have guiding our employment relationships is the existing body of common law. I would not claim to know exactly what we should put into a labour statute - that is a matter on which we should be seeking the advice of the world's best legal and economic minds. But I think that we can draw analogies from commercial law, and we can learn from the lessons from the past and not cram our labour law with provisions *intending* to protect people, but in practice defrauding them of their basic freedoms as both workers and consumers, to the sole benefit of monopoly unionists.

From commercial law, we can learn the value of well-conceived and clearly stated rights and duties. We can learn that these rights and duties perform their intended functions best when they focus on equality of opportunity and due process in the way in which people are *treated*. Rights and duties couched in terms of *outcomes* - a "right" to equality in income, for example, or a "right" to a minimum wage - are not so much defendable rights as items off some social engineering wishlist.

One of the lessons that New Zealanders seem particularly bad at learning is that conferring a "right" to something doesn't guarantee that it happens, and can indeed produce very nasty side effects. Take the notion of a minimum wage, for example. A "right" to a certain wage *sounds* like a good way of raising the standard of living of the most disadvantaged in a society. In practice, it can serve instead to shut these people out of jobs altogether - witness the unemployment created among black youth by minimum wage laws in the United States, or the effects of comparable worth policies in the same country in redistributing income from low-skilled women in small firms to educated, middle class women in big firms and government bureaucracies.

Another thing that we can learn from commercial law is the value of a law that offers examples of what acceptable contracts might look like, by setting out standard form contracts. Standard forms give guidance about what contractual terms will apply if the parties involved don't explicitly agree to something different. They have a number of virtues - they provide small employers and their employees with a contract that they can lift "off the shelf", saving themselves costly negotiation and litigation. They provide workers with a yardstick against which to assess the performance of their union, or the means to negotiate on their own behalf without massive expense. Yet at the same time they let people whose needs or situations don't fit the standard negotiate contracts that reflect their particular circumstances.

Another issue that a labour statute should be able to deal with is that of union recognition - the conditions under which unions may be formed, any special constraints on their activities, and how they should be treated by the courts. A lot of the problems of our existing system could be removed by making union membership a matter of voluntary association, and applying the laws of contract and tort to unions as to other individuals and institutions. I don't see why there should be any particular restriction on the form taken by unions, but I would imagine that many unions would function best as incorporated societies.

An unwinding of the special privileges of unions would remove the need for tortuous attempts to legislate for "fair" behaviour on the part of unions. (The problems of the courts in assessing the fairness with which unions operate have been described as akin to the problems of a "Council of Spectral Assessment" in deciding whether Hamlet saw a ghost.) But it may be that we decide we want to rely on more than common law notions of duress or fraud or unconscionability of contracts to defend the interests of workers against "exploitation" by employers or unions - or, for that matter, to protect employers against "exploitation" by unions, which is often what strikes are about.

But before we consider adding "protections" against such "exploitation" to a labour statute, we should seriously consider the potential role of antitrust. It is the principal function of antitrust legislation to control the abuse of market power. There is no reason why this should not be applied to the employer who deliberately shuts off the options available to his or her workforce, so that they have no choice but to work for a depressed wage. Nor is there any reason why it should not be applied to the monopoly union that negotiates work practices that discriminate against some of its members, or that result in a loss of employment.

Adaptation by employers to increased competition should be opening up a whole range of new opportunities for New Zealand workers to find productive and satisfying employment, and creating the kinds of options for workers that guard them against exploitation. A worker who has options is a worker with *real* bargaining power. But the continuing abuse of power by unions which don't face the constraints of competition robs workers of the one thing that they have got to bargain with - their own labour services. For this reason, the Business Roundtable has been seeking the extension of the jurisdiction of the Commerce Act to the labour market, as part of the current review of the Act. It will be interesting to see whether the Government accepts this logic or treats the topic as another no-go area.

In an economy as open as New Zealand's, with a relatively mobile workforce, I do not think that there would be much need to resort to a Commerce Commission over problems of monopolisation in a reformed labour market. But I would argue that this is the right place for dealing with monopoly problems in labour markets, where they arise. To use the commercial law analogy, company law does not attempt to deal with the problem of market power in commercial relationships. Common law provides the generalities; statutory law can contribute to certainty and social and economic vigour not by additional generalities but by clarity, simplicity and specialisation.

The Government has taken some tentative steps towards a system based more on the tenets of a standard law of contract. For example, in 1984 it replaced compulsory with voluntary arbitration, and in the 1987 Labour Relations Act it strengthened the safeguards against breaches of awards and agreements, and separated out the judicial functions of the Labour Court from the largely redundant "industrial" role of the Arbitration Commission. At the same time, however, it has introduced new statutory restrictions, such as the 1000 member minimum union size.

Reforming New Zealand's labour market law along the lines that I have suggested would mean a more comprehensive and consistent change not only in legal principles but in how we think about employment relationships, and how we think about the value of individual workers. It is natural enough to ask how the day-to-day experience of workers might be expected to change as a result - and how we can be sure that a reform of this magnitude would actually make us better off.

In response to these kinds of questions, we cannot - and should not be trying to - say what employment relationships *should* look like, or what kind of unionism *should* predominate. The whole point of a legal system that tries to get the ground rules right rather than trying, as we have in the past, to manipulate outcomes is that it lets people do the things that are best for them. It leaves them free to be employed usefully and in ways that they find satisfying. Freedom of contract in labour markets is about encouraging workers and unions, not just businesspeople, to be entrepreneurs.

We *can* get some idea of what employment relations might look like from other countries with more liberal regimes than our own. For example, in the United Kingdom an increased emphasis on the rights of individual employees has led to increasing variety in workplace arrangements - everything from entire workplaces shifting to individual contracts to collective arrangements of the kind negotiated by Nissan in New Zealand, drawing on the skills and ideas of innovative unionists. The benefits of these reforms are now spreading widely, as unemployment falls and regional disparities decrease. Margaret Thatcher isn't the scourge of the working classes that she was made out to be; a majority of trade union members voted for her government at the last election. By contrast, the Australian Accord, an extreme exercise in collectivism, has delivered little other than lower real wages and poor economic prospects.

But the experience of other countries can only give us insights; it can't provide some ready-made model or tell us in detail what is best for us. This is something that we must work out for ourselves. And the only way that we will succeed in working it out is to put as many decisions as possible in the hands of the workers and employers that they affect.

This means making union membership voluntary, and allowing unions to compete for members. It means moving away from awards with blanket coverage, freeing workers and employers to negotiate arrangements that meet their special needs and the special characteristics of their enterprises or workplaces. It also means tackling the wider range of regulations such as occupational licensing that have been used by trade or professional organisations to bolster their own privileges at the expense of other workers. And it means resisting the temptation to replace the anti-productivity minimum conditions imposed by monopolistic unions, to the detriment of workers and firms, with an equally inappropriate set of minimum conditions imposed by the government, whether unilaterally or on the basis of tripartite negotiations between organisations with little claim to representativeness.

If not tackled, the present rigidities and inequities of the labour relations system stand to undermine much of the good work that the Government has done in recent years. This isn't something that can be put into the "too hard" basket. As Arthur Shenfield, a leading British commentator on labour markets, has said:

> "The cry of 'political impossibility' is the bane of good government and good social arrangements. To know what ought to be done, whether it is for the time being thought politically possible or not, is an indispensable foundation for the solution of political or social problems."

In practice, I don't think that fundamental labour market reform is politically impossible - quite the reverse. Sure, if the Government gets all of its information about what workers want from meetings with union officials in smoke-filled rooms, it can convince itself that there is no support for reform. But if it has the courage to look to workers themselves - the real electorate - the polls tell us that it will find a massive constituency for change.

The potential pay-offs to labour market reform, however measured, are great. They do not stop at the empowering of individual workers; they extend to greatly improved prospects for productivity and growth, and a fairer sharing of the benefits of that growth. The penalties for continued tinkering and backroom compacts are correspondingly large and socially destructive. It's time the Government started thinking about labour market policy as if they really cared for the well-being of all New Zealanders.

New Zealand National Marketing Conference
Getting On Top In A World Turned Upside Down

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Getting On Top Internationally

- The Centrality of Labour Market Reforms

By

Professor Michael G. Porter
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Getting On Top Internationally -

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"Understanding of labour market reform among the general public in New Zealand, understanding of the term, is virtually zero. The vested interests kick it around as if they were playing football with a bomb. The preferred tactic is to boot the thing well into your opponent's half: if it does go off, your team will be safe, and their team will be demolished".

"A recent survey showed that 84% of New Zealanders favour workplace bargaining: and 73% favour choice about which union you join. The exercise of either option is so hedged with difficulty as to be virtually illegal, under our present system. Yet if anyone tries to draw attention to problems of that kind, the vested interest groups and media both tend to go berserk.

"What we have at present amounts to de facto immunity from the normal requirements of the law. Unions are largely exempt from the legal and economic consequences of their actions. It makes me furious that unions - who complain non-stop about unemployment - at the same time, non-stop insist on policies that lock the unemployed out of the workforce and keep them out."

Extracts from a speech given by Roger Douglas at a Centre of Policy Studies Seminar, Melbourne, April 1989.

Overview

Economic reform, as a popular cause, has been greatly, if unevenly, advanced in the 1980s, and in a wide variety of countries, including New Zealand, the United Kingdom and even Australia. However the actual achievement of economic progress in these countries has been far more limited than the rhetoric would suggest, and it is the central thesis of this paper that in those countries or industries in which success has been substantial (e.g. U.S, Japan, S. Korea, Hong Kong and Singapore) it has been in association with, and indeed facilitated by, a labour market and legal structure which respects individualised and enterprise level negotiations of labour contracts.

To get on top internationally, firms and their workers need to sort out their competitive edges - and the enterprise is the level at which competition starts. To handicap firms with wage deals divorced from their enterprise, makes it unlikely that even the best Kiwi entrepreneur can make it in the tough world market. This is not the rhetoric of the "right", it is the message of competition, the beneficiaries of which will be workers who gain sustainable employment in a dynamic world economy.

This paper also sets out to undermine the analytical basis of policies based on fictional terminology such as the real wage - a wage negotiated between big labour and peak councils of business, and then imposed on individual workers and firms. It is noted that in a real labour market a myriad of decentralised wages and conditions are generated as part of the information exchange within markets, exchanges which generate employment contracts, which in turn can enhance productivity, profits and wages. For those wishing to save on negotiating costs, which can be considerable, there is, of course, a powerful case for sharing information, for labour associations and unions, and for uniformity of conditions when situations are repeated. But free associations, or unions, formed as part of this process would be competitive - or contestable, to use the latest buzz word - and not subject to the monopoly or "convenience" clauses which characterise New Zealand and Australian labour law.

This information intensive, and micro-oriented view of labour markets is in direct contrast to the mechanistic view of wages and labour markets portrayed by advocates of Wage Rounds, Tripartite bargaining and Accords. Macroeconomic models and policies, from Keynes to Keating, have been preoccupied with issues such as "getting THE real wage down", THE wage/tax trade-off, THE basic wage and so forth, ignoring the microeconomic fundamentals and the fact that each firm and market situation is different. It is ironic, in democracies where tastes inevitably differ, needs vary, and training and other skills are quite diverse, that there should be a concern to set a wage and set of employment conditions centrally, and enforced across firms, industries and trades, as if we live in the homogenous one person society of some of our economic models.

It is the economics profession, in large part, which has entrenched simplistic understanding, based on simple models, in which there is a level of income, a level of employment, and a wage, all of which are determined in response to a level of government expenditure, a money supply and so forth. Rather than attempting to portray a market economy as based on exchanges between individuals with their own commercial analogue to a linguistic system - with a central feature being prices as signals of scarcity - the Keynesian branch of the economics profession, and the supporters of Wage Rounds in New Zealand, and the Accord in Australia, have trivialised the information characteristics of a functioning labour market, and have continued to sanction the wage setting activities of the Commissions which actually prevent individuals from getting together to create mutually beneficial investment in capital and people.

To quote Roger Douglas again, on the contrived wall between workers and work:-

> *"I am a labour politician. What makes me mad is that unions who claim to represent ordinary working people insist on shutting those people out of deals which directly affect them".*
>
> *"Genuine labour market reform in New Zealand would be about giving a totally new kind of power to the most disadvantaged people in our society - a voice for them in decision-making processes from which they are essentially excluded at present. It would be about giving the underprivileged direct personal opportunities to take action to improve their own lives where the present system keeps them more or less impotent to do so".*
>
> *"Labour market reform would be about welcoming the unemployed into the workforce instead of making sure they are walled out of employment. It offers to open up new routes into employment for disadvantaged young people who lack skill and experiences, new routes back into work for women who have been raising their families and improved opportunities for the disabled".*

Whereas economists across-the-board, and even in the Soviet Union, China and other Eastern Bloc countries, have come increasingly to see the error of their ways in relation to protection policies, state enterprise, regulation and so forth, the centralised labour market has been left largely above criticism; indeed, some have openly advocated extension of the corporate state structure which fits so neatly into the "tripartite-Wage Rounds-Accord" style of thinking, and which always neglects the rights of individual workers and consumers. I am told, for example, that whereas in China free enterprise now gets a respectable hearing, and while it is possible to criticise freely state enterprise in such a communist country, there is nevertheless a centralised employment process setting THE wage in China, or in parts of China, such that markets are prevented from doing their most valuable work - looking after the interests of individuals, individually and collectively, as they change in response to structural changes and shifts in market prices.

The Great Economic Debate

In order to understand both recent economic achievements and the shortfall in Australia and New Zealand, due to the non-reform of labour markets, it may be helpful to reflect on the circumstances that brought about this market-oriented change. Assisted by the experience and the analysis of three decades of increasingly costly government intervention and protection, in countries such as the United Kingdom, Australia and New Zealand, associated with declining rates of economic growth, the careful observer in these countries came to question the size and role of government and to see more clearly the virtue of markets. Think tanks, common sense, economists and even Treasuries contributed to this increased awareness of the superior organising and signalling power of markets.

In terms of the economic and political debate, the high ground became dominated by the economic rationalists, with Adam Smith ousting Maynard Keynes as the source of inspiration, with "government waste" rather than "market failure" being perceived as the major problem, and with the principle of "user pays" challenging the "perpetual pipeline from private pockets to the public purse" as the dominant theme of public policy debates. As a comment on the popularity of these new ideas, we have seen flocks of politicians joining in the free market chorus, often from parties of the so called "left", and all very impressed with their reading of the new economic rationalism.

But it has been more than just "Smithian" ideas that have been in the ascendance, intellectually. Many policy changes actually have been effected which reflect those ideas. The notable successes, in such countries as the United Kingdom, Australia and New Zealand, include financial deregulation (perhaps the easiest form of deregulation, given the diffusion of workers and the prior competition from the unregulated financial sector), lower tariffs, reduced quotas and diminished subsidies in key product markets, and the privatisation or corporatisation of many state enterprises.

Even more reassuring to those battling the cause of economic rationalism is that the oxy-moronic meaning of the two words "state *enterprise*" has become clear, and there has also been a broader recognition of the virtue of simpler and flatter tax regimes, which should apply across-the-board to all real incomes. But in all of the abovementioned cases, progress has not been as real as many would suggest. Nevertheless the collectivist, privileged, anti-market forces have definitely been on the back foot in the last decade; they have received some painful blows and have had to invent words such as "New Right" and play other word games in the media, in a vain attempt to counter the decentralised market attack on their regulatory privilege and power.

Some interest groups have started to see the "big picture" associated with this agenda of reform, for example, in New Zealand, as in Australia, the farmer groups have actually welcomed deregulation and reduced protection, but have asked that other groups also be obliged to face real competition.

But while there is much good news, profound difficulties remain. Indeed my thesis is that the results of this apparent shift to economic liberalisation have, in fact, been highly disappointing, and usually for very simple reasons centering on the failure to tackle labour market conditions. It took Arthur Scargill to induce Margaret Thatcher to re-order her economic priorities (having been saved by the war in the Falklands), and to take on both uncontestable unions and their friends - the state owned enterprises. It took the traffic controllers strike in the United States to bring the Reagan administration out loudly and clearly on the side of labour markets, not union muscle; and it has probably taken the loss of office of Roger Douglas in New Zealand, prompted by the high and rising unemployment associated with coporatisation and reduced protection, to make the community at large, and even the economics profession - not to mention many politicians - wake up to the primacy of the labour market in structuring economic reforms, if there is to be widespread gain from the hard won reforms.

In the case of Australia, where there has been increased centralisation of wages, associated with the Accord since 1983, the resulting suppression of wage relativities, the significant hand-over of cabinet power to the ACTU as part of the deal, and the failure to implement microeconomic reforms, have all combined to prevent Australia from participating fully in a booming world economy. The Australian economy overheats, as at present, at very modest rates of economic growth, precisely because our labour productivity is abysmally low. This pathetic productivity growth, despite our massive resources; our squandering of labour, particularly youth; and our continued resort to state enterprises are, I suggest, all connected to the open unwillingness of our politicians in government genuinely to allow markets in the most vital areas when it comes to raising living standards - labour, education, training and skills.

The contractual approach to the employment of labour, and the bundling of employment, training and lifetime skills accumulation, as in some of these Asian countries, including Japan and Korea, makes an interesting contrast with Australian labour "market" arrangements. In Japan, as in South Korea, workers can start on modest wages in the unregulated sector, get a "toe in the door" and gain training and industrial experience. Workers can also be bid away to the larger and longer term employers, employers which offer what has become known as "cradle to grave" employment. Not just employment, but training, education and housing may be packaged with the job.

The message that comes from these examples is that the firm has a major capital asset in its workers, and rational firms which do invest resources in training their workers also make sure that, should workers leave, they will lose considerable privileges. The implication in all of this is that were Australian and New Zealand employers not obliged to pay uniform wages but to reward performance, then it would be possible for employers to be far more generous, and even offer shares in the enterprise. An element of contract which would offer some safety valve to employers, in the case of such "cradle to grave" employment, is the scope to adjust the bonus up and down, to reflect profitability of the firm. While no one should suggest immediate transplantation of systems from one country to another, given the differing cultures, the point in relation to the labour contracting arrangements in the successful Asian countries is that those arrangements are typically precluded in Australia. (The exceptions, such as Lend Lease, Fletcher Jones and some other firms which offer profit sharing, by their very rarity, prove the point, given the potential profitability of shifting towards a system without centralised wage awards.)

It would seem, then, that the countries which are success stories, in economic reform, are those where labour markets were freed first, where individuals and groups of individuals were free to contract for their own labour, or simply to respond to market offers, rather than accept the decisions handed down from irrelevant benches. Countries with few labour market restrictions such as Hong Kong, Taiwan, South Korea and Singapore (except in 1979-80, see below) have experienced phenomenal economic growth with little labour market or welfare intervention, thereby pulling up wages as well as other forms of income. The prevalence of bonuses in Japan and South Korea, for example, for workers in highly profitable firms; the resulting capacity of relativities in Japan to adjust up (electronics) and down (aluminium) when new products emerge or old products fade; the capacity to bring in untrained workers at very modest training wages and so give them a "toe in the door" while they train on the job, are all characteristics found in labour markets of our once poor, but now thriving, Asian competitors.

Labour Market "Versus" Product Market Reform

There is a genuine debate amongst economists and analysts of public policy regarding the question of whether product market or labour market reform should have priority. A recent tendency in economic debates has been to argue that the most useful and strategic way in which to achieve labour market reform is to cut tariffs, reduce protection and so forth, since this exposes firms to the chill winds of competition. It forces them to change their labour market ways, it is argued. In New Zealand, Australia and in many other countries, it is common to hear economists argue that it is impossible effectively to tackle union power, and to rearrange labour markets directly so that individualistic and more enterprise oriented negotiations are possible. Union power simply does not allow this. But all is not lost, the argument goes, since with reduced protection in product markets, firms will seek to vary their own labour market arrangements so as to become more competitive.

The weakness in this argument is that the same unions which have succeeded in lobbying for protection, typically with the support of their employers and industry associations, continue to have (political) power for a significant time after protection is reduced. Given that workers tend to be located in the same electorate, and given the capacity of the media to produce genuine cases of hardship and suffering associated with structural change and lower tariffs, for example, it takes a courageous politician to persist with free trade policies given the transitional difficulties. It follows that if monopoly union power persists, and if there is not the normal recourse through legal channels against unions abusing monopoly power, then the reduced level of protection can rapidly be reversed through union and local community pressure.

Far better than punting on lower protection, I suggest, is that priority be given to first facilitating labour market arrangements which allow, and indeed encourage, direct negotiation of enforceable contracts, with bonuses based on good performance, since this gives workers a vested interest not in the prior and inefficient structure, but in the profits of the new jobs.

Of course, nobody is suggesting that we should not take reform when we can get it - the reduced protection, the corporatisation and, in Australia, the Whitlam 25% tariff cuts were a good thing - even if some of these measures were partially reversed. Similarly, financial deregulation on its own is a good thing, partly because it exposes other areas of protection. Likewise, corporatisation is better than non-corporatisation even if it is inferior to privatisation. Political beggars such as free marketeers are not really free to be too choosey!

But the key point, in all of this, is that those who argue that labour reform is too difficult, and may lead to civil war, but who also argue passionately for reform in all other areas, are running a very real risk of losing the reforms they have achieved, such as lower tariffs and reduced quotas, because the residual union power continues to be capable of reversing the change.

Singapore - The Saga of Misguided Wage Intervention[1]

Singapore is an interesting example of both the gains from liberal labour and trading arrangements, and of the severe costs of artificially, or centrally, setting wages by fiat. In 1979 the government of Lee Kuan Yew pushed up wages dramatically, in an effort, they said, to foster high technology and labour saving manufacturing. It was an explicit attempt to restructure the economy, and to raise (labour) incomes. The consequences, predictably, were nothing of the sort, with businesses used to competing internationally losing their edge, and with workers from Singapore crossing the Causeway to work in less regulated Malaysia. If ever there is a text book example relevant to the current debate on the centrality of labour market reform it would be Singapore at the start of the 1980s.

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[1] I am indebted to Professor Richard Snape for reminding me of this case.

The Tasman Causeway

While Australia and New Zealand both have the (other's) labour market as a safety valve once the exchange rate, incomes or employment opportunities get out of line, the costs of centralised wage setting are not as stark as in the Singapore example, given that both labour markets are highly regulated and that relocation costs are rather high. Nevertheless, both the workforce and welfare force in Australia are known to be highly infiltrated by New Zealand labour at the moment, reflecting the currently limited labour opportunities in New Zealand. It is a sad irony, at present, that a country which has led the way in converting state enterprises into corporations, in shedding redundant labour in the forest industries, agriculture, transportation, communications and electricity, thereby increasing productivity and potential income, should nevertheless be unable rapidly to foster adequate new employment opportunities, because of an inability to negotiate new training oriented employment packages, or because of an inability to form enterprise unions with a vested interest in the new enterprise.

As in Australia, the New Zealand Cabinet, when it came to the crunch, and despite the writings and arguments of Roger Douglas, was not able to tackle those business and labour leaders who had grown comfortable riding the uniform wage train.[2] In a protected economy, and New Zealand was nothing if not over protected in the Muldoon era, the fact that all firms faced the same (excessive) labour costs meant that they did not have to compete with each other in terms of labour market conditions. Firms in trouble would typically be competing against other firms in similar trouble, and with government, in effect, providing both with tailor-made protection of one form or another.

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[2] We had a protected economy which meant employers could pass on the going rate in prices because there was little imported competition. It was easier than risking the chance of industrial action. There was no point in trying to introduce issues like productivity. Nor did the decisions of the Arbitration Court encourage employers to take a firm line. When cases were referred, the court tended to concede the going rate so employers gave in, knowing they would eventually have to pay. Finally there was the role of Government itself. During the seventies in particular, it often intervened in wage-fixing and the overall base settlement figure was largely determined by the unions' and employers' perception of what the Government would accept without intervention. There were wage freezes or wage regulations or implicit threats they would be introduced if the wage round was not to the Government's liking.

Roger Douglas, Towards Prosperity, David Bateman Ltd, 1987, page 95.

With the advent of dramatically reduced protection in manufacturing, and other industries, previously protected firms were obliged to face world markets and therefore to shed labour if they were to cut costs. But where could this labour go? It could not go to the state enterprise sector, since they too were (and are) shedding labour. Where it <u>should</u> go is to the many thousands of potential small new enterprises which characterise a dynamic service and computer oriented economy. But if minimum wages are high, if hours of work are severely regulated, if rostered days off, accident compensation, penalty rates and so forth are all imposed according to the judgements of social welfare lobby groups rather than through mutually acceptable negotiations, then such small firms which have blossomed all over the United States tend not to blossom or even to be conceived in the heavily regulated Australia and New Zealand. As a result, <u>*sans* labour deregulation, the more effective the privatisation, deregulation and pro competition policies, the greater the unemployment created.</u>

With more unemployment, the political and social basis for a government oriented towards economic reform is undermined, as was nearly the case in the early days of Margaret Thatcher, and as the exit of Roger Douglas from Cabinet confirms. The very real danger, then, is that in the absence of real labour reform, the community will throw economic reforms away and revert to "protection" all around, contrived low wages and "secure" jobs in the newly protected sectors.

<u>The Centrality of Labour Markets in Welfare Reform</u>

In order to understand more fully some of the mysteries of unemployment and the misery of those in states of unemployment or poverty, it is necessary to look beyond the labour market barriers to frequent employment, and to understand the incentives to participate in the welfare system. Australia, in the 1970s, saw dramatic increases in the incentives for youth and adults <u>not</u> to work, the result of both contrived increases in wages and increases in welfare benefits, which had the effect of both reducing the number of job offers to less skilled people and increasing the benefits they received in the event that they did not work.

In the United Kingdom and New Zealand the incentives <u>not</u> to work also increased dramatically around this time. The victims of artificially imposed wages were not those with high skills, good connections or those at the top end of the tertiary education system, since they were typically earning far more than any minimum wages imposed from the Arbitration Commission. The victims were, rather, the less skilled, the aboriginal stockmen, the women attempting to rejoin the workforce after long periods out of work due to family obligations, and others who simply did not conform to the standards expected by employers obliged to pay high minimum wages.

In earlier times, so long as the minimum wages were modest, as indeed they were for much of the 20th Century in most countries, there was little by way of an unemployment problem, since those wage minima were largely irrelevant (as they are in most of the United States today). But as union muscle increased, as the group setting wages increased their claims as to what constituted a "fair wage", and as the welfare industry succeeded in negotiating very generous welfare, compensation and other terms and conditions associated with <u>not</u> working, so unemployment in the western world exploded. (In the communist world, it was <u>under</u>employment which exploded.)

