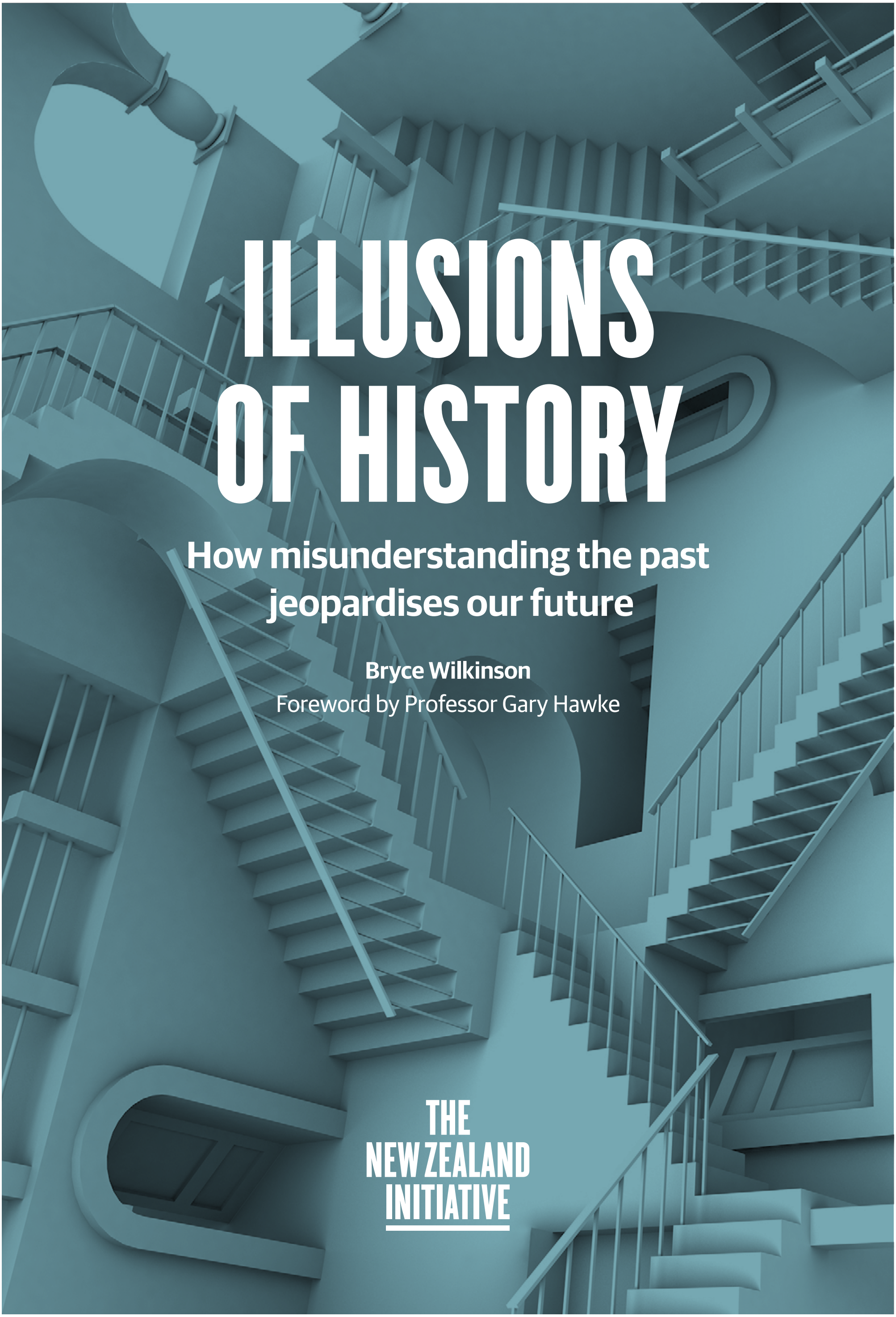

ILLUSIONS OF HISTORY

How misunderstanding the past jeopardises our future

Bryce Wilkinson
Foreword by Professor Gary Hawke

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Foreword

Myths may be both important and useful. They can contribute to social cohesion, especially through reinforcing shared values. But they should not be mistaken for history.

New Zealand's First Labour Government is rightly recognised for presiding over recovery from the Depression of the earlier 1930s, when unequal experience of economic hardship and insecurity about any individual's position on the widely dispersed spectrum of experience generated social tension. But just as the origins of the Depression were deep and mostly overseas, so were the fundamental reasons for the recovery. The First Labour Government skilfully rode and moulded international causes.

There is much to admire in the history of the First Labour Government. Savage, Fraser, Nash and their colleagues took responsibility not just for direct public services, but for managing the economy as a whole. They drew on a longstanding tradition whereby the tools and agencies of the state were used to protect the interests of the settler community against overseas influences, the tradition which had provided government-owned railways, insurance companies, a bank, and collective provision of mortgages. In the circumstances of the 1930s such state activities merged with the private sector. Also from the 1930s, Keynesian economics created a consensus that governments were responsible for economic aggregates rather than for only their own operations but the impact on economic policy in New Zealand and elsewhere came later. The Labour Government proceeded by learning by doing, and experienced the errors common to such a process. In this report, Bryce Wilkinson gives an accurate assessment of achievements and errors.

Similarly, the First Labour Government adhered to ideals of resisting poverty, and standards of poverty changed as living standards improved but "equality" in the 1930s referred to social status and dignity rather than to the statistical distribution of material incomes. For the Labour Government, the key was the contemporary slogan: "The First Charge on the wealth of the nation should be the aged, the sick and the poor"; it was not equality or modern ideas of welfare state, not even ability to participate in society.

The actions of the government were subsequently interpreted in the light of different prevailing ideas. The myths so created became part of later political rhetoric. Measures adopted with specific intentions became fossilised, and difficult to change when they became ineffective or even counterproductive.

Myths can be useful, but they should not be mistaken for historical experience. This study by Bryce Wilkinson is a valuable restoration of the difference between myth and history. Mistaken understanding of the First Labour Government can mislead those who see themselves as inheriting its mantle. I used to think that historians would ensure that corrections prevail, but I have come to realise that this is not automatic. Myths are durable, and studies like this one are needed to keep history to the forefront.

It also exemplifies a lesson with many applications. Bryce asks questions and looks at the evidence. History is a process of enquiry, not a repetition of myths.

Professor Gary Hawke
18 June 2021

Introduction

> *There are few times in your life when you get to hit the reset button.*
> — Grant Robertson[1]

Closing his 2020 Budget speech, Finance Minister Grant Robertson looked back to the First and Fourth Labour governments for lessons on how to tackle New Zealand's current economic challenges. His first history lesson was that the way forward today lay in the "great traditions of the First Labour Government" (1935–49) that "rebuilt New Zealand after the Great Depression" under Prime Minister Michael Joseph Savage.

> It was a time when they understood a genuine partnership between Government and the people … They built houses, rail, and roads, they created the welfare state and a strong public health system, and they backed shopkeepers and manufacturers. We are taking those principles into the modern era.[2]

Robertson's second history lesson was that the Fourth Labour government (1984–90) led by David Lange and the succeeding Fourth National government (1990–97) led by Jim Bolger showed how *not* to respond to an economic crisis.

> As the economic carnage of the 1980s and 1990s wreaked havoc in our communities, I saw that up close. It was based on **a tired set of ideas** that the market would save us, that **if the Government sat on the sidelines all would be well**. Well, it didn't work out that way and lives and livelihoods were lost.[3] [Emphasis added]

Politicians can usefully look to the past for future guidance – as long as they do not misread it. A government that models itself on a misdiagnosed past risks repeating past follies.

The risk of error is considerable. Politicians and historians have different motivations. Incumbent politicians need to get re-elected. They may draw lessons from the past that best serve that purpose. Historians may not draw the same conclusions.

This report examines the accuracy of the Minister's representations of those two episodes in New Zealand's economic history.

Chapter 1 documents how the First Labour government turned the recovering economic situation it inherited in 1935 into a serious foreign exchange crisis in just three years. Its policies proudly featured much increased state direction and control of economic activity. It also favoured large increases in government spending funded, in too good a measure, by overseas borrowing.

Chapter 2 traces the "borrow, spend, regulate and hope" government policies from 1973/74 that precipitated a major foreign exchange crisis in 1984. In brief, undue faith in big government – dirigisme[4] (state direction and control) – and big increases in state spending funded in part by overseas borrowing preceded both the 1938 and 1984 foreign exchange crises.

Chapter 2 also explains the successes of the Fourth Labour government and the succeeding National government in dealing with multiple fiscal and regulatory problems. New Zealand has not experienced comparable crises since.

Chapter 3 draws lessons from the two economic crises in the context of Robertson's assessment. Robertson's account of the two episodes utterly ignores their historical context. The First Labour government blew the strong economic recovery it had inherited, whereas the Fourth Labour government had to respond to a foreign exchange crisis before it was even sworn in.

The economic pain from the First Labour government's spending excesses was lost from view amidst the far greater reductions in living standards caused by necessary World War II measures. But the economic pain precipitated by the events leading up to the 1984 economic crisis was in full view of people at home and abroad.

As the events preceding the 1938 and 1984 crisis illustrate, spending borrowed money is potentially as addictive for governments as the drug addict's fleeting euphoria. To borrow is to defer pain. The pain of eventually addressing the debt or breaking a drug habit is the deferred cost of the earlier indulgence. Yet Robertson blames not the self-indulgence, but those who have to deal with its consequences.

Another lesson from 1938 and 1984 is that incumbent politicians, regardless of party affiliation, can fail to take needed correction action prior to a general election, if doing so implies an admission of failure.[5] They would rather assure the public that all is well under their 'astute' management. Yet, only earlier preventative action can avert a crisis. Hubris and self-delusion were likely compounding factors, for example, in the belief in 1937 that lenders must lend, or in 1984 that foreign exchange 'speculators' can be faced down. Avoided reality compounds future pain.

As the Fourth Labour and National governments recognised, New Zealand needed better institutional economic policy safeguards. Otherwise, a future profligate government could undo their painful work to correct major imbalances. That is why they created new safeguards against imprudent levels of government debt and ensured that central banks focus on price stability and had operational independence. Central banks must not exist to fund fiscal deficits.

Some of those safeguards are being tested now. The current Labour government is on a directive regulatory and big spending path, borrowing heavily along the way. Covid-19 provides some short-term justification, but Robertson has made it clear that the government favours this path regardless. The Reserve Bank of New Zealand is effectively borrowing on its behalf. The fact that New Zealand has plenty of company internationally heightens the risks. Debt to fund profligacy is pain deferred.

CHAPTER 1

First Labour Government (1935–49)

> *It is a testimony to the depths to which New Zealand's credit has fallen that it took the Governor of the Bank [of England] nearly a week before he could secure the necessary support for floating the proposed loan.*
> — Sir Eric Machtig, Under-Secretary of State for Dominion Affairs (1939)[6]

The economy in 1935

The Labour Party led by Michael Joseph Savage won a resounding victory in the November 1935 general election at a time when economic recovery from the Great Depression was well underway:

- Real gross domestic product per capita in 1935/36 was already 21% higher than in 1932/33;
- In 1935, export prices were already up 21% on import prices relative to 1932 and 1933; and
- Real per capita tax revenues in 1935/36 were 50% higher than in 1931/32.[7]

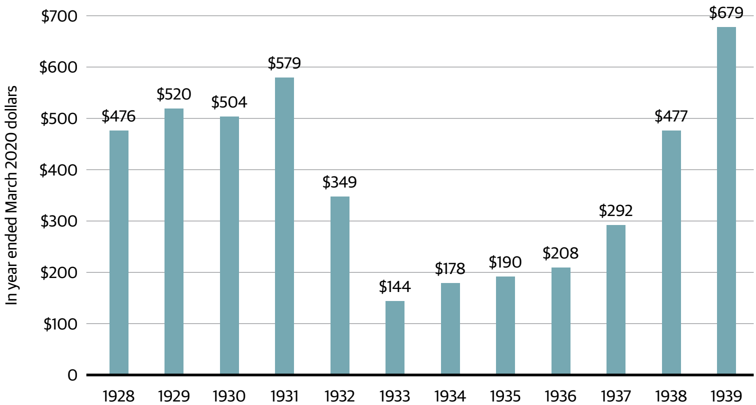
Labour was able to increase current spending while still running fiscal surpluses on the standard measure of the time. But it still faced difficulties. Unemployment and public debt were both high, and the backlog of deferred capital works spending needed to be tackled.

The making of a foreign exchange crisis

The Savage government strongly believed it knew best and was the most competent commander of productive resources. On the way to the 1938 general election, Savage nationalised the principal highways, domestic air services, radio stations, and the Reserve Bank. His government intervened heavily in the labour market by setting wages and regulating industries. It increased spending on social services. Even more consequential was introducing state housing and a comprehensive welfare state, for which the government is remembered, venerated even, to this day. Its "crowning achievement" was passing the *Social Security Act 1938*.[8]

Public works spending had been cut severely during the Great Depression (see Figure 1). Prime Minister George Forbes lifted works spending in real per capita terms only after the year ended March 1933. A material portion of that spending was on imports. The Savage government lifted this spending further (see Figure 1) by borrowing funds from overseas. But it over-reached and got the country into serious financial trouble later (see below).

