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Contents

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REFORMING THE LABOUR MARKET
IDLE DREAMS OR REAL PROSPECTS?

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REFORMING THE LABOUR MARKET – IDLE DREAMS OR REAL PROSPECTS?

Thank you for the opportunity to speak to you today on reforms to our labour market and industrial relations system.

This is a subject to which the 30 or so chief executives who comprise the New Zealand Business Roundtable have devoted an enormous amount of thought over the past twelve months. No single issue is more important to the prospects of realising the full benefits of the economic initiatives of recent years.

In response to the government's invitation for submissions on its Green Paper, the Business Roundtable sought to present a careful, reasoned analysis of why our labour market was producing results that no one could be satisfied with and was contributing to our anaemic economic performance.

The deficiencies of our system are evident in:

- poor rates of growth in labour productivity;
- unemployment: perhaps the most obvious sign that something is wrong;
- a concentration of unemployment among disadvantaged groups such as the young and the unskilled, contributing to disturbing social trends;
- a degree of hyper-regulation of employment contracts which excessively constrains voluntary choices and raises labour costs;
- a failure to deal adequately with equity and low income problems and to uphold normal democratic and individual rights; and
- a lack of flexibility which is incompatible with the needs of a rapidly adjusting and open economy in a competitive world environment.

On the basis of a set of criteria which we believe New Zealand's labour market institutions should meet, we put forward proposals for some quite fundamental changes which we believe would offer a better deal for all New Zealanders.

We have been encouraged by the range of positive and thoughtful reactions to our analysis. I believe there are good grounds for optimism that this area is not the "no go" territory it is popularly assumed to be.

At the same time, some legitimate questions have been asked about our arguments, and scepticism has been expressed in some quarters which have perhaps not been accustomed to examining too deeply some of the basic precepts on which New Zealand's labour market laws and regulations have been constructed. Rather than restate our conclusions in detail, I would like to take this opportunity to answer some of those questions and criticisms.

When agreeing to this engagement, I was advised that the topic of industrial relations was thoroughly boring to the media and the general public. It is the first depressing commentary on the nature of our industrial relations system that this should be so. Most of us spend most of our time in employment relationships. Whether these relationships provide work satisfaction, a positive sense of involvement with our organisations, incentives to improve our lot, the prospects of jobs for our kids, opportunities for the disadvantaged and so forth should be of intense interest to us all as individuals. Whether the system produces outcomes in respect of labour costs and productivity which can sustain enterprises, generate jobs and put us back on our competitive feet is vital to the future of the country.

But it is not hard to see why discussions of our present system risk sending most audiences into a state of terminal boredom. The rules and procedures are often practically incomprehensible, even to the initiated. An employment relationship should be a relatively straightforward deal. An employee is essentially offering his or her labour services to a willing buyer, on terms and conditions which are periodically renegotiated. We noted in our submission the likely puzzlement of a visitor from another planet on discovering the bizarre New Zealand procedure for renewing this simple employment contract. Technically a “dispute” must be created, normally by the employer “rejecting” the claims of the union, and a “conciliation” process then follows, the function of which is to commit the parties to a negotiation!

Why should this subject be taken far more seriously – by chief executives, union leaders and indeed all New Zealanders? Some have queried whether, as the Business Roundtable argued, the operation of the labour market is really crucial to general economic performance. For example, in a column which I did not take to be resolutely negative in its general thrust, Rob Campbell observed that:

> ... economic development is not the result of wishful thinking or belief. Rather it is the product of careful assessment and determined allocation of resources. There has been no persuasive evidence produced that either of these processes have been hindered by labour market structure.

The question is a serious one and deserves a serious answer.

It is, of course, never easy for economic research to precisely evaluate the mix of contributing factors in a country’s economic performance. We cannot know, for example, precisely how much damage is done by artificial financial sector controls, an inward-looking industrial strategy, a distorted tax system or a lax monetary policy – either as individual ingredients in the total mix or, more importantly, through their interaction with other parts .of the economic system.

One attempt to explore the aggregate consequences of unsatisfactory labour market regulation was made in a recent study by the World Bank on price distortions and growth in developing countries. The study found that:

> … the cost of labour was distorted primarily because of the misplaced interventions of government and pressures from trade unions. Most developing

> country governments in the 1950s favored the Fabian Socialist principles of encouraging trade union activities and promoting minimum wage legislation on the basis of "adequate" income for workers ...

It went on to report that:

> In many developing countries ... real wages increased very rapidly in the 1960s as a result of trade union activity and government pressures and went much beyond the rate of increases in productivity. In many other countries, the spread effects of high incomes in protected industrial sectors, privileged mining, or foreign enclaves, pushed wages up faster than productivity. By the late 1960s ... evidence showed that capital-labour ratios were in fact sensitive to the relative cost of labor and capital. Distortions in labor markets tended to hurt both growth and its labor intensity and thus impeded the growth of employment and in particular contributed to urban unemployment.

The study attempted some quantitative evaluation of the aggregate effects of labour cost distortions and intervention in labour markets by governments in a range of countries. It found that during the 1970s there was a difference in the respective growth rates of high distortion countries and low distortion countries of 1.4 percentage points per annum. The adverse effects of labour market distortions were also most marked in the growth rates of exports, in the savings rate and in the efficiency of investment.

Over a working career (say 40 years) a differential growth rate of 1.4 percentage points per annum would add up to a 74 percent difference in attainable standards of living. In addition, the interactions of the labour market with other policy areas could well represent the difference between the success or failure of a programme aimed at stabilising and liberalising the economy and escaping from economic stagnation. My reading of the evidence suggests it is difficult to overestimate the importance of the topic.

Another theme that seems to have been adopted by some commentators is that this area is inevitably one of irreconcilable perspectives, or worse, a battlefield for class warfare. Our submission dwelt on the fallacies inherent in such perspectives. The goal of a better system should be higher incomes, including wage incomes, and better and more secure jobs for all. A better system should also promote more positive employer-employee relationships, and more democratic and equitable processes for expressing individual preferences for employment terms and methods of representation.

We stated that the key requirements as we saw them were to:

- allow greater flexibility in the labour market to encourage the effective deployment of resources, reward performance, and create greater incentives for innovative efforts to enhance productivity;
- provide for necessary decentralisation of primary bargaining at levels such as the enterprise or industry which often suit the interests of workers and employers far better;
- provide greater freedom for the parties to develop their own approach to bargaining;

- ensure commitment to and respect for contracts; and
- develop better approaches to handling equity and low income issues.

Close observers of the industrial relations scene would recognise in those principles a lot of common ground with other parties. For example, the union perspectives on reform set out in the paper to the Economic Summit in September 1984 in the following terms are just as relevant now:

> The union movement has become increasingly concerned about the inability of the old system, and particularly the way the old system operated, to take account of the desirability of changing relativities between occupations. In the 1981 wage round, for example, 91 percent of awards were settled within 1 percent of the movement in the core rate in the metal trades award. To cope with this problem, the unions would like to see the old system modified so that more consideration could be given to factors that were specific to an industry or occupation, and a good deal less to entrenched relativities.

In the same context, there was joint employer and union agreement to the following conclusion:

> All parties agree that more encouragement should be given to industry or enterprise based bargaining, since this form of bargaining by its very nature is better able to take account of specific industrial factors than the formal national award system can.

The essence of our proposals is an industrial relations system based on voluntary contracting, at whatever levels parties find it most convenient to do business. In many cases, we would expect this to be at an establishment, company or industry level, but regional levels or even a national level would not be excluded. The important point is that whatever level is chosen should be the primary focus of bargaining, and not some subsequent stage. Similarly, the important point as far as bargaining arrangements are concerned is that employers should not be required to deal with more than a single bargaining group, but this would not preclude associations or federations of unions forming at national or sub-national levels.

There seems to be no reason whatsoever to conclude that New Zealand is best served by our 1894 industrial relations system nor that the interests of one or more parties would be detrimentally affected by a departure from it, and that they would therefore rationally oppose it. In most countries, craft or occupationally based forms of union organisation have now largely disappeared as the prime form of unionisation, the main exceptions being New Zealand and Australia (respectively, I might note, the OECD's worst and third worst economic performers over the last 25 years). Uniform national agreements are virtually unknown outside the same two countries. Unions and workers in most other countries have seen their interests best served by arrangements offering a closer identification with the interests of their employers. Why should New Zealand unions and workers, considering their interests rationally and intelligently, reach a different conclusion?

The Business Roundtable's approach has been derived primarily from a basic examination of the principles on which a sound industrial relations system for New Zealand should be based. It is not a carbon copy of any overseas model. It has some features in common with industrial arrangements in the United States, an economy which has demonstrated considerable structural flexibility and employment growth in the face of the economic shocks of the 1970s and ‘80s. But there are a number of aspects of the US system which we would not judge to be well-conceived or suitable for New Zealand, and it has not been a prime influence in our thinking.

There are also features in common with the Japanese model of industrial relations, which is of special interest because Japan switched, with obvious beneficial results, from a primarily craft-based union structure to one in which more than 90 percent of all unions are enterprise or company ones.

Some would argue that cultural differences would make Japan a dubious model for New Zealand to study. Personally I am not a great believer in cultural explanations of economic performance or individual productivity. It is interesting in this regard to read the accounts of observers of 19th century Japan.

One wrote:

> Wealthy we do not think it (Japan) will ever be ... [T]he love of indolence and pleasure of the people themselves forbid it. The Japanese are a happy race; and being content with little are not likely to achieve much.

Another commented:

> In this part of the world, principles, established and recognised in the West, appear to lose whatever virtue and vitality they originally possessed and to tend totally towards weediness and corruption.

Tell that to today’s worker or manager in Toyota – or General Motors! Japan, the “low wage” economy of the 1950s – the perceived competitive threat in labour intensive products such as textiles and clothing – has enjoyed far faster rates of productivity and real wage growth than New Zealand. Quite obviously what is basically relevant is not culture but rather the methods of economic organisation we choose to adopt, which have such pervasive effects on individual enterprise, effort, innovation and risk-taking.

In Japan, while unionisation is low (only 30 percent of employees are now unionised) there are some 70,000 unions averaging 170 in size. While the Japanese experience suggests that, in a voluntaristic framework of industrial law, enterprise or company unions will generally be preferred, there remain some 720 craft unions and 1775 industrial or trades unions which suggests they may be efficient methods of representation in a minority of situations. The large number of quite small unions also seems to call into question the New Zealand predisposition towards amalgamations or forced marriages of small unions, although some of these may well take place of their own accord in a freer environment.

Labour market behaviour is similarly affected by the legal and institutional framework. According to a recent article in the *Far Eastern Economic Review*, in Japan:

> Labour/management disputes mostly are settled by private consultation between the parties involved . . . Strikes and lockouts are rare. When railway unions do strike, they do so in such a way as to register their grievance without unduly inconveniencing the public. A railway strike would usually be announced at least two days in advance, conducted outside rush hours and last for no more than a day or two.

There seems to be a discernable difference between such behaviour and the attitude that "the public can go to hell".

One of the characteristics of the Japanese labour market most frequently commented upon is its flexibility, which has helped it adjust to massive falls in Japan's terms of trade during the 1970s while maintaining one of the OECD's lowest rates of unemployment. Labour incomes have been flexible through extensive use of bonus systems and other profit-sharing arrangements. A curious theme of some New Zealand commentators has been that labour market "flexibility" is some sort of codeword for downward adjustment of wages. A recent European Communities' study of the poor performance of many European labour markets identified some of the main dimensions of flexibility that are needed for healthy economic and employment growth:

- an evolution of real wages per head which on average should grow more slowly than the expected growth in productivity until equilibrium in the labour market is restored;
- wage structures that are responsive to the development of new technology, new patterns of demand and new working methods;
- greater flexibility in wage differentials so as to adequately reflect in each region and industry the relative scarcities of different kinds of labour; and
- the appropriate contractual framework for determining wage structures and the organisation of work, both at the level of industrial sectors and individual firms.

To this list could be added the flexibility to devise employment contracts with incentive structures which promote cooperation and high productivity – packages which the existing system of centralised bargaining biased towards wage contracts is ill-equipped to develop.