<u>Structural Changes</u>

Structural changes, such as those wrought by a dramatic shift in relative prices associated with the jump in the price of oil, for example in 1973 and 1979, lead to circumstances in which the flexibility of labour markets was critical in order to enable a community fully to employ itself and to achieve the maximum from its skills, capital and resources. Interestingly, it has been in countries such as Japan and South Korea that the real economic downturns associated with oil have been minimal, despite the fully imported nature of oil in those countries; whereas countries such as Australia suffered more in the longer run, despite their extraordinary endowment of energy intensive commodities.

Whereas Japan accepted cuts in the myriads of independent wages in areas made vulnerable, often via the technique of reduced bonuses, in Australia the automatic (CPI based) pressures, in the context of such temporary shifts in relative prices, took the form of <u>increased</u> wage demands as workers sought compensation for higher prices of petrol, for example. Rather than encourage on-the-job training for new firms and new industries to expand in the context of such a structural change, made possible by lower nominal wages allowing employers to add in a training component to take on unskilled, or unemployed workers, Australia had the habit of imposing high minimum wages which had exactly the opposite effect of the wage structure in our Asian neighbours. We were starting to lock ourselves out of the Asian miracle.

Again, we see that the preoccupation with THE wage, as opposed to the process of searching out new occupations and opportunities, and associated packages of wages and training schemes, has meant that in Australia the debate always centered on the "next wage deal", the best "wage/tax package", or some other temporary fix.

Australia and New Zealand - Poor White Nations of the Pacific?

Some will argue, for example, from the trade union perspective, that we do not wish to adopt all the standards of Asia. Of course we do not, but that is hardly the point. What we do wish to adopt from Asia is the capacity to reward the highly productive worker with a bonus or special training opportunities, and to signal to those in down-market jobs that they should look elsewhere. We wish to pull labour out of unproductive areas by making it expensive for them to remain there, by enabling the highly profitable new areas to seek labour at any wage packet they like. Rather than have centralised union and employer organisations tell marginal firms or disadvantaged workers that they would be better off on welfare, I argue that the small firm, the entrepreneur, the unskilled worker, should be given a go on terms they accept, with the media being a watchdog against any possible exploitations (although the real point is that firms will lose workers if they fail to pay market wages).

It is in the NIC's (newly industrialised countries) of Asia in which the rate of growth in wages has been higher than any union leaders's dream and there has been no need in the NICs for "Muldoon styled" industry plans, or for redistributions from taxpayers to successful lobbyists of government. Government contrived sunrises, Multi Function Polis's and other attempts to imitate the successful features of economic growth in Japan, Hong Kong, Singapore and South Korea also miss the point. These countries have, I argue, raised themselves by their bootstraps by using two fundamental techniques:

1. Free labour markets, and

2. An orientation towards exports and the external market place

Australia, New Zealand and the United Kingdom have talked about union power, comparative wage justice, protection from dumping and foreign competition and so forth - with the result that some of the suburbs of England, Australia and New

Zealand are now at the edge of exhibiting a lower standard of living than the previously impoverished suburbs of our Asian neighbours.

MITI, Winner Picking and Corporate Statism

There are many who argue that the success of Japan is due to Japan Inc., that is, the complex relationships between MITI and the private sector, with government direction and selection of some key new industries, playing a major role in Japanese success. While one should not dismiss the significance of cultural factors, and whilst it is true that Japan has made many sound strategic decisions, the question is whether Japanese success has been because of, or in spite of, MITI? Certainly, it can be said that the flexibility of the labour market, the capacity of successful Japanese firms generously to reward workers, and offer them incentives to stay on in exchange for on-the-job training, has lead to extraordinarily rapid accumulation of labour skills in Japan. (A competitive education system, with a large private tertiary sector, has also assisted.)

Furthermore, the absence of unionization and the absence of universal coverage of awards, in the context of the many small firms which back up Japanese manufacturing and supply components, has meant that there is a safety valve, or adjustment factor, in Japanese industry which is simply not present "down under". In other words, relativities in Japan may adjust in a quite dramatic fashion relative to Australia and New Zealand, with the market's key signalling system being allowed to work.

Conclusion

The ascent of economic rationalism, or the "rise of the dries", has been one of the real triumphs of the 1980s. The associated, and not independent political successes of Margaret Thatcher, Ronald Reagan, Roger Douglas and to a lesser extent Paul Keating and Peter Walsh, has also caused spirits to lift in the free market camp. However, it is the burden of this paper that restoring New Zealand and Australia to the top of the international growth ladder - where they were a century ago - requires implementation of an agenda including such vital steps as:

* privatisation of state enterprises
* deregulation of transport and communications
* withdrawal of the public monopoly over tertiary education
* the use of vouchers in primary and secondary education

* the promoting of lower, flatter taxes with incentives to effort
* the levelling of the business tax and savings/investment playing field, and
* the general retreat from big government

But all these reforms, I argue, hinge, quite crucially, on the reform of the labour market, for example, to allow a more contractual approach to employment, with labour contracts reflecting diverging tastes and interests, tailor-made to the preferences of the potential workforce and the enterprise. It has been argued that countries such as Singapore, with its abortive attempt to set wages by fiat in an attempt to restructure the economy, demonstrated in a crystal clear fashion the consequences of putting the cart before the horse (wages before employment) when it comes to generating incomes.

New Zealand, in dramatically lowering regulation, corporatising many state enterprises, and removing subsidies to agriculture and "think big" enterprises, has drawn the applause of those in Australia who see the need for both of our countries to wake up to the realities of the world market place. But your reforms, because they have been more far reaching than ours, have released a lot of underemployed labour and so increased unemployment *en masse* because, it is argued, they have not been matched by the removal of barriers to employment.

Or, as Roger Douglas summed up the current challenge facing New Zealand:-

> *"A refusal to learn from international labour market experience is producing reactionary policies which will fail the nation. The blind, gutless attitudes on both sides of the House, now place the achievements of the last four years at deep and serious risk".*

The continued dominance of craft unions, convenience clauses and other priorities of the privileged monopoly unions, have undermined these many moves towards free enterprise in New Zealand, moves capable of generating sustainable employment and much higher real incomes. The consequences of going the next step in economic reform are likely to be profound, and to help the less privileged workers in particular, who will face lower barriers to employment. This all suggests that a better label for those proposing such far reaching labour reforms would be "market left" rather than "new right"![3]

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3 As I argued for the Institute of Public Affairs, 1988, in their submission to the Bishops Inquiry into Wealth, the potential benefits of combined labour market reform, lower tariffs, lower taxes and less regulation could add up to a 1.5% rise in the growth rate, meaning a lift in a worker's wealth of about $250,000 (1988 prices) over a full lifetime. While these numbers are mere projections, they are consistent with growth rates achieved in countries unburdened by I.R. Clubs and others who seek to interpose their views on appropriate wages rather than allow individuals and associations of individuals the freedom to contract for the profitable employment of their labour and capital.

ADDRESS TO THE AUCKLAND BRANCH OF THE NEW ZEALAND

DAIRY FACTORIES' INDUSTRIAL UNION OF EMPLOYERS

INDUSTRIAL RELATIONS CHALLENGES FOR THE FUTURE

- AN EMPLOYER PERSPECTIVE

LINDSAY FERGUSSON
NEW ZEALAND BUSINESS ROUNDTABLE

HAMILTON
14 JULY 1988

INDUSTRIAL RELATIONS CHALLENGES FOR THE FUTURE - AN EMPLOYER PERSPECTIVE

Crunch time has arrived for the New Zealand economy.

We are part way through a long-delayed economic adjustment. For the third time in 15 years, we are trying to overcome the habit of spending more than we earn, borrowing more than we can afford, and paying ourselves more than the value of what we produce.

The adjustment to living within our means, and standing on our own competitive feet in the world, is not easy. On previous occasions we chose to pack it in. Each time the inevitable slowdown occurred, we opted to print money, borrow more and hand out subsidies to those that complained loudest. Each time we ended up with an economic structure that made less and less sense, and the hangover became worse.

This time the Government has gone further, but there are still many obstacles between us and a stable and dynamic economy.

For two years or more, the Business Roundtable has been expressing deep concern at the failure of the Government to get on top of its own spending. Events of recent weeks have again vindicated these concerns. Whatever progress is revealed in the coming Budget, the fiscal problems will not have gone away. Instead of another round of crisis management this time next year, much more sustained progress on major policy areas needs to be made without delay. Like any commercial firm, the Government should aim to improve on its budget target.

A second near term obstacle, which is the subject of your seminar, is our wage fixing and labour relations system. This continues to operate in a way which is virtually oblivious to all the other changes in the economy. I want to address the bulk of my remarks to the economic factors which employers and workers must come to terms with in the next wage round. I shall also touch on the urgent need for the Government to go further in deregulating the labour market and creating the right environment for realistic wage bargaining.

First, the wage round. I would like to think that this term is approaching the end of its useful life. Successful economies do not treat wage negotiations as a ritualised inflation-based annual 'round'. In a low inflation economy wage agreements are periodically renewed to recognise real factors such as productivity improvements, changes in international competitiveness, individual company performance, and changes in the supply of and demand for particular skills in particular locations. Agreements may be annual or multi-year. Individual firms and their workforces determine the timing. The sooner we move into this pattern of negotiating, the better for everyone.

Renewal of awards and agreements this year will take place at the most difficult point in the economic adjustment process. The economy is in recession and is expected to remain flat into 1989. Equally important, the impact of recession is being felt in sharply different ways across occupations, industries and regions.

If employers and unions do not recognise these factors in wage bargaining, the consequences for businesses and jobs will be serious. Looking at this positively, we have the opportunity to renew wage agreements in a way which will bring forward economic recovery and the reversal of the unemployment trend.

I do not propose to suggest in detail what the shape and size of the new agreements should be. There are two reasons for this.

The first is that it is too early to make that judgment. Some important economic information has only become available this week, including the Government's briefing to the Tripartite Wage Conference and the June CPI figure. However, more will be to hand, including the Budget, before negotiations get underway.

In addition, a great deal more information will come out over the 6-9 months during which agreements are being renewed, and they must reflect up-to-date and forward-looking circumstances. It was bizarre, for example, to observe wage settlements in the latter part of the latest wage round not reflecting the declining inflation trend that had set in since the first settlements were struck. The notion of 'trend setting' awards for a whole wage round must be consigned to history.

Secondly, there is no way anyone amongst us can possibly assess the extent of adjustments, if any, that are warranted in the thousands of employment relationships across the economy. The days of central planners telling us what the prices should be for a whole range of our inputs and our outputs are over. The same is true of our labour costs. The buck stops with individual parties to make that assessment.

We can, however, look at some economic factors which help us, at this point of time, to form a broad picture of the labour cost outcomes the economy needs.

First, <u>inflation</u>. It is now plain that the last wage round took place on the basis of quite false assumptions about inflation trends. Some commentators hailed the 7 percent settlement in the Metal Trades Award as a responsible outcome which would usher in a sub-inflation wage path. Quite clearly it did nothing of the sort. Real wages over the period of most current agreements will have increased and added to the unemployment problem.

The rate of inflation currently being experienced is probably already below 5 percent. There are now few inflationary risks ahead. The official objective of achieving stable prices within a couple of years is quite feasible. Just about the only threat to this goal is unrealistic wage movements.

The Minister of Finance indicated last month that he expected the inflation level for the year from October next (which is the relevant period for forthcoming wage settlements) to be around 3-5 percent. I see no reason why it should be near the upper end of that range. The Minister suggested that wage adjustments should average somewhat less than inflation.

Compared with this outlook, the level of inflation expectations of up to 8-9 percent still being reported in surveys is unreal. Any of your managers planning on that basis should be a candidate for early retirement.

A second general factor is New Zealand's <u>international competitiveness</u>. It is probably not exaggerating to say this is at an all-time low. The latest OECD Economic Outlook showed that New Zealand's international competitiveness has worsened considerably. Comparative indices of New Zealand's relative unit labour costs in manufacturing expressed in a common currency showed that New Zealand costs had increased faster between 1987 and 1988 than those of any other OECD country. Many countries recorded declines in that period.

I want to state as emphatically as I can that New Zealand has to achieve reductions - not just stability - in its relative labour costs. That is the only way in which we can regain our lost competitiveness.

In your industry direct labour costs are some 25-30 percent of your expenditure. In the economy as a whole, labour costs account directly and indirectly for about 60 percent of total costs. Labour costs - the combination of wages, other employment conditions and productivity - are the key determining factor in our competitiveness.

Labour costs are also the central issue in unemployment, the third factor I wish to mention. Despite all the efforts of politicians to evade the issue, the excessive growth in labour costs (including non-wage costs such as accident compensation, taxes and government charges) is the single most important cause of the serious unemployment problem we are now facing. Wage and non-wage labour costs are simply too high, relative to the productivity of many parts of the workforce, for it to be profitable for employers to hire all those who are seeking jobs.

If ever clear evidence of the link between labour costs and jobs were available, it is New Zealand's experience over the last 6 years. The 1982-84 wage freeze, for all its limitations, brought about a reduction in labour costs which, after the effects had worked their way through the economy, led to employment growth in 1984-85 of 40-50,000, the highest in a decade. By contrast, the nominal wage increases of almost 20 percent in the 1985/86 wage round have been the major single cause of the fall in employment and steep rise in unemployment during 1987-88. The union leaders who claimed these wage increases as a victory now carry the burden of 100,000 unemployed people around their necks.

There is total agreement among all competent economists on this point. A recent report by the Hawke Government's Economic Planning Advisory Council, on which the ACTU is represented, summarised the results of a variety of studies in Australia thus:

> "All of the models support the view that lower real wages contribute to employment and output growth and there is also close agreement on the size of the effects...
>
> "[I]n all cases the effect is through increased competitiveness on the demand side and increased profitability on the supply side... Model results suggest the following rule of thumb: over a medium term horizon each 2 percent of restraint in real wages delivers a 1 percentage point reduction in the unemployment rate."

Available New Zealand evidence suggests there is an even stronger relationship between real product wages - the relevant factor for the employer - and employment in New Zealand, and that firms now adjust employment to wage changes faster than was previously the case.

Two years ago the Australian Treasurer, Mr Keating, had the courage to tell Australians that real wages had to fall. The trade union movement accepted the reality of the situation, and a cumulative real wage reduction of around 5 percent has occurred in Australia since that time. This has contributed enormously to Australia's greatly strengthened economic position, including an improvement in its unemployment rate.

The fourth and final general point in this context relates to productivity. The reduction in labour costs which I have argued is essential can be achieved either through productivity improvements or by a lower wages bill. Quite obviously the productivity route is to be preferred; over the medium term it is the basis for improvements in all incomes, including wages.

Some outstanding improvements in productivity are occurring in both the public and private sectors. But over the economy as a whole we cannot bank on any significant gain in the period relevant to the next wage round. Firms will be operating below capacity, output will be falling more rapidly than numbers employed in some cases, and little new productivity-raising investment will be put in place. At least in the case of broad occupational awards, it would be foolhardy to incorporate unrealised productivity improvements into wage agreements.

Consideration of these four general factors - a forward-looking view of inflation, competitiveness, unemployment and productivity - provides some helpful parameters to guide wage bargaining in general. But they are not the most meaningful criteria for an individual employer. The cardinal rule for an individual employer is that he or she should pay whatever is necessary to attract and retain employees in the quantity and quality required to operate a profitable business.

Quite clearly this rule has important implications in the present economic environment. Many parts of the labour market are slack. We would be making matters worse by raising wages and making hiring less attractive in industries where queues of workers are looking for jobs. Young people, for example, would be denied employment and training opportunities which would lead to higher incomes. At the same time some skills are scarce in the new economy, and we may need to increase some wages to encourage people to change jobs, relocate or undertake training. Relative rates of pay must be allowed to adjust to bring about a better balance.

I have no doubt that such factors are relevant in your industry. In some provincial areas which have been hard hit by the downturn, and where costs of living are lower, it is imperative that labour costs are not set by reference to conditions applying elsewhere. Adherence to rigid national awards in such circumstances is a certain recipe for job destruction and regional decline. With the highly centralised wage fixing system that we still suffer from, I realise that striking bargains which meet local needs is difficult, but both employers and unions must try harder.

A recent example of the rigid union attitudes in the meat industry in this regard is disappointing evidence of the obstacles to be overcome. While hundreds of meat workers were losing their jobs in Christchurch last week, the union refused to agree to another meat works offering some of them employment on shift work because the national award did not provide for multiple shifts.

There are four common fallacies about wages I would like to point out and suggest you think hard about as employers.

The first is that the so-called ability of an employer to pay is a reason in itself for wage increases. Profits, even good profits, are not necessarily a basis for wage increases unless labour is scarce. Suggestions to the contrary rest on a misunderstanding as to how the economy works. If an industry achieves good profits, firms in it will normally invest or expand, or new firms will be attracted into the industry. This will create a demand for labour which will be available at the going rate if the necessary skills are in plentiful supply. Only when the supply is exhausted will firms need to bid up wages to attract new trainees or workers from other industries or regions. If temporary profits are siphoned off into an increased wage bill, the potential for investment and job creation is lost. We need to keep in mind the way the economic mechanism for reducing unemployment works: today's profits are tomorrow's investment and the day after tomorrow's jobs.

The second follows from the first. Productivity should be reflected in wage increases over the longer term. But productivity improvements are not an automatic basis for wage increases in the present environment. Many firms need to make productivity gains just to survive and to retain existing jobs. To make inroads into unemployment, we have to allow productivity gains to flow into profits, and hence investment and jobs, in the manner I have just described. As a nation, we also have to put them towards retiring our massive burden of debt.

The third fallacy is the hoary old chestnut that wage increases are necessary to sustain purchasing power and hence output and employment. Why wage incomes should be assigned this task - rather than, say profits, farm incomes, foreign demand, government expenditure or any other source of demand you care to think of - is curious to say the least. The latest group to offer their services in this role is the National Association of Superannuitants. They recently told the Government that if only it would increase their spending power they would stimulate the "consumer-driven demand which is so urgently needed to lift the country out of its present depression". Anyone who believes in a pensioner-led or a wage-led recovery is living in fairyland. Wage increases merely reshuffle income unless they are backed by real economic factors. The Government's monetary policy is aimed at maintaining an adequate level of nominal domestic demand, and the key factor for New Zealand is to be competitive in every way so that we can tap demand in world markets. Concepts of unemployment due to deficient demand make no sense, and never have, for small, open economies. Excessive wage increases can only lead to less employment, less exports, less business investment, less saving, less price stability and less reduction in overseas debt.

A fourth piece of nonsense is the claim that some politicians have made, and I have heard it again recently, that unions have more realistic expectations about wages than employers. Some employers do need to wake their ideas up as I suggested earlier, but I would take that claim seriously if we had not seen double digit claims by unions in the last wage round and the absurd spectacle of the hotel and hospital workers' union talking about a 9.5 percent wage increase this year. In Australia, which has a higher rate of inflation in prospect than New Zealand and is experiencing strong real output growth, the ACTU's claim in the current National Wage Case is for 6 percent in two 3 percent instalments (and the Government and employers are arguing for lower increases). It will be a sign that we have got closer to the real world when we start seeing claims below that level in New Zealand.

Finally I want to say a word about the rules for wage negotiations laid down by the Labour Relations Act which, it would appear, we are cursed with for at least another wage round. The Minister of Finance has argued again recently that it is the Government's responsibility to eliminate inflation through its monetary and fiscal policy, and that it should be held accountable for any failure to do so. By contrast, the Minister pointed out that the Government does not have control over wage and employment outcomes. If employers and unions agree to price their firms out of business and their members out of jobs, the argument runs, they have only themselves to blame.

This is the message that Mrs Thatcher and her Government drummed into employers and unions in the United Kingdom during the painful reconstruction of that economy. Mr Douglas has a point, but there is a crucial difference between the two cases, namely that the Thatcher Government gave employers and workers the freedom to carry it out.

Early in the process, Mrs Thatcher moved to introduce an environment for employment relationships which is now based on voluntary and contestable unionism and predominantly enterprise-related bargaining. While behaviour took time to change and adjustments are still occurring, massive benefits are now being seen. Major productivity improvements have been recorded. There has been a reduction in unemployment of around 750,000 over the last 2 years, and some parts of the United Kingdom are now approaching full employment. All observers, including many union members, regard the Thatcher Government's willingness to tackle trade union reform as a key reason for Britain's economic success.

By contrast, New Zealand is still going through the earlier United Kingdom experience of ever-rising unemployment. We are now a medium unemployment country and will be a high unemployment one within 18 months. Even if the Government were to free up the labour market tomorrow, the economic forces already at work would, I believe, push unemployment close to the 10 percent mark in that period, but the move would bring forward the time when the tide would be turned. As things stand, the prospect is not just for high average levels of unemployment, but for a similar pattern to the United Kingdom with high regional levels, higher rates among young people and a growth in long term unemployed, and there is no indication of the necessary policy responses to put an end to it. Any employment package in the Budget which does not address the labour relations system will be an exercise in evasion.

Being an optimist, I cannot believe that public opinion will tolerate much longer the retention of a system that Michael Fay recently described as "ludicrous beyond comprehension". Claims that a deregulated labour market is some kind of free-for-all or jungle cannot withstand the evidence that those countries with high wages and high levels of employment are those with the freest labour markets. No country other than Australia has maintained a labour market system remotely resembling ours, and Mr Keating has recently identified the labour market as the last great area of change to be overcome in Australia.

In a situation where public opinion polls - such as the Heylen poll released by the Business Roundtable earlier in the year - are showing a large majority (including union members) support a decentralised and voluntary labour relations system, where respected trade union leaders are recognising that such changes are on the way, and where the Government has made similar moves in the state sector, I cannot believe that change will be long in coming.

However, with the ever-rising cost of unemployment, including the jump in the fiscal costs which will no doubt be revealed in the Budget, time is not on our side. That is why it is crucial that seminars such as this are used to prepare for any freeing up of the wage bargaining process in the future and why, as employers, you must win the support of your workforce, your local community and your political representatives to bring it about.

COMMENTARY ON TOWARDS EMPLOYMENT EQUITY

NEW ZEALAND INSTITUTE OF PUBLIC ADMINISTRATION
SEMINAR

DR PENELOPE BROOK
EXECUTIVE ASSISTANT
NEW ZEALAND BUSINESS ROUNDTABLE

WELLINGTON
10 NOVEMBER 1988

COMMENTARY ON *TOWARDS EMPLOYMENT EQUITY*

NEW ZEALAND INSTITUTE OF PUBLIC ADMINISTRATION SEMINAR
10 NOVEMBER 1988

The case for comparable worth or "pay equity" legislation is often described in terms of a sacrifice of efficiency to achieve a greater good in terms of equity. Thus in the report of the Royal Commission on Social Policy, for example, women are numbered among the "victims" of the drive for a more efficient economy; proposals for comparable worth are in this context seen as a kind of compensation.

The Working Group on Equal Employment Opportunities and Equal Pay, in its proposals for a pairing of pay equity and equal employment opportunities legislation, argues instead that they would result in improvements in both efficiency and equity.

I would be among the last to dispute that a number of features of the current environment foster employment, promotion and remuneration decisions detrimental to the interests of some women and relatively disadvantaged minorities. Similarly, I would not dispute the possibility that a policy designed to promote genuine equity in the treatment of men and women, Maori and Pakeha, able-bodied and disabled, could indeed increase both the efficiency with which the economy operates, and hence the size of the economic cake, and the fairness with which this cake is distributed.

However, I am far from convinced that the recommendations of the Working Group are based on a thorough assessment of the factors underlying and perpetuating discriminatory or "unfair" treatment, or the extent to which such treatment is the source of unequal outcomes. And I am likewise unconvinced that the proposed legislation would, in fact, lead to more equitable, let alone more efficient, outcomes. I shall concentrate here on the proposals for "pay equity" legislation, but would like to signal a similar disquiet at EEO legislation of the kind proposed.

In their report, the Working Group acknowledges that a number of factors could explain the observed differential in earnings between women and men. These include qualifications, continuity of work experience, and such "supply and demand" factors as skill shortages and surpluses. Discrimination is also counted a factor, although it is recognised that it cannot be measured directly. (Rather, I would argue that its presence is best assessed by the presence of the conditions which will breed and perpetuate it.) It is such discrimination which is the focus of the proposals for legislation.

The Working Group assumes a need for "pay equity" legislation from the inequality of outcomes (despite the fact that this inequality is acknowledged to stem from other factors in addition to discrimination), rather than from identified inequities in the pay-fixing process. Similarly, the proposed legislation focuses on equality of outcomes, and devises a bureaucratic procedure for achieving these, rather than on tackling inequitable pay-fixing processes directly. In other words, the proposed legislation is not concerned with equitable treatment of diverse individuals, or equality of opportunity, but with equality of outcomes. It is concerned not with attacking discrimination, but with doing away with what are *perceived* to be its manifestations.

Such mis-targeting is not necessarily harmful. In a world where all activities are constrained and all decisions are imperfectly informed, policies which we would dismiss in a "perfect" world can sometimes produce the results which we desire. The indications are, however, that pay equity legislation would not be one of these happy mismatches. In particular, it would harm not only efficiency, but most probably equity as well. In other words, it would likely amount to a sacrifice without a cause.

The "successful" pursuit of a pay equity claim will lead to a wage being set above that equating supply and demand for a certain kind of labour. The effect is analogous to that of any minimum wage rule: all other things remaining equal, the job will at once become more attractive to prospective employees and less affordable to employers.

Employers who cannot pass on increased costs to consumers will respond either by cutting other employee benefits or by laying off their least productive employees. If other occupations are difficult to enter, for example because licensing arrangements or work conditions in these occupations are incompatible with the needs of working mothers, increased unemployment will result.

As the adverse effect on employment is disputed by the Working Group, it is perhaps worth noting that the weight of existing empirical evidence goes against them. Comparable worth policies themselves have in most jurisdictions been in place insufficiently long to yield a useable body of data. Studies of the effects of - directly analogous - minimum wage policies do, however, show a significant negative impact on employment. In the United States, for example, they have been shown to be largely at the expense of young blacks, for whom employment experience arguably ranks as highly as income in determining their present and future well-being.

More recently, studies in Australia - which has had a form of pay equity legislation since the early 1970s - have suggested that this legislation has had a strongly detrimental impact on the growth rate of women's employment. In other words, even though overall employment of women continued to increase after the implementation of comparable worth legislation, because of increasing female participation in the workforce, job opportunities for women did not increase as fast as job demands - some women who wanted to join the workforce were rendered unable to do so. The fact that overall employment was growing does not make this any less of a sacrifice, or any less inefficient.

Arguably even more worrying are suggestions that the benefits and costs of comparable worth policies are not equitably shared. A recent study in the United States, for example, suggests that the benefits are concentrated among relatively well-off women in secure jobs in the government sector and in large corporations, at the expense of women in relatively insecure jobs and in smaller firms. While the structure of industrial relations in New Zealand could be expected to lead to results that differed in detail, the fact remains that it will be the least skilled, least experienced workers, and those in firms already struggling to survive, who bear the greatest share of "pay equity's" disemployment effects.