Figure 1: Public works spending per capita (1928–39)



Source: Statistics New Zealand. "The New Zealand Official Year-Book, 1940," Website. De facto population, CPI. Years ended March.

This public works spending contributed to a 45% increase in imports of goods in the three years to March 1939.[9] Meanwhile, export income rose by only 16%.[10] That difference reduced the banking system's net overseas funds.

This was risky because Labour's policies and rhetoric unsettled investors.[11] The government's reassurances were unconvincing. Economic historian Gary Hawke said: "Savage was a master at smothering inconsistencies in soothing platitudes."[12]

Investors had the option of switching from holding New Zealand pounds to pounds sterling. The banks' net overseas funds fell from £36.1 million in 1935 to £6.8 million in 1938.[13]

The collapsing reserves wrecked New Zealand's international credit standing. Those days, reserves of pounds sterling were a key indicator of the sustainability of New Zealand's economy. Reserves paid for imports of goods and funded loan repayments, which is where the next tribulation was brewing.

By 1938, New Zealand was facing defaulting on a £17.2 million London loan. The loan was due to mature on 1 January 1940 – but the odds were against the government being able to roll it over.[14] A memo to Montagu Norman, Governor of Bank of England, on 14 November 1938 showed how desperate things were:

> The affairs of the Reserve Bank [of New Zealand] are fast approaching a critical stage … while [it] is receiving roughly £400,000 sterling a week from sales of dairy produce, its payments of sterling have recently been at the rate of roughly £1,000,000 a week … The Reserve Bank's sterling funds have now fallen below £5,000,000 … At the current rate of decrease [these] funds can last only another seven or eight weeks …[15]

Speculation against the New Zealand pound put more pressure on bank reserves.[16] Labour had opposed New Zealand's exchange rate devaluation following that of the sterling in 1933. However, once in government, Labour did not revalue. As expectations of revaluation faded, speculators repatriated their foreign exchange.

Worse, the government had fudged the funding of its spending programme. Treasury Secretary Bernard Ashwin privately complained that the Minister of Works "went ahead [with] building commitments around the country, even though the employment promotion fund had been replaced by a social security fund."[17] Household savings drained out of the Post Office Savings Bank as rumours swept the country that the deposits were not safe.[18] Ashwin said Savage did not understand the seriousness of the situation:

> … the rank and file of people continue to enjoy prosperity without realising that the foundations are crumbling beneath them… Increases in pensions and social services, as well as the enormous programme of public works and subsidised relief work, meant that capital expenditure was now well ahead of savings… The lavish expenditure had only been possible because of the reserves built up since devaluation in 1933.[19]

RBNZ Governor Leslie Lefeaux too felt the country was not living within its income.[20]

The government amplified the crisis with a tardy response. Finance Minister Walter Nash, the central figure of the crisis and a future Prime Minister, had been advised of declining foreign reserves throughout 1938.[21] Yet as the flow of reserves offshore turned into a torrent in the second half of 1938, both Savage and Nash denied the capital flight. They accused opponents of a lack of patriotism and a desire to damage the country's credit.[22] Only in December 1938 did they act.

Why did the Labour government leave its run so late? Nash was already known to be indecisive, with Ashwin calling him "definitely not a man of action" in his private journal. Nash might have held off deciding because he expected the British would oppose any attempt to control imports. But Nash's biographer Keith Sinclair offers another explanation:

> Probably the main reason why nothing was done for so long was that it was an election year. To admit that there was a crisis, to introduce exchange or import restrictions, would have been an admission of failure and a powerful stimulus to the Opposition.[23]

Politically, the strategy was masterful. Labour pulled out all the stops in its 1938 campaign, printing its messages on more than two million leaflets. Savage shrewdly set 1 April 1939 as the start date of the *Social Security Act*, making the election a referendum on social security.[24] It worked. Labour won a resounding 56% of the vote in the 1938 election, the highest yet in New Zealand's history.[25]

With the election won, Labour turned its attention belatedly but urgently to the foreign exchange crisis it had helped create.

Domestic financial woes

Governments of the 1930s tended to protect foreign exchange reserves either through direct belt-tightening or devaluation. Belt-tightening meant cutting government spending relative to revenue and raising interest rates to curb household spending – thus increasing unemployment. Devaluing the currency would raise the cost of imports, reducing living standards for those not earning overseas income. But Labour was committed to protecting living standards for workers, and had opposed devaluation in 1933.[26] Politically, both options were non-starters.

So Labour introduced comprehensive foreign exchange controls and imposed an import licensing regime. The "temporary" new controls took effect on 6 December 1938, not even two months after the election, but they lasted 50 years.[27] Initially, the scheme was a mess.[28] Rapid implementation caused major coordination problems across the affected organisations, including Customs, Reserve Bank, Treasury, and the trading banks.[29] Imports in the first six months of 1939 were far *higher* than in 1938, possibly because importers had anticipated the new controls and inflated their import license applications accordingly.[30] The government added further pressure on reserves by increasing its imports of plant, machinery and raw materials for its industrial and defence policies.[31]

Throughout this foreign exchange and default crisis, Nash was also under pressure from within the party. Savage's health was failing and Labour was facing a backbench revolt led by John A. Lee. Lee disagreed with Nash over the interest rate paid to the Reserve Bank on loans for state housing.[32] He also wanted further radical reforms to be funded by cheap Reserve Bank loans: "We will make Walter print and print and print to the limit of common sense."[33] There was considerable support within Labour for social credit and further socialist policies, including nationalising trading banks. As the Treasury Secretary said: "Many people in the [Labour] Party object to paying interest at all."[34]

Lee wrote a long letter to the Labour caucus attacking Nash and Savage. He accused Nash of being a conservative blocking reforms[35] and under Savage's protection.[36] Lee's letter was published, possibly by a National supporter, as a pamphlet titled, "A letter which every New Zealander should read" in December 1938. Nash survived.[37] Lee did not have the numbers in the Labour caucus to roll Nash.

But Nash's greatest challenges still lay ahead. He needed to borrow a further £14.75 million to fund Labour's industrial growth policies, and he also needed to refinance the aforementioned £17.2 million loan from the Bank of England. The Bank of England told the High Commissioner in London that lending even £10 million would be next to impossible and that Nash would have to repay in cash some £10 million of the £17 million loan. That would leave him short of almost £25 million.[38]

New Zealand was staring into the abyss. Up until then, the government had rolled over loans as they came due. But New Zealand's credit was in tatters. Failure to secure replacement loans would mean defaulting on the outstanding loan. Cabinet decided to send Nash to London to face the financiers.

London calling

Nash arrived in London in June 1939 to a frosty British establishment tinged with impatience, scorn and outright hostility.[39] British officials saw New Zealand's difficulties as self-inflicted, the product of wasteful spending. The UK Treasury was "incensed over the policy of the New Zealand Government which has brought about this situation…"[40] The British High Commissioner in Wellington said, "It appears little short of childish that the New Zealanders should waste their substance over a period of years and then complain because H.M.G. is unwilling to come to their assistance."[41] The consensus in London was clear – no more loans to New Zealand.[42]

Britain had two main objections for its reservations. It believed the Labour government was using a temporary economic crisis to establish permanent industries, violating a trade agreement signed in Ottawa in 1932.[43] Second, Britain objected to New Zealand introducing import licensing, which meant losses for British exporters. In any case, it was not a good time to offer help. Britain itself was borrowing nearly £400 million a year for its own defence needs.[44]

But Nash was tenacious. During his two months in Britain, he met with Ministers; officials from the Bank of England, Treasury, and the Board of Trade; and many others. The negotiations were some of the most unpleasant of Nash's career. He had to secure the necessary funds on terms that did not impugn New Zealand's creditworthiness when it had already hit rock bottom. At one meeting, Bank of England Governor Norman told Nash:

> You have been up and down talking figures that damage your credit. If you had set out to destroy your position you could not have done it better… I won't say you're bankrupt but you have no credit…[45]

Early in his stay, Nash had been offered loans on unacceptably onerous terms or outright refusals. But the British position gradually softened as negotiations continued. Unknown to Nash, British Prime Minister Neville Chamberlain had directed officials to help New Zealand.[46] Politically, the British government did not want to oversee financial default by one of its dominions.[47] Nash began receiving conflicting advice from the authorities. Though confusing, the mixed signals encouraged him because they showed the British officials were not single-minded about refusing to assist.[48]

In mid-July, after Nash had twice postponed his return voyage, Norman became an ally.[49] A deal was on the table: a loan of £16 million to be repaid in five annual instalments. Without telling Nash,[50] the Bank of England had leaned on London trading banks to underwrite the loan, and Norman secured £6 million. Such was the state of New Zealand's credit that it took Norman a week to "ram it down the bankers' throats."[51] The Bank of England underwrote the remaining £10 million. Norman further assisted by arranging low commission fees.[52]

Throughout the negotiations, Nash typically refused to admit that his government's policies had caused New Zealand's problems.[53]

He also resisted British attempts to use lending to influence New Zealand policies,[54] but ended up agreeing not to use import licensing to foster uneconomic industries or protect companies from British imports; British industries would be invited to suggest what New Zealand could produce economically and the government would take into account their views; British interests could bid for manufacturing licenses.[55] These substantial concessions committed New Zealand "to a continuance of its colonial position," says William B. Sutch.[56]

Back in New Zealand, consternation reigned. Cabinet was displeased not just with the British but also with Nash, who had made his concessions without discussing them with the Labour Party.[57] Bob Semple, the Minister of Public Works, wanted the British told to "go to hell".[58]

But no other option was at hand. The terms Nash had achieved were onerous but grudgingly acceptable. They bought time for New Zealand before war came to its financial rescue.

UK wartime needs rescue the government

Nash left London for home on 2 August 1939. Germany invaded Poland on 1 September. Britain declared war on 3 September. Two days later, it cabled a request to buy New Zealand's entire exportable surplus of meat. The next day, Britain asked for all of New Zealand's surplus dairy produce as well. These bulk purchases at generous prices, combined with wartime limits on imports, helped rebuild New Zealand's foreign exchange reserves rapidly.[59] By the end of 1940, reserves once again exceeded £20 million.[60]

Despite its rhetoric and spending increases, Savage's economic management from 1935 to 1938 was much more orthodox than the caucus radicals desired. As Hawke observed:

> In the economy, 1935–38 were years mostly of continuation of earlier policies in more favourable circumstances. It was the response of the Labour government to the foreign exchange crisis in 1938, rather than its election in 1935, which marks a significant change in economic management in New Zealand.[61]

This change in economic management is the true legacy of the First Labour government. For half a century, long after the crisis and the war were over, New Zealand suffered under an anachronistic import licensing regime until another Labour government phased it out from the late 1980s.[62]

Nash's experience in London in 1939 had a lasting effect on him.[63] He became a debt hawk and firmly opposed overseas borrowing. He also opposed borrowing from domestic trading banks, fearing ceding government independence. Nash's preferred source of funds was household savings in the Post Office.

At a personal level, Nash was forever grateful to Montagu Norman for his support. Nearly 30 years later, Nash penned a newspaper article expressing his gratitude. In it, Nash revealed Norman had personally visited him in his rooms at the Savoy the day before his voyage home. He was particularly moved because Norman, the lender, had called on Nash, the borrower.[64]

Thus ended the ignominious circumstances of the First Labour government's "great reset".

A timeline for the events leading up to the 1938 foreign exchange crisis is in Appendix 2.

Concluding comments

The war spared Labour's dirigisme from a legacy of economic disruption and default with the Bank of England. Britain secured New Zealand's surplus meat and dairy at generous prices. Our reserves of foreign exchange rapidly recovered. The fact that this averted crisis has been largely forgotten should not be allowed to hide its lessons.

It is true that other New Zealand governments have struggled to fund lavish promises. Julius Vogel, Harry Atkinson, J.G. Ward and Gordon Coates were all "able men and wizards of finance" who had fallen "trying to make the ends of promises and economics meet."[65] But the First Labour government's policies so undermined economic stability that by 1939, "New Zealand's credit, among conservatives and investors, was nearly nil."[66]

To fail to learn from that past is stupidity. Spending borrowed money too freely comes with salutary consequences. That is the real history lesson Robertson needs to learn from the 1935 Labour government.

CHAPTER 2

The path to 1984–93 and fixing the mess

After getting the Governor General's approval shortly before, an under siege and visibly inebriated Prime Minister Robert Muldoon announced a snap election to waiting journalists late in the evening of 14 June 1984. A month later, Labour ousted Muldoon in a landslide victory and embarked on reforms that would shape life in New Zealand for the next 40 years.

As a metaphor for the New Zealand economy standing on unsteady legs in 1984, it is hard to beat the fallen image of the previously formidable Muldoon.

Prime Minister for nine years, Muldoon was a conservative whose premiership ended in a spiral of economic turmoil and intervention. His economic mismanagement engendered the foreign exchange crisis of 1984. For years, Muldoon had refused to raise interest rates, leading to inflation and an overvalued exchange rate. The New Zealand dollar was pegged to the US dollar, and Muldoon refused to allow devaluation, which he saw as conceding to the failure of his policies. Labour had supported devaluation since 1983.