The New Zealand system is deficient in all these dimensions of flexibility . In a healthy, growing economy, wages should grow along with other incomes and there is no reason why it should ever be necessary for the general level of wages to fall. What is necessary to achieve higher employment and growth are continuous changes in relative wages as prospects become less attractive in particular industries or occupations and the demand for labour expands in others. And at a time of economic adjustment with some incomes (such as farm incomes) falling while others rise, we should not have institutional barriers to some falls in wages (or more particularly labour costs) in hard pressed-industries such as meat processing to preserve businesses and jobs.

Within our present system, these relative adjustments are extremely difficult to achieve. In many cases upward flexibility is as difficult as the reverse, because the consequences of wage increases in areas where they are warranted spill over or feed back into areas where they are not.

There is also a great deal of confusion in the New Zealand discussion of approaches to equity and low income issues. I recall that Rob Campbell suggested in one of his columns last year that the Treasury thought low pay was a brand of yoghurt. More seriously, there appears to be abroad a labour market version of the China syndrome, namely the idea that that if the so-called protections of blanket awards were removed, wages would melt down to Taiwanese levels.

A first response might be to note that at our present relative rates of progress, New Zealand workers might be very happy to receive Taiwanese wages within a couple of decades. A second would be that as a piece of economic analysis, the proposition is as much science fiction as its nuclear counterpart. Employers pay market wage rates not out of charity or because of statutory regulations but because they need to attract the labour they require. This is demonstrated, for example, by the fact that a large proportion of New Zealand workers in the private sector are paid more than the statutory minima. The labour market is a complex one, but it is a market just the same.

Clearly, in a healthy economy the basic sanctions or form of bargaining power available to workers (or shareholders or bondholders) dissatisfied with their returns is the ability to transfer their services (or funds) to alternative employment. Forms of compulsion which may force higher returns for a few will invariably disadvantage a great many more – and especially those in less fortunate situations. If the current barriers to employment were broken down, few workers would be unable to find alternative employment beyond the short term, so that any interventions to address their problems should be specifically targeted in order not to penalise their fellow workers.

The Business Roundtable made reference to the vast number of economic studies which have established that wage regulation typically has perverse effects on the very groups it is supposedly intended to help. It is not difficult to see that up to a certain wage level, an employer will find it profitable to employ an extra worker, but if he or she is forced to pay ,some additional amount that worker will not be hired. Those that are hurt most in the process are the unemployed, the young and the unskilled.

Many professional economists have examined the reasons why minimum wage rates are often supported. Discussing the United States evidence, one such analysis inquires:

> Are minimum wage laws intended to hurt low productivity workers? Probably not. Many supporters of minimum wages are merely trying to protect their own economic interests. It is no accident that labour unions are among the strongest backers of higher minimum wages (and the most vigorous opponents of a teenage exemption from the minimum wage).

In New Zealand I would suggest that there is genuine altruistic concern among many groups, including many unionists, about equity and low income problems, but there are others whose motives reflect a narrower self-interest. We need to distinguish between the two groups, and to reconsider past ways of dealing with the problems in this area. We advocate in our submission an approach to low income and equity issues based on policies to improve economic performance, reduce barriers to participation in the work force, provide a sound body of employment standards, and redistribute income to those genuinely in need in a targeted way, rather than an approach based on interventions through blanket awards or wage minima.

Finally, I would like to respond to some criticisms that, whatever the merits of our arguments (and these have sometimes been acknowledged), there is little chance of reform in this area being accepted. It is argued that what we have described as a return to common law and common sense in employment contracts, more competitive and hence more effective unions which would benefit workers as consumers of union services, a more decentralised system of bargaining and the abolition of several tribunals or quangos, coupled with better approaches to worker protection, would be too radical a package to contemplate.

Perhaps the first point to note is that such criticisms have been refreshingly few. There seems to be a greater disposition both in the community and in political life to reassess established views and attitudes and to set higher goals than the mediocre second best to which we have been accustomed.

Secondly, in issuing the Green Paper, the government placed upon itself the requirement to undertake a total review of the industrial relations system. I suggest that any careful reader of the prime minister's address to the recent FOL conference would form the opinion that the government appears to mean what it says about a total review. I believe it was most important that Mr Lange gave a lead by declaring himself in the camp that would argue for radical reform. This is because whatever the logical merits of a business viewpoint, it is bound to be suspected or misinterpreted by those who choose to see ogres or demons in such quarters. Now that most businesses outside the state sector are facing competitive conditions in their markets, the scope for business interests to diverge from those of the general community has become much narrower, but some people will no doubt continue to see ogres long after they have turned into ghosts.

Thirdly, there can be no escaping the conclusion that an effective approach to improving our ossified labour market has to be a fundamental one. To escape the consequences of smoking it is unfortunately necessary to give up smoking. Our analysis concluded that a "tinkering" approach of partial reform was likely to be ineffective and come unstuck. As with previous such attempts over the past decade, it would be likely to give rise to complex, unintended and undesired side effects and thus the restoration of the previous state of affairs. The proponents of interventionism will, of course, argue that a comprehensive approach is politically impossible and administratively impractical. I would argue that other regulatory reform initiatives such as those implemented in the New Zealand financial sector have proceeded successfully and smoothly precisely because they were comprehensive and well-conceived.

Lastly I would suggest that there is a real prospect of change because many elements in the community want it to happen. The government ought to be able to expect bipartisan support for worthwhile initiatives. The business community is supportive of substantial changes to the existing labour market institutions, even though they would pose major challenges to many businesses. I also believe that a number of trade union leaders and many more workers are receptive to such changes, since few can be satisfied with the outcomes that our present system is delivering.

However, there is a need for a greater measure of support for, or at least acquiescence in, reform than exists at present. Major changes could be pushed through in the face of a resistant trade union movement, and a government which has staked its reputation in governing in the interests of the wider New Zealand community may have to contemplate such an option, but it would obviously not be a preferred one. For this reason, the Business Roundtable is seeking to play its part by stepping up its contacts with union representatives in the interests of developing a greater measure of common understanding.

To demonstrate why I am convinced that such understanding is possible, I want to end by quoting some passages from a recent address on the subject of industrial relations.

> We are in competition [the speaker said] with societies in manufacturing which do not understand a them-and-us situation, in particular the Japanese, where by tradition there is complete and absolute unity of purpose between the capital and the labour in big manufacturing plants ...
>
> If one believes that industrial relations, unemployment and well-being can hide behind protection barriers in those circumstances, then one has to believe in other fallacies such as Father Christmas ...
>
> It is necessary to develop the concept of positive incentives and a positive sharing of responsibility at an enterprise and/or industry level, or in common with like societies become increasingly irrelevant as not only capital but expertise shift to a different world ...
>
> The fact that the workers working for an enterprise or the executive staff of an enterprise are doing slightly better or even much better in financial or other return than the general norm does not mean that it is not working to the general advantage of the community. It is in this field that a rigid concept of comparative wage justice can do harm ...

Some captain of industry delivering a lecture to a stop-work meeting? A maverick leader of some fringe trade union? No, the speaker was Charlie Fitzgibbon, former senior ACT vice-president and a member of the Hawke government's inquiry into the Australian industrial relations system.

Quite frankly, I do not believe that the thinking of a number of respected New Zealand trade union leaders is poles apart from Mr Fitzgibbon's. I would put money on a real chance of reform in these directions. In that event, and despite all the evidence of the last generation, New Zealand might really have a future.

YOUNG NATIONALS POLICY CONFERENCE

OUT OF PARADISE – INTO A REAL FUTURE?

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NEW ZEALAND BUSINESS ROUNDTABLE

PALMERSTON NORTH
1 JUNE 1986

OUT OF PARADISE – INTO A REAL FUTURE?

Thank you for inviting me to address your conference.

Your chairman mentioned two points in his letter of invitation. First, he asked me to address the topic of this particular forum: “The Finance Sector – How Much Freedom?” Secondly, he noted that you were a young and well-informed audience and that I should feel free to challenge your ideas and attitudes.

I shall try to do something of the former, though I am not a financial market specialist. I hope to do rather more of the latter.

I want to start by telling you about a survey that appeared in the financial magazine *Euromoney* a few years ago. *Euromoney* is probably best known in this country for according New Zealand, in successive years, the distinction of receiving the wooden spoon for economic management and then the Finance Minister of the Year award.

But the survey I refer to, of May 1980, was not about New Zealand but about a rather comparable small country, namely Finland.

As some of you will know, at the end of the last war Finland was a country debilitated by conflict, both internal and external, burdened by reparation obligations and in many respects facing a bleak future. Its economy was one of the poorest in Europe, predominantly agricultural and, apart from huge forests, lacking in natural resources.

On the freezing northern edge of Europe, the Finnish people had to fall back on a quality they call *sisu*, which *Euromoney* translates as guts. They needed a lot of it, and their progress was not steady. Industrial unrest was epidemic and for a long time the country seemed trapped in a devaluation cycle.

Many of the adjustments were painful. A full quarter of the country’s working population left the countryside. Pressures were imposed by the decision to open Finland’s frontier in the late 1950s, with an immediate freeing of nearly four-fifths of the country’s imports from any restrictions. Subsequently Finnish industries had to adjust to free trade with the EFTA countries and the EEC. The manufacturing sector did not shrink in size as a result; contrary to trends in almost all other OECD countries it grew as a proportion of GDP. The share of exports in industrial production now stands at around 50 percent.

Through the 1960s, the Finnish economy moved to rates of growth in line with the OECD average. Then the combination of a collapse in the terms of trade, a wages explosion and a current account deficit that reached 8 percent of GDP “brought the Finnish economy to a screaming halt in 1975, as its industrial competitiveness plunged for the first time in a decade”.

“As before in Finnish history,” *Euromoney* wrote, “a national consensus was found.” Wage restraint was accepted, money was kept tight for a couple of years and expectations were thoroughly doused. “For three years the economy barely grew at all. Then, as monetary restrictions were eased, as the world economy picked up, as the Finns regained their old competitiveness, they found themselves in far better shape to withstand the shocks of 1979 than almost any other country in the world.”

In 1979, real output growth soared by 7.6 percent and in 1980 by 6.0 percent. “Suddenly,” as *Euromoney* put it, “the problem was success … The Finns were so used to thinking of themselves as Europe’s poor relations that their present prosperity slightly stunned them.”

Although growth slowed with the recession in the early 1980s, Finland has continued to do better than the OECD average. Its per capita income, which was well below New Zealand’s after the war, is now some 40 percent higher.

The secrets of Finland’s success are not hard to discover. It has maintained an open economy, with support from all sections of the community. After a visit a couple of years ago, the chairman of the New Zealand Planning Council observed that “Trade liberalisation was undoubtedly the major factor in enabling Finland to close the gap in living standards between it and its western neighbours and trading partners.” It has maintained strict housekeeping in its public budgets. For four years through to 1981 the size of the public sector as measured by the ratio of general government outlays to GDP *declined*, and the tax burden was reduced by a full 3 percentage points of GDP. Last year, a budget *surplus* of 0.5 percent of GDP was projected. Inflation has been a problem, but is now down to the 5 percent mark and falling.

I would not wish to imply that the Finns have got everything right – far from it. They have maintained a grossly subsidised agricultural sector. They have been slow in some respects to fully internationalise their financial markets. Perhaps most seriously, as the OECD has pointed out, they have allowed rigidities in their labour market to persist, including a centralised wage fixing system which has generated periodic wage pressures and contributed to maintaining unemployment stubbornly high at 6 percent or more. Finland has not been in the same performance league as Japan, always the first model to study in respect of inflation, productivity and especially its labour market flexibility and employment record. But as a small country with which New Zealanders can readily identify, I believe it offers valuable lessons.

The starting point for consideration of New Zealand’s future is some clear thinking about where we have been. I believe some New Zealanders still do not recognise the abysmal nature of our past economic performance and the precarious situation we are still in. They continue to view the past through rose-tinted spectacles. Images persist of the island paradise, God’s own country, the economic and social laboratory, the big farm, the land of milk and subsidies and she’ll be right, hard done by through no fault of its own by the rest of the world.

In the thirty years to 1982, our position in the per capita GDP league table fell from the 3rd to the 32nd slot. In the decade to that year, our per capita

GDP *declined* on average by -0.3 percent per annum. Singapore, one of Asia's poorest countries at the time of its independence 25 years ago, now has a per capita income higher than ours. In the same decade to 1982, World Bank statistics show that for the 156 countries for which data were available, 125 achieved higher rates of growth than New Zealand while only 30 – mostly in Africa – performed more poorly.