Policies which gratuitously create unemployment can hardly be construed as equitable. When this unemployment is created at the expense of the most vulnerable groups of workers - those with the fewest alternatives and arguably the greatest need of work experience - the inequity is magnified, and the sacrifice of efficiency loses any justification that might have been claimed for it.

The Working Group claims that any such effects will be softened or mitigated by the time frame over which pay equity would be implemented, the voluntary nature of claims, and the provision for "allowable differences" in paid rates. Time does not permit rigorous discussion of these points here. However, it may be noted that an effect spread over time is not the same thing as an effect dissipated; that claims taken voluntarily by national occupational unions will not be voluntary for their members; and that "allowable differences" will be assessed quite differently by people facing bureaucratic and people facing economic constraints.

To summarise, there are strong indications that the "pay equity" proposals would, if implemented, have an adverse impact on both economic performance and equity; that they would not tackle directly the discriminatory behaviour on which they are premised; and that they would benefit relatively well-off female workers at the expense of the more vulnerable.

This does not mean, however, that there is no role for policies promoting equality of opportunity in all aspects of employment relationships. Rather, there is a very strong case for policies aimed at breaking down social, institutional and in particular regulatory barriers to the equitable treatment of women and disadvantaged members of the "designated groups". The necessary starting point is a rigorous analysis of the sources of inequity, and a focus on the processes that permit inequity, rather than on their outcomes.

COMPARABLE WORTH : A BOON OR A BURDEN FOR WOMEN WORKERS?

NATIONAL BUSINESS REVIEW ECONOMICS BRIEF

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WELLINGTON
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Comparable Worth : A Boon or a Burden for Women Workers?

New Zealand has had equal pay legislation in the public sector since 1961, and in the private sector since 1972. However, while pay differences between men and women have narrowed since the introduction of these policies -- women's average ordinary time earnings rising from 69.9 percent of those of men in 1972 to 80.3 percent at the beginning of 1988 -- an "earnings gap" has persisted. The Report of the Working Group on Equal Employment Opportunities and Equal Pay[1], released in July, recommends the introduction of further "Employment Equity" legislation, aimed at narrowing or eliminating this gap by means of a combination of equal employment opportunities programmes and "pay equity".

In this article, the concern is with "pay equity", sometimes referred to as "equal pay for work of equal value", or "comparable worth". This differs from "equal pay", which requires workers performing the same task to be paid the same rate, in that it requires workers performing tasks considered to be of "equal value" to be paid the same rate. The article begins by considering the causes of the earnings gap which such policies purport to address. The mechanics of comparable worth policies, and their likely effects in practice on employment and earnings, are then discussed. Finally, some alternative policies are suggested.

A number of factors underlie differences in the earnings of women and men. These include differences in education, years of work and continuity of service. Employers will quite rationally pay different rates to workers with different qualifications and experience. In this regard, it has been shown that the earnings gap is significantly smaller for unmarried women, or women without children, than for married women or women with children, as the former are less likely to work reduced hours or to have broken service.

While factors such as education, experience and continuity of service do not appear to explain the whole of the difference between men's and women's wages, this is not in itself evidence of "discrimination" against women. The existence of discrimination is inherently difficult to verify statistically, although case studies do hint strongly at its existence. In trying to understand differences in earnings, it is not especially fruitful to split hairs over the existence or otherwise of discrimination by employers. It is, however, fruitful to consider whether inadequate competition in labour or product markets mean that employers can *afford* to discriminate on grounds such as sex or race.

The factor yielding the best statistical explanation for earnings differences is occupation. Women work in a relatively narrow range of occupations, predominantly in the service sector, and often outnumber men in these occupations, despite making up only a third of the full-time, and 40 percent of the total, labour force. Strong statistical links have been found between dominance of an occupation by women and low pay. Women are also disproportionately represented in the lower ranks of most occupations, even those which they dominate.

A useful starting point for understanding the earnings gap is therefore to understand why such concentration occurs. One reason may be that some jobs are actively preferred by women, because of job characteristics other than wages. While there is doubtless some truth in this, in particular because some jobs combine more conveniently with breaks in service or reduced working hours because of child-rearing, it is not satisfactory as a total explanation. In particular, it is necessary to look as well at how women's job preferences are formed; whether job stereotypes are reinforced in primary and secondary education, and whether there are inadequacies in role models or careers advice.

It is also necessary to consider whether there are barriers to women entering male-dominated occupations that hang on something other than mere employer prejudice. Do differences exist in access to occupational training, for example under apprenticeship schemes? Does the monopoly power conferred by professional licensing make it more difficult for women to break into "male clubs"? Do tenure systems in universities block the promotion of better qualified young female academics? Do union stipulations on work hours or part-time work make certain jobs unattractive? Is there pressure to exclude women within male-dominated unions, by workers fearful of competition for employment?

These questions about educational and professional barriers to the employment (or promotion) of women must be answered before we can understand how employers, prejudiced or not, could *afford* not to employ the best person for any job, or to pay a wage based on his or her contribution to the firm.

This has a product market dimension as well as a labour market one. If an employer is constrained by competition from other firms and products, or by the threat of such competition, he or she will be unable to afford to employ workers other than the most productive. Similarly, if an employer must compete for workers, he or she must offer a wage (and promotion prospects) attractive to those workers. In recent years, considerable progress has been made in exposing New Zealand employers to competition in product markets. Progress on removing barriers to competition in labour markets has been underwhelming by comparison. The barriers that remain are likely to be an important explanation of earnings gaps.

Comparable worth policies, rather than focusing on these underlying factors, seek to eliminate their results directly, by decree. The mechanisms by which they operate are now considered.

The implementation of comparable worth legislation involves a bureaucratic process of job evaluation, in which occupations are rated according to the mix and level of skills, qualities and responsibilities that they require. The Working Group's proposal for New Zealand is that this ranking would be carried out by a specially created bureau, at the instigation of women, or unions representing women, in female-dominated occupations (those where 60 percent or more of workers are women). The pay rates for these occupations would then be reset by reference to male-dominated occupations deemed to be of equal value. Pay rates would not be revised downward for either group as a result of this evaluation process.

Such evaluations will inevitably be subjective. Evidence from the United States, where a number of states have introduced their own comparable worth programmes, reveals profoundly different job rankings and resulting pay structures between states. While those carrying out evaluations may attempt to take account of the different economic circumstances of firms or industries, their incentives to do so will be weak.

This brings us back to the central economic question of how to measure the value of goods and services, and the value of the labour and other resources used to produce these goods and services. In economies that are not directed by a planning commissariat (and in practice, even with one) there is no way of measuring absolute values. The value of a resource in a pluralistic market economy depends on how much or how little is available and the nature of demand; it is measured by the other resources that people are willing to sacrifice to obtain it, its market price. Particular prejudices can only be perpetuated in such a system to the extent that employers are sheltered by barriers to entry in product markets, and privileged groups of workers by barriers to entry in the labour market.

What comparable worth advocates are saying, by contrast, is that we can pin down the value of a job directly, by assessing its component qualities. In other words, they are saying that sociologists, lawyers, economists or bureaucrats can systematically outperform the price mechanism – a repetition of a fallacy now being laid to rest even in the Soviet bloc. As Thomas Sowell has put it:

> "If we buy the key assumption of comparable worth – that third party observers can tell what jobs are really worth – then our whole economic system should be scrapped. Why let supply and demand determine wages – or product prices, or

> interest rates, or anything else -- if you can tell what things are 'really' worth and establish that equitably? If somebody has this God-like ability, why restrict it to cases involving jobs that are predominantly male or female? Aren't we all entitled to 'pay equity'? And why not rent equity, tuition equity, vacation equity, and all other kinds of equity? Supply and demand is why not. Employers do not choose salaries in a seminar... People who go around saying that women are only paid 59 percent of what men get are in effect saying that employers could cut their labour costs 41 percent, just by hiring women instead of men. If that were true, there wouldn't be an unemployed woman in America -- or an employed man."

While the efficiency costs of bureaucratically determined wages are in some cases recognised by proponents of comparable worth, it has been argued that some such sacrifice of efficiency is worthwhile in the interests of greater equity. However, it is far from clear that comparable worth programmes do, in practice, yield more equitable outcomes.

The creation of relatively rigid wage relativities on the basis of inter-occupation or inter-company job evaluations could be expected to have mixed results for the lowly-paid women that comparable worth programmes are intended to benefit. Any system which fixes relativities between wages establishes wage minima (and maxima). If a minimum wage is binding (so that the prescribed wage is greater than that which would equate supply and demand), companies will face a choice between employing fewer workers and losing market share. (Ironically, the pressure may be greatest on employers who are least "discriminatory" in their hiring practices -- employers in male-dominated industries will be little affected.)

If the former option is taken (and it often will be), the workers laid off will be the least productive ones -- typically the lowest skilled or those most recently recruited. Studies in the United States, for example, have shown minimum wage laws to be particularly harmful to young, unskilled, black workers -- effectively denying employment experience and income to one of the most vulnerable groups in society.

The minimum wage effects of comparable worth policies are similar. Although few comparable worth schemes have been in place sufficiently long to generate useable data on their wage and employment effects, there is evidence that, at least in the United States, they have primarily benefited relatively well-paid female state employees and employees of large private companies. Most in this group have retained their jobs and gained some increase in earnings. By contrast, the policies appear to have had an adverse impact on the wages of women in very small firms (at least in part because coverage of these firms is more difficult). In other words, the implementation of comparable worth appears to be exaggerating earnings inequalities between women[2].

Simulations run on Australian data suggest that, although employment of women has continued to grow since the implementation of comparable worth legislation in 1972, this is primarily a reflection of strongly increasing labour force participation by women. The underlying impact was a reduction in employment by nearly six percent, for both women *and* men[3]. In the New Zealand context, the women most likely to be adversely affected are the most vulnerable -- the lowly skilled, women trying to re-enter the workforce after raising families, school leavers, Maori women and women in depressed regions.

At the same time, the new relativities established by the application of comparable worth policies will give inappropriate signals to people training for and entering the labour market. To the extent that the initial low wages were a result of over-supply (for example because of barriers to entry in male-dominated occupations), the underlying problem will be aggravated.

More generally, the new rigidity that such policies would bring to wage relativities, in an economy already hamstrung by restrictive labour market regulation, could be expected to aggravate the unemployment effects of firms' attempts to adjust to greater international competition.

The Working Group has proposed combining comparable worth policy with equal employment opportunities policy -- effectively placing restrictions on both the price and quantity of female labour employed by firms. Despite the rhetoric of fairness (it is difficult to disagree with a concern for greater equity) and permissiveness (the employment equity proposals avoid the use of quotas; pay equity cases are raised by the women involved, not by some bureaucratic watchdog; the policies would be phased in over three years), the result would be a potentially severe restriction of options for women, and a reduction in employers' ability to adapt to a changing economic environment.

Rejection of a comparable worth solution to an undeniably important problem -- limited earnings opportunities for significant numbers of women -- calls for the formulation of more effective alternatives.

There are no easy answers to the problems faced by women in the workforce, and in particular women on the edge of the workforce, struggling to gain or retain employment. Education may change attitudes and reduce stereotyping, public sector reforms may result in more promotions on merit rather than on seniority, changes in town planning laws may make it easier to establish workplace creches, "old girl" networks may evolve. However, such developments will have little effect on women's employment options if barriers persist within the labour market itself.

A first priority must therefore be to reduce barriers to entry in the labour market, where these are institutionalised in training programmes, professional cartels, and restrictive practices on the part of unions. Professionals dependent for their survival on the quality of service they provided, rather than on statutory monopoly power, unions obliged to compete to serve the interests of workers, and employers encouraged to deal directly with their employees rather than delegating this responsibility to centralised bargaining, could all be expected to be more open to the contribution which can be made by women.

Attitudes and practices take time to change, and changes in the way in which employment relationships are approached are particularly time-consuming. Despite the impatience understandably felt by many involved, the long-run trend has been towards a convergence of men's and women's earnings. There is always a temptation to "hasten history" by placing "socially desirable", if coercive, restrictions on outcomes. The danger of such an approach is that it will divert attention from the causes underlying these outcomes, and in so doing perpetuate them. In the process, those whom the restrictions were intended to help are often the first to suffer.

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1 Working Group on Equal Opportunities and Equal Pay (1988), *Towards Employment Equity*, Wellington, Government Printer.

2 Smith, R.S. (1988), "Comparable Worth : Limited Coverage and the Exacerbation of Inequality", *Industrial and Labour Relations Review*, 41, pp 227-239.

3 Bonnell, S, (1987), "The Effect of Equal Pay for Females on the Composition of Employment in Australia", *Economic Record*, pp 340-351.

WELLINGTON REGIONAL EMPLOYERS' ASSOCIATION (INC)

MAKING INDIVIDUALS COUNT

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NEW ZEALAND BUSINESS ROUNDTABLE

JAMES COOK HOTEL
WELLINGTON
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MAKING INDIVIDUALS COUNT

When he invited me to address you this afternoon, John McCarthy suggested that in view of the emphasis that seems to be given to political parties, industries, trade unions and all the other power groups in our society, it might be timely to refer to the role and value of the individual man or woman in industry.

I agree wholeheartedly with that proposition, and propose to reflect on some of its implications for today's enterprises and those who work in them.

The valedictory economic report of President Reagan to the United States Congress earlier this year opened with some remarks that are relevant to this topic. Surveying the extraordinary changes that have occurred in the world since the end of World War II, it pointed out that the prime historical reality of this period has been the rivalry between two competing political and economic systems.

One system, it noted, operates by concentrating power in the hands of the few, by limiting personal freedoms, and by centralising economic decisions. At its best, it is a system of state paternalism; at its worst, one of tyranny.

The other system believes that power emanates from the individual, not from the state; that the function of government is to serve individuals, not to dictate to them. It recognises that political and economic freedom are indivisible, and that policies that threaten one of these freedoms inevitably undermine the other.

At the end of World War II, the outcome of the contest between these two competing visions was, to some, far from certain. Many intellectuals, looking back on the depression years, felt that the future was with socialism or fully-fledged communism. They felt that capitalism, with its emphasis on the individual and decentralised decision-making, could not cope with the complexity of a modern economy. In the years that followed, many countries, by choice or by force, took the route of central economic planning, regulation, state enterprise and inward-looking development in preference to the alleged chaos of the marketplace.

> "Today," the report went on, "Few doubt which of these systems will emerge triumphant. Comparisons of economies with common cultures and people, such as North and South Korea, East and West Germany, or the People's Republic of China and Hong Kong or Taiwan, uniformly show that systems that emphasized individual initiative, open markets and personal freedoms - as opposed to collective action - have prospered most."

The evidence has shown that today's more and more complex society necessitates less, not more, centralised control. A central authority is less and less able to acquire dispersed information, reflect individual preferences and motivate the initiative and enterprise on which economic and social success ultimately depends.

New Zealand learned some of these lessons very slowly, and prominent voices are still heard in support of the collectivist vision. Bill Andersen declared earlier this year that, for him, the model society was East Germany. The Socialist Unity Party *Tribune* has recently run a series of columns praising that country's alleged virtues. A recent article in *The Economist* entitled "Where Marx still drives a Trabant" gave a somewhat more factual account of East Germany. It pointed out that:

> "It now takes seven East German marks to buy one West German mark on the black market; three years ago it took five. And it takes 13 years of waiting to buy a nasty little Trabant; the waiting list for real cars is even longer. Party officials boast that

> prices of basic foods and rent have not changed for 30 years. But the 20 percent or so of national income that goes on these subsidies gets harder to afford."

Ken Douglas, also writing in a recent edition of the *Tribune* on the government's proposed compact with the trade union movement, presented a similar collectivist vision:

> "The struggle for the compact is in fact a question of a campaign for the re-regulation of the economy," he said. "The struggle for all workers is to have the state perform the function of reflecting workers' and people's needs."

Compare that with Mikhail Gorbachev's view:

> "The market is not omnipotent. But mankind has not been able to devise a different, more effective and democratic mechanism of economic management. The economy... [should] be based on low-regulation rather than administrative injunctions and orders."

Mr Douglas was also recently quoted as being affronted by the poverty and squalor that he encountered in Hongkong in the 1960s. The transformation of what has been one of the world's most successful free market economies in the past 25 years seems to have passed him by. As *The Economist* again pointed out recently, Hongkong people's annual per capita incomes are now around US$9,500:

> "...which, at least statistically, makes them as rich as New Zealanders and a little richer than Irishmen... [They] are well fed, well clothed, reasonably educated and adequately housed. The rich are very rich; and not many of the poor are very poor. Somehow, Hongkong people are creating a middle class society."

By comparison with the mass poverty that still exists in China, Hongkong has made enormous progress. The tragedy for Hongkong is that it may yet be dragged down by the incompetence, the bureaucracy and the corruption of China's economic system.

The worldwide pressures for greater democracy and individual freedom were graphically demonstrated by the recent events in Beijing. One of the profound and revealing ironies of those events was the students' denunciation of their oppressors as 'fascists'. It brought home what has long been recognised, namely that there is little to choose between collectivism of the left and the right, and that the real division is between collectivists and those who elevate individual freedom and choice above any social system or political creed. The New Zealand counterpart to this linguistic confusion is the invention of words like 'New Right' by the anti-liberalisation forces in an attempt to counter the attack on their regulatory privileges and power.

The lesson that only a decentralised market economy can deliver rising prosperity is now widely understood and accepted. But what is still poorly understood, in New Zealand at least, is that an open and competitive economy is also far more egalitarian than its alternatives.

Yet this lesson is also clear from the economic experience of the last 30 years. A recent study by the International Centre for Economic Growth entitled "*Asian Development : Economic Success and Policy Lessons*" summarises a large body of evidence on this matter. It noted that the successful Asian countries have given priority to economic growth over social welfare spending. But flexible job markets and outward-looking policies encouraged the use of the abundant factor of production : labour. Increased demand for labour and emphasis on human resource development helped to spread the benefits of growth widely. The study found that:

> "As a result, the Newly Industrialising Countries are among the most egalitarian countries in the world, far more so than Latin American and South Asian countries that have stressed redistributive policies... Countries wth the highest economic

growth rates since 1960 have also had the greatest improvement in general living standards, poverty amelioration and income distribution. In Korea and Taiwan the incomes of the poorest 40 percent grew as fast or faster than GDP... and urban-rural income differences were reduced in both countries."

There can be no argument with the proposition that an important role for the government is to provide security and promote fairness. Policies to achieve these objectives include the provision of efficient social services and community help to those genuinely in need. But the evidence is clear-cut that the most powerful forces for egalitarianism arise in competitive systems and that where government allocation and privilege prevail, whether in the bureaucracy in China or the nomenklatura in Russia, the result is not just inefficiency but also gross inequality in income, status and power.

Nowhere has the inefficiency and unfairness of centralised arrangements and the power associated with them been more apparent than in employment relationships in New Zealand. However, far from having absorbed the lessons from the dynamic Asian economies, we are still stuck with a system based on ideas of another era, and are confronted by proposals which would take us even further away from what is needed. The proposals for pay equity, for example, involve a pre-Gorbachev concept of pay determination by a Pay Equity Bureau and a return to arbitration by the Labour Court. The concept of 'industrial democracy' being promoted in some quarters would involve a return to national economic planning and to the type of confused accountability for the management of enterprises which has crippled the Yugoslavian economy.

More generally, our whole structure of employment relationships is based on a series of premises which history has shown to be false or outmoded. The idea that the economic process is a struggle between capital and labour and that workers are unequal in bargaining with employers is one of the most pervasive of these myths. Another that is relevant in the present context is the Marxist slogan that 'labour is not a commodity'.

There is a profound paradox in the way this notion has influenced labour market thinking in New Zealand.

On the one hand, as a excellent study on labour market deregulation by the Fisher Institute has pointed out, the proposition is nonsensical:

> "Labour will always be a commodity, something of value. An employee will always be a seller of labour, and an employer will always be a buyer of labour, and wages (or compensation generally) will always be the price of the commodity. This cannot be changed; at most it might be distorted."

The authors go on to say that the reasons why otherwise perceptive people should fall prey to this blind spot are a mystery. They suggest that:

> "...the so-called 'humanitarian' arguments have been based upon the misconception that treating labor as a commodity somehow implies a pernicious form of slavery. But no economist has ever suggested that buying and selling *labor services* is in any way comparable, conceptually or functionally, to buying or selling people."

Selling labour services, they point out, whether for reward in the form of professional fees or salaries or wages, is a perfectly normal market transaction and is in no way dehumanising. Indeed, they add:

> "...if there is dehumanization in labor exchanges these days, it may be found primarily in regulations that prevent laborers from controlling who purchases their services and that prevent them from determining for themselves what will be the terms and conditions of the exchange."

Yet herein lies the paradox in relation to labour law in New Zealand. Despite the ideological denial that "labour is not a commodity", we have proceeded for decades to treat workers as if they were commodities of the most undifferentiated and depersonalised kind. Blanket national awards have, as it were, offered workers for sale to employers at a standard price up and down the country regardless of all the diverse characteristics and preferences of the individuals involved and their particular employment relationships. There is little scope to tailor packages to meet the needs of different workers for different working hours, different forms of training and different mixes of rewards. Monopoly unions have in effect cartelised large sections of the labour market, fixed prices and erected all kinds of barriers to competition. Unlike other monopoly positions which sooner or later dissolve in the absence of statutory backing, our labour law has supported these monopoly structures. The inevitable result, of course, has been the extraordinary gains made by some privileged groups of workers, the concentration of others into low-paying occupations and the reduced job opportunities which have helped create the present rate of unemployment.

The same point was made more plainly by a correspondent to the *Evening Post* last year. She wrote:

> "[Labour] is a commodity, the same as others to be bargained for and competed over, the best of what's available reaching the best price. Others not so in demand would receive less.

But unlike a fixed commodity, we can change and improve our usefulness to an employer and easily become one of those reaching the best price.

If we didn't try and squeeze guarantees out of employers - e.g. minimum wages, redundancy etc. - through the might of the strong-arm unions, then today there would be only a handful of New Zealanders unemployed and employers would be desperate for good staff."

Since New Zealand has been opened up to worldwide competition, there is no longer any place for cartels, industry plans, and deals among players on the so-called commanding heights of the economy. That world is gone for ever. The business unit that is relevant in today's world is the enterprise. And enterprise competition is about doing things in distinctive ways. Managers are having to open their minds to the possibilities of how design, service, production, sales and distribution can be done in innovative ways that others can't quickly copy.

Fred Hilmer, Dean of the Australian Graduate School of Management in Sydney, has made the point that:

> "In this environment, the term 'industry', which implies a collection of like firms meeting similar needs, loses meaning. So 'industry plans' make less and less sense. Enterprise competitiveness is what matters."

> "Similarly," Hilmer adds, "to be distinctive and competitive, managers will soon realise that they need enterprise-specific jobs, supported by enterprise-specific training. While the outside world - colleges or universities - can provide core skills, leading enterprises also need to develop and train their people in enterprise-specific skills. For example, pilots need to know how to fly the aircraft and the routes of their enterprise's airline, not just any old plane. Banking staff need to be able to work with the unique systems and service packages that each bank offers; the ANZ teller of the future with Transaction banking will be quite different from the Westpac teller with CS90."

Hilmer's examples illustrate why the current union push for an airline industry agreement and the proposals for levies aimed at forcing employers to undertake some standardised level of skill training make no sense at all.

There are signs that some policy-makers are finally coming to understand what is wrong with New Zealand's employment relations system. Mike Moore has been attracted to the ideas of Professor Martin Weitzman in his book *The Share Economy* and proposes to bring him to New Zealand as part of the compact discussions. As one commentator on Weitzman's analysis has observed:

> "...the claims that can be made for the share economy require renewed belief in some very old ideas about the way labor markets work - and wholesale repudiation of some respectable myths that are a legacy of the Keynesian era... In the share economy, wage rates will be unusually responsive to both short- and long-term fluctuations in supply and demand. The same mechanisms that determine the prices of stocks, bonds, houses and used cars will determine the wage rates of labor, and union attempts to impede this process will be undermined."

Regrettably, however, there are still too few signs in government ranks of a willingness to take a thoughtful interest of this kind in the workings of labour markets. The air is still thick with empty rhetoric and attacks on straw men such as non-existent proposals for 'total labour market deregulation'. Thinking New Zealanders are well aware that labour market reform is about more productive working arrangements and a high wage economy, not the low wage one we have been used to, and about laws which will promote democratic and responsive unions, not about attempts to do away with them.

In defending its record on labour market reform, the government appears to be behaving like the proverbial emperor when all the rest of the world can see it has no clothes. National Bank economists have pointed out that:

> "The Cabinet has only one option if it wishes to make quick inroads into the unemployment problem. It should deregulate the labour market without delay."

Ministers were given the same message at the Vogel House meeting on unemployment. The OECD said bluntly in its recent survey of New Zealand : "Given the recent steep rise in unemployment, further reform of labour-market practices is needed." The Auckland Regional Chamber of Commerce recently stated that complex labour laws are making it increasingly difficult for small companies to survive and called for voluntary unionism to help provide more jobs. *The Herald* has called for "wholesale removal of the union bargaining monopolies which prevent employers from reaching agreements with their particular staff". Groups of workers up and down the country have been frustrated by their unions' refusal to act in their interests. Public opinion polls have shown overwhelming support for the kind of labour market reforms - voluntary unionism, worker choice of union representation, and freedom to negotiate at an enterprise level - advocated by employers.

What the OECD, business organisations in New Zealand and others are calling for are the key features of the labour market arrangements that are the norm in virtually all OECD countries other than Australia and New Zealand - and in particular for what are widely regarded in the OECD as the most successful models for employment relationships in countries such as Japan, Switzerland and the United States. Is it too much to ask the government to drop its rhetoric about the excesses of labour market deregulation for a moment and to explain in simple, comprehensible terms what its objections are to the type of employment laws which help make these countries high productivity, high wage and high employment economies?

No one in New Zealand, to my knowledge at least, is calling for "total labour market deregulation", whatever that means. There is an important role for a sound body of employment law to protect both parties to the employment relationship. The government has improved some features of that law, for example by tightening up provisions governing breaches of contract. But there is also an important role to be played by a freer and more flexible labour market in providing employment protection. The individual workers or job seekers that we should be concerned about would be protected in a very real way if there were fewer barriers to employment and mobility, wider choices over terms and conditions of employment and more options for creating the potential jobs that should abound in businesses across the economy.