Muldoon's announcement of a snap election triggered rampant speculation against the New Zealand dollar. Foreign exchange flooded out of the Reserve Bank. The Bank was bound by policy to sell US dollars and other currencies at the overvalued official rate. Labour won the election on a Saturday, making devaluation all but certain; by Monday, New Zealand's foreign exchange reserves were exhausted.

Muldoon's defeat also triggered a constitutional crisis. Labour had been duly elected but not yet sworn in. Muldoon initially refused to act on instructions from the incoming government on matters that could not wait. His parliamentary colleagues had to force him to back down.

After taking office, the Fourth Labour government introduced sweeping reforms in virtually every area of governance by:

- abolishing foreign exchange controls and most farm subsidies, while reducing import protectionism;
- floating the exchange rate and directing monetary policy at controlling inflation, a world first;
- ending the wage, price, rent and interest rate freeze;
- giving government commercial activities a much clearer commercial focus;
- actively expanding state spending on social services and welfare, while improving the focus of this assistance;[67] and
- introducing major legislation seeking to prevent repeating the calamitous economic situation it had inherited in 1984. Examples include the *Economic Stabilisation Act Repeal Act 1987*, the *Reserve Bank Act 1989, Public Finance Act 1989* and *State Sector Act 1988*.

Those changes have largely withstood the test of time.

The following is the story of New Zealand's second "great reset" under a Labour government.

From the First to Third Labour Government

To understand the second "great reset", we need to go back to 1949. National had defeated the First Labour government but decided to retain Labour's centralised economic management. After the election, Prime Minister-elect Sidney Holland said he wanted "as little disturbance as possible."[68] His government gradually removed rationing, which Britain maintained after the war, but only tinkered with import licensing and tariffs.[69] The regime was protectionist. Foreign exchange was rationed to prevent imports of goods competing with local production – effectively import licensing.[70]

In 1950, Holland's government reduced or removed subsidies on consumer goods like coal, bread and butter. The resulting inflation led to industrial unrest, culminating in the 1951 waterfront strike. The strike lasted 151 days and remains the largest ever industrial confrontation in this country.

The strike split the trade union movement and the country. It ended with a decisive defeat for the watersiders' union.

The Second Labour government was elected in 1957 with Walter Nash as Prime Minister. It unexpectedly raised taxes in its first budget in response to a balance of payments problem caused by a collapse in the price of butter in the United Kingdom. Nash himself is said to have been a key figure in the tough decisions, perhaps reflecting his scarring experience in 1938.[71]

The opposition National Party, under the leadership of Keith Holyoake, successfully demonised the government's "Black Budget". Holyoake won the 1960 election – and the next three elections. His was a conservative government.

Robert Muldoon had entered Parliament in the 1960 election and became an increasingly important member of the government. Prior to entering Cabinet in 1967, Muldoon organised currency decimalisation as finance undersecretary. Holyoake appointed him Minister of Finance in early 1967, on the death of his predecessor in this position, Harry Lake. At 45, Muldoon was the youngest Minister of Finance since 37-year-old Joseph Ward in 1893.[72]

It was an eventful time. Decimalisation took effect in July 1967 and the New Zealand dollar was devalued by 19.45% against the US dollar in November 1967. The collapse of the Arbitration Court's "nil general wage order" in 1968 was followed by a wage breakout. Muldoon decried the wage breakout as an "unholy alliance" between employer groups and trade unions. Wage and price inflation was just taking off.

In contrast to the quietly conservative Lake, Muldoon wanted 'flexible economic policies' and 'fine-tuning'. He introduced mini-Budgets, the first in May 1967, which meant regular appearances on television – raising his profile.[73]

Muldoon wanted a fair, egalitarian, prosperous and racially integrated society.[74] "Family is the basis of national life," he said.[75] Muldoon was capable of empathy. After becoming Minister, he said a person "who is unemployed is not just a statistic" and complained that "theoretical economists fail to realise that economics are people."[76]

A decade of failed policy responses: 1974–84

A tired National Party lost the 1972 general election to Labour led by Norman Kirk, a charismatic and able orator. Raised in a low-income working-class family, he left school before he turned 13 but was well read. Kirk was a big man with visionary aspirations in office and a strong advocate of the welfare state and government spending on housing, health, employment and education.[77] Kirk is also remembered for withdrawing New Zealand's troops from Vietnam, sending a frigate with a Cabinet Minister to oppose French nuclear testing in the Pacific, and stopping the South African rugby team's tour of New Zealand, given apartheid in that country.

During the 1972 general election campaign, Muldoon had infamously declared that the opposition leader, Kirk, would not be able to promise more spending because Muldoon's 1972 Budget had already "spent it all".[78] That was not going to stop Kirk.

Government spending under Kirk rose from 25% of GDP to 31% between 1973 and 1976. This was a 19% increase in real per capita terms.[79]

The additional spending was risky. Initially, the Kirk government benefited from fortunate economic conditions, but a near four-fold increase in world oil prices in 1973–74[80] and Kirk's premature death destroyed Labour's prospects.

Higher oil prices cut effective national income, fuelled domestic inflation, and wrecked the balance of payments. Imports vastly exceeded exports, necessitating heavy overseas borrowing with no end in sight.[81] The government "borrowed and hoped".

That borrowing was the origin of New Zealand's large net external indebtedness, a situation that persists to this day. It has permanently increased the proportion of domestic production belonging to foreigners.[82]

Muldoon became leader of the National Party in 1974. With Holyoake's aid, he displaced Jack Marshall, who had led National to defeat in 1972. (Muldoon repaid the favour by appointing Holyoake as Governor General in 1976.)

Muldoon toured the country prior to the 1975 general election with charts showing the extent of deficits in both government accounts and balance of payments. Inflation was high, economic growth was low, and unemployment was rising. The message was that Labour were bad economic managers, and Muldoon could put that right. He won by a landslide.

Muldoon was not a visionary, however. His economic policies were politically determined. A National Party General Secretary said Muldoon's long-term strategy was tomorrow afternoon's headlines.[83] "He is certainly the most cynical Prime Minister New Zealand has ever had," says Michael Bassett.[84]

The 1975 National government with Muldoon as both Prime Minister and Minister of Finance inherited stagflation and fiscal deficits. Its 1976 Budget was tough but did not survive rising unemployment. Even the massive windfall in the form of the Maui gas field in 1979 was a headache. New Zealand was already self-sufficient in gas, and the Maui field was big on an international scale. Although there was no immediate use for the gas, the government was committed to pay for an agreed amount of the gas every year for 30 years, under a take-or-pay contract signed in 1973. The government ruled out exporting gas on political grounds. That meant it had to find domestic uses or suffer the political embarrassment of paying for something it was not using.[85]

Spurred by further rises in global oil prices in 1979 and 1980 to US$32 a barrel, the government sponsored several large-scale energy projects with a focus on greater energy self-sufficiency and job creation. "The projects raised loans and expanded on the basis of a range of direct and indirect Government guarantees and understandings that high levels of assistance would be maintained."[86] Far from continuing to rise, oil price prices dropped to a low of US$17 a barrel, and for this and other reasons National's projects as a group failed to deliver. Treasury estimated in 2000 that the Maui project cost the country $1.3 billion in 1988 dollars and increased public debt by 20%.[87]

By its third parliamentary term (1981–84), the National government had lost its way. In a desperate bid to reduce inflation, Muldoon froze wages, prices, interest rates, rents and exchange rates in 1982. This was alongside ongoing large fiscal deficits and spiralling public debt, much of which was owed in overseas currencies.

By 1984, New Zealand's sovereign debt credit rating was slipping, unemployment was increasing, inflation was suppressed, and the cost of servicing the spiralling public debt was about to account for $1 of every $5 collected in taxes. The policy settings were unsustainable.

Treasury and Reserve Bank officials were concerned. But Muldoon would neither devalue nor raise interest rates to protect the currency.[88] He was determined to face down foreign currency "speculators" and traders so he could prolong the wage and price freeze. But even his formidable obstinacy could not force those who had other options to hold New Zealand dollars.

Events precipitating the 1984 currency crisis[89]

The event that triggered an accelerating capital outflow and precipitated a major foreign exchange currency crisis was a pending vote on a matter of national security. The National government, led by Muldoon, had won a third term in 1981 by a single seat. The government's youngest member, Marilyn Waring, was resolute in supporting an opposition bill on nuclear-free ships despite the ramifications for New Zealand's defence relationship with the United States and blowback from her own party.[90] Faced with losing a parliamentary majority on this issue, Muldoon secured the Governor General's approval on 14 June 1984 to call a snap general election on 14 July.

This was a last-ditch move to hold on to power. National had long sold itself as the party of free enterprise in contrast to Labour's trade-union dominated socialism. Muldoon's government no longer looked like a free enterprise government. By the year ended March 1984, adjusted government spending on Treasury's measure was up to 36% of GDP. The rise from 31% in 1976 was in part because spending on finance costs was 4.5% of GDP in 1984, compared to 2.4% of GDP in 1976.

Barry Gustafson, Muldoon's biographer, summed up this political problem:

> By 1984 Muldoon had come to typify for many traditional National voters what the founders of the National Party had criticised the first Labour Government of Savage and Fraser for – an almost totalitarian form of economic management, overlaid with a political style which could be portrayed by its opponents as neo-fascism or neo-socialism.[91]

Reflecting this perception, the charismatic property market investor, Bob Jones, had formed a political party before the snap election. It was dedicated to explaining the foolishness of Muldoon's policy to a listening public. In the event, his candidates got a remarkable 12.25% of votes counted, but no seats in Parliament under the first-past-the-post system. No wonder National lost.

Investors widely considered the exchange rate to be over-valued. The announcement of the snap election had heightened devaluation expectations in the event Labour won. Labour's Saturday, 14 July 1984 victory guaranteed a stampede if the Reserve Bank's foreign exchange window were to open on Monday morning.[92] Unbeknownst to the public, officials had repeatedly urged the Prime Minister (who was also Minister of Finance) to devalue, or at least allow interest rates to rise to defend the currency. Muldoon refused to accept that advice. To do either or both would have undermined his government's comprehensive price, wage, rent and interest rate freeze.

During the month-long election campaign, the Reserve Bank sold $1.4 billion of foreign exchange. This was as much as it would have expected to sell in a 'normal' year.[93] By 16 July, Treasury had exhausted all of its short-term foreign currency borrowing facilities and was liquidating its medium-term foreign currency bond portfolio.[94]

As already mentioned, Labour won the general election on Saturday, 14 July 1984 by a landslide. But Prime Minister David Lange would form the Fourth Labour government only 12 days later – on 26 July. These 12 days were dramatic politically, economically and constitutionally.

On Sunday, 15 July Reserve Bank officials obtained Muldoon's agreement to suspend convertibility of the New Zealand dollar with effect from Monday, 16 July. To put the issue starkly, RBNZ had run out of the foreign exchange necessary to defend the value of the New Zealand dollar.[95]

The incoming Labour government accepted RBNZ officials' devaluation recommendation, but could not implement it. Labour had the people's mandate but had not yet been sworn in. Muldoon called on the newly elected government to jointly rule out devaluation. Lange roundly rejected this pre-emptive strike to dictate his economic policies. Labour had the mandate to govern, not Muldoon. This constitutional crisis was resolved only when Muldoon's senior Cabinet colleagues forced him to change his mind.[96] At long last, the New Zealand dollar was devalued by 20% on Wednesday, 18 July.

The devaluation was controversial because Muldoon had not told the public, or Parliament, how dire the foreign exchange situation was.[97] Only when official reserves were gone did devaluation become imperative. But that secrecy gave academic and political opponents of reform room to allege that RBNZ officials had conspired to magnify the problem in order to force the new government's hand.

Two of the biggest public and internal critics of the devaluation and associated reforms were Jim Anderton, new Labour MP and former president of the Labour Party, and, of course, Muldoon. Together, Anderton and Muldoon got Parliament's Public Expenditure Committee to set up a sub-committee to inquire into the circumstances of the devaluation. The sub-committee's focus was not the institutional performance of Treasury and the Reserve Bank but their leading economic advisers, Roderick Deane (later Sir Roderick) and Graham Scott. This was a personal crusade.

Deane was forced to appear in front of the sub-committee while the heads of Treasury and RBNZ were barred. Deane was on his own. He had no legal representation, no clarity about the allegations against him, no cross-examination rights, and no assurance of an "adequate record of procedings".[98] The Governor of the Reserve Bank was reduced to waiting outside the chamber, in mute support, while Deane was interrogated for two hours, mostly by Muldoon. Deane's biographers say Muldoon's questions had little to do with devaluation and more with discrediting the government's advisers as a first step towards discrediting the government for accepting that advice. That made political sense.

In the event, Lange, acting on legal advice that the inquiry was illegal, terminated it after Deane's ordeal. Labour's political opponents naturally portrayed that termination as evidence of wrongdoing.[99]

The episode scarred the bureaucracy. It showed how thin are constitutional protections for public servants under expedient political attack. Yet a cowed and complaisant public service cannot adequately serve the public interest. Governments need official advisers capable of telling them when things are going wrong and helping them get out of a mess.