Some of those who have grasped the enormity of these statistics still fail to understand the causes. Rather than acknowledge their origins in internal mismanagement, they prefer to put them down to the vicissitudes of the outside world – for example, British entry into the EEC, or the fall in our terms of trade in the 1970s. Yet the evidence of deteriorating performance was apparent years before either of those events. The 1962 report of the Monetary and Economic Council, which dealt precisely with this topic, stated that during the period 1949–61 "the New Zealand economy has earned the unfortunate distinction of having one of the slowest annual rates of growth of productivity among all the advanced countries of the world". Many countries suffered terms of trade losses as severe as those which we faced in the 1970s, but adjusted far more successfully to them. Singapore, with no oil or natural resources at all, was just one case in point.

Despite the lamentable returns from throwing the hard-earned savings of New Zealanders – and increasingly those of foreigners – into misguided investments, defenders of former policies are still to be found. New Zealand has now run up total overseas debt – public and private – equivalent to around 60 percent of GDP. The equivalent figure for Finland is around 15 percent. New Zealand's public debt amounts to around 70 percent of GDP. The equivalent figure for Finland is again around 15 percent. The New Zealand government's debt problem is the same as that of many of our farmers. The problem of fiscal management has become horrendous and the drop in our credit rating reflected lenders' judgement that we had become a poorer risk.

The recent Expenditure Statement documented some of the paltry returns on this borrowing and investment. The performance of many of our state-owned enterprises is similar to that of their lame duck counterparts in Britain. This is not the place to talk about the Think Big projects . I am mindful of the fate of a former speaker on that subject at this meeting a few years ago. One of my Chief Executives was quoted a few weeks ago as saying the steel expansion was the greatest commercial disaster in New Zealand's history. I have to tell you that I did question his diplomacy more than his judgment.

The adjustment process we are going through is in many ways a painful one, just like Finland's. Nowhere is this more acute at the present time than in some parts of the farming sector. I have been associated with the pastoral industries all my life and the dilemma I see some farmers in is tragic. Fletcher Challenge is heavily involved in rural servicing. Our rural trading group is taking a hammering and facing massive reorganisation to keep costs down and stay in business.

But, as Bert Kelly, the Modest Australian Farmer and member of parliament once remarked, "Most people who try to look at the problems that beset farmers are so soft-hearted that it seems to affect their heads also, or their eyes get so misty that they cannot see clearly." Sentiment and hysteria are no substitute for careful analysis. I shall merely point to a few of the relevant aspects of a complex issue which warrants your careful attention.

One thing we have to recognise is that international commodity prices have not risen with the world recovery in recent years, and that farmers everywhere are in trouble. Land prices have plummeted in the United States and Australia and many farmers have been forced out of business. Short of creating a New Zealand version of a Common Agricultural Policy, there is no way we could escape the same consequences.

Secondly, as is well known, past policies drove some farm land prices far beyond values justified by the earnings stream which they were capable of generating. The poor income prospects were partly accepted because of the prospect of capital gains in an environment of high inflation and artificially suppressed interest rates.

Much has been said about an excessively rapid reduction of assistance to farming, and indeed about an excessively rapid adjustment programme generally. The facts are, however, that of the billion dollars of assistance being provided to farming a couple years ago, about three quarters continued to be paid out in the 1985/86 year.

What we unfortunately have to recognise is that where the effects of reduced agricultural assistance have been sharpest, we were looking previously at what had become some of New Zealand's most highly protected activities. Effective rates of subsidy to sheepmeat appear to have peaked at several hundred percent, several times higher than the manufacturing sector average. Indeed some figures suggest that in 1983/84 subsidies were being paid for production that actually *decreased* New Zealand's value added – the outputs were worth less than the inputs going into them.

It has been suggested that recent policy changes have created overload for businesses and individuals trying to adapt to them. While the difficulties are undeniable, I think this proposition needs rather careful scrutiny. The issue is whether they would be more or less acute with a slower pace of change.

There are several dangers in unnecessary delays in any programme for reform:

- delays produce doubts as to whether the promised reforms will be implemented. Uncertainty about future government policies is bad for all decision-makers;
- delays in increasing the ability of businesses to avoid high cost sources of supply increase the risks that excessive retrenchment of those businesses may occur, and sheltered activities may even expand;
- delays in reforming the public sector add to the costs of businesses in the form of higher government charges and/or taxation in order to

recoup the costs of overmanning, inefficient practices and unwise capital expenditure;

- delays in increasing the responsiveness of the labour market to the underlying realities of the imbalances in the supply and demand for labour inhibit the ability of businesses to get the labour they require at a price which individual workers would find acceptable. The upshot is fewer jobs, greater unemployment and lower productivity.

My reading of the evidence, both in New Zealand and overseas, suggests there is a good case for faster rather than slower adjustment. Moreover, it seems crucial that a liberalisation programme should be as comprehensive and even as possible so that undue burdens are not thrown on any one sector. I think an argument can be made at the present time that the farm sector *is* taking more than its share of the burden. To my mind the best response to that problem is for more vigorous efforts to be made in other areas. Chief among these in my view are the public sector, the more highly protected parts of the manufacturing sector and the labour market. In all of these I believe such action would benefit the businesses and individuals involved, even though some may well find that difficult to accept at this juncture.

Let me illustrate this theme by referring briefly to developments in the New Zealand financial sector. This sector has undoubtedly faced the most rapid and comprehensive changes of any part of the economy. Such action was, I believe, imperative to halt the flight of funds overseas, regain monetary control, stabilise the economy and encourage efficient intermediation and allocation of capital. The process was not without difficulties. Institutions were forced to adapt to the removal of an artificially distorted interest rate structure and quite new competitive conditions. My own firm was again a case in point. After much soul-searching we decided that we did not have sufficient competitive advantages in financial services in the new environment. There will undoubtedly be further changes and problems ahead. But I believe that, in general, adjustment in the financial market was enormously facilitated by the fact that it was rapid, coherent and not impeded by interventions which would have hindered the process or even put some institutions in jeopardy.

As for the answer to the question “How much freedom?” I can do no better than quote the following passage by Peter Churchouse in the latest issue of the *Accountants’ Journal*:

> Some people will say that to open a minute economy like New Zealand to world influences is naive, and that nowhere in the world is there a true free market. I contend, however, that the smaller the economy, the harder (and even more naive) it is to try and insulate it from the impact of world trends. While there may not be a truly free market anywhere in the world, this does not mean that one should not be moving more towards ensuring that government intervention does not unduly distort market signals. As usual, it is really a question of whether the alternatives are not obviously and clearly (and certainly in New Zealand’s experience) worse than what is being offered now.

Right now I would put a bounty on the head of any leading banker or financier you could track down who would not speak positively about the changes occurring in the finance industry. Two years ago, I suspect you would have had a very different response.

As an Opposition party and particularly with an election looming in the not-too-distant future, you have a duty to take a thoughtful and responsible approach to financial policy and indeed to economic management more generally. The latest *Business Outlook* survey from the National Bank had some very pertinent observations on this point. It noted that, some limited deficiencies aside:

> … financial markets around the world function extremely efficiently, continually adjusting a vast array of interest and exchange rates on the basis of a perpetual stream of economic and political information ... Whatever indicators are in pre-eminence at any time in the future, it is apparent that those which reflect directly the quality of economic management in New Zealand will be among them ... Economic policy-making in New Zealand over the years ahead will have to pay considerable attention to what is considered internationally good practice and could pay a heavy price for departing from it.

At present, interest rates in New Zealand remain high because our inflation rate is high and because international lenders are building in a risk element on investment in New Zealand. Even if we cannot match the performance of Japan and Germany which look as though they will practically eliminate inflation this year, we should be firmly aiming to get into the sub–5 percent range within the next two years. The risk premium will only fall if and when domestic and foreign lenders gain confidence that New Zealand has turned the corner and is set on a path of stable and consistent policy. In this, the political element is critical. For example, if perceptions take hold that a soft monetary policy is in prospect either in the run-up to the election or after it, interest rates will stay up and the adjustment process will be delayed or reversed. Any party that encouraged such perceptions would rightly be blamed for the consequences.

The present period calls for far-sighted leadership from all political groups in New Zealand. Initiatives such as transport deregulation, CER, initial moves to liberalise import licensing, a start on financial sector deregulation and voluntary unionism recognised the imperative for change. More recent initiatives have reflected the need for a more vigorous and consistent approach. Many policy weaknesses and threats to an improved performance still remain. Amongst the most important are the labour market, the public sector and the existence of a number of economic activities that are still sheltered from competitive pressures. On another level are the problems of a welfare state and a set of social policies which were designed for a different type of society, and are providing many services in an inefficient and unresponsive manner. They are often not helping those most genuinely in need while money is being wasted on some of us who can afford to pay and should be self-reliant.

The weaknesses in economic management over the past generation or so have not been a party political matter. Both the major political parties and many business, trade union and other interest groups – including much of the government bureaucracy – were in accord in supporting policies which protected individual sectors from the realities of the international market place. Most New Zealanders were guilty of so enjoying the apparently prosperous life of God's own country that they preferred pragmatic solutions to try to keep it as it was rather than to accept the excitement, the challenge and sometimes the discomfort of changing and growing through exposure to the real world.

Changes are occurring now because our lack of growth, our high inflation and our heavy overseas indebtedness leave no other realistic option. There is no reason why both political parties cannot again be in accord on the broad economic policy framework. There is plenty of room right now for the Opposition to take the high ground over the timing, management and consistency of application of present policies without criticising the broad framework and thrust. The real tragedy would be to suggest that we can return to the policies and style of the past.

What I would expect from any New Zealand political party that seeks to present itself credibly to the electorate would be a clear recognition of the things that have gone wrong, support for intelligent and courageous actions to get the economy back on its feet and a well-conceived approach to current policy weaknesses and outstanding business.

In more specific terms, I would hope New Zealand voters would demand of any party competing for office a clear intellectual framework and a set of principles on which policies would be based. In the economic field, I would see some of the key ingredients as being:

- a medium-term orientation to policy, recognising the counterproductive nature of quick fixes and the time needed for beneficial adjustments to occur;
- a stable and predictable macroeconomic environment, requiring persistence with monetary and fiscal restraint to eliminate inflation and reduce the burden of debt;
- an extension of market liberalisation, to increase the flexibility of the economy, improve resource allocation and reduce interest rate and exchange rate pressures;
- a recognition that faster rather than slower adjustment, and a comprehensive programme of reforms, appear on the evidence more likely to produce positive results more quickly and ease adjustment difficulties overall;
- a careful articulation of the appropriate role of the government in all areas and, by contrast, a view on the appropriate scope for individual choice, entrepreneurship and innovation; and
- a clear and coherent sense of direction to help private sector decision-making, and a consensus-building approach to reduce doubts about the durability of policy reforms.

Whether the quality of political leadership in New Zealand satisfies such standards will, quite bluntly, determine whether or not New Zealand has a future. There is no reason why we cannot match the achievements of a country like Finland. It is not basically a question of discovering the set of technically correct economic policies – in general terms they are known. It is much more a question of whether we can display the guts and the intelligent political attitudes that people like the Finns have shown. The answer to that question may lie largely with the emerging generation in New Zealand politics and other walks of life. Your responsibility to address it – fully, seriously and intelligently – is a heavy one.

WEDNESDAY CLUB

NEW ZEALAND LABOUR MARKET REFORM: CLASS STRUGGLE OR PRODUCTIVITY STRUGGLE?

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WELLINGTON
9 JULY 1986

NEW ZEALAND LABOUR MARKET REFORM:
CLASS STRUGGLE OR PRODUCTIVITY STRUGGLE?

I am pleased to have the opportunity to address this forum. I know that it has been a useful vehicle for an interchange of ideas on important policy issues.

The topic of the New Zealand labour market and industrial relations system is one to which the 30 or so chief executives who comprise the New Zealand Business Roundtable have devoted great attention over the past twelve months.

The issue of reform in this area is pivotal in realising the full benefits of recent economic initiatives. If we fail to change our labour market institutions and attitudes we will remain a low growth, low wage country. We will continue our abysmal record of the past decade of having 50 percent higher inflation and 50 percent lower productivity growth than the rest of the OECD, with one of the highest levels of industrial disputes. We can no longer afford the senseless waste of a mindless conflict society.