Similarly in many employment relationships there is a role for unions that are formed and joined on a voluntary basis. Collective bargaining will often be preferred over individual contracting, even at enterprise level. Unions can act as negotiating agents, help protect individual workers' rights and provide other services to members. The problem in the New Zealand context is the outmoded and unsatisfactory forms of regulation governing union membership and structures, and the monopolies that result from them. Unionisation has been in long term decline around the world as the nature of industry and work patterns have changed. But there is ample evidence from countries like Switzerland, where the unionised section of the workforce has remained around 30 percent for a long period, that voluntary, democratic unions can survive and prosper in a deregulated environment. The key point is that individual workers should be able to enter into the type of employment relationship that they prefer, and if they choose to become union members it is their needs and views that should democratically prevail.

An article last week in *The Economist* made the familiar point that New Zealand's mistake was not to tackle the labour market first in liberalising the economy, and added that reforming the wrong way round is one reason why the economy is still struggling. This point can be overstated. It is a bit like arguing about whether a baby elephant should get up on its front legs or its hind legs. The real point is that if the elephant is still using only three legs some five years later, it is not likely to be walking very well.

At the present time - and despite the somewhat desperate proposals for mega-unions, sectoral bargaining and a centralised compact - the constituency for reforming employment relationships on voluntary, decentralised lines has never been stronger. In its submission to the inquiry on industrial democracy, the Business Roundtable suggested that if there were any doubts at all on this score, a referendum could be undertaken to find out. Colin Clark of the PSA responded with the absurd claim that this would be "anti-democratic", and gave the game away by arguing that unions know best : "as unions, we have the obligation to protect our members".

I believe history is telling us that the days of the big battalions are numbered. New Zealanders are not a lumpenproletariat. People are demanding to count as individuals, to be free from domination and to be able to express their entrepreneurial creativity. Employers must respond to those needs, and competitive markets are making us do so. As someone recently put it:

> "The class struggle is over. The politics of the next century will be about the individual, and her place in the community."

If we could get the power groups mentioned by John McCarthy out of our lives, if we could reduce the regulations and tax burdens that go with them, and if we could focus our attention on the needs of individuals, their families, their work places and their communities, then I believe New Zealand really would have a chance of walking on four legs.

LABOUR RELATIONS : THE STATE OF THE DEBATE

INSTITUTE FOR INTERNATIONAL RESEARCH CONFERENCE

ON

MANAGING CHANGE IN INDUSTRIAL RELATIONS

Lindsay Fergusson
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Sheraton Hotel
Auckland
17 August 1989

LABOUR RELATIONS : THE STATE OF THE DEBATE

In thinking about my remarks today, I was reminded of the story about a surgeon, an architect and a politician arguing about whose profession is the oldest.

> "Eve was carved from Adam's rib, and that surely was a surgical operation," began the surgeon.
>
> "True enough," said the architect, "but before that, order was created out of chaos - and that is a task for an architect."
>
> "Just a minute," interrupted the politician. "First someone had to create chaos!"

Certainly the politicians have worked hard on our industrial relations system over the past 100 years, and its chaotic state bears witness to their efforts. Despite persistent tinkering, we have retained to this day the essentials of an arbitration and conciliation system based on a conflict model of the employment relationship. The politicians of 1894 gave us the system of registered unions, blanket coverage awards and conciliation procedures initiated by the creation of a "dispute" of interest. Their successors in the 1930s added compulsory unionism. Only Australia and the ill-fated Weimar Republic in Germany went down the same track. None of the world's successful economies has structured its system of employment relationships in the way New Zealand has done.

Of course it was not only in the field of labour relations that, for decades, New Zealand pursued a set of policies that were well outside the economic mainstream. Over time, these did untold damage to the capacity of the economy to create wealth and jobs. You may remember the early 1980s comparison that seemed to sum up our predicament:

> "In America they have Ronnie Reagan, Johnny Cash, Bob Hope and Stevie Wonder. In New Zealand we have Rob Muldoon, no cash, no hope and no wonder!"

In the 1980s - and the trends go back further than the term of office of the present government - our politicians have been trying to make a break with the past and abandon stop-go policies, fortress New Zealand, and borrow and hope approaches to economic management. In some areas the progress made has been remarkable. In the labour relations field, by comparison, changes have been far more limited and piecemeal. The National government's introduction of voluntary unionism was not part of a coherent framework for labour market reform and was accompanied by a total freeze on wages. The present government restored compulsory unionism and its limited efforts in the Labour Relations Act and elsewhere to change the system have been regarded by a multitude of observers as inconsistent with its general reform programme.

The Business Roundtable has been among those who have tried to take the role of architect and consider how order might be created out of our industrial relations chaos. At the outset of the debate, the task seemed utopian. The idea of moving away from a conciliation system mired in union monopoly rights to a system based essentially on freedom to contract seemed too radical a step to contemplate. Now I believe there is an overwhelming constituency for further change in this direction.

It is perhaps a sign of the times that this is the third of four major conferences on labour relations being held within a two-month period. From the beginning of this year, to go back no further, there has been a succession of events signalling to politicians both the case and the extent of support for change:

- an Insight NZ public opinion survey released in January revealed 77 percent of respondents favoured voluntary unionism, 74 percent considered workers should be able to join any union they wished, 69 percent wanted direct negotiations between workers and employers or unions and employers rather than national awards, and 89 percent thought unions should not be affiliated to a political party;

- the message to the February Cabinet meeting on unemployment was that the problem was not macroeconomic policy but wage growth in excess of productivity and labour market rigidities;

- the OECD report on New Zealand reiterated that "Given the steep rise in unemployment, further reform of labour-market practices is needed." Like New Zealand employer organisations, the OECD has recommended the introduction of voluntary, contestable unionism and moves away from blanket coverage award bargaining;

- Roger Douglas has given a clear and courageous analysis of the need for reforms. The National Opposition have highlighted labour market policy, along with unconstrained government spending, as the government's two key policy failures;

- The Reserve Bank, *The Economist*, editorial writers, independent economists and many others have added their voices to the calls for reform.

In the face of this body of opinion, what opposing arguments are being put forward? At the government level, Ministers appear to be saying esssentially three things.

First, that the moves made to open up the economy and not accomodate unjustified wage and price increases are changing bargaining behaviour.

Second, that the government's policy of standing aside from industrial disputes is encouraging more direct and responsible relationships between the parties directly affected.

Third, that the changes made to the Labour Relations Act and the State Sector Act have altered the wage fixing climate for the better.

Nobody on the employer side at least would, I believe, dispute any of these propositions. The first two factors in particular have brought about significant changes in attitudes and practices. The contribution of changes to labour law has been much more modest. But the contention of the advocates of greater change is not that nothing has happened. It is merely that not enough has been done, and done fast enough, to help New Zealand firms and workers cope with adjustment and global competition and to avoid the unnecessary unemployment costs associated with restructuring.

Some other points made by Ministers are worth examining in detail.

A favourite tack is to point to the agreements reached at Firestone, Fortex, Nissan and Kinleith over the last year or so as evidence that constructive outcomes are possible within the framework of the Labour Relations Act. A closer look at each of these cases reveals how weak this argument really is.

First, each of these agreements would have been possible under the previous legislation. There was already a composite agreement at Kinleith prior to the Labour Relations Act. The Fortex agreement is an unregistered and unenforceable document - hardly a model employment contract - which would also have been possible under the previous legislation.

Secondly, each of these agreements is enterprise-based. The lesson here is that by and large real progress towards arrangements that improve productivity and safeguard jobs is only possible outside the award system.

Thirdly, each of the industries in question is in survival mode. Despite this, the Nissan agreement was only a partial one and was achieved only in the face of fierce resistance by some unions. It is a poor commentary on our labour relations system that the examples of change being held up as models by the government are businesses whose continuing existence would otherwise be in question. And in the case of the meat industry, the example of Fortex misses the basic point that, in the last award round, the major meat companies failed once again to gain union acceptance of the plant agreements (like that at Fortex) that are necessary if the industry is to have a viable future.

The meat industry example also underlines the irony of Ministers' claims that there is more acceptance of the need for change on the union side than there is amongst employers. I am unsure whether these claims are disingenuous or just simply naive, but it is time they were exposed.

For a start, there have been continuous efforts by the Council of Trade Unions to turn the clock back and reinstate compulsory arbitration. Similar objectives are being pursued in the context of pay equity and industrial democracy. The overwhelming priority of the central union movement in the last two wage rounds was expressed in its rhetorical objective of "defending national awards". The obstacles that have been thrown up to the government's intentions under the Labour Relations Act of facilitating alternatives such as enterprise agreements have been virtually impenetrable.

To illustrate this point, I invite you to study the criteria for agreeing to exemptions from awards established by the Engineers' Union which I have appended to the written version of my address. The procedure is like a fortified Maori pa; if one of the outer walls is breached a series of further lines of defence is encountered. The overriding emphasis is on the interests and decision-making power of the union, not the interests of the workers in the plant or company that might be exempted from the award.

Small wonder that there have been few cases of citing out from the Metal Trades Award in either of the award rounds that have occurred under the Labour Relations Act. Nor has there been any tangible progress with the much-heralded 1987 initiative to restructure the metal trades document. And yet the Engineers' Union is regarded , not entirely without justification, as one of the more "progressive" unions.

Another familiar government response, which can only be regarded as a cop-out, is that the need is for change in attitudes rather than legislative change. I do not recall hearing Ministers arguing that the problem of protected manufacturers or loss-making state-owned enterprises was attitudes rather than the incentives and constraints which they faced. Experience around the world demonstrates that labour market behaviour is profoundly influenced by the legislative environment. I leave it to you to try to make sense of this schizophrenia.

A more specific argument made by some Ministers is that voluntary unionism is of little importance as an element of labour market reform. The claim is that its effect would be felt mainly in industries like retailing - with the implicit suggestion that it would result in a fall in unionisation which would reduce necessary worker protections - and that it would make little contribution to resolving the "hard core" industrial relations problems of industries like meat processing, construction and pulp and paper.

In part, this argument is a straw man. No one claims that voluntary unionism is a panacea. However, it is part of a coherent programme of reforms aimed at establishing a free and decentralised system of contracting. It is absurd to argue that such an environment oppresses non-unionised workers. Fewer than 10 percent of retail industry workers in the United States are now unionised. Any suggestion to an American that millions of retail employees work in conditions of oppression would be greeted with disbelief. Among their most important protections are the flexible work options open to them and the high employment demand which results from the job-creating capacity of the United States labour market. It is interesting to note that a recent NZ Herald-NRB poll showed that employees in the New Zealand retail industry were more strongly in favour of voluntary unionism than most other occupational groups.

Part of the argument for voluntary unionism is that it facilitates more flexible and individualised forms of contracting which suit workers whose needs vary from the norm. Another part is that it is a stimulus to better union performance, since union representatives are forced to become more responsive to their members' needs. Beyond that, all OECD countries other than New Zealand and Australia have regarded freedom of association as a basic individual right. While the solution to some labour relations problems lies in other elements of reform, there is no doubt that the adoption of the kind of voluntary union membership arrangements that are the norm in other OECD countries would be beneficial in New Zealand. I have little doubt that Ministers who regard themselves as in the social democratic camp in contemporary international politics would privately acknowledge these arguments, but it is a pity that they are not prepared publicly to promote the abandonment of this aspect of New Zealand's insularity.

Similarly, it is a pity that we have not yet seen in New Zealand a new generation of trade unionists who are positively arguing the case for the adoption of the kind of reforms that trade unionists in successful OECD countries actively support. Indeed, the trade union movement has in some ways become more inward-looking since the time when Sir Tom Skinner was arguing for a labour contracting system along United States lines and a voluntary unionism regime.

In large part I believe this is due to the fact that trade unionists have not yet had to face the competitive stimulus to better performance that the government has imposed on most other groups in the community. It is interesting to note that of the 40 chief executives currently on the Business Roundtable, only 9 were members at the time of our original submission on the Green Paper on labour relations three years ago. By contrast with this transformation in business sector leadership, there have been few changes among the leading figures in the trade union movement. I believe this helps explain why national trade union officials are still grasping for anachronistic government-union compacts and for changes in union and bargaining structures which would take New Zealand even further away from where we need to go.

Followers of the labour relations debate will have noticed a fascinating commentary on this point in a recent National Business Review article by Chris Trotter (who could hardly be called a member of the so-called 'New Right'). Noting that the CTU's *Strategies for Change* document purported to set out a realistic alternative strategy for the union movement in the 1990s and beyond, Mr Trotter wrote that:

> "...it might more accurately be described as the clearest expression of the fundamental imperatives of the trade unionism of the past. As such, it should cause trade unionists to shudder : it has the smell of institutional death about it."

The article went on to point out that trade union structures have few points of genuine contact with the lives of union members. It observed that paid officials' prime loyalty is to the institution rather than the membership. It argued, correctly in my view, that the government has made this situation worse, noting, for example, that:

> "The Labour Relations Act, by deregistering unions with fewer than one thousand members, has entrenched the bureaucratic character of New Zealand trade unionism."

Mr Trotter seemed to see merit in some aspects of the National Party's approach to labour relations, and the article at least showed a refreshing willingness to explore the issues in an open-minded way. Clearly if we are to make progress, we must get beyond the mindless shibboleths still being recycled by the opponents of labour market reform. For example:

- the labelling of advocates of change as supporters of "total labour market deregulation", whatever that means. The real issue is about establishing the right rules for employment relationships. As the Business Roundtable said in its Green Paper submission, there is indeed a case for removing many of the current obstacles to mutually beneficial arrangements, but there is also a need for stable and enforceable labour contracts to reduce the propensity for chaos and laissez-faire - "or, for those who need a label, to *re-regulate*." We have, for example, argued that normal antitrust law should apply to the labour market.

- A second shibboleth is the proposition that labour market flexibility is a codeword for lower wages. From the outset we have argued that New Zealand has become a low wage country by following a set of misguided economic policies, including its labour market policies. Labour market flexibility is essentially about freedom to contract, to adopt the kind of productive employment relationships that characterise the high wage, high productivity, high employment economies. Wage rates are not, by themselves, the issue for employers; it is the cost of labour that matters and that includes wage rates and productivity. High productivity leads to high wage rates while low productivity leads to low wage rates, as in New Zealand.

- A third shibboleth which it has suited some to maintain for their own purposes is that such a programme is anti-union. We have consistently maintained that in many employment relationships there is a role for unions that are formed and joined on a voluntary basis. Collective bargaining will often be preferred over individual contracting, even at an enterprise level. As our original study put it:

  > "To some advocates of complete deregulation of labour markets, there would seem to be a case for a shift towards totally individualised contracts, based on the characteristics of each and every member of the workforce and the needs of the enterprise. However, it does not follow that individualised contracts are generally the most efficient form of contract given economies of scale in the negotiation, monitoring and enforcement of agreements and the similarity of many workers' demands and characteristics."

  While individual employment contracts will undoubtedly grow in number as the nature of work and lifestyle preferences change, for the foreseeable future unions have an important role to play as negotiating agents, to help protect individual workers' rights and to provide other services to members.

The widespread public and political support for further labour market reform indicates that the public are not taken in by these deliberate misrepresentations. Nor, I believe, are they impressed by the performance of those who play the man rather than the ball. It used to be said that every time a trade unionist appeared on television in the United Kingdom haranguing and threatening, he - for it was almost always a man - advanced the cause of trade union reform. Attacks by people like Pat Kelly and Ros Noonan on the Governor of the Reserve Bank, or Roger Douglas, or Ruth Richardson or employer organisations - as opposed to serious examination of the issues being raised - merely discredit their own position.

This conference provides another opportunity for an objective and dispassionate debate about the future direction of labour relations in New Zealand. I hope alternative options will be put forward and elaborated; all too often participants in the debate do not specify in any detail a coherent alternative or explain how it fits within a consistent overall economic programme. All the implications of a model like the compact, for example, should be laid out for public scrutiny.

For its part, the Business Roundtable recently provided a positive restatement of its thinking in a paper which is available at the conference for anyone who is interested to read it. We do not claim to have definitive answers to all the relevant questions; as the paper indicates, the exact shape of the best labour statute for New Zealand is a matter on which the advice of the world's best legal and economic minds should be sought. Part of our ongoing work programme this year involves obtaining advice from precisely such sources.

Nor have we ever contended that labour market reform is an "all or nothing" option, though we do regard it as legitimate to argue for arrangements which would offer the greatest benefits to New Zealanders. There would be widespread agreement among employers that a top priority for reform would be to grant firms the same rights as unions currently enjoy to take the initiative to be cited out of awards. A simple, democratic ballot among the workers directly concerned should decide the issue.

Allowing a degree of equality between union and employer in the determination of appropriate bargaining structures is not the all-out assault on current award structures that some union officials would have us believe. Nor would it result in the mass abandonment of awards and industry agreements, for the simple reason that some employers will continue to find these bargaining structures satisfactory.

This is because some employers in New Zealand feel well served by an award or agreement structure that does not involve them directly in negotiating with their employees. But this is no reason to deny the majority of employers the right to seek a direct bargaining relationship with their employees or unions representing those employees, in order to achieve employment conditions appropriate to their business and the competitive challenges they face.

My own company has a number of subsidiaries each facing its own competitive challenges. Each will assess its own requirements for bargaining structures and will arrive at an answer that reflects its own circumstances.

Our Dominion Breweries subsidiary is clearly an example of a situation where a strong desire on the part of the company and a very significant number of its employees to enter into a more appropriate, meaningful bargaining arrangement has been frustrated by opposition from union officials committed to a centralised approach to bargaining. A union policy which has been determined at a distance from, and with little or no involvement by, DB employees is nevertheless imposed on them.

While DB is unequivocal in its belief that enterprise bargaining is the appropriate bargaining structure given the two-player, highly competitive nature of the brewing industry, other Magnum subsidiary companies may well feel that, at this point in time, awards or industry agreements meet their needs.

Our experience is not unique. While there would be a large number of companies that would opt for enterprise bargaining if given the choice, there are also those that would opt for award or industry agreement coverage.

Clearly there can be no sensible reason for union opposition to an employer seeking direct negotiations with employees and their union representatives. Such a negotiation must produce a more meaningful result than a negotiation conducted far from the workplace by employers, delegates and union officials who have no knowledge of, nor real concern for, the circumstances of individual employers and their workforces.

How these issues are resolved will determine whether New Zealand completes the transition away from its insular past and becomes a dynamic Pacific Rim economy, or whether the outlook remains the present mediocre one. The forthcoming award round will be another indication of how much progress is being made. If, as the government maintains, inflation and inflationary expectations have been beaten, then any claims for wage adjustments should be at minimal levels on average since no one can argue for generalised pay increases at present levels of unemployment. There needs to be more differentiation in settlements to reflect the adjustments occurring in different industries. The only important criterion for employers should be whether they need to pay more to recruit or retain workers with the skills they require. We need more citing out, and more productivity bargaining aimed at reducing labour costs so as to improve competitiveness and reduce unemployment. The fact that the national award system can be used by employers to deliver low wage increases is no reason for them to stop pushing for more productive arrangements.

The increase in GST is not a factor that can enter into negotiations since employers' ability to increase wages or recover costs will be unaffected by the change. It should be seen as part of the contribution to the "social wage" which the union movement has supported. If workers are unhappy about the implications of reduced after-tax incomes or spending power, they should add their voices to those advocating lower government spending.

If the award round proceeds on these lines, there is the potential for further falls in inflation and interest rates and a strengthening of the present weak recovery. If it does not, there is every likelihood that the economy will stay in recession. Even in the most favourable scenario, it is plain that unemployment will remain stuck at high levels with our present labour market regulations. And until they are reformed, there will always be macroeconomic uncertainty in New Zealand.

Change *is* occurring in New Zealand labour relations, but at a snail's pace compared with what is needed. Those who are content with this rate of progress are still playing Macbeth:

> "Tomorrow, and tomorrow, and tomorrow,
> Creeps in this petty pace from day to day."

Unless this petty pace is stepped up, New Zealand will become a second class citizen among Pacific Rim nations. If this conference can make a modest contribution to accelerating the necessary changes, it will have served a useful purpose.

COMMERCIAL LAW

MAKING THE LAW MEAN BUSINESS

NEW ZEALAND COMPANY SECRETARIES' CONFERENCE

DOUGLAS MYERS
VICE-CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

AUCKLAND
14 MARCH 1989

WELLINGTON REGIONAL EMPLOYERS' ASSOCIATION (INC)

MAKING INDIVIDUALS COUNT

SIR RONALD TROTTER
CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

JAMES COOK HOTEL
WELLINGTON
6 JULY 1989

MAKING INDIVIDUALS COUNT

When he invited me to address you this afternoon, John McCarthy suggested that in view of the emphasis that seems to be given to political parties, industries, trade unions and all the other power groups in our society, it might be timely to refer to the role and value of the individual man or woman in industry.

I agree wholeheartedly with that proposition, and propose to reflect on some of its implications for today's enterprises and those who work in them.

The valedictory economic report of President Reagan to the United States Congress earlier this year opened with some remarks that are relevant to this topic. Surveying the extraordinary changes that have occurred in the world since the end of World War II, it pointed out that the prime historical reality of this period has been the rivalry between two competing political and economic systems.

One system, it noted, operates by concentrating power in the hands of the few, by limiting personal freedoms, and by centralising economic decisions. At its best, it is a system of state paternalism; at its worst, one of tyranny.

The other system believes that power emanates from the individual, not from the state; that the function of government is to serve individuals, not to dictate to them. It recognises that political and economic freedom are indivisible, and that policies that threaten one of these freedoms inevitably undermine the other.

At the end of World War II, the outcome of the contest between these two competing visions was, to some, far from certain. Many intellectuals, looking back on the depression years, felt that the future was with socialism or fully-fledged communism. They felt that capitalism, with its emphasis on the individual and decentralised decision-making, could not cope with the complexity of a modern economy. In the years that followed, many countries, by choice or by force, took the route of central economic planning, regulation, state enterprise and inward-looking development in preference to the alleged chaos of the marketplace.

> "Today," the report went on, "Few doubt which of these systems will emerge triumphant. Comparisons of economies with common cultures and people, such as North and South Korea, East and West Germany, or the People's Republic of China and Hong Kong or Taiwan, uniformly show that systems that emphasized individual initiative, open markets and personal freedoms - as opposed to collective action - have prospered most."

The evidence has shown that today's more and more complex society necessitates less, not more, centralised control. A central authority is less and less able to acquire dispersed information, reflect individual preferences and motivate the initiative and enterprise on which economic and social success ultimately depends.

New Zealand learned some of these lessons very slowly, and prominent voices are still heard in support of the collectivist vision. Bill Andersen declared earlier this year that, for him, the model society was East Germany. The Socialist Unity Party *Tribune* has recently run a series of columns praising that country's alleged virtues. A recent article in *The Economist* entitled "Where Marx still drives a Trabant" gave a somewhat more factual account of East Germany. It pointed out that:

> "It now takes seven East German marks to buy one West German mark on the black market; three years ago it took five. And it takes 13 years of waiting to buy a nasty little Trabant; the waiting list for real cars is even longer. Party officials boast that

> prices of basic foods and rent have not changed for 30 years. But the 20 percent or so of national income that goes on these subsidies gets harder to afford."

Ken Douglas, also writing in a recent edition of the *Tribune* on the government's proposed compact with the trade union movement, presented a similar collectivist vision:

> "The struggle for the compact is in fact a question of a campaign for the re-regulation of the economy," he said. "The struggle for all workers is to have the state perform the function of reflecting workers' and people's needs."

Compare that with Mikhail Gorbachev's view:

> "The market is not omnipotent. But mankind has not been able to devise a different, more effective and democratic mechanism of economic management. The economy... [should] be based on low-regulation rather than administrative injunctions and orders."

Mr Douglas was also recently quoted as being affronted by the poverty and squalor that he encountered in Hongkong in the 1960s. The transformation of what has been one of the world's most successful free market economies in the past 25 years seems to have passed him by. As *The Economist* again pointed out recently, Hongkong people's annual per capita incomes are now around US$9,500:

> "...which, at least statistically, makes them as rich as New Zealanders and a little richer than Irishmen... [They] are well fed, well clothed, reasonably educated and adequately housed. The rich are very rich; and not many of the poor are very poor. Somehow, Hongkong people are creating a middle class society."

By comparison with the mass poverty that still exists in China, Hongkong has made enormous progress. The tragedy for Hongkong is that it may yet be dragged down by the incompetence, the bureaucracy and the corruption of China's economic system.

The worldwide pressures for greater democracy and individual freedom were graphically demonstrated by the recent events in Beijing. One of the profound and revealing ironies of those events was the students' denunciation of their oppressors as 'fascists'. It brought home what has long been recognised, namely that there is little to choose between collectivism of the left and the right, and that the real division is between collectivists and those who elevate individual freedom and choice above any social system or political creed. The New Zealand counterpart to this linguistic confusion is the invention of words like 'New Right' by the anti-liberalisation forces in an attempt to counter the attack on their regulatory privileges and power.

The lesson that only a decentralised market economy can deliver rising prosperity is now widely understood and accepted. But what is still poorly understood, in New Zealand at least, is that an open and competitive economy is also far more egalitarian than its alternatives.

Yet this lesson is also clear from the economic experience of the last 30 years. A recent study by the International Centre for Economic Growth entitled "*Asian Development : Economic Success and Policy Lessons*" summarises a large body of evidence on this matter. It noted that the successful Asian countries have given priority to economic growth over social welfare spending. But flexible job markets and outward-looking policies encouraged the use of the abundant factor of production : labour. Increased demand for labour and emphasis on human resource development helped to spread the benefits of growth widely. The study found that:

> "As a result, the Newly Industrialising Countries are among the most egalitarian countries in the world, far more so than Latin American and South Asian countries that have stressed redistributive policies... Countries wth the highest economic

> growth rates since 1960 have also had the greatest improvement in general living standards, poverty amelioration and income distribution. In Korea and Taiwan the incomes of the poorest 40 percent grew as fast or faster than GDP... and urban-rural income differences were reduced in both countries."

There can be no argument with the proposition that an important role for the government is to provide security and promote fairness. Policies to achieve these objectives include the provision of efficient social services and community help to those genuinely in need. But the evidence is clear-cut that the most powerful forces for egalitarianism arise in competitive systems and that where government allocation and privilege prevail, whether in the bureaucracy in China or the nomenklatura in Russia, the result is not just inefficiency but also gross inequality in income, status and power.

Nowhere has the inefficiency and unfairness of centralised arrangements and the power associated with them been more apparent than in employment relationships in New Zealand. However, far from having absorbed the lessons from the dynamic Asian economies, we are still stuck with a system based on ideas of another era, and are confronted by proposals which would take us even further away from what is needed. The proposals for pay equity, for example, involve a pre-Gorbachev concept of pay determination by a Pay Equity Bureau and a return to arbitration by the Labour Court. The concept of 'industrial democracy' being promoted in some quarters would involve a return to national economic planning and to the type of confused accountability for the management of enterprises which has crippled the Yugoslavian economy.