Fixing the mess: Fourth Labour Government 1984-1990

> *Sir Roger Douglas is well-known as the man who initiated the first and most courageous wave of economic reform beginning in 1984 in New Zealand. This reform is widely acknowledged as the most radical and complex ever undertaken by a developed country.*
>
> — Ján Oravec[100]

On becoming Prime Minister, Muldoon had said his hope was to leave New Zealand no worse off than before. This was widely seen as uninspiring. Hindsight showed it was also far too optimistic.

The extent of the economic mess

The economic situation that confronted the Lange-led government in July 1984 was grim. It featured:

- zero economy-wide labour productivity growth in the decade to 1984, the lowest among member countries of the OECD.[101]
- a deficit of 7.2% of GDP for the year ended March 1985 in the current account in the balance of payments (requiring heavy overseas borrowing to finance).
- a deficit of 6.2 to 7.6% of GDP in government accounts, set to become higher if market interest rates were restored for new borrowing.
- gross public debt of 66% of GDP in March 1984, and 51% of GDP if "departmental and other" holdings were excluded.[102] Treasury forecast that servicing this debt would absorb 21% of taxation receipts in the year ended March 1985.[103]
- net external public debt was 19% of GDP compared to 6% of GDP in 1975, and set rise to 28% of GDP in two years when losses on major energy projects and producer board lending were crystallised.[104] One major international

rating agency downgraded New Zealand's sovereign credit rating in 1983. Another would soon follow.[105]

- grim economic growth, inflation and unemployment projections.[106]
- suppressed inflation, with the grave threat of a wage rate explosion on exiting the wage freeze.
- the highest registered rates of unemployment since the Great Depression, with considerable disguised unemployment.[107]
- widespread structural problems of uneconomic activities (lost income) from misallocated resources due to import protection, export and farm subsidies, underperforming protected government trading enterprises, and labour market regulation.
- a tax system with too narrow a base to raise the taxes needed to close the fiscal deficits.

Treasury's 1984 briefing for the incoming government identified the problems and pointed to possible solutions (see Appendix 3).

Labour's team

The problem for Labour was to put matters right while carrying enough voters with them to win the 1987 general election. Prime Minster Lange's crucial decision was to appoint three ministers to tackle the challenges. Roger Douglas, later Sir Roger, was appointed minister of finance and reform architect, and Richard Prebble and David Caygill as associate finance ministers. They proved to be extraordinarily able. The three ministers worked as a cohesive team, initially with the full support of the Prime Minister.

Many other Labour parliamentarians at the time shared in the brunt of the tough but necessary decisions. These included Minister of Labour Stan Rodger, Minister of Agriculture Colin Moyle, Associate Minister of Inland Revenue Trevor de Cleene, and Minister of Trade Mike Moore.

The policy dilemmas

Douglas faced a situation where every policy setting was at odds with at least one other policy setting.[108] Changing any one policy would set off a chain reaction of changes to other policy settings. Every change was painful for one important group or another.

Devaluation was incompatible with a comprehensive wage and price freeze. Without foreign exchange reserves, a return to market-determined interest rates was necessary to defend the new value for the exchange rate. They were also necessary to attract the funds needed to cover the fiscal deficits. But they raised costs, reduced investment incentives, and risked increasing unemployment. The exchange rate could not be floated right away given the extensive foreign exchange controls, but to remove those controls needed careful management. The fiscal deficit had to be reduced, but without increasing unemployment. The wage freeze had to be ended, but without triggering a wage blowout that monetary policy had to lean against, with the consequent unemployment. Tax revenues had to be raised, but without increasing unemployment. Raising indirect taxes would also raise prices, which would increase wage increase pressures and put controlling inflation at risk. To improve the standard of living, adjustment pressures needed to fall on inefficient industries rather than efficient ones. But that meant addressing farm subsidies and distortive import protections dating back to 1938, and achieving better performance from dominant state monopoly enterprises, such as the Post Office. Each structural adjustment meant painful displacement of workers. State sector redundancy payments would add to the fiscal deficit. And this was a Labour government inextricably linked to the trade union movement and a strong believer in the welfare state.

Lange's new and unproven government had no proven credibility for achieving disinflation. Nor had any earlier government since 1970. Labour parliamentarians were known to be internally divided on trade unions and centralised wage fixing. Expectations that Lange would allow inflation to resume if unemployment started rising were reasonable. Investors' expectations for high inflation were implicit in the very high nominal interest yields on auctioned government securities. Nor was it easy for trade union leaders to help a government reduce inflation, even if they wanted to. Many of their members would likely insist on 'catch-up' wage increases and bet that the government would blink rather than see unemployment rise.[109]

So great were the economic policy challenges that Labour thought it could not win the 1987 general election regardless of what it did. To its credit, Labour chose to 'do the right thing' by implementing strict but necessary measures, focusing on stopping the public debt spiral by reducing the burgeoning fiscal deficits, rather than play politics – which was quite unusual in New Zealand political history.

Douglas' reform strategy

Douglas was forced by these onerous circumstances to start major changes from day one and focus on moving fast while sustaining momentum. He carried the public with him by communicating the reasons, immediate directions and beyond. Respecting the public bought support. He aimed to judiciously combine necessary financial pain with enhanced opportunity to build and prosper. This was in stark contrast to Muldoon's borrowing and state control, which both deferred pain and reduced opportunity.

Douglas was probably unique among ministers of finance internationally at the time in recognising the importance of good communication, transparency and consistency in words and deeds to establish credibility, and thereby bolster business and investor confidence in New Zealand's economic prospects.[110] He believed that New Zealanders would accept necessary changes if they were coherent and properly explained. His many speeches at the time clearly explained the problem to be addressed and the associated remedy.

Douglas became an expert in preparing and announcing policy packages that took away some government-conferred benefit from each of the affected groups with one hand, while giving back something with the other. For example, he increased tax revenues by broadening the tax base while reducing top marginal income tax rates. Devaluation helped exporters and protected domestic firms, but reduced farm subsidies and import protection did the opposite.

His comprehensive reach made it awkward for any one faction to complain about what it had lost. Doing so just opened the door to attacks by other factions whose self-perceived grievance was greater. Douglas was helped by general acceptance in the community that big changes were necessary after Muldoon's extreme policies by New Zealand standards.

In 1989, Douglas distilled his reform strategy into 10 principles (see Appendix 5). A short version of his speech was published by the Australian think tank, The Centre for Independent Studies.

Achieving and sustaining credibility by deed and good communication was at the heart of Douglas' approach. Credibility for staying the course is particularly critical for a successful disinflationary monetary policy. High interest rates are painful and visible – and demonstrably due to government policy. Yet, the new government had no proven credibility for achieving disinflation.

The following four of Douglas' 10 principles illustrate how central was achieving credibility to his strategy:

- "Credibility is crucial. It is hard to win and you can lose it overnight. Winning it depends on consistency and transparency.
- "The dog must see the rabbit. Adjustment is impossible if people don't know where you are going. You have to light their path.

- "Stop selling the public short. Voters need and want politicians with the vision and guts to create a better future.
- "Don't blink or wobble. Get the decisions right and front up. Confidence often rests on your own visibly relaxed composure."

Consistency between word and deed is essential. Some years later, Douglas summed up the importance of policy consistency in these terms:

> People need to know that the government is firm about the decisions it's made. If they believe they can persuade [you] to change your mind, then all their efforts will be focused on getting you to change your mind and putting the old order back in place. Reform is only successful when people believe that you're going to carry it on and they adjust. Speed doesn't kill, but uncertainty does.[111]

The "don't blink" prescription is particularly hard to sustain during the long process of reducing entrenched inflationary expectations and habits. Few politicians and central bankers have the steel to stand the course in the face of public pressure caused by company failures, job losses and asset price declines.

Faced with such pressures amid disinflation in the United Kingdom, Prime Minister Margaret Thatcher famously declared in 1980 that she was "not for turning." When Lange was challenged on national TV to ease off on monetary policy because of the hardship it was causing, he said that would be like giving in to the alcoholic's request for "just one more glass."

Such leaders are so rare that the public has come to expect politicians will buckle and do a 'U-turn'. It is that lack of credibility which makes disinflation so costly. Unions will go for large wage increases expecting that the government will blink.

Employers agree to large increases for the same reason.

The ending of the wage-price freeze proved that it had not removed expectations that governments would accommodate a resumption of high rates of inflation. Large double digit increases in wage rates quickly followed. Double digit yields on tendered government stock told the same story. It took a decade to reduce inflation into the 0–2% range. Eye-watering unemployment occurred.

The lesson for the current time is that credibility for low inflation is hard won. To put it at risk is to put a great many jobs and businesses at further risk.

Douglas later summarised the essence of what Labour had to do, and did, in three words: "[w]e abolished privilege."[112] Farm subsidies were a privilege, so was protection from import competition, foreign exchange controls that benefited those with overseas funds, state-protected monopolies, and state-mandated closed shops or compulsory trade unions.

Everyone benefiting from a privilege was likely unwittingly funding someone else's privilege. The system was impenetrably interconnected and interdependent. Cartoonist Tom Scott brilliantly depicted a hospital ward where a myriad drip feed lines connected every patient with every other patient to such a degree that no one could tell who was supplying whom with life support. 'Lead medical specialist' Roger Douglas resolved that dilemma by ripping out all the drip lines, that is, he removed privileges from all parties while enhancing incentives.

Reform measures to 1987

Labour's multiple reform measures have been widely documented. A great many economic restrictions were removed or eased, and fiscal deficits were much reduced by increasing tax revenues.

The high quality and breadth of the government's economic policies attracted international attention. In 1985, *Euromoney* conferred its Finance Minister of the Year award on Douglas.

Nor were these measures initially at the expense of output and employment. Treasury's "Briefing for the Incoming Government" in 1987 noted that economic growth between 1984 and 1987 was actually higher than it had forecast.[113]

Astonishing its critics, Labour marginally increased its considerable parliamentary majority in the 1987 general election.[114]

When Labour self-destructed in 1988–90

Internal stresses saw Labour self-destruct after the 1987 general election. Lange and Douglas fell out over a package of measures announced in December 1987 that responded to the October 1987 global and domestic share market collapse.[115] Both the Prime Minister and the Minister of Finance eventually lost their positions.

Lange was in an extra-marital relationship with a staff member who was ideologically opposed to the government's direction. It killed his marriage and the government. Lange decided the government needed to curb the pace of reform and 'take a cuppa'. Douglas was in London when, without prior reference to him or Cabinet, Lange told the public he had scrapped the December tax package.

That signalled a divided Cabinet and the end of confidence in policy consistency. On Douglas' account:

> It looked like a huge U-turn. The government's credibility was gone. We actually went from being 6% ahead in the polls to 15% behind … 4 years [establishing credibility] down the drain in the matter of 50 seconds.[116]

After Douglas' return to New Zealand, a compromise was patched together that saw the top tax rate reduced to 33%. All to little avail. The economy slumped into serious recession as the government progressively lost its way. Defeat in the 1990 general election became likely.

The Labour government still achieved material institutional reforms, most notably with the *Reserve Bank Act 1989* and the *State Services Act 1988*. The former made the Reserve Bank of New Zealand the first central bank responsible for determining and implementing the monetary policy measures necessary to achieve and maintain stability in the general level of prices. Ruth Richardson, in the National opposition, was instrumental in getting National to support this constitutional safeguard.

It also managed to sell in whole or in part some of its commercial operations.[117] It could not do this prior to its second term given its pre-1984 promise to the contrary.

How could a Labour government do all these things? Muldoon's economic policy excesses created wide acceptance for tough changes, the books had to be put right. Those within Labour who supported an enhanced welfare state with a large state-controlled health and education sector could (and largely had to) grudgingly accept economic reforms elsewhere as long as those reforms did not intrude materially into forbidden ground.[118] The fallout between Lange and Douglas was in part over that dividing line.

Fixing the mess (cont.): Fourth National Government 1990–96

It was left to the Fourth National government to continue to address the ongoing recession, high unemployment, rising inflation, and fiscal deficits. Under the leadership of Jim Bolger as Prime Minister and Ruth Richardson as Minister of Finance (1990–93), it largely did so.

Bolger had been a senior Cabinet Minister under Muldoon's leadership. He was not notably opposed to control and command government, without necessarily endorsing Muldoon's extreme, and did not communicate a clear political philosophy. He was a pragmatist.

Richardson was very different.[119] During Muldoon's administration, she had been a doughty caucus questioner and critic of his command-and-control approach to economic management.[120]

She led National's economic strategy post-Muldoon until 1993. Brave, determined, vigorous and principled, Richardson believed deeply in liberty and excellence in government. She was not against the welfare state, but she did not believe government helped people by making them dependent on welfare.[121] She believed in leading from the front, setting clear goals for policies, and under-promising and over-performing. If anyone in National was going to continue the task of extricating New Zealand from the economic mess built up between 1974 and 1984, it was she.