The perspective we endeavoured to adopt in thinking about the issue was the general interests of the New Zealand community. It was gratifying to read one acknowledgement that we appeared to have been genuine in this effort. In a recent review, the Director of the Australian Institute for Public Policy and former MP, John Hyde, noted the statement in our submission that "[The] proposals do not reflect merely the .specific interests of employers, still less those of larger businesses". He went on to say:

> I detected nothing in the submission that would preserve any advantage for big businesses over little businesses. It explained carefully how the employees' interests were to be enhanced. And it advocated no prestige or perk-distributing councils for industry's captains. My cynicism about political lobbies seldom fails me but I believe this one might have New Zealand's interests in mind.

In its deliberations on the Green Paper issues, I hope it can be assumed that the government will also operate on the principle of putting New Zealand's interests first. There are obviously some political risks involved in such a course. From a narrow and short term perspective, the interests of some employers and some unions might be adversely affected. But it is not valid to evaluate proposals for change in terms of their impact on, for example, the structure or role of some existing unions or the position of their officials. The relevant interests are those of all workers, all employers, the unemployed and other sections of the community who would stand to gain enormously from labour market reforms.

The business community has been generally supportive of the recent changes in economic direction in New Zealand. In some important respects, these have been evolving in New Zealand for several years but they have been pursued more vigorously and comprehensively since the change of government.

There has been widespread recognition of the dismal and socially distressing results of past policies. For more than a generation these policies were broadly supported by all New Zealand political parties and community groups. What I believe the business community is looking for now does not reflect any party political preferences. It seeks a broader constituency for intelligent and determined efforts to overcome the many obstacles that still stand in the way of recovery from our precarious economic position, and thus an assurance that the difficult adjustment efforts will not be in vain.

At present, sufficient confidence is still lacking in many parts of the private sector. The process of adjusting to live within our means requires a number of real income reductions until economic restructuring and productivity improvements restore the possibility of sustainable income growth. But some of the income reductions have been falling quite disproportionately. For example, many farmers are incurring income falls that are out of proportion to their medium term competitiveness, while the last wage round has seen some employees receive real wage increases quite unrelated to their productivity. Offsetting adjustments and greater productivity gains must be achieved in the next twelve months to reflect the inescapable economic relationships between wage levels, international competitiveness, profitability and employment.

New Zealand's economic history has been littered with attempts to break out of a debilitating pattern of stagnation. Typically these have faltered and policies have been reversed because of the reaction to short-term discomfort or the resistance of powerful interest groups. I believe that the anxiety that we will repeat this experience is now uppermost in the minds of many farming leaders. As one recently wrote:

> It remains to be seen whether the present Government has the time, or the political strength and will power to carry through the reforms in the labour market and in import protection which are essential to reach the eventual goal of a free and rational economy. I'm dead scared we're going to get stuck half way.

Such perceptions inevitably affect confidence and hence a whole series of business decisions. The government last year watered down its initial proposals for tariff reductions, with the result that the programme of assistance reductions is probably no longer evenhanded, and the timetable which extends only to 1988 is shorter than is desirable for sound business planning. The recent decisions on West Coast rail services and the town milk industry were interpreted as owing more to political calculations than sound economic principles. A number of features of the new Commerce Bill make no economic sense and will unnecessarily put at risk businesses and jobs.

Any such departures from a consistent policy framework affect investor perceptions. Domestic and foreign investors build a margin of risk into their expectations. This inevitably affects interest rates and the exchange rate, thereby making the adjustment process more difficult. At present, investors are expecting substantial progress on labour market reform this year. If there is not, we can expect interest rates to increase again and more exchange rate volatility.

In both Australia and New Zealand, the political obstacles to achieving a labour market environment that is compatible with a more open and competitive economy have to date been considerable. As Hyde noted:

> In both countries reform has run up against an inflexible, regulated labour market ... Both Governments seem to accept that this will thwart their goals but both have tip-toed among party sensibilities.

In Australia, the accumulating pressures generated by the Accord are now placing enormous strains on economic management. The Accord embodies all the rigidities of our previous wage and price freeze – and in some ways more, since its commitment to wage indexation has denied Australia the real wage reductions that occurred in New Zealand in 1982-84 and that contributed, as the effects worked through, to an employment spurt which exceeded anything achieved in the past decade.

Australia should be an object lesson to us not only in respect of the weaknesses of Accord-type arrangements but of the risks of financial and exchange market instability and general loss of confidence if a country's labour markets are not responsive to changes in other economic policy settings.

There can be absolutely no doubt about the importance of the labour market both to long-run economic performance and to an adjustment programme aimed at restoring economic balance. World Bank research has estimated that the differential in growth rates of a group of countries with highly distorted labour markets in the 1970s was of the order of 1.4 percentage points per annum compared with a group of countries with less regulated labour markets. That difference represents the potential for a 74 percent higher standard of living in one working lifetime. Studies have also pointed to the crucial importance to firms of being able to reallocate labour resources, change wage contracts and adopt new production methods and work practices in response to changing economic incentives.

Two particularly interesting cases in this context are Yugoslavia and Korea. Despite large reductions in real wages and its real exchange rate in recent years, Yugoslavia is still experiencing adjustment problems because its labour arrangements impede changes in work practices and the movement of workers from factory to factory. In Korea on the other hand, as in Japan in earlier periods, temporary real wage reductions were combined with substantial industry restructuring when the economy got out of balance in the early 1980s, following which real wages and other incomes resumed a high growth path.

Around the world, the functioning of labour markets has become a prime focus of policy attention following the deterioration in economic performance and surges in unemployment in many countries in the 1970s. There is no reason for electorates to tolerate the waste involved in high rates of unemployment and the associated social tensions. It should be perfectly feasible to return to unemployment rates of, say, 3 percent or less which were typical in the 1950s and '60s. Countries like Japan and Switzerland have maintained such a track record. It is unconscionable that we now have a double digit rate of youth unemployment and that a mentality accepting the inevitability of long-term unemployment for some is in danger of developing.

There are, of course, many factors that have contributed to these outcomes. Education and training policies have played a part, as have tax, social security and housing arrangements which have reduced work incentives and labour mobility. But unsatisfactory labour market institutions and rules have had the central role, not just in the field covered by the Green Paper but in the public sector, the professions, the self-employed sector and via other statutory or regulatory interventions.

In this central area, the analysis undertaken by the Business Roundtable concluded that our present industrial relations system was delivering outcomes that were neither conducive to employment growth and high productivity nor equitable towards the most disadvantaged groups in the work force.

Our current system is based on regulated representational arrangements and centralised award structures and bargaining procedures. It has little regard for the individual preferences of many workers, the profitability of enterprises or the varying employment conditions in industries or regions. It provides poor incentives for positive employee relations, demands excessive government involvement and all too frequently generates inconclusive bargaining and conflict.

The key elements of our present system are the rules governing union formation, the uniform national coverage of awards, the imposed conciliation procedures and the separate status that industrial law has acquired via the Arbitration Court. These elements cannot be viewed in isolation. A framework and set of criteria for judging good labour market institutions are necessary for identifying necessary reforms.

The approach which we see as in the interests of all parts of the employment community is based on decentralised, voluntary contracting within a framework of generally accepted legal principles. In essence it would involve changes to union registration rules to enable alternative groupings, responsive to member interests, to emerge on a competitive basis. Bargaining arrangements would be liberalised to enable deals to be struck at whatever levels parties find it most convenient to do business. In many cases we would expect this to be at an establishment, company or industry level, but regional levels or even a national level would not be excluded. The important point is that whatever level is chosen should be the primary focus of bargaining and not some subsequent stage. While employers should not be required to deal with more than a single bargaining group, this would not preclude associations or federations of unions at national or sub-national levels. Negotiated contracts would be interpreted and enforced in ways similar to other legal contracts.

There is nothing radical about such ideas. Our present institutions are now substantially unique to New Zealand. The organisation of labour markets elsewhere has evolved towards arrangements of the type we are proposing, most successfully in countries like Japan and Switzerland. There seems no reason why New Zealand workers and unions, considering their interests rationally and intelligently, should wish to mount the barricades in defence of our archaic system.

In no way can our proposals be construed as anti-union. Trade unions reflect the need to have associations in many circumstances, not least to minimise the costs of negotiating and enforcing agreements. They can also provide valued services to members. What is at issue is the form of many unions, which is often divorced from the common interests of a workplace, and the lack of effectiveness stemming from protected positions. Unionisation should not be forced on groups in the economy where such arrangements are not relevant. But in an environment where unions were free to adapt their structures and compete for the provision of services, their vitality, responsiveness and democratic accountability to members could only be enhanced.

It is no accident that, as the prime minister recently remarked, unions and union officials at present are often held in low esteem by union members, employers and the public in general. This is reflected in the poor resources that unions possess and in their consequent inability to be innovative and positive, rather than defensive and reactionary. Just as import licensing made many manufacturers “fat, dumb and lazy”, as one leading industrialist has put it, so has New Zealand’s industrial relations system severely hampered the development of efficient, responsive and innovative unions. Thorough reform of the system, including breaking down barriers to competition, will transform unions in much the same way that the deregulation of product markets has transformed business in New Zealand and made it more productive and responsive to consumers.

Nor is our approach in any sense anti-worker. We have made it clear that our basic objective is growth in jobs and increases in all incomes, including wage incomes. For far too long, economic stagnation has meant that New Zealand has remained a low wage economy.

We should not set our face against short-term reductions in wages (or more particularly, labour costs), especially in hard-pressed industries, in order to preserve jobs and firms and speed the process of restoring economic balance. But the most important aspects of flexibility which we lack at present are the capacity to readily change such things as production methods, working hours and bargaining procedures and the scope to devise employment contracts with better incentives to promote cooperation and high productivity.

Many firms in New Zealand could afford to pay higher wages now if such productivity improvements could be implemented. Nor would productivity improvements resulting from reduced over-manning be at the expense of jobs overall, because our inflated cost structures are simply impairing our competitiveness and reducing the purchasing power of incomes that would otherwise be spent and bring forth jobs in other parts of the economy.

The ideas we have put forward are based on the best insights we could gain from experience and contemporary thinking about the operation of labour markets. We sought to analyse all relevant issues, including approaches to equity and low income problems. Our analysis should be subject to critical scrutiny and it should be modified if it can be shown to be deficient.

I believe the same degree of scrutiny should be applied to other contributions to the policymaking process. I have yet to read a commentary examining whether the FOL's submission, to mention just one, is based on a set of principles which reflects broad community interests. It might be thought striking, for example, that in a lengthy document the interests of the unemployed barely receive a mention.

I have some apprehension as to whether the discussion of this topic in government circles is proceeding on the basis of a clear set of principles and objectives. As many commentators have observed, such a framework was lacking in the Green Paper. In order to gain support for major initiatives and to enable all parties to adapt in the intended manner, valid and coherent changes are needed. The many initiatives in this area in the past 10 or 15 years have basically involved ad hoc tinkering, and have not materially improved the bargaining environment.

By way of illustration, there have been news reports suggesting that one idea being promoted is a minimum size for unions, in order to force union amalgamation. I believe the currency of this idea in New Zealand over the years derives in part from former favourable impressions of the labour market in Germany, where one feature is the existence of a number of large industrial unions. The deterioration of Germany's productivity performance in the 1970s and a rate of unemployment approaching 10 percent should call into question the validity of such a simplistic model.

I am not aware of any economic analysis which would support a prescriptive approach to union size, any more than there is good reason to prefer large businesses to small ones. The relevant policy objective is surely to frame rules which will allow effective unions to develop, whether by membership growth, amalgamation, separation or changes in form or purpose. Some of the smaller unions in New Zealand are amongst the most effective, democratic and responsive to their members' needs. The imposition of minimum size requirements would greatly obstruct the process of moving towards enterprise or establishment unions. The presence of some 70,000 unions (averaging 140 in size) in Japan suggests that in a competitive market for union services bigger is not obviously best.

It is essential for the credibility and success of the general programme of economic reform and liberalisation that the government adopts a principled approach to reviewing the industrial relations system, not one characterised by political expediency. No enterprise is without risk, as chief executives are only too keenly aware. The successful ones are those that take risks that are justified by the rewards. We have suffered too long from a failure of political risk-taking in New Zealand, with economic and social consequences that are now obvious to all.