More generally, our whole structure of employment relationships is based on a series of premises which history has shown to be false or outmoded. The idea that the economic process is a struggle between capital and labour and that workers are unequal in bargaining with employers is one of the most pervasive of these myths. Another that is relevant in the present context is the Marxist slogan that 'labour is not a commodity'.

There is a profound paradox in the way this notion has influenced labour market thinking in New Zealand.

On the one hand, as a excellent study on labour market deregulation by the Fisher Institute has pointed out, the proposition is nonsensical:

> "Labour will always be a commodity, something of value. An employee will always be a seller of labour, and an employer will always be a buyer of labour, and wages (or compensation generally) will always be the price of the commodity. This cannot be changed; at most it might be distorted."

The authors go on to say that the reasons why otherwise perceptive people should fall prey to this blind spot are a mystery. They suggest that:

> "...the so-called 'humanitarian' arguments have been based upon the misconception that treating labor as a commodity somehow implies a pernicious form of slavery. But no economist has ever suggested that buying and selling *labor services* is in any way comparable, conceptually or functionally, to buying or selling people."

Selling labour services, they point out, whether for reward in the form of professional fees or salaries or wages, is a perfectly normal market transaction and is in no way dehumanising. Indeed, they add:

> "...if there is dehumanization in labor exchanges these days, it may be found primarily in regulations that prevent laborers from controlling who purchases their services and that prevent them from determining for themselves what will be the terms and conditions of the exchange."

Yet herein lies the paradox in relation to labour law in New Zealand. Despite the ideological denial that "labour is not a commodity", we have proceeded for decades to treat workers as if they were commodities of the most undifferentiated and depersonalised kind. Blanket national awards have, as it were, offered workers for sale to employers at a standard price up and down the country regardless of all the diverse characteristics and preferences of the individuals involved and their particular employment relationships. There is little scope to tailor packages to meet the needs of different workers for different working hours, different forms of training and different mixes of rewards. Monopoly unions have in effect cartelised large sections of the labour market, fixed prices and erected all kinds of barriers to competition. Unlike other monopoly positions which sooner or later dissolve in the absence of statutory backing, our labour law has supported these monopoly structures. The inevitable result, of course, has been the extraordinary gains made by some privileged groups of workers, the concentration of others into low-paying occupations and the reduced job opportunities which have helped create the present rate of unemployment.

The same point was made more plainly by a correspondent to the *Evening Post* last year. She wrote:

> "[Labour] is a commodity, the same as others to be bargained for and competed over, the best of what's available reaching the best price. Others not so in demand would receive less.

But unlike a fixed commodity, we can change and improve our usefulness to an employer and easily become one of those reaching the best price.

If we didn't try and squeeze guarantees out of employers - e.g. minimum wages, redundancy etc. - through the might of the strong-arm unions, then today there would be only a handful of New Zealanders unemployed and employers would be desperate for good staff."

Since New Zealand has been opened up to worldwide competition, there is no longer any place for cartels, industry plans, and deals among players on the so-called commanding heights of the economy. That world is gone for ever. The business unit that is relevant in today's world is the enterprise. And enterprise competition is about doing things in distinctive ways. Managers are having to open their minds to the possibilities of how design, service, production, sales and distribution can be done in innovative ways that others can't quickly copy.

Fred Hilmer, Dean of the Australian Graduate School of Management in Sydney, has made the point that:

> "In this environment, the term 'industry', which implies a collection of like firms meeting similar needs, loses meaning. So 'industry plans' make less and less sense. Enterprise competitiveness is what matters."
>
> "Similarly," Hilmer adds, "to be distinctive and competitive, managers will soon realise that they need enterprise-specific jobs, supported by enterprise-specific training. While the outside world - colleges or universities - can provide core skills, leading enterprises also need to develop and train their people in enterprise-specific skills. For example, pilots need to know how to fly the aircraft and the routes of their enterprise's airline, not just any old plane. Banking staff need to be able to work with the unique systems and service packages that each bank offers; the ANZ teller of the future with Transaction banking will be quite different from the Westpac teller with CS90."

Hilmer's examples illustrate why the current union push for an airline industry agreement and the proposals for levies aimed at forcing employers to undertake some standardised level of skill training make no sense at all.

There are signs that some policy-makers are finally coming to understand what is wrong with New Zealand's employment relations system. Mike Moore has been attracted to the ideas of Professor Martin Weitzman in his book *The Share Economy* and proposes to bring him to New Zealand as part of the compact discussions. As one commentator on Weitzman's analysis has observed:

> "...the claims that can be made for the share economy require renewed belief in some very old ideas about the way labor markets work - and wholesale repudiation of some respectable myths that are a legacy of the Keynesian era... In the share economy, wage rates will be unusually responsive to both short- and long-term fluctuations in supply and demand. The same mechanisms that determine the prices of stocks, bonds, houses and used cars will determine the wage rates of labor, and union attempts to impede this process will be undermined."

Regrettably, however, there are still too few signs in government ranks of a willingness to take a thoughtful interest of this kind in the workings of labour markets. The air is still thick with empty rhetoric and attacks on straw men such as non-existent proposals for 'total labour market deregulation'. Thinking New Zealanders are well aware that labour market reform is about more productive working arrangements and a high wage economy, not the low wage one we have been used to, and about laws which will promote democratic and responsive unions, not about attempts to do away with them.

In defending its record on labour market reform, the government appears to be behaving like the proverbial emperor when all the rest of the world can see it has no clothes. National Bank economists have pointed out that:

> "The Cabinet has only one option if it wishes to make quick inroads into the unemployment problem. It should deregulate the labour market without delay."

Ministers were given the same message at the Vogel House meeting on unemployment. The OECD said bluntly in its recent survey of New Zealand : "Given the recent steep rise in unemployment, further reform of labour-market practices is needed." The Auckland Regional Chamber of Commerce recently stated that complex labour laws are making it increasingly difficult for small companies to survive and called for voluntary unionism to help provide more jobs. *The Herald* has called for "wholesale removal of the union bargaining monopolies which prevent employers from reaching agreements with their particular staff". Groups of workers up and down the country have been frustrated by their unions' refusal to act in their interests. Public opinion polls have shown overwhelming support for the kind of labour market reforms - voluntary unionism, worker choice of union representation, and freedom to negotiate at an enterprise level - advocated by employers.

What the OECD, business organisations in New Zealand and others are calling for are the key features of the labour market arrangements that are the norm in virtually all OECD countries other than Australia and New Zealand - and in particular for what are widely regarded in the OECD as the most successful models for employment relationships in countries such as Japan, Switzerland and the United States. Is it too much to ask the government to drop its rhetoric about the excesses of labour market deregulation for a moment and to explain in simple, comprehensible terms what its objections are to the type of employment laws which help make these countries high productivity, high wage and high employment economies?

No one in New Zealand, to my knowledge at least, is calling for "total labour market deregulation", whatever that means. There is an important role for a sound body of employment law to protect both parties to the employment relationship. The government has improved some features of that law, for example by tightening up provisions governing breaches of contract. But there is also an important role to be played by a freer and more flexible labour market in providing employment protection. The individual workers or job seekers that we should be concerned about would be protected in a very real way if there were fewer barriers to employment and mobility, wider choices over terms and conditions of employment and more options for creating the potential jobs that should abound in businesses across the economy.

Similarly in many employment relationships there is a role for unions that are formed and joined on a voluntary basis. Collective bargaining will often be preferred over individual contracting, even at enterprise level. Unions can act as negotiating agents, help protect individual workers' rights and provide other services to members. The problem in the New Zealand context is the outmoded and unsatisfactory forms of regulation governing union membership and structures, and the monopolies that result from them. Unionisation has been in long term decline around the world as the nature of industry and work patterns have changed. But there is ample evidence from countries like Switzerland, where the unionised section of the workforce has remained around 30 percent for a long period, that voluntary, democratic unions can survive and prosper in a deregulated environment. The key point is that individual workers should be able to enter into the type of employment relationship that they prefer, and if they choose to become union members it is their needs and views that should democratically prevail.

An article last week in *The Economist* made the familiar point that New Zealand's mistake was not to tackle the labour market first in liberalising the economy, and added that reforming the wrong way round is one reason why the economy is still struggling. This point can be overstated. It is a bit like arguing about whether a baby elephant should get up on its front legs or its hind legs. The real point is that if the elephant is still using only three legs some five years later, it is not likely to be walking very well.

At the present time - and despite the somewhat desperate proposals for mega-unions, sectoral bargaining and a centralised compact - the constituency for reforming employment relationships on voluntary, decentralised lines has never been stronger. In its submission to the inquiry on industrial democracy, the Business Roundtable suggested that if there were any doubts at all on this score, a referendum could be undertaken to find out. Colin Clark of the PSA responded with the absurd claim that this would be "anti-democratic", and gave the game away by arguing that unions know best: "as unions, we have the obligation to protect our members".

I believe history is telling us that the days of the big battalions are numbered. New Zealanders are not a lumpenproletariat. People are demanding to count as individuals, to be free from domination and to be able to express their entrepreneurial creativity. Employers must respond to those needs, and competitive markets are making us do so. As someone recently put it:

> "The class struggle is over. The politics of the next century will be about the individual, and her place in the community."

If we could get the power groups mentioned by John McCarthy out of our lives, if we could reduce the regulations and tax burdens that go with them, and if we could focus our attention on the needs of individuals, their families, their work places and their communities, then I believe New Zealand really would have a chance of walking on four legs.

LABOUR RELATIONS : THE STATE OF THE DEBATE

INSTITUTE FOR INTERNATIONAL RESEARCH CONFERENCE

ON

MANAGING CHANGE IN INDUSTRIAL RELATIONS

Lindsay Fergusson
Group Managing Director
Magnum Corporation Limited
and
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New Zealand Business Roundtable

Sheraton Hotel
Auckland
17 August 1989

LABOUR RELATIONS : THE STATE OF THE DEBATE

In thinking about my remarks today, I was reminded of the story about a surgeon, an architect and a politician arguing about whose profession is the oldest.

> "Eve was carved from Adam's rib, and that surely was a surgical operation," began the surgeon.
>
> "True enough," said the architect, "but before that, order was created out of chaos - and that is a task for an architect."
>
> "Just a minute," interrupted the politician. "First someone had to create chaos!"

Certainly the politicians have worked hard on our industrial relations system over the past 100 years, and its chaotic state bears witness to their efforts. Despite persistent tinkering, we have retained to this day the essentials of an arbitration and conciliation system based on a conflict model of the employment relationship. The politicians of 1894 gave us the system of registered unions, blanket coverage awards and conciliation procedures initiated by the creation of a "dispute" of interest. Their successors in the 1930s added compulsory unionism. Only Australia and the ill-fated Weimar Republic in Germany went down the same track. None of the world's successful economies has structured its system of employment relationships in the way New Zealand has done.

Of course it was not only in the field of labour relations that, for decades, New Zealand pursued a set of policies that were well outside the economic mainstream. Over time, these did untold damage to the capacity of the economy to create wealth and jobs. You may remember the early 1980s comparison that seemed to sum up our predicament:

> "In America they have Ronnie Reagan, Johnny Cash, Bob Hope and Stevie Wonder. In New Zealand we have Rob Muldoon, no cash, no hope and no wonder!"

In the 1980s - and the trends go back further than the term of office of the present government - our politicians have been trying to make a break with the past and abandon stop-go policies, fortress New Zealand, and borrow and hope approaches to economic management. In some areas the progress made has been remarkable. In the labour relations field, by comparison, changes have been far more limited and piecemeal. The National government's introduction of voluntary unionism was not part of a coherent framework for labour market reform and was accompanied by a total freeze on wages. The present government restored compulsory unionism and its limited efforts in the Labour Relations Act and elsewhere to change the system have been regarded by a multitude of observers as inconsistent with its general reform programme.

The Business Roundtable has been among those who have tried to take the role of architect and consider how order might be created out of our industrial relations chaos. At the outset of the debate, the task seemed utopian. The idea of moving away from a conciliation system mired in union monopoly rights to a system based essentially on freedom to contract seemed too radical a step to contemplate. Now I believe there is an overwhelming constituency for further change in this direction.

It is perhaps a sign of the times that this is the third of four major conferences on labour relations being held within a two-month period. From the beginning of this year, to go back no further, there has been a succession of events signalling to politicians both the case and the extent of support for change:

- an Insight NZ public opinion survey released in January revealed 77 percent of respondents favoured voluntary unionism, 74 percent considered workers should be able to join any union they wished, 69 percent wanted direct negotiations between workers and employers or unions and employers rather than national awards, and 89 percent thought unions should not be affiliated to a political party;

- the message to the February Cabinet meeting on unemployment was that the problem was not macroeconomic policy but wage growth in excess of productivity and labour market rigidities;

- the OECD report on New Zealand reiterated that "Given the steep rise in unemployment, further reform of labour-market practices is needed." Like New Zealand employer organisations, the OECD has recommended the introduction of voluntary, contestable unionism and moves away from blanket coverage award bargaining;

- Roger Douglas has given a clear and courageous analysis of the need for reforms. The National Opposition have highlighted labour market policy, along with unconstrained government spending, as the government's two key policy failures;

- The Reserve Bank, *The Economist*, editorial writers, independent economists and many others have added their voices to the calls for reform.

In the face of this body of opinion, what opposing arguments are being put forward? At the government level, Ministers appear to be saying esssentially three things.

First, that the moves made to open up the economy and not accomodate unjustified wage and price increases are changing bargaining behaviour.

Second, that the government's policy of standing aside from industrial disputes is encouraging more direct and responsible relationships between the parties directly affected.

Third, that the changes made to the Labour Relations Act and the State Sector Act have altered the wage fixing climate for the better.

Nobody on the employer side at least would, I believe, dispute any of these propositions. The first two factors in particular have brought about significant changes in attitudes and practices. The contribution of changes to labour law has been much more modest. But the contention of the advocates of greater change is not that nothing has happened. It is merely that not enough has been done, and done fast enough, to help New Zealand firms and workers cope with adjustment and global competition and to avoid the unnecessary unemployment costs associated with restructuring.

Some other points made by Ministers are worth examining in detail.

A favourite tack is to point to the agreements reached at Firestone, Fortex, Nissan and Kinleith over the last year or so as evidence that constructive outcomes are possible within the framework of the Labour Relations Act. A closer look at each of these cases reveals how weak this argument really is.

First, each of these agreements would have been possible under the previous legislation. There was already a composite agreement at Kinleith prior to the Labour Relations Act. The Fortex agreement is an unregistered and unenforceable document - hardly a model employment contract - which would also have been possible under the previous legislation.

Secondly, each of these agreements is enterprise-based. The lesson here is that by and large real progress towards arrangements that improve productivity and safeguard jobs is only possible outside the award system.

Thirdly, each of the industries in question is in survival mode. Despite this, the Nissan agreement was only a partial one and was achieved only in the face of fierce resistance by some unions. It is a poor commentary on our labour relations system that the examples of change being held up as models by the government are businesses whose continuing existence would otherwise be in question. And in the case of the meat industry, the example of Fortex misses the basic point that, in the last award round, the major meat companies failed once again to gain union acceptance of the plant agreements (like that at Fortex) that are necessary if the industry is to have a viable future.

The meat industry example also underlines the irony of Ministers' claims that there is more acceptance of the need for change on the union side than there is amongst employers. I am unsure whether these claims are disingenuous or just simply naive, but it is time they were exposed.

For a start, there have been continuous efforts by the Council of Trade Unions to turn the clock back and reinstate compulsory arbitration. Similar objectives are being pursued in the context of pay equity and industrial democracy. The overwhelming priority of the central union movement in the last two wage rounds was expressed in its rhetorical objective of "defending national awards". The obstacles that have been thrown up to the government's intentions under the Labour Relations Act of facilitating alternatives such as enterprise agreements have been virtually impenetrable.

To illustrate this point, I invite you to study the criteria for agreeing to exemptions from awards established by the Engineers' Union which I have appended to the written version of my address. The procedure is like a fortified Maori pa; if one of the outer walls is breached a series of further lines of defence is encountered. The overriding emphasis is on the interests and decision-making power of the union, not the interests of the workers in the plant or company that might be exempted from the award.

Small wonder that there have been few cases of citing out from the Metal Trades Award in either of the award rounds that have occurred under the Labour Relations Act. Nor has there been any tangible progress with the much-heralded 1987 initiative to restructure the metal trades document. And yet the Engineers' Union is regarded , not entirely without justification, as one of the more "progressive" unions.

Another familiar government response, which can only be regarded as a cop-out, is that the need is for change in attitudes rather than legislative change. I do not recall hearing Ministers arguing that the problem of protected manufacturers or loss-making state-owned enterprises was attitudes rather than the incentives and constraints which they faced. Experience around the world demonstrates that labour market behaviour is profoundly influenced by the legislative environment. I leave it to you to try to make sense of this schizophrenia.

A more specific argument made by some Ministers is that voluntary unionism is of little importance as an element of labour market reform. The claim is that its effect would be felt mainly in industries like retailing - with the implicit suggestion that it would result in a fall in unionisation which would reduce necessary worker protections - and that it would make little contribution to resolving the "hard core" industrial relations problems of industries like meat processing, construction and pulp and paper.

In part, this argument is a straw man. No one claims that voluntary unionism is a panacea. However, it is part of a coherent programme of reforms aimed at establishing a free and decentralised system of contracting. It is absurd to argue that such an environment oppresses non-unionised workers. Fewer than 10 percent of retail industry workers in the United States are now unionised. Any suggestion to an American that millions of retail employees work in conditions of oppression would be greeted with disbelief. Among their most important protections are the flexible work options open to them and the high employment demand which results from the job-creating capacity of the United States labour market. It is interesting to note that a recent NZ Herald-NRB poll showed that employees in the New Zealand retail industry were more strongly in favour of voluntary unionism than most other occupational groups.

Part of the argument for voluntary unionism is that it facilitates more flexible and individualised forms of contracting which suit workers whose needs vary from the norm. Another part is that it is a stimulus to better union performance, since union representatives are forced to become more responsive to their members' needs. Beyond that, all OECD countries other than New Zealand and Australia have regarded freedom of association as a basic individual right. While the solution to some labour relations problems lies in other elements of reform, there is no doubt that the adoption of the kind of voluntary union membership arrangements that are the norm in other OECD countries would be beneficial in New Zealand. I have little doubt that Ministers who regard themselves as in the social democratic camp in contemporary international politics would privately acknowledge these arguments, but it is a pity that they are not prepared publicly to promote the abandonment of this aspect of New Zealand's insularity.

Similarly, it is a pity that we have not yet seen in New Zealand a new generation of trade unionists who are positively arguing the case for the adoption of the kind of reforms that trade unionists in successful OECD countries actively support. Indeed, the trade union movement has in some ways become more inward-looking since the time when Sir Tom Skinner was arguing for a labour contracting system along United States lines and a voluntary unionism regime.

In large part I believe this is due to the fact that trade unionists have not yet had to face the competitive stimulus to better performance that the government has imposed on most other groups in the community. It is interesting to note that of the 40 chief executives currently on the Business Roundtable, only 9 were members at the time of our original submission on the Green Paper on labour relations three years ago. By contrast with this transformation in business sector leadership, there have been few changes among the leading figures in the trade union movement. I believe this helps explain why national trade union officials are still grasping for anachronistic government-union compacts and for changes in union and bargaining structures which would take New Zealand even further away from where we need to go.

Followers of the labour relations debate will have noticed a fascinating commentary on this point in a recent National Business Review article by Chris Trotter (who could hardly be called a member of the so-called 'New Right'). Noting that the CTU's *Strategies for Change* document purported to set out a realistic alternative strategy for the union movement in the 1990s and beyond, Mr Trotter wrote that:

> "...it might more accurately be described as the clearest expression of the fundamental imperatives of the trade unionism of the past. As such, it should cause trade unionists to shudder : it has the smell of institutional death about it."

The article went on to point out that trade union structures have few points of genuine contact with the lives of union members. It observed that paid officials' prime loyalty is to the institution rather than the membership. It argued, correctly in my view, that the government has made this situation worse, noting, for example, that:

> "The Labour Relations Act, by deregistering unions with fewer than one thousand members, has entrenched the bureaucratic character of New Zealand trade unionism."

Mr Trotter seemed to see merit in some aspects of the National Party's approach to labour relations, and the article at least showed a refreshing willingness to explore the issues in an open-minded way. Clearly if we are to make progress, we must get beyond the mindless shibboleths still being recycled by the opponents of labour market reform. For example:

- the labelling of advocates of change as supporters of "total labour market deregulation", whatever that means. The real issue is about establishing the right rules for employment relationships. As the Business Roundtable said in its Green Paper submission, there is indeed a case for removing many of the current obstacles to mutually beneficial arrangements, but there is also a need for stable and enforceable labour contracts to reduce the propensity for chaos and laissez-faire - "or, for those who need a label, to *re-regulate*." We have, for example, argued that normal antitrust law should apply to the labour market.

- A second shibboleth is the proposition that labour market flexibility is a codeword for lower wages. From the outset we have argued that New Zealand has become a low wage country by following a set of misguided economic policies, including its labour market policies. Labour market flexibility is essentially about freedom to contract, to adopt the kind of productive employment relationships that characterise the high wage, high productivity, high employment economies. Wage rates are not, by themselves, the issue for employers; it is the cost of labour that matters and that includes wage rates and productivity. High productivity leads to high wage rates while low productivity leads to low wage rates, as in New Zealand.

- A third shibboleth which it has suited some to maintain for their own purposes is that such a programme is anti-union. We have consistently maintained that in many employment relationships there is a role for unions that are formed and joined on a voluntary basis. Collective bargaining will often be preferred over individual contracting, even at an enterprise level. As our original study put it:

  > "To some advocates of complete deregulation of labour markets, there would seem to be a case for a shift towards totally individualised contracts, based on the characteristics of each and every member of the workforce and the needs of the enterprise. However, it does not follow that individualised contracts are generally the most efficient form of contract given economies of scale in the negotiation, monitoring and enforcement of agreements and the similarity of many workers' demands and characteristics."

  While individual employment contracts will undoubtedly grow in number as the nature of work and lifestyle preferences change, for the foreseeable future unions have an important role to play as negotiating agents, to help protect individual workers' rights and to provide other services to members.

The widespread public and political support for further labour market reform indicates that the public are not taken in by these deliberate misrepresentations. Nor, I believe, are they impressed by the performance of those who play the man rather than the ball. It used to be said that every time a trade unionist appeared on television in the United Kingdom haranguing and threatening, he - for it was almost always a man - advanced the cause of trade union reform. Attacks by people like Pat Kelly and Ros Noonan on the Governor of the Reserve Bank, or Roger Douglas, or Ruth Richardson or employer organisations - as opposed to serious examination of the issues being raised - merely discredit their own position.

This conference provides another opportunity for an objective and dispassionate debate about the future direction of labour relations in New Zealand. I hope alternative options will be put forward and elaborated; all too often participants in the debate do not specify in any detail a coherent alternative or explain how it fits within a consistent overall economic programme. All the implications of a model like the compact, for example, should be laid out for public scrutiny.

For its part, the Business Roundtable recently provided a positive restatement of its thinking in a paper which is available at the conference for anyone who is interested to read it. We do not claim to have definitive answers to all the relevant questions; as the paper indicates, the exact shape of the best labour statute for New Zealand is a matter on which the advice of the world's best legal and economic minds should be sought. Part of our ongoing work programme this year involves obtaining advice from precisely such sources.

Nor have we ever contended that labour market reform is an "all or nothing" option, though we do regard it as legitimate to argue for arrangements which would offer the greatest benefits to New Zealanders. There would be widespread agreement among employers that a top priority for reform would be to grant firms the same rights as unions currently enjoy to take the initiative to be cited out of awards. A simple, democratic ballot among the workers directly concerned should decide the issue.

Allowing a degree of equality between union and employer in the determination of appropriate bargaining structures is not the all-out assault on current award structures that some union officials would have us believe. Nor would it result in the mass abandonment of awards and industry agreements, for the simple reason that some employers will continue to find these bargaining structures satisfactory.

This is because some employers in New Zealand feel well served by an award or agreement structure that does not involve them directly in negotiating with their employees. But this is no reason to deny the majority of employers the right to seek a direct bargaining relationship with their employees or unions representing those employees, in order to achieve employment conditions appropriate to their business and the competitive challenges they face.

My own company has a number of subsidiaries each facing its own competitive challenges. Each will assess its own requirements for bargaining structures and will arrive at an answer that reflects its own circumstances.

Our Dominion Breweries subsidiary is clearly an example of a situation where a strong desire on the part of the company and a very significant number of its employees to enter into a more appropriate, meaningful bargaining arrangement has been frustrated by opposition from union officials committed to a centralised approach to bargaining. A union policy which has been determined at a distance from, and with little or no involvement by, DB employees is nevertheless imposed on them.

While DB is unequivocal in its belief that enterprise bargaining is the appropriate bargaining structure given the two-player, highly competitive nature of the brewing industry, other Magnum subsidiary companies may well feel that, at this point in time, awards or industry agreements meet their needs.

Our experience is not unique. While there would be a large number of companies that would opt for enterprise bargaining if given the choice, there are also those that would opt for award or industry agreement coverage.

Clearly there can be no sensible reason for union opposition to an employer seeking direct negotiations with employees and their union representatives. Such a negotiation must produce a more meaningful result than a negotiation conducted far from the workplace by employers, delegates and union officials who have no knowledge of, nor real concern for, the circumstances of individual employers and their workforces.

How these issues are resolved will determine whether New Zealand completes the transition away from its insular past and becomes a dynamic Pacific Rim economy, or whether the outlook remains the present mediocre one. The forthcoming award round will be another indication of how much progress is being made. If, as the government maintains, inflation and inflationary expectations have been beaten, then any claims for wage adjustments should be at minimal levels on average since no one can argue for generalised pay increases at present levels of unemployment. There needs to be more differentiation in settlements to reflect the adjustments occurring in different industries. The only important criterion for employers should be whether they need to pay more to recruit or retain workers with the skills they require. We need more citing out, and more productivity bargaining aimed at reducing labour costs so as to improve competitiveness and reduce unemployment. The fact that the national award system can be used by employers to deliver low wage increases is no reason for them to stop pushing for more productive arrangements.

The increase in GST is not a factor that can enter into negotiations since employers' ability to increase wages or recover costs will be unaffected by the change. It should be seen as part of the contribution to the "social wage" which the union movement has supported. If workers are unhappy about the implications of reduced after-tax incomes or spending power, they should add their voices to those advocating lower government spending.

If the award round proceeds on these lines, there is the potential for further falls in inflation and interest rates and a strengthening of the present weak recovery. If it does not, there is every likelihood that the economy will stay in recession. Even in the most favourable scenario, it is plain that unemployment will remain stuck at high levels with our present labour market regulations. And until they are reformed, there will always be macroeconomic uncertainty in New Zealand.