After taking office the new government found that the Bank of New Zealand Limited was a casualty of the collapse in asset prices. The BNZ needed to be bailed at a significant fiscal cost. That unpleasant surprise was on top of reduced revenues due to the recession. The government's adjusted financial balance deficit in the year to June 1991 was 3.4% of GDP. The rate of unemployment peaked at a searing 11.2% in the September quarter 1991.[122] Government spending was high at a record 40% of GDP, up from the 31% at the end of the Third Labour government.[123] The new government faced the threat of a further downgrade in New Zealand's sovereign credit rating. It had to take credible action to address the situation.

Richardson's 1991 Budget boldly addressed these imbalances. It cut spending, raised revenue, and continued recourse to user pays and privatisations. To reduce unemployment and promote job creation, the government dramatically freed up the labour market, abolishing compulsory unionism and compulsory occupation-wide collective bargaining.

The phrase "The Mother of All Wars" was in vogue at the time. Iraq's President Saddam Hussein used it at the onset of the American invasion after Iraq had invaded Kuwait. In a pre-Budget TV interview, Richardson, ad-libbing and searching for a sound-bite, joked that the 1991 Budget would be the Mother of All Budgets. Supporters of big government have never let anyone forget it. The phrase has entered folklore for the first Budget in New Zealand cutting rates payable on welfare benefits. For good measure, they commonly attach the epithet "Ruthanaesia" to her name.

The moral level for benefit rates

In his 2021 Budget Speech, Robertson labelled his raising welfare benefits as primarily a moral issue. He blamed "hardship and deprivation over the last 20 years" on Richardson's benefit cuts.

There are several difficulties with that assertion. First, Richardson also saw benefit levels as a moral issue, but from a longer-term efficacy perspective. She questioned the morality of targetting assistance poorly and failing to assess whether programmes were helping or hindering beyond the short-term.[124] More money for people for whom lack of money is a symptom rather than a cause could worsen the situation. For example, giving cash to alcoholics feeds their problem. Second, any succeeding government could have reversed them at any time and Richardson can hardly be blamed for that. Third, welfare spending per capita even in 1992 was appreciably higher than in earlier decades.[125] How can higher spending, if effective, cause greater "hardship and deprivation"?

Fourth, unemployment and hardship could have been much worse had the Richardson Budget not been followed by the rapid productivity and employment growth that her critics denied could happen.

In today's popular thinking, budget cuts represent austerity, the opposite of prosperity. Indeed, the 1991 Budget was an affront to academic economists of a Keynesian persuasion. In naïve Keynesian theory, budget cuts worsen a recession. Fifteen academic economists at The University of Auckland signed an open letter to Auckland's daily newspaper in June 1991 asserting "in the strongest possible terms" that the 1991 Budget could "only depress the economy further."

The academics likely under-appreciated the confidence-inducing effects of decisive government action to reduce imbalances.[126] They also underestimated the employment-generating effects of the *Employment Contracts Act 1991* to free up job creation.[127] Treasury's pre-Budget advice to Richardson indicated positive economic effects.

In the event, and no doubt to the great embarrassment of the Auckland academics, three Victoria University of Wellington economists assessed the June quarter 1991 to be the trough of the recession.[128] Whereas the Auckland group had unequivocally declared that the measures would be considerably "self-defeating":

- a government financial surplus of 0.9% of GDP was achieved by the year ended June 1994;
- real gross domestic product in 1995 was 17% higher than in 1991; and
- full-time-equivalent employment in June 1996 was 11.6% higher than in June 1991.[129]

In fact, during the five years from 1991 to 1996, New Zealand had the fastest employment growth among member countries of the Paris-based Organization for Economic Co-operation and Development (OECD).[130] How could rapid employment growth – the opposite of what Keynesian economists so confidently predicted – cause "hardship and deprivation"? The case for equating fiscal prudence with austerity looks as flimsy today as it did in 1991.

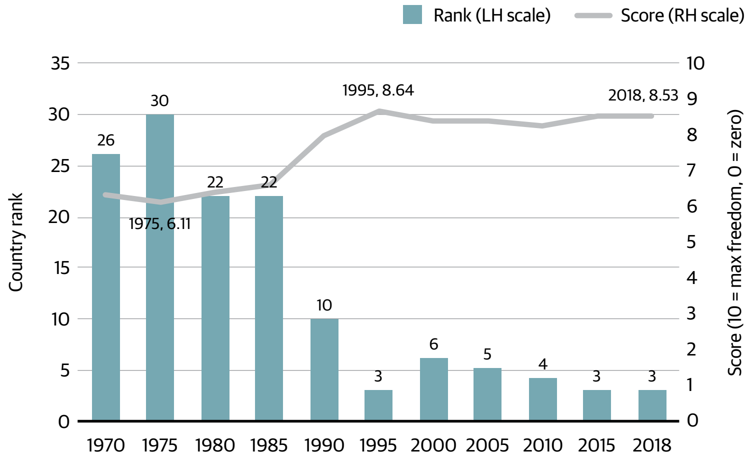
The move from financial deficit to surplus was largely achieved by expenditure control. During Budget-setting processes, government agencies were required to explain why they could not achieve productivity gains in order to retain unchanged nominal budgets.

As Douglas had partially done earlier, Richardson sought institutional reform to make it harder for future politicians to conceal growing fiscal problems from the public and the next incoming government. Her *Fiscal Responsibility Act 1994* aimed to prevent an easy return to chronic deficit spending and public debt spirals. Governments were to set their own targets for achieving and sustaining public debt at a prudent level. They would have to report regularly against those targets. A 2018 NZIER working paper assessed it to be "an astonishing success."[131]

The extent to which government policies restricted people's ability to create jobs and generate income prior to 1984 and subsequently is illustrated in Figure 2.

The big fiscal beneficiary of the decade of painful economic reform was the Helen Clark-led Fifth Labour government (1999–2008). The fiscal surpluses peaked at 4.5% of GDP in the year ended June 2005. Labour's Budget in 2005 increased spending sharply. That plus the 2008 global financial crisis turned those surpluses into deficits by the year ended June 2009. Five more years of fiscal deficits followed.[132]

Figure 2: Economic Freedom Index for New Zealand (1970–2018)



Source: Fraser Institute, "Economic Freedom of the World Index 2020" (2020).

It took the Fifth National government nine years of fiscal graft led by Bill English as Minister of Finance to restore sustainable fiscal surpluses. The 2017 general election became an auction to spend those surpluses. The 2017–20 Labour-led government was well on its way to turning those projected surpluses into deficits before Covd-19 hit.[133] Spending under Covid-19 has finished the job.

Amidst the acrimonious debates on how best to respond to an economic crisis, it is easy to forget that earlier corrective action could have avoided much future pain. Why drift into crisis by neglect? The events leading up to the 1938 and 1984 crises answer that question. Incumbent politicians facing a general election are not going to let Parliament or the country know that a crisis is developing – if they can avoid it.

CHAPTER 3

Robertson blames the cleaner

The economic carnage of the 1980s and 1990s … was based on a tired set of ideas that the market would save us, that if government sat on the sidelines all would be well.
— Grant Robertson[134]

Robertson blames the consequences of an excess of dirigisme and profligate spending on those who had to address the mess. By the same logic, he should blame the costs of the devastation left by riotous partygoers on the next day's cleaners and repairers.

Robertson's observation does not acknowlege the need for tough decisions when fiscal profligacy has run its course. It is as if excess public debt and regulation have no bad consequences.

Consider this parallel. A crowded passenger train collapses on an ill-maintained bridge. The train plummets into a ravine, killing or maiming all on board. The owner blames the carnage on the medical staff who were called to the scene and failed to make it all good, quickly, painlessly and without cost. He asserts that they applied a **tired set of medical ideas** – otherwise known as best medical practice – but offers no meaningful alternatives.

Reasonable people would say that the carnage was caused by the failure to maintain the bridge and stop the train's momentum towards it. They would certainly point out that only prevention could have avoided the carnage. A private owner would not escape liability.

The 1938 and 1984 overseas debt crises were built under the watch of governments that were increasing spending sharply and dependent on overseas borrowing. In neither case did the public have access to official assessments that the situation was becoming increasingly desperate. Politicians who knew did not tell the public fearing that would endanger their re-election prospects.

The big spending increases from 1935 to 1938 were partly in response to the end of the Great Depression and partly ideological. Similar increases from 1972 to 1984 were partly ideological and partly in response to the recession-related hikes in the relative cost of oil imports from 1973.

The 1938 and post-1973 responses – bigger and more intrusive government spending, limitless borrowing and reduced economic freedom – were controlling to a degree people today might find difficult to appreciate. Shops were not allowed to open on weekends. Pubs had to close at 6 pm. Restaurants could not serve wine to complement their food. Today you can buy clothes or books from anywhere in the world without needing government permission. That is an extraordinary change.

People accustomed to such controls come to accept the lost freedom of action. The onset of World War II caused Britain to bail New Zealand out of its debt crisis, but this bailout and subsequent much greater war-related hardships hid the policy failure from public view. Controls restricting long-standing freedoms became the norm. The 1935 Labour government got off lightly. The Muldoon-led government did not. Its increasingly dirigiste response to the 1975 situation played out in full public view.

In contrast, the 1984–93 measures achieved their goals of ending the public debt spiral, removing extreme controls, and effecting sustained strong employment and output growth. Bigger government is not the solution to every problem, but it can be the problem.

Nor is the Minister of Finance's claim above that government **sat on the sidelines** rooted in reality. These were highly active and involved governments. Government spending and taxation were far higher relative to GDP during the reform decade than either before or after – until Covid-19. Perhaps the clearest area where government became less active was in its direct involvement with employers and unions in wage negotiations. Minister of Labour Stan Rodger earned the sobriquet "Sideline Stan" for resisting pressures to step between employers and trade union to resolve wage bargaining disputes.

It is true that measures that increase the public's freedom of action (e.g. abolishing foreign exchange controls and import protection) reduce the need for bureaucracy. Government should withdraw where government action is unhelpful. Any notion that government should always be meddling in people's affairs, whatever their nature, is fundamentally dictatorial and authoritarian.

Six myths about the 1984–93 reforms

The illiberal critics of the 1984-93 reforms have created several myths in support of their cause. They include assertions that:

1. the reforms caused economic carnage;[135]
2. the reform results failed live up to the expectations of the reformers;[136]
3. the reforms were extreme;[137]
4. the reforms were undemocratic;[138]
5. the reforms greatly exacerbated economic inequality;[139] and
6. the welfare state was decimated.[140]

Myth 1: The reforms caused economic carnage: New Zealand's unemployment rate peaked in 1991. Was that due to the reforms or was it less than it might have been but for the reforms? The Minister of Finance's assertion trusts that readers will assume the former. In reality, spendthrift economic policies and stifling regulations have painful consequences. If New Zealand governments had not addressed those consequences by their own volition, they would likely have had to borrow from the International Monetary Fund, whose assistance would have been conditional on reforms. The Fourth Labour government might have fallen apart much the same. The global share market crash in 1987 would have happened regardless. New Zealand would likely have had a wage breakout and the need to control inflation by monetary policy means, regardless of who was in power.

Many other member countries of the OECD experienced double-digit rates of unemployment at some point during the 1980s and 1990s. New Zealand's peak rate of unemployment during this period was comparable with that in Australia and the United Kingdom, among others (see Table 1). New Zealand's unemployment rate rose from 4.2% in 1987 to 10.7% in 1992, on the OECD's measure.[141] This was lower than in both Australia and the UK. The rise of 6.5 percentage points was comparable to that in the United Kingdom, but was nevertheless higher than in many other countries.[142]

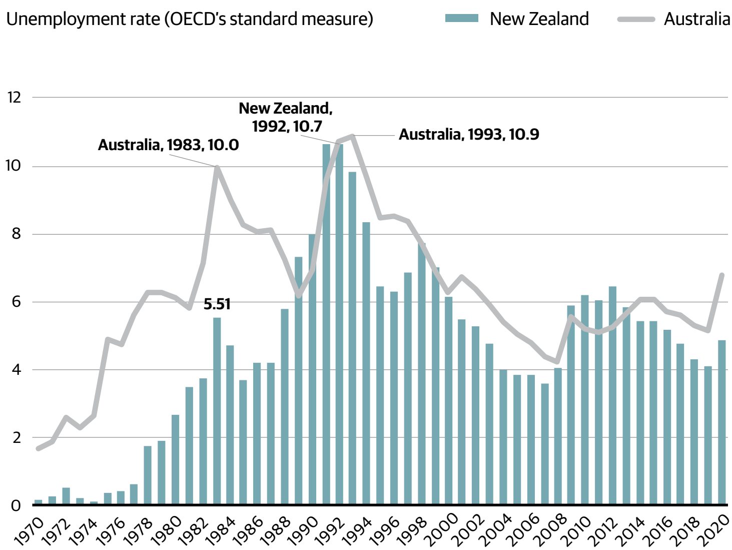
Table 1: Countries with significant increases in unemployment in the 1980s or 1990s

Country	Peak Rate of Unemployment	Year of Peak	Rate 5 years Earlier	Increase
Spain	19.8	1994	13.1	6.7
Slovak Republic	16.4	1999	13.6	2.7
Netherlands	12.7	1983	4.6	8.2
Canada	12.0	1983	8.4	3.6
United Kingdom	11.8	1984	5.4	6.4
Sweden	11.7	1997	6.6	5.0
Estonia	11.4	1999	7.4	4.0
Italy	11.3	1998	9.7	1.6
Australia	10.9	1993	7.2	3.6
Belgium	10.8	1984	6.3	4.5
New Zealand	10.7	1992	4.2	6.5
France	10.7	1997	9.0	1.7
Denmark	10.0	1993	5.9	4.1
United States	9.7	1982	7.0	2.7
Germany	9.6	1997	6.6	3.1
Portugal	8.9	1985	8.4	0.5
Czech Republic	8.7	1999	4.3	4.4
Turkey	8.4	1993	7.9	0.5
Korea	7.1	1998	2.9	4.2
Norway	5.8	1993	3.1	2.7
Iceland	5.3	1994	2.4	2.9
Switzerland	4.8	1997	3.4	1.4
Japan	4.7	1999	2.9	1.8
Austria	4.3	1997	3.6	0.7
Luxembourg	3.0	1997	1.4	1.7
Total OECD	**7.8**	**1983**	**4.8**	**3.0**

Source: OECD Database (2 December 2020).