In fact, the risks of initiatives in this area are now far less than they are commonly supposed. Many aspects of economic management are no longer a matter of political ideology. From Deng to David Lange and Roger Douglas, political and economic helmsmen have questioned many of the nostrums that became embedded in national folklore and found them wanting.

In respect of the labour market, the logic of the arguments in support of change is compelling. The prime minister has declared himself in the camp of those favouring radical reform. Support from the Opposition for valid initiatives should be forthcoming.

The attitude of the employer community is interesting. Sounding very much like the recent report of a Planning Council group, the Employers Federation expressed the view only. a few years ago that:

> … any proposition which calls for radical change to industrial relations and wage fixing is probably doomed to failure. The inherent resistance to change in New Zealand makes this option unrealistic.

It is a measure of the shift in opinion in New Zealand since 1979 and the pressures and incentives of a new economic regime that there is now broad employer support for fundamental changes, even though they would pose major challenges to many businesses.

In union circles, I believe attitudes are shifting also, perhaps more rapidly than official pronouncements suggest. One submission from a union source on the Green Paper stated:

> ... there is widespread support for radical change although this support is rarely articulated publicly.

It went on to say:

> ... the most knowledgeable and intelligent union leaders of corporations and unions in such basic industries as pulp and paper / meat freezing / transport... dairy products / housing etc are aware of the fact that the nation’s economy is in deep trouble, it is rapidly being restructured and increasingly will be restructured radically for better or worse in the years ahead. The decisions being made now will determine the future – and the future is somewhat bleak.

Similarly the Coalition of Non-Aligned Associations and Unions, which covers some 60,000 workers, stated in its submission that:

> … there is widespread support for positive changes in New Zealand industrial relations. Unfortunately public discussion so far has centred on narrowly perceived equity issues (ie “attacks” on the national award structure etc) rather than taking a broad look at the nature of the economic changes occurring within New Zealand now.

The tide of ideas which has long since changed attitudes on this subject in the dynamic societies overseas is now reaching this part of the world. Let me conclude by quoting from a recent address by Charlie Fitzgibbon, former senior ACTU vice-president and member of the Hawke government’s inquiry into the industrial relations system:

> Australia is not the only country struggling to come to terms with the need to improve its competitiveness and productivity performance in the face of strong international competition. The debate is certainly. occurring across the Tasman. I was struck with the commonsense approach espoused by the New Zealand

> Business Roundtable ... [in] their recent submission to the New Zealand Labour Government on industrial relations matters. They say that: “The notion of the economy as a fixed pie, and of union – business negotiations as about the division of the pie, is demonstrably false, yet it underlies a good deal of our current labour market negotiations ...”

In the same part of the submission we argued that:

> Henceforth employers and unions will increasingly be striving to devise the sets of labour market arrangements which will create the maximum benefits. Instead of the class struggle, we will have the productivity struggle and the challenge to survive and prosper in a competitive world.

That, I hope, is the idea that will guide the government’s approach to industrial relations reform.

CANTERBURY EMPLOYERS' ASSOCIATION
ANNUAL GENERAL MEETING

POLITICAL AND ECONOMIC CHANGE IN BRITAIN AND NEW ZEALAND

SIR RONALD TROTTER
CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

CHRISTCHURCH
20 OCTOBER 1987

POLITICAL AND ECONOMIC CHANGE IN BRITAIN AND NEW ZEALAND

Thank you for inviting me to be your guest speaker this evening.

The 12 months since your last Annual General Meeting have been not been easy for most New Zealand employers. The adjustments taking place to the new economic environment have been unpalatable for many firms and their workforces. I want to make a few remarks later about some of the policies shaping the present environment, and weaknesses in them.

On a recent overseas trip I had the opportunity to gain some more detached perspectives on the changes that are occurring in New Zealand. I thought I would begin by sharing some of those reflections with you.

Over the past ten years, there has surely been a sea change in the way much of the world is tackling its economic and social problems.

The OECD countries have been struggling to extricate themselves from the stagflation of the 1970s. They have been grappling with the problems of over-extended public budgets and regulatory controls that stifled economic vitality. The great bureaucracies of India, China and now the Soviet Union are attempting an even more radical transformation away from centralised planning and controls and towards more market-oriented economic systems. The market is the place where the individual can exercise choice.

I was in the United Kingdom, the country from which New Zealand has inherited so many of its institutions and intellectual traditions, at the time of the recent Conservative and Labour Party annual conferences. These were taking place, of course, in the wake of the return of Mrs Thatcher's government to a third term of office.

The flavour of political commentary on these events was fascinating in the light of our own election result and the New Zealand political climate.

Some extracts from an article in one Sunday paper will give you an impression of the general theme:

> It is now difficult to believe that any party will ever again come to power in Britain to the Left of Mrs Thatcher ... By a party to the Left of Mrs Thatcher, I mean one more concerned than hers to use the power of the State on behalf of the majority of the people. In that respect – which is the only relevant respect – Mrs Thatcher's Tory Party is very Left indeed; far more so than are the Labour and other Opposition Parties.
>
> The confusion arises from the fact that political commentators persist in supposing that State activities in favour of the majority must have something to do with helping the poor ... Mrs Thatcher's battle against the over-mighty trade unions was a collectivist battle – ie one that used the power of the State to liberate the people from a neo-feudal baronial tyranny. Likewise her battle with the teaching trade unions is a collectivist battle to use the power of the State to give parents the education they want for their children.

Another article in the same paper pointed out that the socialist movement was once held to represent the industrial working class. It believed that the workers were exploited, and it sought various ways of bettering their lot. The state bureaucracy was the medium through which welfare and education could be spread and private property administered once it entered into public ownership.

This article went on to refer to the growing consensus that state bureaucracies are increasingly unable to control or inspire anything, and that welfare is more surely guaranteed by the creation and spread of private prosperity.

Despite the opposition and cynical pursuit of power of some party activists, moderate Labour Party politicians like Mr Kinnock and Mr Gould “whistle tunes that Mrs Thatcher invented”.

Since the Conservative government came to office in 1979, the performance of the British economy has greatly improved. For most of the post-war period, Britain was almost on a par with New Zealand in having the worst economic performance in the OECD. In recent years, its economy has been growing faster than most European economies, inflation has remained low and unemployment is finally starting to come down.

The government’s policies have enjoyed wide popular support, especially among young voters. Interestingly, polls have shown that they have also attracted considerable support among trade union members.

At the same time, and despite the political rhetoric, the Thatcher government has been far from radical in many of its economic policies and the British economy continues to operate well below its productive potential.

It is commonly observed, for example, that government expenditure in the United Kingdom has not been reduced relative to national income, the privatisation programme has been poorly handled in many respects, aspects of the tax system such as VAT are a mess, and massive subsidies to agriculture and parts of industry have been maintained. The quality of recent New Zealand decisions in some of these areas, for example GST, has been much higher.

Undoubtedly the main blight on the UK landscape during the 1980s has been the record rate of unemployment. An address by the British minister of employment earlier this year presented an analysis with striking parallels to the New Zealand scene.

Its theme was the need to make the UK labour market more flexible and responsive to economic change. Over the post-war period, it observed that a flood of economic pressures had impacted on rigid institutional structures, producing steadily rising unemployment.

Wage bargaining was not linked to economic reality. Employees in a firm teetering on the edge of bankruptcy would laugh if a cut in wages was suggested. The right to an annual rise was regarded as sacrosanct. The end result of wage increases negotiated without reference to productivity or profitability was fewer jobs.

The minister argued for a system more clearly based on market forces, on demand and supply, on competition and on ability to pay. In particular, he advocated a move away from the annual pay round; from the going rate; from comparability; from job evaluation (the bogus science of determining the worth of a job); and from national pay bargaining.

To promote job creation and productivity, what was needed was local wage bargaining, performance-related pay and forms of profit sharing.

The analysis in this UK government statement is almost identical to that of the Business Roundtable, the Employers Federation and other groups in respect of New Zealand's malfunctioning labour market.

In my opinion, and that of many other observers, the inadequacy of its labour market policies is a crucial and perhaps fatal weakness of the government's economic strategy.

The present wage round is again demonstrating the nature of the problem. The uniformity of increases around a 7 percent level will do nothing to ease the cost pressures faced by many firms or facilitate responses to skill shortages and surpluses. Unnecessary plant closures and job losses are inevitable. Although change is undoubtedly occurring in bargaining attitudes and structures, it is happening far too slowly in the present competitive and non-accommodating environment.

The handling of the labour portfolio has been seriously in conflict with the government's overall economic approach. Despite his commendable non-interference in wage round bargaining, the minister has practised a degree of interventionism in private sector affairs which is wholly at odds with the efforts of his colleagues and directions taken by previous ministers of labour.

Consider the track record. Compulsory unionism has been re-established. The heavily regulated framework of a conciliation and arbitration system has been maintained intact in the Labour Relations Act. Workers are being forced into union organisations of at least 1000 members. A new form of social engineering has been created in the Trade Union Education Authority. Legislative proposals are being canvassed or threatened in areas as diverse as worker representation on company boards, occupational health and safety, equal pay for work of equal value, and redundancy notification.

The minister was again reported recently as regarding the Business Roundtable's views on these interventions as "extreme". I am reminded of a former minister applying the same label to the Honourable Derek Quigley's criticism of some of his policies just a few short years ago. History has a habit of showing such judgments in a different light.

My belief is that as unemployment continues to rise over the next 18 months, the public will increasingly recognise that unemployment is basically a labour market problem, and that the prime responsibility for failure lies squarely in the labour portfolio. Changes in such things as a country's exchange rate or its level of protection and subsidies can be accommodated smoothly if its labour market is sufficiently flexible, as Japan's experience has repeatedly shown.

The evidence is clear that the solution to unemployment problems does not lie in job creation schemes, or so-called "active" labour market policies on Swedish lines, or highly subsidised public education and job training programmes. As one recent study put it: "Training outside the workplace does not create jobs. Jobs create training".

The answer lies in a flexible, decentralised labour market along Swiss *or* Japanese lines, and in a tax and social security system that encourages workforce participation not dependency.

Sooner or later I am confident that the issue *of* labour market reform will come back on the policy agenda. Employers, academics and politicians of all political parties who understand the disastrous social and economic consequences of a UK unemployment scenario have a duty to explain the need for change. For the sake of groups such as school leavers, Maori and provincial communities, now facing double digit rates of unemployment, I can only hope it happens sooner rather than later.

In passing, I would observe that a move to decentralised bargaining, reflecting local costs of living and lifestyle preferences, would be the single most important contribution to regional development in this country, if only because the cost of labour is so important to most enterprises.

In a recent talk to your organisation, Athol Hutton of Waitaki International referred to the opening of a plant in Japan to further process New Zealand chilled meat. He said:

> We chose the site 1 1/2 hours from the centre of Tokyo, because the local township had labour available at about half the price of Tokyo. There was no national award that imposed Tokyo-level wages on these workers and prevented then obtaining gainful employment in their own preferred locality.

Mr Hutton might also have asked his audience to reflect on why this processing task was being undertaken in high wage Japan rather than low wage New Zealand. There are no prizes for guessing that the reason may have had something to do with productivity.

Job creation, higher productivity and wage growth, and a strengthening of regional economies would all be fostered by a move away from national awards to enterprise-related agreements.

Your local member for Sydenham was recently speaking of his concern to have job creation and regional development addressed at the forthcoming Labour Party conference. If he is genuine in his concerns, one of the principal remedies is plainly apparent.

Our craft-based trade union structures, the adversarial basis of our industrial relations and the underlying doctrines of Fabian socialism are all part of our British inheritance. We also acquired many of the institutions and doctrines of the British welfare state, of which Lord Beveridge was perhaps the foremost architect.

I refer to Lord Beveridge specifically in the context of ideas which did much to motivate New Zealand's approach to accident compensation. Beveridge argued the case for state insurance "as a new type of human institution" which would be both compulsory and involve a pooling of risks, except insofar as separation of risks served a social purpose.

With respect to workers' compensation, Beveridge noted an example of an argument that has become familiar in New Zealand, namely that:

> ... as other industries cannot exist without coalmining ... employees in all industries should bear equally the cost of industrial accidents and disease, in coalmining as elsewhere.