Change *is* occurring in New Zealand labour relations, but at a snail's pace compared with what is needed. Those who are content with this rate of progress are still playing Macbeth:

> "Tomorrow, and tomorrow, and tomorrow,
> Creeps in this petty pace from day to day."

Unless this petty pace is stepped up, New Zealand will become a second class citizen among Pacific Rim nations. If this conference can make a modest contribution to accelerating the necessary changes, it will have served a useful purpose.

COMMERCIAL LAW

MAKING THE LAW MEAN BUSINESS

NEW ZEALAND COMPANY SECRETARIES' CONFERENCE

DOUGLAS MYERS
VICE-CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

AUCKLAND
14 MARCH 1989

MAKING THE LAW MEAN BUSINESS

New Zealand has got into the habit of priding itself on the immense economic restructuring of the last few years. It is true that massive changes have occurred. Many of us in business have learned to turn the competition which we would have regarded as a threat ten years ago into a positive advantage. We have learned that meeting the challenges of an economy opened up to competition is something not just to be survived, but to be thrived upon. In Tom Peters' words, we've begun to learn the art of thriving on chaos, of looking for opportunities rather than breathing spaces. It hasn't been an easy experience, but it has been an exciting one, and one that we can see yielding real benefits for New Zealanders.

But if we look at what has been achieved so far, we can't help but recognise that there are only limited grounds for satisfaction. There are things that we haven't done well; things that we haven't attempted at all. We've made the decision to join the real world, to reach out for the benefits of an open economy, but we've only done it by halves. And we have been slow to recognise how much unnecessary pain can be caused by this kind of half-heartedness.

It has always struck me that the people who complain most about how much change has occurred in the last four years - or, more usually, how much pain has been borne - and who call for breathers and tea breaks are those who in reality have been least affected; those who have never had to understand that gain without pain is impossible. This can't help but make me suspicious that the only cause they are championing is their own - that they will do anything in their power to duck the sorts of adjustments that those of us on the raw edge of business, and those who work for us, have had no choice but to face.

This doesn't give confer any particular virtue on those who have faced up to change. But I do think that the changes that we have experienced so far, and the lessons that we have learned in dealing with them, have provided us with some important insights on what still needs to be done.

I would like this morning to talk first about how the process of opening up the economy affects the environment in which business operates, and of the costs imposed on business - and therefore workers and consumers - when that process is inconsistent. I will then turn to the question of business law reform, and offer some thoughts from a business perspective on some areas of this law that are currently under review.

Debate on the role of government in New Zealand has long evolved beyond the point of crude arguments over whether or not regulation is needed in any particular market. People recognise that when we talk about free markets we're not talking about the anarchy of a Lebanon or about some primeval state of nature, but about protecting the freedom of individuals by setting legal limits on coercive behaviour by either government or business. This has enabled us to focus on the regulations needed to make a market function well - to make sure that scarce resources are used as well as they can be, and that transactions are fair.

The hallmark of the Government's approach to economic management, at least in its first term of office, has been the establishment of a basic framework and set of principles for analysing economic issues. The emphasis, in general, has been on the need to get fundamental medium-term policies right, not to address symptoms or attempt ad hoc solutions.

In the regulatory area, there has been a shift away from a philosophy of compulsive regulation to one of identifying the best form of intervention, if any, needed to deal with a particular problem. We can see evidence of this in everything from the floating of the dollar, to the shift in prudential responsibilities directly to financial institutions, to the restructuring of the Government's commercial activities in the SOEs.

In moving from a closed to an open economy we have had to reconsider the whole thrust of the law. We have had to think carefully about how to promote the joint goals of efficiency and equity.

However, this approach to reform has not been applied consistently. As a result, we find ourselves in a hybrid system. In some markets, we now face strong incentives to innovate; in others we continue to face constraints that thwart our attempts at innovation.

For example, we borrow money on relatively freely operating finance markets and trade with minimal reliance on border protection, but continue to be shackled by an archaic and adversarial labour relations system. Many businesses have had the experience of being unable to meet international competition effectively because of the virtual impossibility of sitting down with their workers to figure out better ways of running their businesses. Many of you will also have seen how much more difficult this makes it to restructure without laying off workers - let alone thinking about expanding your workforce. Like the United Kingdom, we are learning the hard way how damaging this can be in terms of unemployment.

Yet this is an inconsistency - and a burden on businesses and workers - that the Government seems intent on aggravating through its pledge to implement comparable worth, under the misnomer of "pay equity". The idea is that, by regulatory procedures, a female clothing worker could claim to be paid as much as an oil rigger, or a kindergarten teacher as much as a policeman. What this policy comes down to is more centralisation; more rigidity in pay relativities; less responsiveness to market conditions, and fewer real opportunities for precisely those women who have borne much of the brunt of restructuring. In other words, it's about hurting precisely those people that the Government likes to claim it is trying to help. In an era of tough budgetary constraints, even public sector workers like nurses, who in the past may have considered their employment to be immune from economic influences, will suffer the consequences.

In a halting fashion, the Government has been promoting a more decentralised labour relations system with less government intervention in employment relationships. We now have Geoffrey Palmer's oxymoronic proposition that the Government is in favour of pay equity (more centralisation) provided it is consistent with its basic philosophy in this area (less centralisation)!

We can see similar problems arising in the area of natural resource management. What was promised by Geoffrey Palmer to be a review process that went "back to basics" in dealing with the problems of natural resource allocation appears to have lost its way. The objective of ensuring that all the country's resources are used efficiently - in the broadest of senses - has been lost. Questions about the appropriate scope or nature of government rule-setting don't seem to have been asked. It is as though the real agenda of those involved is to make development even more difficult. If left unchecked, the likely result will be a system that delivers high costs to businesses, investors and the taxpayer, but few of the material, environmental or cultural benefits that should be the goal. With its right hand the Government is trying to pull down roadblocks to employment, and with its left hand it is building new ones.

The essence of a sound programme of deregulation is to work market by market at clearing away unnecessary barriers to exchange and at setting good basic rules. Unless we are consistent in the way in which we do this - and that implies the need for stability in macroeconomic policy as well - we end up posing unnecessary strains on some markets, some companies, and some workers.

This brings me to the area of business law - in particular those laws immediately affecting a company's relationships with its shareholders, but also the broader laws affecting business which are the focus of much of this conference.

We have to start by deciding what this area of law is about. The answer given by the drafters of such legislation last century in the United Kingdom was simple. Business law, they argued, is about making it possible for business to do business. And they reflected this attitude in such crucial concepts as the legal recognition of limited liability.

The key point to recognise here is that business laws should be designed to promote efficiency. They should make it as easy as possible to use resources well, to innovate, to grow, to create wealth and jobs for all New Zealanders. An important part of this is treating investors fairly - if you don't, there is going to be little incentive to invest. But this isn't the same as treating them equally, a point which seems to have eluded Colin Patterson and the Securities Commission. Instead, fair treatment - and efficient treatment - is about ensuring opportunities and just rewards for all companies and investors.

In reviewing our current laws there are a number of things that we should be looking for. First, we should be looking for consistency - consistent and neutral treatment of the different parties affected by any one law, and consistency across the whole range of laws that shape business activity.

Secondly, we should be looking for certainty. To an important degree, consistency will breed certainty. So, too, will the construction of laws that are simple and straightforward; which set out clearly rights and responsibilities; which have clear objectives and the equipment to meet those objectives, rather than relying on the ebb and flow of judicial activism or judicial restraint.

In particular, we should be looking for a law that minimises the incentives and opportunities for unethical behaviour, including by rigorously enforcing penalties for misconduct. In an open economy it is essential that businessmen, investors and customers know before they act that their actions are consistent with the law. And they need some assurance that the law isn't suddenly going to change on them - whether by judicial interpretation or by random government intervention.

At present such certainty is lacking. Most people would have expected the Government to have learned a lesson from its blunders last year when it became involved with several problem companies. Yet the litany goes on. Its intervention in the Richmond Smart receivership has abrogated the rights of creditors who had taken proper security. Peter O'Brien has written in the National Business Review about the infringement of the rights of small shareholders in the BNZ sale process. How on earth does the Government hope to generate investment confidence when contractual rights can be interfered with at whim?

Thirdly, we want a regime which is low-cost - not only an administratively efficient regime, though this is vital, but also a regime that doesn't impose a lot of hidden costs and dissuade businesses from doing things that would make the economy as a whole better off.

The Commerce Act has proved particularly troublesome in this regard. There is an increasing number of companies in New Zealand which have attempted to rationalise in order to meet competition, only to find themselves blocked or subject to interminable delays. If we look to the United States, we can see a country forced to alter its whole approach to antitrust as its industries belatedly took on a world focus. It paid for its tardiness. If you looked at a list of the world's largest companies in 1960, you would find the first non-American firm at number 25. By 1980, the first United States firm was tenth on the list. New Zealand, even slower than the United States to face up to economic realities, should be learning from this experience rather than clinging to the antitrust mentality of an era when its markets were closed to international competition.

Finally, in the review process itself we should be satisfying ourselves that we have drawn on the best available research and scholarship of academics and practitioners both in New Zealand and overseas. We can't afford insularity in our ideas any more than we can afford it in the way we run our businesses. And we can't afford to entrust the task of business law reform to those with little understanding of business needs.

Overall, what we should be aiming for is not just a good set of business laws, but the best business law in the world. We are learning to compete in international markets for goods and services. In reforming our business law, what we should be doing is improving our ability to compete with other countries for investment. The better and fairer our regulations, the more attractive investment in this country will be. And the lower the costs imposed by our business regulations, the greater our competitive edge will be in export markets.

When we look at the pattern of reform in New Zealand since 1984, we tend to compare the early, rigorous reform of financial markets - involving such moves as the floating of the dollar, the removal of exchange controls and the freeing up of financial institutions - with the failure to achieve useful reform in the labour market.

We have been less likely to remark on the fact that reforms in financial markets have been largely limited to markets for debt - to the removal of many of the controls on financial transfers and financial institutions. The question of reforming securities markets - the whole realm of legislation that affects investment in shares - wasn't really addressed until the Law Commission was charged with reviewing the Companies Act in 1987.

As Professor Hammond from Auckland University pointed out last week, the Government never seems to have had a cohesive philosophy for addressing this crucial area of the law.

It is illuminating to compare the debates and regulatory changes that followed the foreign exchange "crisis" of July 1984 with the reaction to the events of October 1987 - to compare the performance of Roger Douglas in dealing with a foreign exchange crisis and Geoffrey Palmer in reacting to the share market "crash".

In July 1984, our finance markets were under impossible strains. But once the immediate steps to devalue and free up interest rates were taken, the Government settled down to a careful, rigorous process of assessing how finance markets should be restructured not only to avoid a repetition of this kind of crisis, but to remove barriers to fair, efficient contracting in these markets.

Such rationality and rigour has not characterised the debate on equity market regulation in the wake of the October 1987 "crash".

Little reference has been made to the Wall Street origins of the "crash", and the economic events in the United States in particular which spurred it. New Zealand was inevitably caught up with its worldwide effects. In addition, the economy was moving into a recessionary phase. Property and investment companies had a heavy weighting in the stock exchange listings, and other over-geared companies were vulnerable to a downturn. From December 1987, political uncertainty about economic directions has remained unresolved. Real interest rates have remained high, depressing equity prices. The changes to superannuation tax arrangements have meant that much institutional investment has been on hold. A capital gains tax has been mooted. These fundamental factors go a long way to explaining the performance of the New Zealand share market.

More generally, New Zealand companies were still going through the tough process of learning to work in markets that only a couple of years before had been regulated to the hilt. Some boards and managements had a lot to learn about the relationship between risks and rewards. They weren't helped in this process by the Government, which, through its failure to implement a consistent reform programme, encouraged speculative investment in paper-shuffling extravaganzas. Who would invest in a company fettered by rigid labour market law when opportunities abound in newly liberated financial markets? The first protection for small investors' life savings must be a government policy that doesn't distort investment incentives.

All the concern about shonky practices obscures the fact that there has been solid, ethical performance in the companies producing the vast bulk of New Zealand's real output. There was fraudulent - and plain stupid - behaviour in New Zealand companies, but it wasn't generic. As Mr Justice Meagher of the New South Wales Appeal Court said last week, most companies are run by fairly honest people. You don't get on in business by screwing your customers or your shareholders.

It is disturbing that the Government, egged on by the Securities Commission, has rushed into a programme of regulation without first questioning whether the state of the stock market is, in fact, primarily the result of unscrupulous behaviour and inadequate protection of shareholders. There have been some glaring cases of such behaviour, and they should be condemned outright, but they don't explain either the crash or the sharemarket's sluggish recovery.

And I find it ironic that the Government attributes low confidence in the market primarily to supposedly unfair - or downright criminal - behaviour, rather than to inadequacies in its general economic policies, instability in its own ranks, or the poor performance of its regulatory agencies.

As a result, what began as a much-needed, rational review process, in the form of the Law Commission's review of company law, has become confused, and runs the risk of promoting precisely the kinds of inconsistencies and uncertainties that we should be trying to avoid. The Minister of Justice appears to be concerned only to be seen to be doing something. As Jim Farmer Q.C., a leading commercial lawyer, put it at a conference last year, the sharemarket crash looks like numbering sensible commercial law reform among its victims. More recently, he has expressed concern that the Government's wish to be seen to be cleaning up unscrupulous behaviour is leading to an emphasis on a simplistic definition of shareholder equity at the expense of sound economic policy.

Questions as to whether the existence of unfair or criminal practices is due to inadequate enforcement of the existing law, or inadequacies in its provision for enforcement by shareholders, do not even seem to have been asked. No form of legislation is ever going to stop fraudulent people being fraudulent, as Mr Justice Meagher pointed out. The potential costs and benefits of more attempts at controls and enforcement need to be weighed up. Let's hope that this simple truth is borne in mind in establishing the new corporate fraud squad. The last thing we need are the kind of witch-hunts conducted by Australian corporate affairs commissions which are staffed, according to Mr Meagher, by "incompetent and unemployable cretins".

Because the proper questions have not been asked, we risk being caught with a whole raft of misconceived and counter-productive new policies. There is an urgent need to stop and rethink this process. I have indicated that I see the Law Commission's review of the Companies Act as the right way to begin, and I look forward to Jack Hodder's comments on the review process later this morning.

The Law Commission began from the position of affirming the purpose of company law - the provision of good ground rules for business, and the role of such basic provisions as limited liability. Drawing on a wide range of experience and research, as well as broad consultation, it thoroughly examined the best ways of achieving these ends - looking at how best to encourage a fair and efficient contractual relationship between companies and their shareholders, and how to free them from unnecessary costs.

This has led them towards the kind of philosophy favoured in a submission prepared for the Business Roundtable by Professor Bob Baxt and Stephen Franks - an approach which sets basic objectives; which places responsibilities where they should lie - on directors; which gives shareholders more scope for controlling their relationship with companies, and better scope for redress where their rights are infringed.

A law based on this sort of approach would make us the Delaware of the Pacific, but better - a country whose business laws, because of their efficiency and fairness, made it a highly attractive place to incorporate and invest.

It is vitally important that other aspects of equity market law that are currently under review should be made consistent with the Law Commission's work. Unfortunately, this has not so far been the case.

Instead, we have been dealt such legislative monstrosities as the new provisions on the ill-defined activity of insider trading. This is widely regarded as a piece of legislation so shockingly put together that it will not only fail in the - desirable - task of identifying and discouraging unethical behaviour, but also do great harm to the general pursuit of business.

Stephen Franks estimated recently that about half of New Zealand would currently be in breach of its provisions, and commented on its "grotesquely broad reach." Stockbroking companies such as Jarden Morgan have suggested that the Act casts questions on the legality of even running a research unit. The amount of information available is likely to diminish - hurting most of all those small shareholders who don't have the resources to get around the system. In other words, in attempting to squeeze out a practice that it hasn't even succeeded in defining, the legislation has the potential to vastly increase the cost of investing in New Zealand, penalising all shareholders and companies, and the smallest players most of all.

A similar debacle seems likely in the case of the Securities Commission's proposals for takeover regulation. These display an astonishing disregard for the insights of the best academic scholarship, a fact highlighted in the debates last year between Colin Patterson and Professor John Pound of Harvard University.

The result, again, is likely to be law that makes it more costly for shareholders to control the activities of managers, and more costly for industries to carry out the restructuring that they need to compete on a world stage.

Some months ago Business Roundtable representatives asked Colin Patterson to identify any leading corporate finance academic or recognised authority - just one - whose work supported the approach taken by the Commission in its insider trading report. He was unable to do so. They asked the same question on the Commission's proposals on company takeovers and again drew a blank. Mr Patterson undertook to produce some authoritative sources on both topics but has failed to do so. Such inadequacies in the Commission's work are a totally unsatisfactory basis for advice to policy makers. It is imperative that their work is exposed to greater scrutiny and that they join with others in commissioning professional, international-quality research in order to reach sound conclusions on such topics.

It is tempting to wonder whether we would have to deal with such absurdities as the insider trading and takeovers proposals if the Securities Commission were forced to be as accountable for the quality of its ideas as businesses are forced to be for the quality of their products. It is perhaps time that the Government turned its attention to breaking the effective monopoly on policy advice enjoyed by such agencies. The irony is that as the effects of bad policies feed through, it will be business that is blamed for not investing.

One important recent development is the review of the sharemarket being carried out by a committee chaired by Sir Spencer Russell. It is encouraging that for once such a review has been put in the hands of an experienced businessman, and there is some hope that it can be used to pull the more frenetic bits of business law reform back into perspective. As the Business Roundtable argued in its submission to that committee, we should be endeavouring in a broad way to promote competition in share transactions and in contracting between shareholders and companies; taking advantage of technological developments that make alternatives to traditional stock exchanges feasible; removing stockbrokers' unnecessary regulatory privileges, and providing investors with wider choice about how to invest.

In the end, choice, and the freedom to exercise that choice, is the best protection that we can give investors, and small investors in particular. The Government recognised this - and relied on it - when it reformed finance markets. It appears to have forgotten it in its current panic over securities markets.

This conference will be looking at some of the international aspects of our business law reform. I said earlier that we should be aiming in our business law to make New Zealand the best place in the world in which to invest - the most attractive place in the world to do business. In other words, we have got to compete not only with our products, but with our laws.

One thing this suggests is that we shouldn't be focusing narrowly on Australian law when deciding what to do in New Zealand. The goal of harmonisation with Australia is all very well, but is not the be-all and end-all of policy reform. In goods and services trade, the opening up of relations with Australia was a useful stepping stone on the way to opening up our markets to the world. But Australia isn't our only large trading partner, certainly isn't our most demanding one, and won't necessarily always have the importance that it currently does. Few if any businessmen would now argue that trade reform should have stopped at CER.

It is the same with business law. If we can write laws that are better than Australian laws, that will make New Zealand a more attractive place than Australia to do business. We don't want to sell ourselves short by settling for a copycat form of harmonisation, any more than we would imitate an unsuccessful Australian production process in the name of CER. Writing a better law than Australia has does not preclude harmonisation. However, it would be Australia which would be obliged to harmonise, imitating our law so as to stem the flow of investment in our direction. Of course, Australia could hardly be expected to encourage us to seek this kind of competitive advantage, but it's worrying that Geoffrey Palmer, too, seems intent on levelling New Zealand down to the cumbersome Australian standards.

I would like to conclude by suggesting some messages for would-be reformers of business law:

- If it ain't broke, don't fix it. Some of the best models to follow are the earliest, simplest pieces of common and statutory law.

- Remember that business law is about efficiency, about freeing businesses to thrive in an open market, and building wealth and opportunities for all New Zealanders. If this lesson can be learned in the Eastern bloc - which now sees the introduction of capital markets and broad economic restructuring as its last chance for prosperity - we can surely learn it here.

- Avoid the Frank Spencer "Some mothers do have 'em" approach to law-making. The fact that Australia has an eccentric National Companies and Securities Commission and the United Kingdom has the London takeover code is no reason to inflict such law on New Zealand.

- Don't leave the task to the lawyers. Not enough lawyers, in New Zealand at least, have a sufficient grasp of economic and commercial realities.

- Don't impose massive costs on the majority of businesses in the interests of preventing real or imagined evils among a minority. In this world, or at any rate in this field, perfection is seldom achievable, only trade-offs.

- Getting it right is more important than doing it quickly. Major changes in the area of business law should be the subject of extensive, open deliberation, not of hasty initiatives.

I hope that these messages might have some relevance for your deliberations over the next two days.

THE COMMERCE ACT

NATIONAL BUSINESS REVIEW ECONOMICS BRIEF

MR ROGER KERR
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE

19 JULY 1988
WELLINGTON

THE COMMERCE ACT

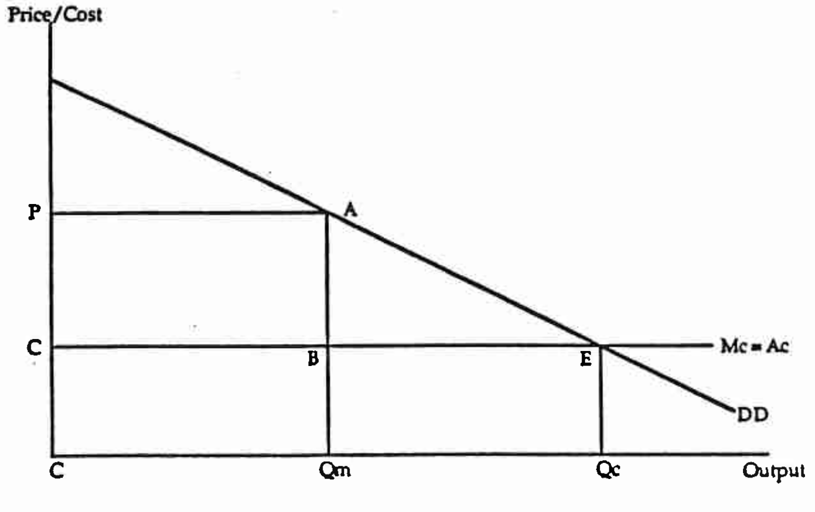
The basic rationale of the Commerce Act is to protect New Zealand consumers against the possibility that open competition between firms in the economy may not always serve consumers' best interests. Its main concerns are the scope for monopolisation and the exercise of restrictive commercial practices which may lead to economic inefficiency.

The preoccupation of economics with 'combinations' of firms or workers acting to restrict trade at the public's expense is at least as old as Adam. In The Wealth of Nations Adam Smith referred to the natural tendencies of producers or suppliers of labour to engage in such 'conspiracies', but he saw them as being most effectively curbed by maintaining open markets and was generally sceptical that direct government intervention would improve matters. His main concern was with monopolies maintained by the state.

By the end of the 19th century, however, this view gave way to fears about the growing industrial dominance of firms in industries such as oil, steel and the railroads. Although subsequent research suggests the emergence of large firms in these industries was largely due to their superior performance and that the push for controls came at least in part from weaker competitors, the legislature in the United States responded by passing the Sherman Act and subsequently the Clayton Act, the main 'antitrust' statutes in that country. Similar laws were enacted in Europe, Australia and New Zealand in the following 50 years. Interestingly, less resort has been had to this form of regulation in many Asian economies.

Much of the support for such laws at the academic level depends on the correctness of the standard theories of competition and monopoly. Traditional neoclassical economics viewed competition as a state of affairs in which rival sellers of a product were so small that they could not influence market prices. Competition between them would allow consumers to obtain the product at the lowest possible price and cost. Monopoly, on the other hand, was thought to result when there was only one supplier of a product with no reasonable substitutes, and a profit maximising firm would operate at a lower rate of output and charge higher prices. Resources would be misallocated and society's welfare reduced.

These traditional results are shown in the accompanying diagram. Assume that long run average costs are constant for both firm and industry and are represented by the line Mc = Ac (marginal cost equals average cost). The perfectly competitive output would be at Qc where Mc intersects the demand curve DD. If a monopolist were substituted, profits would be maximised by producing Qm at price P. The monopoly profit would be represented by the rectangle ABCP. The loss of consumers' surplus is measured by the trapezoid AECP. The part of this area represented by ABCP, however, is not destroyed welfare but simply a transfer of wealth from consumers to the monopolist. The net loss to society as a whole from the monopoly is given by the 'welfare triangle' ABE.



This highly stylised model of competition and monopoly became widely accepted and provided much of the underpinning for interventions aimed at correcting so-called 'market failures'. Monopoly was seen as a pervasive problem, and the focus of regulators' attention was to resist the concentration of industries into a single firm.

However, doubts about the validity of the neoclassical model steadily accumulated. One source of difficulty was the small size of researchers' estimates of the welfare losses arising from monopoly, even when measured against the (in practice unattainable) perfect competition ideal. Most studies put them at a minimal fraction of national income, thus calling into question the pervasiveness of the problem. Nobel laureate George Stigler summarised the conclusions of a large body of research by saying: "The evidence that monopoly is important is negligible, and the evidence that it is a quite minor influence on the workings of the economy is large".

A second source of doubt as to the efficacy of anti-monopoly regulation arose from the recognition that intervention involved costs as well as benefits, and the costs frequently took the form of 'government failure'. Regulators do not always have the information or incentives to make superior decisions, and regulations aimed at protecting consumers may be subverted by producer interests. Antitrust and competition laws have frequently been used by firms to maintain or acquire a competitive advantage over rivals. They have been assisted in this by a large and expensive industry of professional advocates, estimated to yield around $50 million a year to economists alone in the United States.

However, by far the most important reason for the collapse of traditional approaches to this area of regulation has been the revolution that has occurred in understanding the behaviour of firms in competitive markets. Contemporary economic analysis calls into question the intellectual foundations of both 'antitrust' and 'competition policy' approaches to market efficiency.

A key problem with the model of monopoly presented in the diagram is its static nature. It fails to explain adequately how monopoly profits can be maintained for any length of time when new entrants are free to enter the market and compete for business. In the real world, limited and temporary monopoly positions are common, ranging from the dependence of a rural community on a single country store (provided its prices and service do not get out of line with the closest alternative) to the advantages of being first in the market with a new product. The efforts of producers in striving to satisfy consumer wants or fill a new market niche are not a basis for regulation; indeed it is such temporary profit advantages that provide the stimulus for innovation and improved efficiency from which consumers benefit.

Similarly competition is misconstrued as a process of arms-length rivalry between non-cooperating firms. So long as resources are scarce, competition will occur under any set of economic rules; what changes is the form that it takes. Thus the stated primary aim of the Commerce Act of promoting competition is an elusive concept. The economic problem is not one of allocating resources efficiently when everything is known and constant. Rather competition is an entrepreneurial process of discovering what, in fact, consumers prefer and which firms, employing which strategies, can best supply those products. In this view of competition, the costs of acquiring information and the costs of transacting, which are left out of the traditional model, are of paramount importance. Without them, large firms would not exist and there would be no reason to suppose that collectivist systems would be less efficient than market economies.