Comparisons between the experience in Australia and New Zealand usually help assess how well New Zealand has done. In fact, during this period, the track between Australia's unemployment rate and New Zealand's was more remarkable for the commonalities rather than the differences (see Figure 3). Australia's performance was hardly superior.

Figure 3: Rates of unemployment in Australia and New Zealand (1970–2020)



Source: OECD Unemployment rate estimates (2 December 2020).

The challenge for those who claim that the reforms caused carnage is to establish convincingly that there was a less costly, achievable, alternative course of action.[143] To the best of the author's knowledge, no critic has yet risen to that challenge. It was a tough and painful time for many New Zealanders – everyone accepts that. But New Zealand was far from alone in that respect, as Table 1 demonstrates. Why would New Zealand be immune from folly's consequences?

Myth 2: The reform results failed to live up to the expectations of the reformers: This myth is perverse. In fact, the reform results failed to conform to the dire expectations of the critics. The Auckland University economists illustrated that. Both Douglas and Richardson thought the reforms were unfinished business. Disappointing results relative to potential gains were to be expected. Douglas wrote a book with the unfinished business title and set up the Association of Consumers and Taxpayers (now the ACT party) to further the cause. Richardson also wrote a book making her views clear, and has been associated with the ACT party.

Myth 3: The reforms were extreme: David Henderson, former economic director of the OECD, rebutted the claim that the reforms were extreme from an international perspective in a 1996 paper. Australia, the United Kingdom, the United States and other countries were also going through liberalising reform periods, but from a less extreme dirigiste starting point than New Zealand's.[144]

Myth 4: The reforms were undemocratic: The myth that the reforms were undemocratic because Labour did not campaign in 1984 to adopt them – ignores two points. First, the snap election gave no time, and Labour may have been too divided internally and too unaware of how dire the situation was to run on a major reform platform. Second, Labour's sweeping electoral victory in 1987 shows the reform programme to that point enjoyed widespread public support.

Myth 5: The reforms greatly exacerbated economic inequality: Measured income inequality undoubtedly increased on a sustained basis. Doubts arise regarding the validity of the measurement of income during major tax changes involving reduced incentives and means to avoid tax. A related puzzle is that measured consumption inequality only increased temporarily. How could this be if measured income inequality increased permanently?[145]

The progressive lowering of the top rate of personal income tax from 66% to 33% is widely seen as a major cause of the rise in income inequality. However, tax rates are neither tax revenues nor income.

The top income tax rate reductions were combined with measures to broaden the tax base. Tax avoidance incentives and opportunities were reduced. The introduction of a 10% GST, a fringe benefit tax, dividend imputation, and a form of accrual taxation – all widened the tax base. There is evidence of considerable tax avoidance prior to the reform. There was a spike of people reporting taxable income of only $60,000 for no obvious reason other than the tax threshold. Successful tax reform that closes loopholes could see a big increase in the number of people paying tax at the top tax rate. Understimation of tax-sheltered income prior to the change would give a false or exaggerated impression that the change increased income inequality.

The following statistics provide substance to this point. Despite the halving of the top rate of income tax, the income tax liabilities of individuals subject to the top rate of income tax increased from 7.7% of the total personal tax rate in 1986 to 22.8% by 1991. Adjusted for inflation, the increase was from $983 million in 1986 to $2,544 million in 1991.[146] This was despite the sustained collapse from 1987 in both commercial property and the share market followed by a major recession on top of the progressive removal of farm subsidies and import protection. Recessions typically hit profits harder than wage rates. Reduced share market prices and commercial property market prices also tend to hit the rich hardest. Many investors got seriously burned. The critic's assertion that the 'fat cats' were getting richer does not explain how this could occur under the circumstances.[147]

Myth 6: The welfare state was decimated: The welfare state was not decimated, hard though the benefit cuts were for those subject to them. The cuts were from a relatively high level and were targeted to protect those for whom work was not an option, such as the disabled. Between fiscal years 1973 and 1985, spending per capita on social security and welfare, excluding on NZ Superannuation and unemployment, averaged $1,334 per capita in 2020 dollars. It did not exceed $1,520 in any of those years. As a percentage of GDP, it averaged 3.7% and the maximum was 4.4% of GDP (in 1976). Real spending per capita rose sharply to $2,310 by fiscal year 1990 (5.7% of GDP). The low point after the cuts was in the fiscal year 1992. In that year real spending per capita was $1,790 (4.7% of GDP). It was not until fiscal year 1995 that this category of spending exceeded its 1990 levels on both measures.[148]

Of course, the welfare state includes benefits both in kind and in cash. In terms of the total, between 1985 and 1994, spending on health, education and social welfare (excluding those on the unemployment benefit and NZ Superannuation) rose as a percentage of GDP from 4.5% to 4.8%, 4.1% to 4.9%, and 3.4% to 5.6%, respectively. Adding them gives an increase from 12% of GDP to 15.3%.[149] Government was not **sitting on the sidelines** in these areas.

None of this is to deny the widespread pain to farmers, businesses more generally, the great many individuals who lost their jobs, and households that suffered reduced income. But there is no doubt the recession that accompanied these events caused great pain to the least employable.

Implications for Labour's economic strategy today

> *… politicians tend, worldwide, to avoid structural reform until it is forced upon them by economic stagnation, a collapse of their currency or some other costly economic and social disaster.*
> — Roger Douglas[150]

The Minister of Finance's take on the difference between the First (1935) and Fourth (1984) Labour governments ignores their roughly opposite economic circumstances. The First Labour government took office well after unemployment had peaked and when incomes and tax revenues were increasing quickly. It bolstered spending using borrowed money and precipitated the 1938 foreign exchange crisis. In contrast, the Fourth Labour government took office amidst a foreign exchange crisis and public debt spiral. It faced straitened circumstances that required drastic measures. It, and the succeeding National government, sorted out the bequeathed mess on a sustainable basis. No foreign exchange crisis has recurred.

In a nutshell, the First Labour government showed how not to manage economic recovery, whereas the Fourth Labour and National governments showed how to extricate a country successfully from a major economic mess.

The strong economic growth that followed the reforms produced sustained fiscal surpluses. These strengthened the Crown's balance sheet. That generated the fiscal buffer against shocks like the 2008 global financial crisis and Covid-19. Robertson has drawn on that buffer very substantially. As Minister of Finance, he has materially benefited from the reforms that led to those surpluses.

The policies that led to the 1938 and 1984 foreign exchange crises clearly had much in common with each other – and the current times. They were interventionist – adopting an expansionary and directive role for government. They were illiberal in that they reduced rather than expanded the scope for voluntary action. They were ad hoc in that they tended to regulate to suppress specific symptoms as they emerged, rather than address causes. In the current times, measures to artificially suppress housing demand illustrate the genre.

Nevertheless, Budget Speech 2020 indicates that the current government may be falling into the same trap. Treasury's fiscal model for Budget 2021 forecast the fiscal balance (OBEGAL basis) to only be in modest surplus (0.1 to 0.2% of GDP) from 2026 to 2035.This is despite its forecasting solid income and revenue growth throughout that period.[151]

The risk is, of course, that outcomes will be less favourable and the fiscal buffer of sizeable Crown net worth will not be achieved before the next adverse economic shock occurs. Unprecedented central bank credit creation with no plan for restoring normality heightens the concern.

The situation is made more disturbing by international developments. We are witnessing unprecedented peacetime fiscal and monetary excess in Europe and North America. Heavily indebted governments are cavalierly throwing trillions more of borrowed money after bad. Central bankers are egging them on and taking unprecedented actions to flood international financial markets with liquidity. Investors are pricing securities on the expectation that taxpayers are underwriting their risks. Widely underpriced risks are a disaster in the making.

Certainly, the fiscal response to Covid-19 had to be exceptional. That is not the issue. The issue is that exacerbated the unresolved fiscal problems that followed the 2008 global financial crash. No country seems to have a credible plan or timetable for resolving them.

Blind faith in Keynesian thinking is being used to justify continuing the fiscal and monetary excesses. No amount of public debt appears to be too big. Fiscal prudence is dismissed as 'austerity'. Yet empirical research is justifying the obvious conclusion: delaying necessary action raises the future cost.

Why repeat past mistakes? Sadly, in politics, as in human affairs more generally, past mistakes commonly must be repeated, and past lessons relearned. The electorate swings between belief and disillusionment about the benefits of prolonged government borrowing and deficit spending. When debt problems turn sour, the public votes for a party that promises to rectify matters but blame it if any pain is involved. Indeed, the belief that there is a 'free lunch' during the period of excess implies a belief that rectifying measures should be painless, or at least less painful than experienced.

Few non-partisan observers would see Treasury's forecasts above as being consistent with section 26(G)(1)(a) of the *Public Finance Act*. That section requires:

> Reducing total debt to prudent levels so as to provide a buffer against factors that may impact adversely on the level of total debt in the future by ensuring that, until those levels have been achieved, total operating expenses in each financial year are less than total operating revenue.

Holding total debt at a high level and running deficits, or near deficits, despite buoyant growth projections was not the likely intention of Parliament when passing that fiscal principle into legislation.

Finance Minister Robertson's rhetoric in the 2020 Budget Speech is dangerous wishful thinking. Of course, Robertson does not intend to wreck New Zealand's credit by mismanaging public finances. But neither did Savage and Nash in 1935. Or Kirk's Third Labour government. Or Muldoon's Third National government.

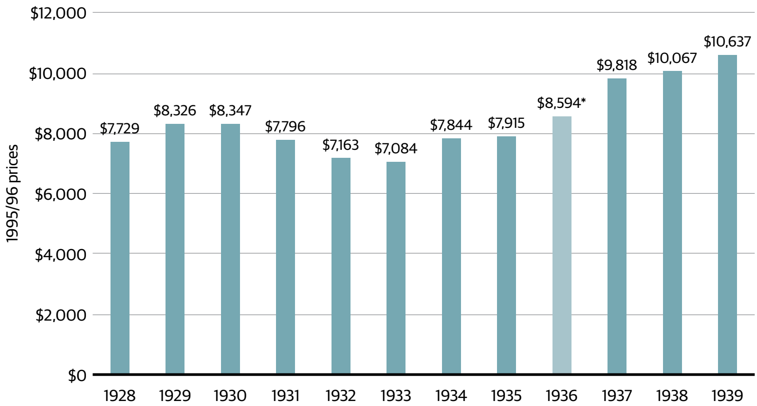
By diminishing the governments that fixed the 1984 crisis, Robertson seeks to justify a return to a bigger and more intrusive and directive government. He does so at our collective peril.

Appendices

Appendix 1: Economic recovery after 1932–33

In the year ended March 1936, real GDP per capita, at $8,594 in 1995/96 dollars, was 21% higher than in the year ended March 1933. (See Figure 4.)

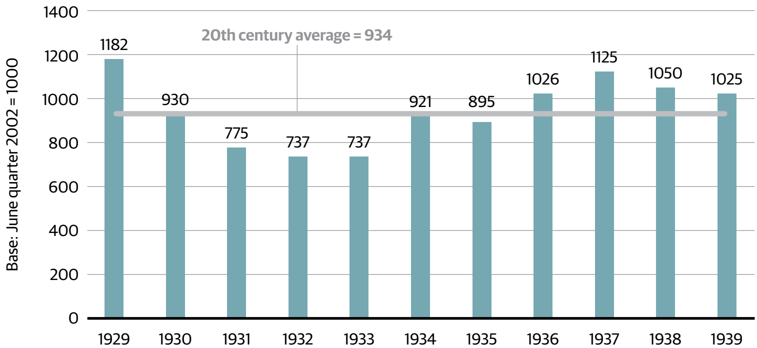
Figure 4: Growth in real GDP per capita (1928–39)



Source: NZIER long-term series, years ended March.
Note: *The First Labour government was elected in November 1935.

The domestic economic recovery started overseas. Export prices rose sharply relative to import prices after 1933. By 1936, the ratio had recovered to the 20th century average (see Figure 5).