However, he acknowledged that in this area "there may be reasons of social policy for adjusting premiums to risks, in order to give a stimulus for avoidance of danger."

New Zealand moved to an accident compensation scheme in line with the Beveridge vision following the Royal Commission of 1967. Its distinctive features are compulsory insurance with a monopoly state insurer and a no-fault legal regime.

It has been the conventional wisdom in New Zealand for many years that our accident compensation scheme is a pioneering innovation, a model for the rest of the world. It should perhaps have given New Zealanders pause for thought at an earlier stage that not a single other country has adopted the same approach.

Indeed those jurisdictions that commenced moves in a similar direction typically halted or modified them as the cost implications became apparent.

As with state-owned enterprises, we have learned a great deal about the effects of incentives on individual and political behaviour in the 20 years since 1967. The Business Roundtable recently completed a study which called into question some of the basic analysis on which the present scheme is constructed. Our submission has been received with shock and horror in some quarters – most of whom did not appear to have read it – but a good deal of interest in others.

In very brief summary, the study concluded that the Royal Commission correctly identified many serious problems with the previous system of dealing with accident disability. The heavy reliance on the legal system, with attendant costs, delays and uncertain outcomes, and the poor forms of government intervention in insurance markets were not a sound way of handling the problem. Nobody would want to return to those arrangements.

Where the Royal Commission went astray, however, was in placing prime emphasis on reform of the legal system and failing to adequately address the prior issue of the capacity of properly structured insurance markets to handle accident risk.

The points which the study made about the current scheme include the following:

- The cost savings which, it was claimed, would occur from redistributing the pool of funds applied to accident disability have not eventuated. Quite predictably, behaviour has slowly changed over time and costs are rising steeply.
- There is no evidence that the New Zealand scheme is the cheapest, even on a like-for-like basis. The study gives a number of reasons why the simplistic cost comparisons that are sometimes made are quite misleading.
- Most fundamentally, the issue is not whether a given system of cover is cheaper but whether it is what consumers really want. The single product available from a monopoly state insurer does not cater for the wide array of individual situations and preferences.

The approach proposed in the study places more reliance on individual choice of accident cover and competitive provision of accident insurance.

The government would require all New Zealanders to buy a minimum level of accident insurance and would provide income support and a safety net for those in low income or poor risk categories. As with other SOEs, the monopoly position of the Accident Compensation Corporation would be removed and it would operate in the market on a competitively neutral basis. The benefits of such an approach would include a reduced cost of insurance, greater choice and improved safety incentives.

One over-riding point in this approach needs to be stressed. As with the proposals to free up the labour market, the prime beneficiaries of more efficient accident compensation arrangements would be workers, since the costs of levies or premia are effectively borne by them. Current government policies in both areas effectively penalise the interests of workers, even more than the interests of employers.

The problems of the scheme have been inconclusively debated by the government for more than two years and the task is now in the hands of the Law Commission. The Commission’s most recent discussion paper fails to address the fundamental issues and canvasses the idea of a uniform levy as its principal proposal.

This would take the social insurance approach even further than Beveridge envisaged away from economic pricing of accident risk and lead over time to still greater cost escalation. Safe industries and employers should not subsidise unsafe ones. Not only would this lead to an expansion of the wrong activities and enterprises, but it would spell financial purgatory for any insurance scheme. The idea has been roundly rejected by most employers.

A fresh approach to this whole area, which also considers the parallel issues of health policy which are now under review – including the anomalous treatment of accident and sickness disability – is urgently needed. Unless this is taken, I believe that the level of employers' frustration with the mounting costs and the government's indecisiveness will rapidly increase.

My concluding observation is that in both the United Kingdom and New Zealand, two closely linked countries, sweeping changes are occurring in response to their record of relative economic stagnation and social decline. That such changes are being made by governments of different political persuasions should really be no surprise. Experience teaches us that community opinion and the political system sooner or later respond to cold facts and hard logic. Electorates in both countries have decisively rejected the failed policies of the past.

The short-term economic situation in New Zealand is extremely difficult, and the government has been slow to move on its mandate to carry on with its programme of reforms and to remedy outstanding weaknesses.

In this it is handicapped by some elements in its own party who are still trapped in habitual modes of thought.

I believe the government has done a poor job of explaining that the policies of competition and deregulation that are being implemented around the world are of special benefit to low income groups in particular. Because such groups are not dominant in the political system, not many regulatory policies work to their benefit.

Moreover, the evidence suggests they are aware of that fact. For example, it has been found that the most poorly paid workers in the United States understand the adverse effects of minimum wage laws, and their representatives vote against such laws. It would be surprising if they were supporters of heavy governmental expenditures on higher education. Poor emigrants have typically voted with their feet and flocked to competitive, dynamic economies such as the United States and Hong Kong.

As one recent Nobel prizewinner has put it:

> An open, decentralised economy is still the land of opportunity for the lower classes.

That should be the message to all those genuinely concerned with social equity, as opposed to social engineering and control, in the conduct of our national affairs.

NEW ZEALAND INSTITUTE OF MANAGEMENT WELLINGTON
DIVISION ANNUAL GENERAL MEETING

PRODUCTIVITY

SIR RONALD TROTTER
CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

WELLINGTON
29 MARCH 1988

PRODUCTIVITY

I understand the Wellington Division of the Institute of Management is focusing this year on the theme of productivity. No concept is more central to the achievement of our national economic and social goals.

With very few qualifications, economics tells us that raising the rate of growth of productivity is the only long-run source of advances in living standards in this or any other economy. It is the systematic, continuous, year-in, year-out advances in productivity that have lifted a country like Japan from the rubble of the war to its status as one of the world's richest economies within the lifetimes of most of us here tonight.

There is nothing complicated about the concept of productivity, or how to improve it. Productivity is about getting your costs down, doing more with less, creating more value per unit of input, avoiding waste.

Raising productivity requires innovation, experimentation, risk-taking and change. These were the characteristics of New Zealand's early history but they have been much less in evidence for the last generation or more.

The fact that productivity growth was becoming an endangered species in New Zealand was recognised by the former Monetary and Economic Council as far back as 1962. Since that time we have been far outstripped by others in the per capita income tables. Japan, the "low wage" competitor of the 1960s, now has wage levels that are roughly double ours. Singapore, Hong Kong and Taiwan, the "low wage" countries of the 1970s, have now reached similar income levels. Korea is not far behind.

Private sector management over this period left a lot to be desired. Too many managers went to sleep in the cocoon. They connived in a host of inefficient work practices. They paid their workers when they went on strike. And they acquiesced in or even promoted the growing entanglement of regulations and controls that brought the economy to a standstill.

The productivity record of our state-owned enterprises was even more mind-boggling. They became factories for burning money. Taxpayer returns in many of them were non-existent. People wasted their lives in work of almost no social value.

None of this was due to the inherent quality of the people employed in these organisations – any more than people factors explain the difference between dynamic Hong Kong and (until recently) stagnant mainland China. The problem was the incentives they faced and the systems they had to deal with.

More recently in New Zealand, managements have been given the chance to get back to their job – concentrating on adding value in a competitive world. Most have risen to the challenges of an environment of greater commercial freedom. A few lost their way, and a still smaller number engaged in practices that brought no credit to them. By and large, the market has disciplined them swiftly and I question the need for the government to interfere in what should be the business of company directors, shareholders, and a competitive equity market.

Experience suggests there is nothing new about good management. The principles are simple:

- focus on what you are good at. Abandon those activities that can never compete;
- concentrate on productivity and quality and involve your workforce;
- emphasise flexibility, change and innovation;
- decentralise and delegate responsibility and authority;
- have confidence: you're better than you think.

New Zealand managers must become part of a dynamic society in which innovation and entrepreneurship are normal, steady and continuous. Many firms have surprised themselves by their ability to improve under the threat of competition. But restructuring is not a one-off process. It is not a matter of working off the backlog of economic adjustment and reverting to a steady state. If we want ongoing increases in job opportunities and living standards, continuous innovation and adaptation must become normal practice in all our organisations.

The *kaizan* message was brought home to me again on a recent overseas trip. Despite its still phenomenal performance, by its own standards the Japanese economy was showing signs of becoming sluggish in the early 1980s. Some two years ago, the yen commenced a climb against the US currency which has far exceeded anything that has happened to the New Zealand dollar. An old Japanese banking friend of mine told me it was the best thing that could have happened to the Japanese economy.

The first reaction of Japanese businessmen, he said, was to say they were going to die. They told the government it had to do something about the currency to save Japanese industry. The government did nothing. So the business sector had to do something themselves. They knuckled down and took huge chunks out of their cost structures. They dropped uncompetitive activities. The results have been dramatic. The yen is no lower but Japan has remained competitive and the economy is currently growing faster than any in the OECD.

Just as in the aftermath of the two oil shocks, Japan has been an object lesson of the benefits of a flexible economy.

With similar currency movements, most other countries would have experienced a job holocaust. Yet in Japan's flexible labour market, the unemployment rate barely flickered. It rose from about 2 percent to 3 percent, and is now on the way back down.

Japan's experience demonstrates that workers have nothing to fear from productivity gains, and New Zealand's experience shows that they have everything to fear from the lack of them. Productivity is not a job killer, any more than women, school leavers or older workers are a threat to existing jobs if our labour market is working properly. Proposals that would suppress productivity advances or labour supply – like the curious proposal by the Royal Commission on Social Policy to raise the school leaving age to 18 – misdiagnose the nature of the employment problem.

First, improving productivity and lowering unit costs will be necessary to enable firms to survive and retain jobs in the new environment. It will be a far more widespread and satisfactory approach than reducing wages, although Japanese experience again teaches us that that option should not be excluded on a temporary basis.

Secondly, jobs lost in a particular firm do not translate into job losses for the economy as a whole. Higher productivity means more income is generated which will be spent elsewhere and create other jobs. Managers have an important duty to facilitate the process of change for those affected, but a dynamic economy cannot keep people in disguised unemployment and put barriers in the way of redundancy, retraining and relocation.

In the more competitive environment, a new generation of New Zealand managers is emerging. There is a premium on skills such as finance and marketing, and even more on "people" skills – the skills to relate to teams, employees, unions, other people. I believe we can develop the resources of management and entrepreneurship to overcome the economic challenges, provided constraints are not put in the way. The constraints are largely of the government's making. There are still too many of them. The government must maintain the momentum of its efforts to promote a higher productivity economy.

Let me give you four examples of what I regard as major constraints to better management and economic performance.

- Much of the sheltered sector of the economy has not had to make the adjustments and productivity improvements that have been forced on farming and manufacturing, as Don Rowlands of the Manufacturers Federation observed earlier this week. Inefficiencies in areas like ports, electricity retailing, petrol distribution, local government, accident insurance and fire services are at the heart of our problem of international competitiveness.
- The Commerce Act has emerged as a massive barrier to industry rationalisation. It is now being said, only half in jest, that to gain consent to putting underperforming assets to better use by merger or takeover it is necessary to know nothing about the industry in question, and preferably to be a foreigner.
- The education system is not producing school leavers with the skills and attitudes needed by firms to foot it with the products of education systems like Japan. It would be surprising if the Picot review, and the similar exercise by the Gibbs task force, did not find enormous scope for productivity improvements in our education and health systems.
- Our labour market, described recently as the British empire's worst legacy to New Zealand, lacks the structures and incentives to encourage the innovation and entrepreneurship we desperately need.

> If ever there were any doubt as to whether the government's attempts to grapple with this area had been adequate, the sharply rising rate of unemployment has answered the question in the negative. There is simply no way. that New Zealand can become a high productivity, high employment economy like Switzerland or Japan with its existing labour market structures.

The Labour Relations Act has come through the first wage round with the equivalent of a School Certificate grade of D for "limited achievement", or what would previously have been recognised as a failure. The highly standardised settlement level of 7 percent, which was established at the beginning of the round and has not fallen despite the declining inflation path, is grossly inappropriate to an economy in recession and subject to widely varying economic pressures.

The weak provisions to enable workers to change union representation have not operated in a single instance, and virtually the only changes have been the artificial amalgamation of unions into units of 1000 members or more. Only a handful of employers have been cited out of awards into new separate agreements, and even fewer new composite agreements have been struck.

Contrary to the views of some commentators remote from the industrial arena, the view of seasoned practitioners is that the round has been far more "business as usual" than a new beginning. Change is occurring at a snail's pace rather than at the rate a rapidly adjusting economy requires.