These insights have had major implications for policy in overseas jurisdictions. It had long been regarded as a paradox that the more efficient and successful a firm became in meeting its consumers' needs and gaining market share, the more it became the object of suspicion on the part of the regulatory authorities. Concepts of 'dominance' and efforts to prevent the formation of monopolies or 'trusts' have given way to a focus on any uneconomically unjustifiable barriers to competition in a market and any problems arising from the size and duration of sunk costs which might provide the potential for behaviour detrimental to consumers. Potential competition in these circumstances is also now seen as being as important as actual competition in disciplining firms' behaviour.

Similarly in the area of trade practices, it has come to be appreciated that a wide variety of information-sharing practices and commercial contracts promote efficient coordination and are not properly viewed as anti-consumer. Again the paradox is apparent when it is recognised that the earlier approach would have the enforcement authority move against firms that charged low ('predatory') prices, charged high (monopoly) prices, and charged prices that are the same (collusion). When information and transaction costs are taken into account, such practices as exclusive dealing, tying of sales and resale price maintenance, which appeared to neoclassical economists as anti-competitive forms of behaviour, can be seen as potentially efficient cost-minimising devices. The modern presumption is that, if such practices are observed in competitive markets where other forms of contracting and commercial organisation are available, their survival indicates that they are serving consumer needs efficiently.

These developments in economic thinking have, as yet, only been partly assimilated in New Zealand law and practice. The revised Commerce Act maintains the old concepts of 'market dominance' and 'substantial lessening of competition' as the central criteria for intervention. A modern approach would distinguish between competition and efficiency and recognise that the former is important primarily as a means to the latter. Indeed it would perhaps reduce confusion if the term 'competition policy' were discarded in favour of 'efficiency policy', since economic efficiency should be the sole rationale for this type of intervention.

At the level of practice, the New Zealand Commerce Commission has remained a more activist body than many overseas counterparts. It is one of the largest quangos with around 60 staff, as well as being one of the least accountable in the sense of not having to set out in a transparent fashion estimates of the costs and benefits of its interventions. The Federal Trade Commission in the United States, an economy around 100 times larger than New Zealand, intervened in only 9 cases last year, and a comparable rate of intervention in New Zealand would imply one such case every 10 years or so. The New Zealand body has declined on average two or three merger or takeover proposals in each of the last four years.

A key consideration for efficiency policy in New Zealand is the widespread liberalisation of the economy in recent years. In the former protected environment, competitive pressures and alternative opportunities for consumers were often absent, and scope existed for firms or other groups to abuse their market position. Such situations are now much fewer, and are largely confined to areas that have not yet been liberalised such as some statutory monopolies, licensed occupations and monopoly organisations in the labour market. In the case of internationally competing industries, it is now critical for the survival and growth of New Zealand firms that there should be no economically unjustifiable barriers to rationalisation and improved efficiency, which may in some cases mean a reduction in the number of New Zealand producers. Regulatory obstructions to such adjustments risk weakening firms, destroying job opportunities and pushing New Zealand enterprises artificially into foreign ownership.

Do the developments in economic thinking and practice, together with the emergence of a more competitive economy, remove the need for an 'efficiency policy' in New Zealand? Governments have a duty to establish well-defined property rights and provide a sound legal system in order to enable markets (voluntary exchanges) to work efficiently. But there is widespread disenchantment with traditional antitrust policy across the spectrum of leading scholars and many have called for its repeal. It includes economists of the 'left' such as Kenneth Galbraith who describes antitrust as a "charade" and "the last eruption of an exhausted mind", and Lester Thurow who has labelled it a failure whose costs "far exceed any benefits it brings". Some of the close associates of presidential candidate Michael Dukakis advocate repealing antitrust to help United States firms meet Japanese competition. At a recent conference the Chairman of the New Zealand Commerce Commission expressed the view that the Commerce Act was "thoroughly defective in very many respects".

However, although a strong consensus exists that the grounds for such efficiency policy interventions are now greatly restricted, it may be premature to conclude that total abolition is justified. There is a danger that in rejecting the basis of many aspects of earlier policy we slip too easily into the conclusion that problems cannot arise in a liberalised economy. If potential efficiency losses can arise, it will then be necessary to consider whether a regulatory agency will improve matters or whether it is likely to do more harm than good. This year's review of the Commerce Act provides an opportunity for a more searching reappraisal of the issues with a view to determining the best policy for New Zealand.

MISCELLANEOUS TOPICS

ADDRESS TO THE WHANGAREI CHAMBER OF COMMERCE

THE NEW ZEALAND BUSINESS ROUNDTABLE

DAVID RICHWHITE
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MEMBER OF THE
NEW ZEALAND BUSINESS ROUNDTABLE

WHANGAREI
14 OCTOBER 1988

THE NEW ZEALAND BUSINESS ROUNDTABLE

In opening my address I would like to set the scene by telling you quite clearly where I stand on the New Zealand economy. I believe that New Zealand is probably at the most critical stage in its economic history. We have two quite clear paths available to us. We either go forwards to greater economic, social and cultural wealth, or alternatively, if we choose the wrong path or do nothing, we will go backwards to third world nation status. We are at a critical watershed.

The New Zealand Business Roundtable is committed to ensuring that we pick the right path for the benefit of all New Zealanders and all sectors that make up our society. The wrong decisions now, a U-turn in economic policy, or any wavering in terms of commitment will be disastrous for New Zealand.

I would like to quote to you from the New Zealand Business Roundtable's Statement of Purpose which sets out the objectives of the organisation.

> "The New Zealand Business Roundtable 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.
>
> A healthy and dynamic business sector, generating an adequate flow of profits and investment, is seen as fundamental to the achievement of the economic, social and cultural aspirations of New Zealanders. 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."

The development of the Business Roundtable has been in part a response to changes in the economic and commercial environment in New Zealand. In its present form, it evolved out of the 1984 Economic Summit. Roger Douglas observed in his recent book that lobbying for sectional interests used to be a full-time activity for businesses in New Zealand. It was directly related to how politicians saw their jobs - as keeping people happy. By the early 1980s it had become clear to many New Zealanders that the outcome of that process was a road to nowhere.

As Roger Douglas recorded, Sir Ronald Trotter - who became chairman of the Business Roundtable after the Summit - and a new breed of business leaders encouraged a more focused debate in the organisation and accepted that it was no longer advantageous to lobby governments for their own interests. He added that:

> "They have shown since then that they 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".

I think that is a fair summary of the approach we have tried to adopt.

The organisation comprises chief executives of major New Zealand business firms. Numbers are limited to around 35-40 to make it practicable to discuss matters 'around a table'. There are several counterpart organisations overseas, set up with a similar purpose of providing busy chief executives with an efficient means of taking an interest in national affairs.

Our members represent firms operating in virtually all sectors of the economy. This has been a deliberate policy. The range of interests extends from the rural sector to forestry, manufacturing, transport, retailing, construction, communications, finance and insurance. With state-owned enterprises becoming increasingly a part of the private sector business community, the chief executives of the two largest SOEs, the Electricity Corporation and Telecom Corporation, have recently become members.

One myth that has been put around is that the organisation does not represent the interests of the manufacturing sector. It has been suggested that its interests are those of the high-flying investment companies, 'paper shufflers' and multi-millionaires.

This is indeed a myth. The fact is that, within the membership constraint of around 40, the majority of large New Zealand industrial companies are represented in the organisation. Elders Resources NZFP and Comalco New Zealand Limited have recently been added to the list. Indeed, some might argue that the sector is over-represented in relation to its share of the economy. Conversely, none of the investment or property companies that have collapsed in the wake of the sharemarket fall of last October were members of the Business Roundtable.

Mike Moore recently observed that some New Zealanders still talk about the 'productive' sector of the economy. Real work in their minds is growing crops or livestock or making things in factories. Banking, telecommunications, education, transport and health services are dismissed as non-productive.

The truth is that New Zealanders nowadays spend the bulk of their incomes on services. An uncompetitive financial sector, a protected transport industry or an inefficient health system is a tax on the farmer or the manufacturer. This directly affects our standard of living.

For these reasons the Business Roundtable is representative of such activities and has taken a close interest in service sector topics such as telecommunications, accident compensation and tertiary education.

Despite its spread of representation and interests, the Business Roundtable is not a large or formal organisation. It meets for half a day on only half a dozen regular occasions a year. It does not have any industry servicing role. We are one of the smaller national organisations with a total staff of three, based in Wellington. In terms of both people and resources, organisations like Federated Farmers and the Council of Trade Unions are far larger.

Let me turn to our philosophy and approach to national affairs. I indicated that the statement of purpose of the Business Roundtable commits it to promoting the overall development of New Zealand and the interests of all New Zealanders concerned with achieving a more prosperous economy and fair society. In other words, the interests are not just those of business, big or small.

We support the concept of a competitive, market-oriented economy and a consistent medium term approach to economic policy. The statement also affirms a government responsibility for promoting a fair distribution of income and for pursuing other social equity objectives in a well-considered and cost-effective way.

There can, of course, be legitimate debate about overall community interests and the means of achieving them. Some of the viewpoints which we have expressed have been controversial. Two years ago, for example, one leading businessman accused the Business Roundtable of having a 'death wish' in arguing for a deregulated, enterprise-oriented labour market. It is rather ironic that, thanks in part to the change in the climate of opinion which the organisation has been instrumental in promoting, his own firm is likely to achieve its longstanding ambition of negotiating a company agreement in the present wage round.

A conflict of ideas is inevitable wherever people are looking for new and better ways of doing things. There is no law that says that representatives of political parties, business organisations or community groups have a monopoly on the public interest. A good deal of evidence tells us that politicians, in particular, often pursue, or are captured by, sectional or party interests. The proper focus of debate should be on the analysis and factual evidence that supports a particular argument, not the source from which it comes.

The Business Roundtable has tried to adopt a professional and well-researched approach to the issues which we have taken up as an organisation, and to steer away from debate that is framed in terms of particular interests and ideologies. In research projects, we have endeavoured to engage the ideas of leading figures in the specific fields of study.

If the ideas are soundly reasoned and consistent with the principle of advancing broad national interests, we hope that governments, other political parties and the public will be influenced by them. If these standards are not met, our views deserve to be ignored.

Against this background, I regard the accusations of self-interest that have been made about the goals which my business colleagues and I share as ill-informed. In the first instance, their duties as chief executives are not to look after themselves but to serve the interests of, for example, the 200,000 shareholders in Brierley Investments, the 25,000 employees in Fletcher Challenge, and the half a million New Zealand policyholders in AMP.

More than that, they have been prepared to give up their time to Business Roundtable activities, and in many cases to help the government as directors of state-owned enterprises, because they want to make New Zealand a better place in which to live, work and do business. Colleagues like Colin Jenkins and Alan Gibbs have devoted an enormous amount of time to government inquiries into social welfare and health. Cheap shots about millionaires both miss the mark and are a throwback to the politics of playing the man instead of the ball.

When the history of the 1980s is written, and assuming we complete the transition away from the third world status into which we were rapidly sliding, I believe it will record that New Zealand owes a considerable debt to business leaders like Sir Ronald Trotter and farming leaders like Sir Peter Elworthy who put their credibility on the line in the interests of the country.

It takes a brave man to swim against the currents of the last fifty years' trends and attitudes. Believe me, these people are New Zealanders and have New Zealand's best interests at heart. They are not driven by personal gain. They are not driven by some alien political ideology. They simply want to make New Zealand a better place for all of us.

It has been remarkable that within the Business Roundtable there has been little disagreement over the economic direction that New Zealand needs to take. For a group of independently-minded people, the divergences of view have been few and far between by comparison with the spectrum of opinion that exists elsewhere.

In my view this is partly due to the fact that sound analysis and research points to relatively clear-cut conclusions on many economic issues. Where there have been differences of view, they have not been about fundamental analysis but about whether politicians will have the understanding and resolve to put in place all of the elements of a successful economic strategy for New Zealand. There has been justifiable concern that the job may only be half done, and that those who have borne the brunt of the adjustment to date will be left floating in the breeze.

There have been two areas of major doubt about the government's performance. The first is its abysmal record of controlling government spending. Between 1984/85 and 1988/89, spending on administration has increased by 83 percent in real terms, social welfare by 28 percent, education by 26 percent and health by 18 percent. As Ministers have themselves acknowledged, few New Zealanders regard themselves as commensurately better off. Virtually all the progress in reducing the fiscal deficit has been made by raising taxes, not by the government restraining its own spending.

This big spending pattern is similar to the Whitlam and Kirk Labour governments of the 1970s, but very different from the Hawke government in Australia. As Australian commentators have noted, the Hawke/Keating administration has replaced the woollyminded social policy mentality of the Whitlam era with hard-headed economic realism. Whereas they have reduced central government spending by around 4 percentage points of GDP, from 30 percent down to 26 percent, government spending in New Zealand has *increased* by a similar proportion.

Achieving social goals in New Zealand still appears to be measured by many politicians in terms of increased government spending. The cost of fifty years of misdirected government spending in social areas will be counted for many years to come in this country, and it is vital that our leaders come to grips with the inter-relationship between the economic and social dimensions of life. I cannot understand why you would have a social policy that encourages people not to work. We have bred a generation of New Zealanders who sincerely believe that the state owes them a living. They do not believe in the fundamental principle that you get out of life what you put into it.

The second major area in which the government has appeared paralysed, and a hostage to outmoded ideas, is the labour market. It is a tragedy for the 120,000 workers now unemployed, and for regions like Northland, that the freeing up of the labour market is precisely the change that has been most strongly resisted by some union officials and elements in the Labour Party and the government. The return to compulsory unionism, the absurd barriers placed in the way of workers wishing to opt for coverage by a different union or form new ones, and the forced amalgamation of unions into units of at least 1,000 members all seem designed to protect the position of the established union hierarchy at the expense of the unemployed.

Similarly the sharp rise in minimum wages and the contemplated increase in female wage rates under comparable worth legislation demonstrates the political power of those in jobs over those without.

New Zealand has no chance of becoming a dynamic, high employment economy, and Northland has no chance of becoming a prosperous region that can exploit its own advantages, while rigid national awards and centralist union structures obstruct progress.

The labour market has many diverse characteristics, but fundamentally labour is like any other commodity. Ultimately the price for it must be determined by supply and demand. Both employers and workers alike must be able to negotiate the price of labour free from outside influence that is motivated by political ideology rather than sound economic objectives.

Just as the Business Roundtable has both supported and criticised aspects of the government's economic policy, we have done likewise with respect to the Opposition. We criticised the National Party's Extax proposal, and remain critical of their muddled approach to labour market issues. There is little consistency between the views of Ruth Richardson, Winston Peters and Bill Birch in this area. They seem unsure whether they are for deregulation and less intervention, or job subsidies and more intervention.

Similarly, the National Party is totally inconsistent as to whether or not to intervene in order to influence the exchange rate and interest rates.

These are not only my views or those of the Business Roundtable. They are shared by many, including the *Wall Street Journal* which, in a recent article on Roger Douglas's battle to reform New Zealand economic life, wrote:

> "The Opposition blows 'an uncertain trumpet'.
>
> "Go-getters like Ruth Richardson would like to carry forward Mr Douglas's reforms. The other half, which includes party leader Jim Bolger, are still floundering...
>
> "Had the Nationals been out there with Joshua, the walls of Jericho would still be standing."

After four years in Opposition the National Party should have made considerably more progress in reshaping its economic thinking.

The Business Roundtable is committed by its charter to a stance which is totally a-political. Our interest is in promoting the adoption of sound policies by all political parties. Business and unions are not estates of the realm and there is no place for political compacts with them. Not only does corporatism undermine the quality of a democracy but it serves the interests of workers and shareholders poorly if their representatives are not able to work constructively with all governments and political parties.

One of the positive things about New Zealand in recent years has been the willingness of many sections of society to accept sacrifice and change and put New Zealand's interests first. Fifty years of economic mismanagement gave rise to a broad consensus that New Zealand had to change and join the real world. In its first term of office the government showed itself prepared to take the longer view, accept political risks and, by and large, deny special interests privileged treatment. The electorate endorsed that approach.

We must continue to be positive, take the longer view and put New Zealand first. Last year my partner Michael Fay spoke of his vision for New Zealand in the 1990s. The Prime Minister has spoken of his vision of the country a decade out from 1984. I see little difference between these visions and I share them.

As a nation we must have vision. We must be prepared to make short term sacrifices and invest for long term rewards.

For 44 of the last 48 months, Michael Fay has been pursuing the America's Cup. This is not one man's dream or some egotistical obsession with winning an old silver mug. It is an investment in New Zealand and New Zealand's future. New Zealand design and construction skills, New Zealand technology and marketing made our effort in the America's Cup possible. The pay-back for my company and for New Zealand from this investment is potentially enormous.

The leading companies in the Business Roundtable have demonstrated the value of strategic, long-run thinking in the relative strength of their performance since the sharemarket crash. Business confidence is tentatively rising again. We must show a willingness to overcome setbacks, eradicate a legacy of sloppy business management and strive for international excellence in all our businesses.

We are entitled to expect no less of our political leaders.

The task of economic restructuring that lies ahead is enormous.

I believe the significant risks for us are not policy U-turns but creeping paralysis, compromises at all the margins and death by a thousand cuts. In this way the adjustment process will at best stretch out interminably and at worst, given spiralling social expenditures and our debt burden, will take us on the long slide back towards third world status.

The path is clear. As *The Economist* recently pointed out, "you leap towards freedom, not shuffle".

I encourage every New Zealander to decide his or her vision, make the short term sacrifice and leap towards the type of New Zealand we all yearn for.

LEFT OR RIGHT : THE BOGUS DILEMMA

AUCKLAND ROTARY CLUB

ROGER KERR
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NEW ZEALAND BUSINESS ROUNDTABLE

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AUCKLAND

LEFT OR RIGHT : THE BOGUS DILEMMA

The title of my remarks today is borrowed from a book written in 1968, a full 20 years ago, by Samuel Brittan, perhaps the leading financial journalist of our day in the United Kingdom.

With understanding and foresight, Brittan demonstrated how explanations of political and economic thinking in terms of a left-right spectrum were meaningless in relation to many issues and becoming increasingly irrelevant to British political debate. Worse, he argued, they lead to the muffling of important issues, to a bias in favour of certain viewpoints against others, and to the erection of unnecessary barriers between those who should be natural allies.

In the intervening couple of decades one of the most remarkable phenomena in politics has been the emergence of what P P McGuinness, the former editor of the Australian Financial Review, has called the social-democratic consensus on economic policy. This consensus cannot in any remote way be analysed in left-right terms. As McGuinness puts it:

> "This agrees on the need for a more liberal economic regime in which government ownership and regulation are not oppressive, in which individual economic activity is not discouraged by excessive taxation or direction, in which the reality of the market is incorporated into the policy objectives of governments, and in which welfare and social policy measures are judged by their efficacy, not by their ideological purity."

There has never been a strong ideological tradition in New Zealand politics. Early historians recorded that it was largely practical expediency, or socialism without doctrines, that led us down the road to the land of milk and subsidies, state ownership and cradle-to-grave social security. Similarly it has been practical evidence of the results of these policies that has led us to a reconsideration of them during the 1970s and 80s.

An amusing illustration was provided last year by MP Paul East. He was reported as remarking:

> "When I said to one of the Labour members the other day, 'How goes the class struggle?' he thought I was talking about the teacher-pupil ratio".

Perhaps because of our customary slowness to absorb the lessons of trends in thinking in economically and socially successful countries, the left-right stereotype has not yet been exorcised from New Zealand political debate.

Partly this may be due to the tendency observed by Andrew Knight, a former editor of *The Economist*, for journalism as an estate to lag behind the flow of opinion, in the case of his own paper to the point of being slow to see the significance of Mrs Thatcher, despite its own liberal, free-market and reforming view.

Partly it may be explained by survey results which have shown that a majority of journalists remain "on the left", in conventional political terms, and may not reflect mainstream opinion.

A third possibility is that, as Brittan notes, "left" and "right" are elite words, despite their constant use in the press and on television, and have meaning only for the small politically interested minority.

Thus a number of commentators continue to apply the conventional labels to identified viewpoints, often for the purposes of opposition or even abuse. New Zealand journalists or columnists like Bruce Jesson, Fran O'Sullivan, Linda Clark and W P Reeves frequently speak of a "new right" while others refer to a "new" (or "broad") "left".

There was a fascinating response to an article a couple of years ago in a Sunday paper on the subject of the so-called "new right".

Bob Jones, presumably a man of the "right" in conventional terms, expressed "bemused disgust" at the notion that there was anything "new" or "right" about the ideas that were being attacked.

Aubrey Begg, a former Labour Party MP and respected farmer-politician, pointed out that:

> "Free marketing and deregulation are not right wing policy stances. They are the policies of those who believe in individual liberty and the availability of choice in a competitive environment. Right and left wings are of the same political ilk. They believe in controls and dictatorial government. There was, for example, no difference between Hitler and Stalin."

Begg's comment says it all, but it is worth underlining. Hitler was a national socialist; he was anti-capitalist; there was a reciprocated admiration between him and Stalin.

Closer to home, we can see the same associations in some of Roger Douglas' critics in the Labour Party.

An article on the recent Labour Party conference reported a spokesperson for Labour Youth calling for a U-turn in Government economic policy - Stalin had achieved in 20 years what the West had taken 200 years to achieve, she said.

On what might appear to be the "other side" of politics, *The Economist* wrote in 1984 that:

> "Sir Robert Muldoon was usually branded a "right-winger". So he was, on social and military issues. In economic terms, though, he was as much an interventionist as any Marxist dreamer or socialist soldier. Markets were there to be suppressed or ignored, businessmen to be bullied".

Perhaps a first clue as to a more relevant distinction in contemporary politics is between advocates of individual initiative and social equity on the one hand, and social engineering and control on the other.

Samuel Brittan, writing as you will recall in 1968, pointed up a number of other paradoxes for those in the grip of the spectrum theory of politics. He noted that the straight identification of the left with opposition to capitalism was in fact only accurate during the so-called "socialist generation" in England from 1918 to about 1950. On the other hand, modern large scale industry had gone virtually unrepresented among Conservative MPs, who tended to be suspicious of this key sector of the British economy.

Political attitudes to the issue of international trade are interesting. In an article last year, Anthony Hubbard of *The Dominion* found it curious that Dr Michael Cullen, in a booklet by Otago Labour activists called 'Looking Left', praised the virtues of competition and criticised heavily protected, uncompetitive industries. Brittan points out that for much of the past century, the "right" in the United Kingdom has typically been more protectionist than the "left". In the United States, the Reagan Administration, despite its rhetoric, has been the most protectionist administration of the post-war period.

Brittan examines some alternative classifications of ideological groupings, some of which offer useful insights, but concludes there is no one alternative set of polarities to replace the unsatisfactory left-right spectrum. The patterns are too complex to be put into boxes.

On several key issues, he finds that the dividing line in political positions is mainly one of generation. Another division is between optimists with faith in the ability of society, led in the right direction, to improve on its organisation and values, and those who are pessimistic in the sense of thinking that change is more likely to do harm than good.

I believe there are applications of all those insights to New Zealand political experience. However, perhaps the most interesting and relevant of all Brittan's findings in this context is that in the Labour-Conservative battle:

> "... the difference between the two parties at any one time is a tiny fraction of the difference that exists between one party's policy today and that same party's policy a few years previously."

The observation, he adds, now applies over astonishingly short periods.

The same analysis is surely true of New Zealand politics. For the past couple of generations, both major parties were essentially in accord on the policies that held the country back. They, and the major interest groups, supported or acquiesced in the development of Fortress New Zealand, the progressive ossification of our labour market, the auction contest for more generous superannuation arrangements, and the relentless growth of government expenditure. How often was it said : "There is really no difference between the two parties"?.

In the 1970s and 1980s both major parties, at first timidly and then with greater boldness, have progressively abandoned the great New Zealand experiment and moved on closely parallel paths towards more orthodox policies. In my interpretation, ideology and dogma have had little to do with this development. History teaches us that while leadership in politics does matter, by and large politicians are the agents of the electorate. The New Zealand electorate quite clearly had the intelligence to recognise that we were on the road to nowhere, and demanded change.

If this interpretation is valid it suggests, for example, that feverish attention to the entrails of periodic scraps in party caucuses may not be the best way to understand likely economic directions in New Zealand in the 1990s. With a more informed and literate electorate, it is possible that any party which fails to learn - or forgets - the lessons of sound economic management will become unelectable, as British experience has shown.

If you think about it, there is not a great deal of dispute in mainstream economic thinking, or in current political debate in the successful economies, about key areas of policy. Privatisation is a world-wide trend; even an industry like electricity is now 70 percent privately-run in the OECD area. Economists of liberal persuasion (in the American sense of the term) like Kenneth Galbraith and Lester Thurow (as well as 'conservatives') have called for the scrapping of anti-trust laws, arguing that their costs far exceed any benefits. Voluntary and contestable unionism, and company or plant bargaining, is the OECD norm and is not called into question when, for example, a Democratic administration replaces a Republican one in the United States. Adam Smith, Marx and Keynes were all free-traders.

Perhaps it is because, to borrow a phrase, we have been living in a gumboot at the bottom of the ocean for so long that these issues are still regarded by some as matters of controversy or political doctrine.

Besides the left-right confusion, we have examples of other labels which do nothing to assist public understanding. One is the use of the term 'monetarist' to describe the financial policies now supported by both parties. To an economist, technical monetarism is an approach to inflation control based on a target rate of growth of the money supply. Ironically, the only attempt to explicitly target a monetary aggregate in New Zealand was by the former Minister of Finance. Official thinking has subsequently been much more broadly based, and in line with the basic rule underlying anti-inflation policies worldwide : "don't print money".

Similarly, the so-called "trickle-down" theory has recently been revived with considerable sound and fury by representatives of the Church in New Zealand. To me, the label more appropriately fits past policies which indeed slowed the river of wealth creation in the economy to a trickle. International evidence strongly suggests that a more open and competitive economic environment narrows the distribution of income, precisely because opportunities for privilege and economic rent are dissipated. It also suggests that, while there is a place for income redistribution, it is a far less powerful tool of equity than growth and progress.

In my view, a twentieth century tragedy is the extent to which the Church has been captured by false doctrines outside the theological domain, including the advocacy of an ever-growing state welfare role in activities formerly carried out so effectively by its own institutions. Those with its interests truly at heart ought to rethink the reasons for the decline in its standing, the logical extension of which is constitutionally godless Russia.

Last year, the two surviving members of the first Labour government were asked their opinion of the economic directions of the present government. They were reported as saying they thought the boy was doing a good job. Given the claims that the party has deserted its roots, I found this intriguing. It prompted me to read the autobiography of one of them, Ormond Wilson, written in 1982 and entitled 'An Outsider Looks Back'.