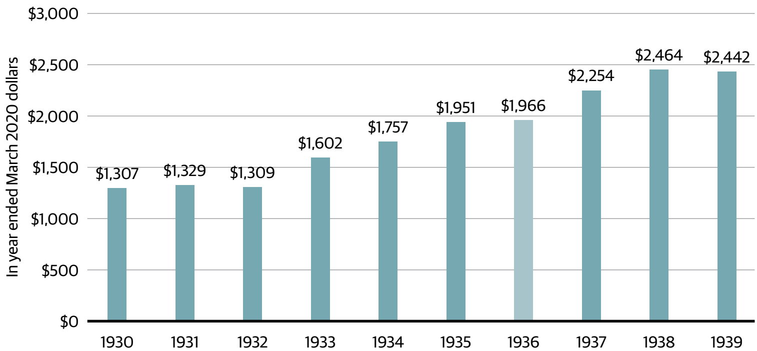
Figure 5: Recovery in New Zealand's Merchandise Terms of Trade (1929–39)



Source: NZIER long-term series, calendar year averages.

Rising domestic incomes had already substantially boosted central government's tax revenues by 1935. Real per capita taxation in the year ended March 1936 was 50% higher than at its low point in the year ended March 1932 (see Figure 6). By the year ended March 1939, real tax revenue per capita was 87% higher than in 1932. Wartime levels of taxation (and spending) followed.

Figure 6: Taxation per capita (including employment promotion tax) (1930–39)



Source: Statistics New Zealand. "The New Zealand Official Year-Book, 1940," Website. De facto population, CPI. Years ended March.

These tax increases were used in good part to turn fiscal deficits into surpluses. The main measure of central government's fiscal balance at the time was the surplus or deficit in the Crown's Consolidated Fund.[152] After six years of deficits or near-deficits, a substantial surplus was achieved in the year ended March 1935. This Fund stayed in surplus until the year ended March 1958. Labour had inherited debt to deal with, along with additional borrowing for capital spending, but the ordinary current government spending did not increase nearly as fast as tax revenues, until wartime.

Appendix 2: Lead politicians from 1930 and 1938 timeline

Table 2: Prime Ministers and Ministers of Finance (1930 to 2021)

Prime Minister	Took office	Left office	Party	Minister of Finance
George Forbes	28 May 1930	6 December 1935	United-Reform Coalition	George Forbes
Michael Joseph Savage	6 December 1935	27 March 1940	First Labour	Walter Nash
Peter Fraser	1 April 1940	13 December 1949		Walter Nash
Sidney Holland	13 December 1949	20 September 1957	First National	Sidney Holland
Keith Holyoake	20 September 1957	12 December 1957		Jack Watts
Walter Nash	12 December 1957	12 December 1960	Second Labour	Arnold Nordmeyer
Sir Keith Holyoake	12 December 1960	7 February 1972	Second National	Harry Lake
Jack Marshall	7 February 1972	8 December 1972		Robert Muldoon
Norman Kirk	8 December 1972	31 August 1974	Third Labour	Bill Rowling
Hugh Watt *Acting prime minister*	31 August 1974	6 September 1974		
Bill Rowling	6 September 1974	12 December 1975		Bob Tizard
Sir Robert Muldoon	12 December 1975	26 July 1984	Third National	Robert Muldoon

Prime Minister	Took office	Left office	Party	Minister of Finance
David Lange	26 July 1984	8 August 1989	Fourth Labour	Roger Douglas
Geoffrey Palmer	8 August 1989	4 September 1990		David Caygill
Mike Moore	4 September 1990	2 November 1990		David Caygill
Jim Bolger	2 November 1990	8 December 1997	Fourth National	Ruth Richardson
Jenny Shipley	8 December 1997	10 December 1999		Bill Birch Bill English
Helen Clark	10 December 1999	19 November 2008	Fifth Labour	Michael Cullen
John Key	19 November 2008	12 December 2016	Fifth National	Bill English
Bill English	12 December 2016	26 October 2017		Steven Joyce
Jacinda Ardern	26 October 2017	Ongoing	Sixth Labour	Grant Robertson

Table 3: Crisis timeline to 1938

November 1935	First Labour Government is elected, winning 53 out of 80 seats.
December 1935	New Zealand's overseas assets: £38 million.
30 April 1938	New Zealand's overseas assets: £28.6 million.
30 November 1938	New Zealand's overseas assets: less than £8 million.
15 October 1938	Labour is re-elected with 53 seats out of 80.
3–4 November 1938	Finance Minister Walter Nash explains the financial crisis to the new Labour caucus. Imports exceeded imports by £3 million in 1938, "when New Zealand needed about a £12 million surplus to service public debts and make other payments."[153]
December 1938	Exchange control regulations are introduced, prohibiting any form of free market in foreign currency.
16 April 1939	Nash explains to Cabinet that the government needed to borrow £14.75 million to fund promised facilities to expand industry and a further £17 million in early 1940 to repay a maturing overseas loan.
June and July 1939	Nash experiences two humiliating months in London trying to borrow money, and eventually gets Bank of England support to borrow £16 million as a short-term loan.
4 September 1939	New Zealand Government declares war on Germany.[154]
5 and 6 September 1939	British government sends cables proposing to buy New Zealand's entire exportable surpluses of meat and dairy produce.[155]

Appendix 3: Treasury's 1984 briefing

Treasury's main briefing to the incoming 1984 government was later published as a 325-page review of the fiscal, monetary, structural and regulatory issues facing the government.[156] Remarkably, it was written in the four weeks after the snap election was announced and amidst the increasingly alarming foreign exchange situation.[157] (Prior to the election, Treasury had been working on helping Muldoon develop his 1984 Budget Statement.)

The briefing discussed the option of floating the exchange rate. If restrictions on foreign exchange were removed, and market interest rates were permitted, private capital flows could replace official overseas borrowing in foreign currencies.

Substantial export subsidies and other forms of farming assistance had been seen as a way of offsetting the hidden tax on exports of import duties and import licensing constraints. The big devaluation provided an opportunity to reduce both the import "taxes" and the export subsidies, if domestic wage inflation did not break out. Doing so would also help ease the fiscal position.

A floating exchange rate would also allow monetary policy to achieve low inflation. Doing so would be painful, but not doing so was already painful and costly.

Reducing the structural rigidities accompanying centralised wage-fixing would also help reduce the institutional ratcheting up of wages and prices through annual "wage rounds" and general wage orders. Greater recourse to decentralised wage bargaining could help reduce unemployment and improve labour productivity, and thereby lift real wage rates more sustainably.

Getting better performance out of the multitude of government pseudo-commercial enterprises was also needed. Doing so would improve productivity and reduce fiscal pressures. But doing so would force the disguised unemployment in NZ Post, the Railways, the Ministry of Works, and the Forest Service into the public view. The real tragedy here was the failure to address the issues earlier. The more problems are allowed to pile up unaddressed, the bigger is the eventual adjustment.

Major tax reform was also needed. The tax base was much too narrow to produce the additional revenue needed. It was also far too reliant on taxing wage and business income.

Appendix 4: Roger Douglas's 10 reform principles

1. Quality decisions start with quality people. Moving quality people into strategic positions is a prerequisite for success.
2. Implement reform by quantum leaps. Moving step by step lets vested interests mobilise. Big packages can neutralise them.
3. Speed is essential. It is impossible to move too fast. Delay will drag you down before you can achieve your success.
4. Once you start the momentum rolling, never let it stop. Set your own goals and deadlines. Within that framework consult widely in the community to improve detailed implementation.
5. Credibility is crucial. It is hard to win and you can lose it overnight. Winning it depends on consistency and transparency.
6. The dog must see the rabbit. Adjustment is impossible if people don't know where you are going. You have to light their path.
7. Stop selling the public short. Voters need and want politicians with the vision and guts to create a better future.
8. Don't blink or wobble. Get the decisions right and front up. Confidence often rests on your own visibly relaxed composure.
9. Opportunity, incentive and choice mobilise the energy of the people to achieve successful change. Protection suppresses it. Get the framework right to help everyone act more effectively.
10. When in doubt, ask yourself: "Why am I in politics?"

Source: 1989 Speech, copied verbatim.

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2 Ibid.
3 Ibid.
4 "Dirigisme or dirigism (from French *diriger* 'to direct') is an economic doctrine in which the state plays a strong directive role as opposed to a merely regulatory or non-interventionist role over capitalist market economy." Wikipedia, "Dirigisme," Website.
5 It is easier politically to change a policy direction if the problem can be blamed on some external event.
6 Keith Sinclair, *Walter Nash* (Auckland: Auckland University Press, 1976), 186.
7 Details and charts are in Appendix 1.
8 Peter Franks and Jim McAloon, *Labour: The New Zealand Labour Party 1916–2016* (Wellington: Victoria University Press, 2016), 96. For a comprehensive list of the 1935–49 measures, see Wikipedia, "First Labour Government of New Zealand," Website. Also useful is Jane Silloway Smith, "Looking Back to Look Forward: How Welfare in New Zealand Has Evolved" (Maxim Institute, 2010).
9 Keith Sinclair, *Walter Nash*, op. cit. 171.
10 Even so, merchandise exports continued to exceed imports. Note that the fall in the terms of trade after 1936/37 was a compounding factor (see Figure 5). See also Peter Franks and Jim McAloon, *Labour: The New Zealand Labour Party 1916–2016*, op. cit. 106.
11 "Overseas funds have declined heavily during the last three years, particularly since May, 1938, ascribable to three principal causes—(1) the repatriation of capital temporarily held in the Dominion, (2) over-importation, and (3) investment abroad of New Zealand." Statistics New Zealand, "The New Zealand Official Year-Book, 1940," Chapter 28: "Overseas Funds of Banks," Website.
12 Gary R. Hawke, *The Making of New Zealand: An Economic History* (Wellington: Cambridge University Press, 1985), 159. For example, to the charge that the proposed Social Security Act was "applied lunacy," Savage said he saw it as "applied Christianity".
13 See Statistics New Zealand, "The New Zealand Official Year-Book, 1940," Chapter 28: "Overseas Funds of Banks," op. cit. Also see Muriel F. Lloyd Prichard, *The Economic History of New Zealand to 1939* (Auckland & London: Collins, 1970), 393. The statistics include the overseas assets of the Reserve Bank of New Zealand.

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21 Ibid. 171.
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23 Ibid. 171.
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25 Ibid. 105.
26 In January 1933, the New Zealand pound was fixed at £NZ125 = £stg100, down from £NZ110 = £stg100 in 1931, and from £NZ100 = £stg100 prior to 1931.
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39 Ibid. 175–176.
40 Ibid. 176.
41 Ibid. 176.

42 Ibid. 177.
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44 Ibid. 179.
45 Ibid. 185.
46 Ibid. 179.
47 Ibid. 186.
48 Ibid. 179.
49 At an early stage of negotiations, Norman decided that Nash's request for further lending had to be satisfied. According to R.N. Kershaw, a senior official at the Bank of England, Norman said he "wanted to make a socialist minister squirm." Gary R. Hawke, Personal communication (13 January 2021).
50 Keith Sinclair, *Walter Nash*, op. cit. 186.
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52 Ibid. 186.
53 Sinclair does say: "Nash was to concede, talking to British ministers in June [1939], that they had acted 'perhaps rather imprudently'," Ibid. 175.
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57 Ibid. 231.
58 Malcolm McKinnon, *Treasury: The New Zealand Treasury 1840–2000*, op. cit. 166.
59 Keith Sinclair, *Walter Nash*, op. cit. 189.
60 Alexander H. McLintock, *An Encyclopaedia of New Zealand*, op. cit.
61 Gary R. Hawke, *The Making of New Zealand: An Economic History,* op. cit. 16.
62 The Muldoon government had early weakened its effects through measures such as auctioning licenses for some products and the Closer Economic Relations trade agreement with Australia that took effect in January 1983.
63 The experience of negotiating with Norman was seared in Nash's memory. At an election meeting during the 1966 election, his last, Nash spoke at length about the problems he had faced in 1939. His audience clapped, but few of those present may have understood the relevance of his subject matter, if there was any, for that election. Michael Bassett, Personal communication (12 January 2021).
64 Keith Sinclair, *Walter Nash*, op. cit. 187.
65 Ibid. 172.
66 Ibid. 175.
67 At the time of writing Wikipedia listed 24 examples. Wikipedia, "Fourth Labour Government of New Zealand," Website.
68 Michael Bassett, *New Zealand's Prime Ministers: From Dick Seddon to John Key* (2017), 213.
69 Ibid. 213–214.
70 Ibid. 214.
71 Wikipedia, "Black Budget (New Zealand)," Website.