There is now almost wall-to-wall agreement that private sector labour market arrangements are a fatal weakness in the government's economic strategy. Employer organisations have highlighted the problem, and farming and other exporting organisations have recently concentrated on it in representations to the government. The National Party spokesperson for Finance has been bringing the issue into sharper focus. A wide range of competent economic organisations – the Reserve Bank, the Treasury, the OECD and *The Economist* – have delivered the same message over the past 12 months. It would be astonishing if the IMF mission that has been visiting New Zealand has not said the same thing in its confidential report and stressed the urgency of reform. In the interests of open government, the public should know its assessment.

The public at large is quite receptive to further labour market change, as a Heylen survey commissioned by the Business Roundtable and released in February clearly demonstrated. It showed overwhelming support for collective bargaining by the workforce of a firm or plant, for the opportunity for workers to join the union of their choice, and for politically independent unions. A large majority of past or present trade union members also supported these concepts.

What then is the source of the political opposition to change? Besides the kind of trade union ideologues we saw at the Nissan plant on 'Frontline' this week, the recurrent theme in the labour market is people with vested interests, for example:

- national level union officials who have obstructed company agreements in the meat industry and the newspaper industry, in the latter case to the point of provoking a strike by workers in protest at their own unrepresentative union;
- union memberships threatened by more efficient work arrangements such as so-called "dependent" contracting;
- representatives of women in secure jobs arguing for interventions such as comparable worth which would improve their incomes at the expense of the jobs of marginal workers; and
- existing retail workers on inflexible work arrangements supported by restrictions on shop trading hours. It is noteworthy that the retail industry in the United States, with its minimal regulation of hours, expanded by 1.5 million jobs over the three years 1982–85.

It is the government's duty to govern in the public interest, not the vested interests of particular groups. The electorate provided it with a mandate to carry on the job of modernising the economy, and it assured the business community of policy continuity. To remedy the severe weaknesses that still exist in the economy, the constraints such as those I have outlined must be vigorously addressed.

In the present difficult economic climate, I have been impressed by business reactions. The heavyweights among the business community have maintained their support for the policy directions which I believe the finance spokespersons for the government and the opposition are both broadly in accord in advocating. To borrow a phrase, those business leaders have not wavered one iota, and the present low level of confidence is in large part due to uncertainty about whether the government will keep its part of the bargain.

Business polls are clearly indicating a concern that both party leaders should get in behind their finance spokespersons. With the present fragile economy, a failure to tackle outstanding rigidities and to avert fiscal risks – for example by adventures in social policy – would be devastating. It would have consequences for interest rates, the exchange rate and unemployment which would put paid to hopes of improving community welfare, and particularly the position of the least well off.

Consider just one statistic. A recent estimate suggests that if inflation comes down to 4–5 percent by next March and interest rates on 5-year government stock come back to 10–11 percent, a household with a $40,000 mortgage will benefit to the extent of a wage increase of between 7.5 and 18.9 percent. There will be few, if any, wage increases of that magnitude around in the next wage round.

If New Zealand has the intelligence to remedy current policy weaknesses, the benefits of a strong economy like Japan, or more recently Britain, should be within our grasp. Indeed we should be able to improve on Thatcherite policies which have been in many ways unbalanced and unfair.

The Economist noted last week that Britain has now secured strong economic growth and, at long last, falling unemployment as a result of the harsh medicine of reducing inflation, closing uneconomic factories and getting companies into competitive shape. It added that the government had done much to help this process, above all by bringing trade unions within the law and making their bosses accountable to their members.

With the latest budget and its reduced tax rates, *The Economist* argued that there was now no excuse for British management. Like their New Zealand counterparts they had run a lousy show in earlier years, and the revival of business self-confidence had been the greatest single achievement of the Thatcher years. Their job was now to make the British economy become as productive as any other. I hope New Zealand managers will soon be given the chance to achieve the catch-up in living standards that ought to be possible after a generation of lost opportunities.

LINCOLN COLLEGE OLD STUDENTS ASSOCIATION ANNUAL GENERAL MEETING

EDUCATION

SIR RONALD TROTTER
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NEW ZEALAND BUSINESS ROUNDTABLE

CHRISTCHURCH
5 MAY 1988

EDUCATION

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

As one business magazine commented, it is:

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

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

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

- Fear of political lobby groups having too much say in schools.
- A sense that traditional values have been lost and that schools actually pose a threat to the desired expectations of the family.
- A suspicion that schools are becoming places for social engineering.
- Concern that the academic disciplines are to be supplanted by such curriculum topics as peace studies, trade unionism and taha Maori.
- A belief that standards are declining, particularly in mathematics and English.
- Lack of discipline in and out of school.

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

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

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

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

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

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

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

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

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

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

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

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

As one commentator responded:

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

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

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

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

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

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

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

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

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

WORLD EXPO CELEBRITY SPEAKERS FORUM

THE SOCIAL DIMENSION

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THE SOCIAL DIMENSION

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Morgan noted that the argument is reasonable, and in accord with our observations of human behaviour both domestically and socially. But it does not have the power to bind people with strong loyalties and deep commitment. It is too reasonable to inspire passionate conviction.
That is why George Gilder's book, *Wealth and Poverty,* published in 1981, caused such a furore. Morgan quoted from the pivotal chapter where Gilder argued flatly:

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

Elsewhere Gilder has pointed out that:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

NAPIER CHAMBER OF COMMERCE

THE NEW ECONOMY

SIR RONALD TROTTER
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE

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THE NEW ECONOMY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In Fletcher Challenge, we like to think we have some vision, but I would be less than honest with you if I said that 12 years ago any of us foresaw the shape of the company in 1988. Twelve years ago the merger with Tasman had not taken place, Fletcher Challenge did not even exist, and the thought of entering into North America had not occurred to us. If anyone had suggested to me then that in 1988 we would be the world's second largest forestry company and have a major stake in New Zealand's petroleum industry, I would probably have dismissed the idea out of hand.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

ADDRESS TO THE ROYAL AGRICULTURAL SOCIETY

SOME NEW ZEALAND MYTHS

SIR RONALD TROTTER
CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

AUCKLAND
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SOME NEW ZEALAND MYTHS

Every country puts a fair dose of myth into how it thinks about itself. These myths serve a variety of purposes. Some are relatively harmless, like the tall stories told over a beer when the shearing is done for the day. Others are potentially destructive. What begins as a little glossing over the truth, a little turning of the head, a little misjudged hyperbole, years later comes to cost heavily.

New Zealand has not been immune. As A R D Fairburn put it 40 years ago:

> We New Zealanders are one of the dullest, most stupidly conservative, most unenterprising races on this planet. By a long course of self-hypnotism extending over several decades we have persuaded ourselves of the opposite – that we are bold, enterprising, progressive, intelligent people, unhampered by the shackles of the past. The sooner we realise what damned nonsense this is, the better for us.

We've seen this in New Zealand in the relationship between Maori and Pakeha. In a rather different way, we've also seen it in the relationship between the rural sector and 'the rest' of the economy. In both cases, the events of the last few years have offered ample opportunities for myth-breaking. I would like to talk briefly this evening about how successful this has been in the case of the rural sector.

Like so many countries whose push for prosperity was based on the creation of an agricultural surplus, New Zealand has nurtured a particular reverence for farming and farmers. Farmers are seen as our best reminders of a pioneer past; our honest side, good by virtue of closeness to the land; practical, hardy, dependable; the backbone of the country.

In itself, it's not a view I'd want to knock – after all, I am a farmer myself. But it has had its costs. In part they have been the costs of attempting to preserve a certain way of life, a way of doing things, come hell or high water (and some of you will feel you have experienced both!). We see these costs in the half-crazed agricultural policies of the European Community or in Japan's massive rice subsidies, and we've also had a good dose of first-hand experience. The last few years have taught us that this experience can be survived.

But there are some more subtle costs to treating the rural sector as something special and apart, and dealing with these is a lot more difficult than cutting fertiliser subsidies or removing SMPs.

In viewing the rural sector as somehow special, or different from the rest of the economy, we tend to forget what different actors in the economy hold in common. We talk about farmers and businessmen, forgetting that farmers *are* businessmen. We worry either that the country is carrying the farmers or that the farmers are carrying the country. We forget that the to-ing and fro-ing of business is about cooperation as much as competition – that business works because different people doing different things find ways of depending on each other, be they farmers or manufacturers, employers or workers.

The experience of recent years has shaken up the relationships between the sectors. In the process some of the false distinctions between them have been broken. The removal of a wide range of protections from the rural sector was seen as a way of bringing farmers into “the real world”. The “backbone of the country” was instructed to exhibit its backbone. At the same time, a lot of manufacturers saw their protection reduced, and were forced to drastically rethink how they did business. Both were forced to face up to the demands of their customers with little or no help from the government.

Both farmers and manufacturers were faced with the need to learn fast. As well as reduced protection, they faced changes in the exchange rate regime and in financial markets. They had many new freedoms, and many new responsibilities. Some survived; some survived better than others, and some disappeared.

One way of seeing how much has changed is to look at changes in what these sectors are producing and how they are producing it. Another is to look at the way that groups such as Federated Farmers and the Business Roundtable talk now, compared with how farming and business organisations talked a few years back. And you will find that they are now talking not about protecting the special interests of their members, but about freeing them from the constraints that make doing business difficult. They talk not about getting their fair share of the economic cake, but about making that cake bigger. They *all* talk like businessmen, and they share many of the same concerns.

Increasingly, these are concerns about a new unevenness in the sharing of burdens. This is not just because it is thought unfair that farmers or manufacturers have had to change while other parts of the economy have gone on much as before. Had the need for change been limited to those sectors exposed to the world marketplace, this would not have been an unfair sharing of burdens.

But New Zealand’s economic problems were much more pervasive. As a result, the sectors which have been forced to adjust have had a much more painful time of it than if the burden of adjustment had been more evenly shared. The high interest rates that have affected all those in the ‘exposed’ sectors, to take just one example, bear witness to that.

Interest rates have not been high by whim. They have been high because monetary restraint has not been accompanied by a will on the part of the government to control its spending, or to spend what it spends well. They have been high because an antiquated labour relations system hampers productivity and encourages annual blow-outs in labour costs. They have been high because it’s hard to be competitive when the government and union sectors are substantially sheltered from the need to be competitive.

This burden is not borne solely by business. If anything, it falls most heavily on those who daily join the queues of unemployed. It is borne by those shut out of jobs by restrictions in the labour market, or by the shortage of funds for investment in a country where the government absorbs around 43 percent of GDP. It is borne by those fobbed off with welfare benefits when what they really want are job opportunities. And the cost of this waste is ultimately borne by all New Zealanders, in the form of poorer and fewer choices and lower growth.

No-one in New Zealand has a monopoly on backbone, on virtue, or on pioneering spirit. Our chances of economic prosperity depend on our willingness to recognise this. We need to credit each other with more, and spend less effort trying to protect ourselves and each other from the inevitable. We need to be sharing the responsibilities of adapting to a world that isn't about to stop changing.

Over the last decade, New Zealand businessmen and women of all kinds have learned a lot about their strengths and weaknesses – and the liberated consumer makes a hard task-master. As a result, we're a lot less likely to succumb to the old myths about our roles, or to champion ourselves at the expense of those we depend on. But we also need a government that is willing to break a few of its own myths; to assess its own responsibilities; to see where further change is needed and to find the spirit for it. Then, and only then, can the chance of prosperity be made more than a myth.

WELLINGTON REGIONAL EMPLOYERS' ASSOCIATION (INC)

MAKING INDIVIDUALS COUNT

SIR RONALD TROTTER
CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

WELLINGTON
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MAKING INDIVIDUALS COUNT

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

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

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

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

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

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

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

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

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

> It now takes seven East German marks to buy one West German mark on the black market; three years ago it took five. And it takes 13 years of waiting to buy a nasty little Trabant; the waiting list for real cars is even longer. Party officials boast that prices of basic foods and rent have not changed for 30 years. But the 20 percent or so of national income that goes on these subsidies gets harder to afford.