It is an absorbing book. Wilson was regarded at the time as a left-wing intellectual, yet the dominant impression of the book is of a hard-headed realist. As early as the 1930s, Wilson was expressing misgivings about the decline in religious belief, and the appropriation by the state of functions that were regarded as the duty of Christian churches and institutions. He portrays the changes of the 1930s as modest, not revolutionary. The core of the debate in the 1935 election was not about socialism but "that practical though elusive commodity, money". Keynes was regarded as an impractical economic theorist. The popular designation of caucus members as left wing or right wing was far from the mark. And so on.

Wilson is particularly interesting on the subject of trade unions. "If some of us had been far-sighted enough", he writes, "I think we might have persuaded [the Minister of Labour] of the potential side effects of his [compulsory unionism] legislation". Compulsory unionism, and the practice of leaving to employers the collection of union dues, has led members "to be lethargic in their attitude toward union affairs and ... hostile to the officials who are seen as masters rather than servants".

More generally, Wilson notes that "the trade union movement was born of the struggle against oppression, and the oppressor was the capitalist boss". "In New Zealand in the eighties", he says, "the capitalist boss has almost vanished from the scene, but the myth remains, and is the stock-in-trade of all those trade union functionaries whose livelihood and raison d'etre depend on keeping it alive". Other orthodoxies like the five day week and penal overtime rates may well have been advantageous in the conditions of the thirties, but "they are not suited to the needs of the eighties and no longer enhance the quality of life of New Zealanders as a whole".

Wilson concludes his book by observing that:

> "... as in the early thirties, all the indicators for the eighties imply change, even traumatic change. The process will be uncomfortable, but if historical precedent is anything to go by, this may yet engender a new social consciousness."

The theme of my remarks has been that such a consciousness may be unfolding in New Zealand, and that it has nothing to do with notions of "left" or "right" wing thinking or some of the other bumper stickers of popular debate.

The intellectual revolution of the 1970s and 1980s has discarded the idea that competitive markets are an instrument of social domination. Markets require willing sellers and willing buyers; they promote co-operation and service. It is poorly directed government intervention and coercion that more typically creates conflict and exploitation in society.

The philosopher Irving Kristol has said that the major political event of the twentieth century is the death of socialism. In an important sense this is true : the megatrends of our time involve a rejection of bigness, centralisation and bureaucracy. But in doing so they embrace small-scale, entrepreneurial, co-operative, profit-sharing endeavours which are spontaneous and communistic in the real sense.

If this analysis is correct, we may be seeing an emerging social consciousness of the "non-left" and "non-right" - perhaps the "far centre" would be a better term. It suggests the battle for electoral success may be fought less on ideological grounds, at least in the economic domain, and more on the quality of political and economic management that a party can offer.

It may even be that a continuation of such trends will result in matters which we now regard as political and contentious becoming effectively apolitical and removed from the political agenda. The scope of national politics might shrink, as in that most successful of democracies - Switzerland. How many of us can think of the name of a single Swiss politician? Remember Thomas Jefferson. He had other things to tell us on his gravestone than that he was once the President of the United States.

THE SWEDISH MODEL?

UPPER HUTT CHAMBER OF COMMERCE

ROGER KERR
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE

13 SEPTEMBER 1988
UPPER HUTT

THE SWEDISH MODEL

In recent years the Business Roundtable and many other employer groups have devoted a lot of attention to employment relations in the New Zealand labour market.

We have been gravely concerned that failure to comprehensively reform what David Caygill once described as New Zealand's 'rickety' industrial relations system would stunt productivity growth and lead to a surge in unemployment as the government pursued other policies to eliminate inflation and make the economy more competitive. Unhappily, those predictions have proved to be all too accurate.

The essence of our analysis has been that New Zealand's highly centralised, occupation-based wage fixing system is incompatible with the new internationalised economic environment. The needs of firms and workers in a diverse and rapidly adjusting economy can only be reconciled by moving employment relations to a much more decentralised level.

Logic and experience tell us that a more and more complex society works less and less well with centralised methods of regulation. Centralised mechanisms are increasingly unable to acquire and process highly dispersed information and to coordinate social activity in a harmonious way. The worldwide trend is away from bureaucratic systems and towards structures that are more flexible, entrepreneurial and individualised.

Nowhere is this tendency clearer than in the area of employment relations. Work patterns in the modern economy have undergone dramatic changes.

Trends have included the growth in female participation, an increase in job changes per career, multi-skilling, a rise in part-time employment, more flexible hours of work, increased labour contracting and self-employment, to name but a few.

Their common feature is the increasingly individualised nature of work requirements. To treat labour as a uniform commodity, as we do for example with blanket, national level awards, is to depersonalise workers and ignore the extraordinary diversity of the labour market. Higher productivity and improved job satisfaction both depend upon the ability to tailor rewards and employment conditions much more closely to the circumstances of specific firms and workers.

For these reasons, employer organisations have argued for moves towards a voluntary, decentralised system of employment relations, primarily along enterprise lines. Progress has been made in this direction. At the policy level, centralised wage controls have been scrapped, voluntary arbitration has been introduced, the government has refrained from intervention in wage bargaining and the State Sector Act represents a significant shift toward enterprise agreements. The Labour Relations Act aims to give workers more choice in union representation and provide bargaining alternatives to national awards.

At the industry and firm level, considerable progress has also been made in improving communication and developing the trust needed to accomplish change. A measure of this progress was the recent action by a group of newspaper workers to strike in protest at the stance of their national union.

A Heylen survey released earlier this year showed there was strong support, including among trade union members, for voluntary unionism, worker choice of representation, individual contracts with employees and workplace collective bargaining rather than national awards.

Both the continuing economic pressures for greater decentralisation and the general climate of opinion suggest the clock is unlikely to be turned back.

The Business Roundtable has often pointed to Japan and Switzerland, and to a lesser extent the United States, as examples of countries where the benefits of a decentralised, deregulated labour market are readily apparent. They are high productivity, high wage, high employment economies. Employment relations are based on a recognition of the mutual interests of firms and their employees, rather than a conflict model. Their systems are stable and largely depoliticised.

The opposition in New Zealand to changes in this direction has come not from workers or the public at large but predominantly from officials of national level unions. Some have promoted an alternative vision of a centralised tripartite approach to employment relations, based on what has sometimes been described as the "Swedish model". Little evidence has been put forward in support of the alleged benefits of such an approach. It may therefore be instructive to examine more closely the facts of Sweden's economic performance and the effects of such policies on the Swedish way of life.

For the last couple of decades, Sweden has in many ways been a laboratory for social engineering. The image portrayed is that of a wealthy, dynamic economy, sustaining high employment levels and coping better than most with the economic challenges of the 1970s and 1980s. By implication this "success story" has been due in no small measure to the workings of the centralised wage bargaining processes, government intervention in the economy and close union involvement in many facets of industrial and social life. (Mainly because of the union monopoly on unemployment insurance, trade unions now cover 85 percent of all employees.)

The reality, as we shall see, has been rather different.

A variety of studies of Sweden's modern economic history are in basic agreement on the central facts. Its impressive rise followed by relative decline has many parallels with New Zealand and many lessons for us.

During the half century to the end of the 1960s, Sweden advanced from being one of the poorer countries in Europe to one of the wealthiest. The 25 years following World War II, in particular, were something of a golden age of high growth, low inflation and virtually full employment. This record was due to what would now be recognised as basically sound, orthodox economic policies.

Sweden took part in the post-war era of trade liberalisation. It offered its industries very little protection against external competition. Few obstacles were placed in the way of industrial specialisation and concentration. Strong multinational enterprises developed with firms like ASEA, Electrolux, Volvo, Alpha-Laval, SKF, Saab-Scania and Ericsson becoming household names around the world. Prudent budgetary policies were followed. In 1960, the share of government expenditure in national income of around 30 percent was close to the industrial country average. Fiscal deficits were small. An important ingredient was a productive workforce and a long tradition of harmonious relations between employer and employee. Wage developments closely matched productivity growth, agreements were strictly enforced and governments generally adopted a "hands off" approach to the labour market.

Some of these traditions of economic management have continued and helped sustain the Swedish economy during the 1970s and 1980s. Among the aspects not always highlighted by admirers of the Swedish model have been a general refusal to shield industries from international competition, minimal state ownership of businesses and considerable freedom in domestic markets such as the absence of any significant restrictions on shop trading hours.

However, Sweden's economic performance took a marked turn for the worse from around the end of the 1960s. The Palme government, elected in 1968, represented a "lurch to the left" which took the bloom off the apparently pragmatic face of Swedish social democracy. The leadership of the trade unions also took a radical turn to sharper, more ideological confrontation with employers.

The old tacit agreement - that wages should be set by reference to the needs of internationally competing industries - broke down. Labour costs escalated, industrial unrest grew and productivity declined relative to major trading partners. Sweden was forced to devalue five times between 1976 and 1982, by a cumulative total of more than 40 percent. Inflation reached double figures for a number of years.

Sweden was struck by stagflation more than most comparable countries, and much worse unemployment was avoided only by expelling migrant workers and expanding public sector and tax-financed jobs. The public sector swelled to huge proportions, rising from 44 percent of GDP in 1970 to a peak of 68 percent in 1982. The entire growth in employment occurred in the public sector; today nearly 2 jobs out of 5 are provided by the government. Tax rates escalated, with the average married industrial worker facing a marginal income tax rate of about 50 percent. The top marginal tax rate reached 80 percent. However, taxes did not keep pace with the growth in government spending, resulting in a budget deficit which peaked at 13 percent of GDP and a build-up of public debt to a level of 25 percent of GDP. Although this is "only" around one third of New Zealand's level of debt, it has been regarded as alarming by most Swedes.

The overall performance of the Swedish economy in this period has been little better than New Zealand's. The volume of Sweden's GDP increased by only around 29 percent from 1970 to 1985, compared with an increase for OECD Europe of 38 percent and for all OECD countries of 48 percent. Its average annual rate of growth of 2.2 percent was even lower than New Zealand's meagre achievement of 2.3 percent in that period. Swedish wages after tax increased less than 10 percent in the fifteen years from 1970, and since 1976 real wages may actually have declined. Measured unemployment has been contained to around 3 percent of the labour force by public sector job creation, but OECD estimates put the total of open and hidden unemployment at around twice that rate.

The Swedish model failed even in achieving its own goal of greater equality of income, as is often the case in countries that have adopted highly interventionist policies. Child care subsidies, for example, amount to about $12,000 per child per year, but it is reported that "the biggest beneficiaries of these programs are not the poor but urban upper-middle and upper-class professionals". The proportion of total disposable income accruing to the wealthiest 10 percent of households (ranked by total household income) is 28.1 percent, nearly the highest of any OECD country. By comparison, the figures for Japan and Switzerland, at 22.4 and 23.7 respectively, are among the lowest in the OECD.

The declining economic performance has taken its toll in the area of social services. An example is the health system, which is largely state-run even though patient charges are considerable: $13 for each visit to the doctor or non-life saving pharmaceutical prescriptions, with no exceptions but with an annual limit per patient of around $200. Despite its generous financing, the hospital system has major problems which would be familiar to any reader of the Gibbs report. A recent article in *The Economist* reported that patients wait up to two years for some operations, including heart surgery and cataract removals, and that neither doctors nor country hospitals have an interest in eliminating inefficiencies. It added that the government is now trying to promote competition by, among other things, blurring the demarcation line between public and private medecine and using competitive tendering for support services, despite union opposition.

The deterioration of Sweden's labour market performance has been due to a number of factors. The "solidaristic" wages policy has involved the application of the philosophy of "equal pay for work of equal value irrespective of a firm's profitability or ability to pay", now being proposed in New Zealand, and a deliberate compression of relativities in favour of the lower paid. Inevitably this led to very high rates of unemployment among young and unskilled people, and severe shortages of some forms of skilled labour. A large body of new industrial legislation was enacted in the decade from 1972, including such things as worker representation on company boards, regulations governing redundancy, "co-determination" at work which requires employers to negotiate before making any operational changes affecting employees, and union-run wage-earner funds, derived partly from company profits, which finance investment in Swedish firms.

These increased forms of rigidity remain offset by features such as an industry- rather than a craft-based trade union structure, enforceable no-strike, no-lockout contracts and cooperative enterprise-level employer-employee relations. Despite the centralised features of the system, much of what matters at the workplace is free from interference by remote intermediaries. Nevertheless, the accumulation of restrictions and ideologically inspired interventions has severely impeded productivity and employment growth in the private sector, and it is clear that business and substantial parts of the trade union movement would like to see greater decentralisation, less regulation and more flexibility in wage determination processes. Recent OECD reports on Sweden have also emphasised the need for greater labour market flexibility, and in particular for changes to the traditional institutional framework for wage negotiations.

The role of the so-called active labour market programmes in Sweden has been to try to maintain labour market flexibility in the face of the solidaristic wages policy and the constraints imposed by labour legislation.

The range of programmes has included retraining, employment services, community work projects, relief work, youth teams and unemployment benefits. Like so much else in Sweden, these seemed to work well for quite a time. However, the evidence suggests that the rigidities in the wages system have become too much for the programmes to cope with, despite the sums involved, and that they have been forced into an increasingly defensive "make work" relief mode. Nevertheless, relief is not open-ended and it is noteworthy, for example, that no welfare benefit is payable to anyone under 20 who refuses to work or train. Unemployment benefit is available for a maximum of 300 days, and can be stopped at any time if suitable work or training is refused.

Approaches to labour market policies based on the so-called Swedish model received prominence in Australia a couple of years ago, particularly in the ACTU document *Australia Reconstructed*. The Business Roundtable's counterpart organisation, the Business Council of Australia, sent a study group to examine Swedish experience at first hand. Its conclusions were that the "major lesson for Australia from the Swedish experience lies in enterprise-level negotiations between employer and employee... In many other respects... Australia has a good deal more to gain by avoiding Sweden's mistakes than by emulating them".

Since 1982, Sweden has made some efforts to return to more orthodox economic policies. A number of domestic financial market controls have been lifted. A Brookings Institute study commissioned by the government recommended more vigorous liberalisation measures, the adoption of a floating exchange rate and cuts in government expenditure. Only limited progress has been made, however, and the Swedish economy remains in what one commentator has described as a "sad state of debility". Next year Sweden's companies will invest more in other countries than they will do at home. Crime, drug-dealing, the black economy and welfare frauds are endemic, and social and political paternalism strikes many as oppressive and intrusive.

Certainly in respect of its labour market arrangements, Sweden does not compare favourably with the decentralised and largely unregulated Swiss system. Employment relations in Switzerland are strongly enterprise-oriented, real and relative wages are particularly flexible, no minimum wage laws hinder employment of young and unskilled workers and there are no regulations on hiring and firing. Trade unions are voluntary and respected institutions, and union membership has remained stable at 25-30 percent of the labour force for many years.

Per capita incomes in Switzerland are higher than in Sweden by a factor of one third, and Swiss wages are the highest in Europe. Unemployment has been the lowest in Europe for 50 years. It did not exceed 5 percent in the great depression. The average numbers of unemployed workers in each of the 4 years 1971-1974 were 100, 106, 81 and 221 - individuals not thousands! Recent rates of unemployment have seldom exceeded 1 percent. While the "guest worker" story is part of the explanation as in Sweden, there is much more to it. Youth unemployment does not differ from the overall rate of unemployment, mainly because of a well-organised and efficient system of apprenticeship and the absence of wage barriers. Strikes and lockouts are headline-making rarities.

There is no doubt that labour market trends around the world are firmly away from centralised systems like Sweden and towards the decentralised arrangements of countries like Switzerland. It is imperative that New Zealand makes further progress in that direction as a matter of urgency. An important statement by the government which has gone largely unnoticed was made in the recent Budget. This noted, in the context of a discussion on the need for greater labour market flexibility, that "In many countries economic growth alone has not solved the unemployment problems". At last we may be seeing an acknowledgement that unemployment is basically a labour market issue.

Cooperation between employers and employees is crucial for labour relations to work well, but can only be created out of a recognition of mutual interest, not as a result of tripartite deals or complex legislation on worker representration and bargaining structures. Flexibility cannot be manufactured by tacking active labour market policies on to a rigid system of wage bargaining; flexibility must begin with a system of bargaining that is responsive to the needs of individual firms and workers.

I believe most employers in New Zealand have accepted the need for changes in employment relations. This year at the national employers conference not a single employer representative among the more than 200 present spoke in favour of a centrally managed wage round. The requirement now is to develop a broader understanding of the importance of accelerating moves to enterprise bargaining, individual contracting and voluntary forms of representation. The proper role of central organisations is to facilitate moves in this direction so that the interests and preferences of firms and workers can be reconciled in a more precise and less confrontational way. There seems no reason why New Zealand cannot develop the kind of stable, a-political and cooperative approaches to labour relations that successful countries like Switzerland and Japan enjoy.

As for Sweden, it would not be surprising if that country soon discarded the Swedish model. Those who have written and spoken about it admiringly may find their assessments changing along the lines of an early work on post-revolutionary Russia. The first edition was bravely entitled "The Soviet Union : A Modern Utopia." A subsequent edition came out in the 1920s as "The Soviet Union : A Modern Utopia?" (question mark). A final revised edition in the Stalinist era reads "The Soviet Union : A Modern Utopia!" (exclamation mark). Just as Britain finally awoke to its predicament after decades of economic decline, we may find Sweden in due course beginning the painful process of recovering from the Swedish disease.

ADDRESS TO THE ROYAL AGRICULTURAL SOCIETY

SOME NEW ZEALAND MYTHS

SIR RONALD TROTTER
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NEW ZEALAND BUSINESS ROUNDTABLE

AUCKLAND
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SOME NEW ZEALAND MYTHS

Every country puts a fair dose of myth into how it thinks about itself. These myths serve a variety of purposes. Some are relatively harmless, like the tall stories told over a beer when the shearing is done for the day. Others are potentially destructive. What begins as a little glossing over the truth, a little turning of the head, a little misjudged hyperbole, years later comes to cost heavily.

New Zealand has not been immune. As A.R.D. Fairburn put it forty years ago:

> "We New Zealanders are one of the dullest, most stupidly conservative, most unenterprising races on this planet. By a long course of self-hypnotism extending over several decades we have persuaded ourselves of the opposite - that we are bold, enterprising, progressive, intelligent people, unhampered by the shackles of the past. The sooner we realise what damned nonsense this is, the better for us."

We've seen this in New Zealand in the relationship between Maori and Pakeha. In a rather different way, we've also seen it in the relationship between the rural sector and "the rest" of the economy. In both cases, the events of the last few years have offered ample opportunities for myth-breaking. I would like to talk briefly this evening about how successful this has been in the case of the rural sector.

Like so many countries whose push for prosperity was based on the creation of an agricultural surplus, New Zealand has nurtured a particular reverence for farming and farmers. Farmers are seen as our best reminders of a pioneer past; our honest side, good by virtue of closeness to the land; practical, hardy, dependable; the backbone of the country.

In itself, it's not a view I'd want to knock - after all, I am a farmer myself. But it has had its costs. In part they have been the costs of attempting to preserve a certain way of life, a way of doing things, come hell or high water (and some of you will feel you have experienced both!). We see these costs in the half-crazed agricultural policies of the European Community or in Japan's massive rice subsidies, and we've also had a good dose of first-hand experience. The last few years have taught us that this experience can be survived.

But there are some more subtle costs to treating the rural sector as something special and apart, and dealing with these is a lot more difficult than cutting fertiliser subsidies or removing SMPs.

In viewing the rural sector as somehow special, or different from the rest of the economy, we tend to forget what different actors in the economy hold in common. We talk about farmers and businessmen, forgetting that farmers *are* businessmen. We worry either that the country is carrying the farmers or that the farmers are carrying the country. We forget that the to-ing and fro-ing of business is about cooperation as much as competition - that business works because different people doing different things find ways of depending on each other, be they farmers or manufacturers, employers or workers.

The experience of recent years has shaken up the relationships between the sectors. In the process some of the false distinctions between them have been broken. The removal of a wide range of protections from the rural sector was seen as a way of bringing farmers into "the real world". The "backbone of the country" was instructed to exhibit its backbone. At the same time, a lot of manufacturers saw their protection reduced, and were forced to drastically rethink how they did business. Both were forced to face up to the demands of their customers with little or no help from the government.

Both farmers and manufacturers were faced with the need to learn fast. As well as reduced protection, they faced changes in the exchange rate regime and in financial markets. They had many new freedoms, and many new responsibilities. Some survived; some survived better than others, and some disappeared.

One way of seeing how much has changed is to look at changes in what these sectors are producing and how they are producing it. Another is to look at the way that groups such as Federated Farmers and the Business Roundtable talk now, compared with how farming and business organisations talked a few years back. And you will find that they are now talking not about protecting the special interests of their members, but about freeing them from the constraints that make doing business difficult. They talk not about getting their fair share of the economic cake, but about making that cake bigger. They *all* talk like businessmen, and they share many of the same concerns.

Increasingly these are concerns about a new unevenness in the sharing of burdens. This is not just because it is thought unfair that farmers or manufacturers have had to change while other parts of the economy have gone on much as before. Had the need for change been limited to those sectors exposed to the world marketplace, this would not have been an unfair sharing of burdens.

But New Zealand's economic problems were much more pervasive. As a result, the sectors which have been forced to adjust have had a much more painful time of it than if the burden of adjustment had been more evenly shared. The high interest rates that have affected all those in the "exposed" sectors, to take just one example, bear witness to that.

Interest rates have not been high by whim. They have been high because monetary restraint has not been accompanied by a will on the part of the government to control its spending, or to spend what it spends well. They have been high because an antiquated labour relations system hampers productivity and encourages annual blow-outs in labour costs. They have been high because it's hard to be competitive when the government and union sectors are subtantially sheltered from the need to be competitive.

This burden is not borne solely by business. If anything, it falls most heavily on those who daily join the queues of unemployed. It is borne by those shut out of jobs by restrictions in the labour market, or by the shortage of funds for investment in a country where the government absorbs around 43 percent of GDP. It is borne by those fobbed off with welfare benefits when what they really want are job opportunities. And the cost of this waste is ultimately borne by all New Zealanders, in the form of poorer and fewer choices and lower growth.

No-one in New Zealand has a monopoly on backbone, on virtue, or on pioneering spirit. Our chances of economic prosperity depend on our willingness to recognise this. We need to credit each other with more, and spend less effort trying to protect ourselves and each other from the inevitable. We need to be sharing the responsibilities of adapting to a world that isn't about to stop changing.

Over the last decade, New Zealand businessmen and women of all kinds have learned a lot about their strengths and weaknesses - and the liberated consumer makes a hard task-master. As a result, we're a lot less likely to succumb to the old myths about our roles, or to champion ourselves at the expense of those we depend on. But we also need a government that is willing to break a few of its own myths; to assess its own responsibilities; to see where further change is needed and to find the spirit for it. Then, and only then, can the chance of prosperity be made more than a myth.

LIST OF NEW ZEALAND BUSINESS ROUNDTABLE

PUBLICATIONS

	PRICE (incl. GST)
NEW ZEALAND LABOUR MARKET REFORM April 1986	22.50
THE NEW ZEALAND PORTS INDUSTRY August 1986	11.25
INDIRECT TAXATION POLICY December 1986	11.25
BETTER VALUE FOR PUBLIC MONEY - THE GOVERNMENT'S 1987 BUDGET AND MEDIUM TERM FISCAL POLICY May 1987	9.00
FREEDOM IN EMPLOYMENT - WHY NEW ZEALAND NEEDS A FLEXIBLE DECENTRALISED LABOUR MARKET June 1987	No Charge
REVIEW OF ACCIDENT COMPENSATION - A SUBMISSION TO THE LAW COMMISSION July 1987	33.75
CORPORATISATION OF HARBOUR BOARDS August 1987	11.25
TELECOMMUNICATIONS IN NEW ZEALAND - THE CASE FOR REFORM November 1987	33.75
PUBLIC OPINION SURVEY OF INDUSTRIAL RELATIONS ISSUES November 1987	11.25
TOWN AND COUNTRY PLANNING - TOWARD A FRAMEWORK FOR PUBLIC POLICY December 1987	33.75
REVIEW OF ACCIDENT COMPENSATION - SUPPLEMENTARY SUBMISSION TO THE LAW COMMISSION December 1987	5.60

THE REGULATION OF SHOP TRADING HOURS - SUBMISSION TO THE SHOP TRADING HOURS ADVISORY COMMITTEE March 1988	5.60
SUBMISSION TO THE COMMITTEE INQUIRING INTO "DEPENDENT" CONTRACTING March 1988	5.60
SUBMISSION TO THE LAW COMMISSION ON COMPANY LAW March 1988	22.50
LABOUR MARKETS AND EMPLOYMENT - NEW ZEALAND BUSINESS ROUNDTABLE STATEMENTS ON LABOUR RELATIONS April 1988	33.75
STATE OWNED ENTERPRISE POLICY - ISSUES IN OWNERSHIP AND REGULATION April 1988	33.75
REFORMING TERTIARY EDUCATION IN NEW ZEALAND June 1988	33.75
UNEMPLOYMENT INCOME SUPPORT IN NEW ZEALAND - OPTIONS FOR POLICY REFORM September 1988	33.75
REGULATING FOR OCCUPATIONAL SAFETY AND HEALTH September 1988	29.75
ANTITRUST IN NEW ZEALAND - THE CASE FOR REFORM September 1988	56.75
EMPLOYMENT EQUITY - ISSUES OF COMPETITION AND REGULATION November 1988	33.75
SHAREBROKING AND EQUITY MARKET REGULATION - A SUBMISSION TO THE MINISTERIAL COMMITTEE OF INQUIRY INTO THE SHAREMARKET December 1988	29.75
INDUSTRIAL RELATIONS ISSUES IN NEW ZEALAND - A SURVEY OF PUBLIC ATTITUDES INSIGHT NEW ZEALAND December 1988	22.50
FISCAL POLICY 1989/90 March 1989	22.50

RETIREMENT INCOME POLICY March 1989	33.75
INDUSTRIAL DEMOCRACY - A CASE FOR REGULATION OR DEREGULATION? May 1989	33.75
SUBMISSION TO THE WORKING PARTY ON EMPLOYER FUNDING CONTRIBUTION TO TRAINING June 1989	11.25
RESERVE BANK OF NEW ZEALAND BILL - SUBMISSION TO THE FINANCE AND EXPENDITURE SELECT COMMITTEE July 1989	11.00
DISASTER INSURANCE POLICY July 1989	22.50
PORTS AND SHIPPING REFORM IN NEW ZEALAND - CURRENT DEVELOPMENTS AND FUTURE REQUIREMENTS September 1989	33.75