72 Barry Gustafson, *His Way: A Biography of Robert Muldoon* (Auckland: Auckland University Press, 2000), 90.
73 Ibid. 93–94.
74 Ibid. 189.
75 Ibid. 56.
76 Ibid. 98–99. In 1968, Muldoon introduced an emergency domestic purposes benefit for deserted wives and single women with dependent children. Labour would extend this benefit to all solo parents in 1973.
77 In just two years – between the years ended March 1973 and 1975 – real government spending per capita rose 17%, based on the Treasury's long-term fiscal series for "adjusted expenditure."
78 Wikiquote, "Robert Muldoon," Website.
79 The measure here is Treasury's long-term statistical series for financial net expenditure, years ended March basis. The real per capita calculation uses the CPI to correct for inflation.
80 Wikipedia puts the rise as being from US$3 per barrel to nearly US$12 globally by March 1974. Wikipedia, "1973 oil crisis," Website.
81 In the year ended March 1975, payments for imports of goods and services exceeded like export revenues by 12.2% of GDP. In the year ended March 1973, exports of goods and services had exceeded like imports by 3% of GDP.
82 Bryce Wilkinson, "New Zealand's Global Links: Foreign Ownership and the Status of New Zealand's Net International Investment" (Wellington: The New Zealand Initiative, 2013).
83 Michael Bassett, *New Zealand's Prime Ministers: From Dick Seddon to John Key*, op. cit. 370–371.
84 Ibid. 372.
85 Te Ara (The Encyclopedia of New Zealand), "Oil and gas: The Māui gas field," Website, 5.
86 Budget Speech 1986, B.6, 31.
87 Statistics New Zealand, "New Zealand Official Yearbook 2000" (Wellington: New Zealand Government, 2020), section 28, 578.
88 To read about the difficulties this created for officials, see Michael Bassett and Judith Bassett, *Roderick Deane: His Life & Times*, Chapter 7: "The Deepening Crisis" (Viking, 2006), 90–106.
89 For a fuller account of the events leading up to this crisis, see Bryce Wilkinson, "New Zealand's Fiscal Reforms, 1984–1996" (Ottawa: MacDonald-Laurier Institute, 2017) and Michael Bassett and Judith Bassett, *Roderick Deane: His Life & Times,* op. cit.
90 See New Zealand History, "Nuclear-free New Zealand," Page 3 – Ship visits, Website. Waring was not alone in opposing her party on this issue.
91 Barry Gustafson, *His Way: A Biography of Robert Muldoon*, op. cit. 378.
92 The Reserve Bank resumed its foreign exchange activities after the 20% devaluation of the New Zealand dollar on 18 July 1984.

93 Michael Bassett and Judith Bassett, *Roderick Deane: His Life & Times*, op. cit. 112.

94 For details, see Treasury, *Economic Management* (Wellington: New Zealand Government, 1984), 82–83.

95 The incoming prime minister, David Lange, reportedly later remarked: "We actually were reduced to asking our diplomatic posts abroad how much money they could draw down on their credit cards!" The situation was undoubtedly parlous, but this may have been a case of witty exaggeration. Wikipedia, "1984 New Zealand constitutional crisis," Website, footnote 9.

96 Ibid. Footnote 12.

97 A dishonest feature of a fixed exchange rate regime is that ministers of finance are obliged to deny that they are going to change it – until the day that they do. Officials' lips are sealed. A floating exchange rate allows greater honesty and transparency.

98 Michael Bassett and Judith Bassett, *Roderick Deane: His Life & Times*, op. cit. 123.

99 Ibid. 121–122.

100 Ján Oravec, "New Zealand 1984 and Slovakia 1998 – Parallels: An Introduction to the Annual Lecture of the F.A. Hayek Foundation, Bratislava," in Josef Šíma and Ján Pavlík (eds.), "Roger Douglas, Author of the Most Successful Economic Reform of the XXth Century" (Prague: Liberální Institute and Centre for Liberal Studies, 1999), 12.

101 Author's calculations using the OECD's total economy GDP per hour series, downloaded 29 April 2021. The OECD average annual compounded growth rate was 2.1% pa, that for Australia was 1.7% pa. Time series covers just 14 member countries.

102 Treasury, *Economic Management*, op. cit. Appendix II, 87 and p 45 for nominal GDP ($33,142 million). The net public debt was slightly more than half of gross public debt in March 1984, according to historical figures from Treasury's Debt Management Office.

103 Ibid. Appendix 1, 73 ($2,420 million as a percentage of $11,600 million).

104 New Zealand Debt Management Office, "External Public Debt History of New Zealand," Excel spreadsheet. Treasury estimated that servicing the official overseas debt would take 26.8% of export income in the year ended March 1985. This was up from 4.2% in the year ended March 1975.

105 Standard and Poor's did so in April 1983, and Moody's Investor Services in October 1984.

106 See Treasury, *Economic Management*, op. cit. Table 1, 15. Treasury forecast the consumer price index would be 7.5% higher in March 1985 than in March 1984 and would rise by another 9.0% to March 1986. It forecast the unemployment rate would be 5.2% in March 1985 and 6.1% in March 1986. Real GDP in the year to March 1986 would be 0.8% lower than in the year ended March 1985.

107 The unemployment rate between 1956 and 1980 ranged between 0.5% and 1.9% according to SNZ's long-term series. It was 4.8% in 1983 and 4.0% in 1984. For earlier years, the online Official Year Books record male unemployment rates in the five-yearly population censes (see, for example, the table in the 1975 Official Yearbook that goes back to 1896). The male rate was only above 4% in 1936, 1901 and 1896 (with 1931 missing, but surely also higher than 4%). Statistics New Zealand, "The New Zealand Official Year-Book, 1975," Section 32: "Employment," Website.

108 For details, see Appendix 4.

109 Jonathan Boston explains the difficulties at length in "Incomes Policy and the 1985–86 Wage Round: From Non-Market Failure to Market Failure," *New Zealand Journal of Industrial Relations* 10:2 (1985), 65–82.

110 In the author's recollection, a visiting US economics expert, a Nobel laureate, commented that Roger Douglas was unique at the time in this respect.

111 Ján Oravec, "New Zealand 1984 and Slovakia 1998 – Parallels," op. cit. 23.

112 Ján Oravec, "New Zealand 1984 and Slovakia 1998 – Parallels," op. cit. 25.

113 Treasury, "Government Management: Brief to the Incoming Government," Volume 1 (1987), 206, Table 4.2. As measured at the time, real GDP had risen by 6.6%, 2.2% and 2.4% for the years ended March 1985, 1986 and 1987, respectively.

114 On election night 1984, Labour won 56 of 95 seats, a majority of 17. It subsequently lost a seat, so prior to the 1987 general election it held 55 of 95 seats, a majority of 15. On election night 1987, it won 57 of 97 seats, a majority of 17. So the 1987 general election increased its parliamentary majority. Of course, economic reform was not the only issue, but it was a major one. (Stopping US warship visits under a 'nuclear-free' banner was another controversial issue.)

115 Douglas immediately recognised the threat to output and employment. The package Cabinet approved in December 1987 sought to minimise the likely downturn in investment and increase in unemployment. Douglas hoped to reduce the top income tax rate from 48% to 23%, but in the event only got it reduced to 33%.

116 Ján Oravec, "New Zealand 1984 and Slovakia 1998," op. cit. 58.

117 John Wilson, "Short History of Post-Privatisation in New Zealand" (Wellington: Treasury, 2010).

118 Former CTU leader Jim Anderton did resign from the Party in protest and formed the New Labour Party.

119 Ruth Richardson, *Making a Difference* (Christchurch: Shoal Bay Press, 1995).

120 Reportedly at one caucus session, when Richardson told Muldoon, as she commonly did, that she 'strenuously disagreed' with a policy, he sighed and interjected along the lines of "why can't you just disagree"?

121 See Ruth Richardson, *Making a Difference*, "Redesigning Welfare," op. cit. 207-217.

122 Statistics New Zealand, "Seasonally-adjusted household labour force survey variable," INFOS Timeseries data sequence HLFQ.S1F35.

123 Treasury's long-term fiscal series, adjusted spending measure, year ended June 1991. (The less rounded figure is 39.9% of GDP). The Treasury's series starts in the year ended March 1972 when this spending measure was 24% of GDP.
124 Ruth Richardson, *Making a Difference*, Chapter 12: "Keeping Our Nerve," op. cit. 207 and 208.
125 See the statistics on spending, excluding on unemployment and NZ Superannuation, in Chapter 3, myth six.
126 See, for example, Alberto Alesina, Carlo Favero and Francesco Giavazzi, "Austerity: When It Works and When It Doesn't" (Princeton University Press, 2019).
127 Then Minister of Labour, Bill Birch, now Sir William, led the task of labour market reform.
128 Kim Kunhong, Robert A. Buckle and Viv B. Hall, "Key Features of New Zealand Business Cycles," *The Economic Record*, The Economic Society of Australia 70:208 (1994), 56–63. Also see Viv B. Hal and John McDermott, "Recessions and Recoveries in New Zealand's Post-Second World War Business Cycles," DP2014/02 (Reserve Bank of New Zealand, 2014).
129 Interest.co.nz, "Naive Keynesianism and other fallacies about the 'Mother of all Budgets'" (11 June 2009).
130 Bryce Wilkinson, "New Zealand's Fiscal Reforms, 1984–1996," op. cit. 15, Figure 7. Between 1991 and 2000, only Ireland and Mexico achieved faster employment growth.
131 Derek Gill, "The Fiscal Responsibility Act 1994: The Astonishing Success of a Weak, Non-Binding Policy," NZIER public discussion paper 2018/1 (2018).
132 The measure being used here is the Total Crown OBGEGAL (operating balance before gains and losses).
133 Treasury projected a budget surplus (OBEGAL basis) for the year ended June 2020 of 1.9% of GDP in its pre-election projections for 2017. In its pre-Covid December 2019 update it projected a deficit of 0.9% of GDP.
134 Grant Robertson, "Finance Minister's Budget 2020 speech," op. cit.
135 Ibid.
136 Yvan Guillemette, "Structural Policies to Overcome Geographic Barriers and Create Prosperity in New Zealand," Working Paper 696 (Paris: OECD Publishing, 2009). See also Bryce Wilkinson, "New Zealand's Fiscal Reforms, 1984–1996," op. cit. 14.
137 See, for example, Brian Easton, "The relevance of Rogernomics," Blog post (1 November 1997).
138 Auckland University Law Professor Jane Kelsey sees the attempts to legislate for Reserve Bank independence and fiscal responsibility as "an undemocratic form of 'economic constitutionalism." Ian Anderson, review of *The FIRE Economy: New Zealand's Reckoning*, by Jane Kelsey, *Fightback* (16 November 2015).
139 Wikipedia, "Economic inequality in New Zealand," Website.

140 Blogger "How Melulater Sees It" adopts such rhetoric: "The new National government of 1990 decimated this social contract in 1991" in a blog post. How Melulater Sees It, "How does child poverty affect access to education and success in achievement for New Zealand children?" Blog post (18 January 2019). (Happily, few critics go this far.)

141 It reached 11.2% in September 1991 on Statistics New Zealand's seasonally-adjusted measure.

142 New Zealand may have had a higher level of disguised unemployment prior to corporatisation of state agencies than did some other countries. Shaking out disguised unemployment in places like the NZ Forest Service, Rail and the Post Office likely contributed to New Zealand's large measured rise.

143 Options that were not politically achievable at the time do not count.

144 David Henderson, "Economic Reform: New Zealand in an International Perspective" (New Zealand Business Roundtable, 1996).

145 Bryce Wilkinson and Jenesa Jeram, "The Inequality Paradox: Why Inequality Matters Even Though it has Barely Changed" (Wellington: The New Zealand Initiative 2016), Figure 9, 22.

146 These are in 1993 dollars, years ended March. See Figure 10 in Bryce Wilkinson and Jenesa Jeram, "The Inequality Paradox," op. cit.

147 Refer also to Michael Reddell and Cath Sleeman, "Some Perspectives on Past Recessions," *Reserve Bank of New Zealand Bulletin* 71:2 (2008), 14, column 2.

148 Treasury's long-term fiscal time series and the author's calculations. A qualification is that the spending numbers include department administrative spending on these programmes.

149 Treasury's long-term time series, year ended March 1985 and year ended June 1994.

150 Roger Douglas, "Politics of Successful Structural Reform," Paper delivered to Mont Pelerin Society in Christchurch (28 November 1989).

151 Treasury has projected the average annual real GDP growth to be 2.4% pa between 2023 and 2034. Treasury, Fiscal Strategy Model for Budget 2021.

152 "The Ordinary Revenue Account of the Consolidated Fund covers the ordinary revenue and expenditure of the General Government—i.e., apart from capital items, commercial and special undertakings, advances, [etc]." Statistics New Zealand, "The New Zealand Official Year-Book, 1940," Chapter 24, Section XXIV, "Public Finance," "Subsection A – Revenue and Expenditure", subheading "Income and Expenditure", Website.

153 Keith Sinclair, *Walter Nash*, op. cit. 171.

154 Ibid. 189.

155 Ibid. 189.

156 There was also a substantial separate Treasury briefing document on land use issues.

157 Of course Treasury had been thinking hard about the issues for some years beforehand.

In his 2020 Budget speech, the Minister of Finance presented COVID-19 as a rare opportunity to 'hit the reset button' for New Zealand. While favouring the big spending 1935-1949 Labour Government, Grant Robertson spurned the policies that he considered caused "economic carnage" in the 1980s and 1990s.

Incumbent politicians are compelled to interpret the past in their favour. Yet misinterpretations of the past risks replaying past follies.

A closer look at New Zealand's economic history reveals that Minister Robertson should reconsider his judgment. It was the First Labour Government that triggered an economic crisis, whereas the Fourth Labour Government resolved one.

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