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

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

Compare that with Mikhail Gorbachev's view:

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

Mr Douglas was also recently quoted as being affronted by the poverty and squalor that he encountered in Hong Kong in the 196Os. The transformation of what has been one of the world's most successful free market economies in the past 25 years seems to have passed him by. As *The Economist* again pointed out recently, Hong Kong people's annual per capita incomes are now around US$9,500:

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

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

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

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

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

> As a result, the Newly Industrialising Countries are among the most egalitarian countries in the world, far more so than Latin American and South Asian countries that have stressed redistributive policies ... Countries with the highest economic growth rates since 1960 have also had the greatest improvement in general living standards, poverty amelioration and income distribution. In Korea and Taiwan the incomes of the poorest 40 percent grew as fast or faster than GDP ... and urban-rural income differences were reduced in both countries.

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

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

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

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

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

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

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

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

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

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

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

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

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

> But unlike a fixed commodity, we can change and improve our usefulness to an employer and easily become one of those reaching the best price.
>
> If we didn't try and squeeze guarantees out of employers – eg minimum wages, redundancy etc – through the might of the strong-arm unions, then today there would be only a handful of New Zealanders unemployed and employers would be desperate for good staff.

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

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

> In this environment, the term 'industry', which implies a collection of like firms meeting similar needs, loses meaning. So 'industry plans' make less and less sense. Enterprise competitiveness is what matters.
>
> Similarly, to be distinctive and competitive, managers will soon realise that they need enterprise-specific jobs, supported by enterprise-specific training. While the outside world – colleges or universities – can provide core skills, leading enterprises also need to develop and train their people in enterprise-specific skills. For example, pilots need to know how to fly the aircraft and the routes of their enterprise's airline, not just any old plane. Banking staff need to be able to work with the unique systems and service packages that each bank offers; the ANZ teller of the future with Transaction banking will be quite different from the Westpac teller with CS90.

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

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

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

Regrettably, however, there are still too few signs in government ranks of a willingness to take a thoughtful interest of this kind in the workings of labour markets. The air is still thick with empty rhetoric and attacks on straw men such as non-existent proposals for 'total labour market deregulation'.

Thinking New Zealanders are well aware that labour market reform is about more productive working arrangements and a high wage economy, not the low wage one we have been used to, and about laws which will promote democratic and responsive unions, not about attempts to do away with them.

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

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

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

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

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

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

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

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

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

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

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

ANNUAL CONFERENCE OF THE NEW ZEALAND BUSINESS PLANNING SOCIETY

STRATEGIC PLANNING AND INTERNATIONAL COMPETITIVENESS

SIR RONALD TROTTER
CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

AUCKLAND
5 OCTOBER 1989

STRATEGIC PLANNING AND INTERNATIONAL COMPETITIVENESS

The most important job of senior management is strategic planning. It is also the most difficult because it involves looking far into an uncertain future and evaluating competing concepts and ideas. The significance of international competitiveness in strategic planning illustrates this difficulty. It encompasses the uncertainty of the whole world economy, and it entails a large number of complex economic relationships.

During this conference you will be discussing many of the issues relevant to the competitiveness of individual firms and industries. I want to focus in my contribution on three fundamental issues. These are:

- the importance for New Zealand businesses of being internationally competitive;
- the significance of international competitiveness for minimising the business risk of New Zealand firms; and
- the need for New Zealand firms striving to be competitive to have a thorough understanding of how the economy works and relates to the rest of the world.

A central aspect of the first issue is the strategy New Zealand businesses must adopt to cope with political risk. As business people, we must understand that New Zealand society in general, and consumers in particular, do not owe us a living. Mrs Thatcher has repeatedly told British industry that there is no way Japanese consumers (or any others in competitive markets) can be forced to buy British goods. We can only expect to survive and prosper if we meet consumer needs, at home and abroad. Our job in business is to combine resources – labour, capital, land, raw materials and intermediate products – to produce the maximum real value added. If we achieve this, we will be making the maximum contribution within our powers to the growth in output, incomes and employment in New Zealand. If we fail to attain this goal, society and consumers will question our right to exist, and will be justified in doing so.

Provided our businesses are genuinely internationally competitive, we are producing value added at world prices. We are delivering products to consumers at the right price and quality. Under these circumstances, we can be confident that consumers and the public generally will tend to be on our side in any political debate affecting our competitiveness.

For many years, business people in New Zealand did not follow this strategy. Many businesses were not genuinely competitive. They came to rely on tight import licensing, high tariffs and large subsidies in order to be profitable in the face of competition from overseas producers. We fooled ourselves into believing that protection and subsidies were necessary for economic growth, the maintenance of jobs and balancing our external accounts.

Eventually most New Zealanders realised that import protection and subsidies gave New Zealand a stagnant economy with a chronic balance of payments problem. They also gave consumers a narrow range of shoddy, over-priced goods and poor service. The adjustment problems that New Zealand businesses have faced during the last few years of deregulation have been of our own making. We became addicted to regular fixes from the state, and it has been painful to kick the habit.

The last few years have been a hard lesson in political risk. Many New Zealand farmers and businesses have lost a lot of money – and some have disappeared altogether – because they took huge political gambles. They gambled that governments would continue the artificial life support systems and indemnify imprudent business decisions. Any business that depends on government policies in this way is a risky business. What governments give, governments can take away.

As strategic planners, we must make sure that we do not repeat those mistakes. We can minimise the risk in the longer term of being on the wrong side of government decisions by seeing to it that our businesses are aligned with the interests of consumers and society as a whole. Making sure our businesses are genuinely competitive is the most certain way of achieving this objective.

The way in which international competitiveness changes the nature of political risk faced by New Zealand business is illustrated by the current debate over the Commerce Act. This branch of commercial law was conceived in an environment of import controls, high tariffs and other forms of heavy industry regulation which caused monopolies to become entrenched and endemic in New Zealand. Such government intervention was basically needed to fix up the mess caused by government intervention in the first place.

With the opening up of the economy, the situation is now reversed. The Commerce Act has become a serious threat to effective competition and entrepreneurship. If it is not substantially reformed, it will undermine the efficiency of the New Zealand economy, to the detriment of consumers as well as business. It was difficult for business people to argue against such legislation while New Zealand industry was heavily regulated and protected, because of the apparent dangers of monopolisation. Now that much of New Zealand industry is exposed to strong international competition, we are in a much sounder position to mount the case for reform. Where trading in global markets is involved, it makes as little sense to worry about the number of producers in an industry in the small New Zealand economy as it does to worry about the number of industry players in Honshu, Wales or the state of Colorado.

As policy makers and the Commerce Commission come to appreciate these realities more fully, I believe there is little risk that the Commerce Act – and similar legislation such as the Fair Trading Act – will get worse. On the contrary, there is every chance that, in due course, they will be reformed along the lines that good sense demands.

One note of caution is warranted. We must be careful to ensure that we are always talking about *genuine* international competitiveness. It cuts no ice with consumers and society if, in order to compete with overseas producers, businesses need government assistance. This is not genuine competitiveness. The argument is not changed even if other countries behave differently. A small country like New Zealand has to take the world the way it finds it. Our export industries have trouble enough coping with trade restrictions imposed by others. If we inflict higher costs on them ourselves, through import protection or the cost burden of subsidies, they are doubly penalised. Contrary to popular perceptions, governments cannot help 'their own' in any general way. They cannot tilt the whole playing field. This is because governments cannot create wealth. They can only transfer income around. One local industry can only be helped by hurting others. Governments that favour some industries over others inevitably sacrifice potential national income in the process.

The second issue I want to focus on concerns the consequences of international competitiveness for business risk. This is an issue that is often lost sight of by strategic planners. The bottom line is that, other things being equal, a firm which is competitive internationally is better placed to reduce business risk than one that is not.

In a nutshell, internationally competitive firms face fewer constraints. They are, by definition, able to sell their products into a range of different economies around the world. They can be flexible, adaptive and innovative. This means that they can be much less dependent on the market in any individual economy. For example, if there is an adverse change in consumer tastes in one country, or a business cycle downturn in another, they may be able to maintain production, employment and profitability much more readily, by altering what they sell and where they sell it.

In addition, internationally competitive firms can diversify the location of their production facilities among different countries. This makes them less vulnerable to changes in cost structures which they cannot hedge against. For example, businesses can hedge known cash flows in foreign currencies through financial markets and thus protect their bottom line. But it may be impossible to offset the impact of exchange rate changes on their underlying competitiveness relative to foreign firms in different markets unless they can locate some of their production facilities in the same countries as those of their competitors.

The reduction of business risk in this way also reduces political risk. It means that businesses are much less affected by short term actions of governments which affect the business cycle. It means that they can afford to take a longer view of their operations, and of the impact of the economic environment on their competitiveness. This in turn makes for a much healthier relationship between business and governments.

In the past, when New Zealand firms were unable to sell into overseas markets because of high domestic costs, were fenced in by exchange controls and had no offshore production facilities, they were more inclined to look to the government to manipulate the New Zealand business cycle and to assist them whenever they lost competitiveness against foreign producers. Now businesses are increasingly looking to the government for a stable and neutral economic policy environment rather than for the short-term palliatives that do so much damage to economic growth over the longer haul.

It follows, of course, that the phenomenon of New Zealand firms investing offshore, and even exporting back into New Zealand, is a healthy one. It is not thought strange in Japan that Toyota and Honda have invested in the United States and are shipping cars from their American plants back to Japan. Firms with global operations are reducing their business risk as part of a strategy of becoming internationally competitive in a fundamental and long-term way. This development does not deprive New Zealand of investment and jobs. On the contrary, by increasing the efficiency of New Zealand firms and of the use of domestic funds, it increases the national income they generate, and hence real demand and employment in New Zealand.

In any case, investment in New Zealand is determined in aggregate by the economy's growth prospects in relation to existing capacity, not by the location decisions of individual firms. And investment in New Zealand has continued despite the recent recession. Fletcher Challenge's annual budget for capital expenditure in New Zealand has averaged over a billion dollars in each of the last two years. Elders Resources New Zealand Forest Products, Telecom, the New Zealand Co-operative Dairy Company and Electricorp, to name just four other large New Zealand firms, are each investing hundreds of millions of dollars in New Zealand. It is nonsense to assert simplistically, as a few people do, that nobody is investing in New Zealand because some New Zealand firms are investing overseas.

This brings me to the third issue I want to discuss. No matter how much we diversify our markets internationally, and how much we diversify our production facilities among different countries, the New Zealand economy is likely to be very important for most New Zealand firms for marketing or production reasons, or both. To manage our marketing and production risk effectively, we must therefore, as strategic planners in internationally competitive firms, be able to interpret properly the New Zealand economic environment.

A central issue here is inflation, the greatest threat to the international competitiveness of any economy. We need to understand the importance of ridding the New Zealand economy of its persistent inflationary tendencies. A stable price level reduces uncertainty, reduces tax distortions and results in more efficient investment decisions and a higher level of output and national income. Therefore, despite the seemingly unavoidable short-term costs of convincing people that inflation can be beaten, the longer-term benefits are indisputably worth the effort, as other OECD countries have concluded.

Over time, inflation is determined by the growth of the money supply, and hence the stance of monetary policy. Since 1984, the government has, by and large, done a reasonable job with monetary policy. Until this year, it had led to inflation trending to below 4 percent. But we cannot be complacent. Inflation expectations are currently well above the government's target of 0–2 percent inflation within the next few years. The Reserve Bank has on occasion allowed monetary policy to be too loose, which, along with political uncertainties, is fundamentally why many observers still feel that the 0–2 percent target is distant. This underlines the importance of the Reserve Bank maintaining a consistently firm monetary policy if we are to achieve price stability within the next few years.

The dangers of throwing away hard-won gains on inflation and losing international competitiveness are well illustrated by developments in Britain and Australia in the last couple of years. Both countries are now struggling with an inflation rate that has risen to around 8 percent and with large current account deficits. It is freely acknowledged in Britain that the mistakes made were to gear monetary policy to the exchange rate and to loosen up after the sharemarket fall. There have been similar inconsistencies in monetary policy in Australia. Neither government has ever achieved a credible record on inflation, and each now faces the costs of growing unemployment as it strives to bring inflation under control again.

New Zealand could very easily face similar problems. Dangerous signals of a resurgence of inflation have been developing over the past year. Under political and other pressures for lower interest rates, monetary policy may have been steered on the easy side of firm. Some exporting interests may yet come to regret their preoccupation with interest rates rather than the underlying problems of relentless increases in government spending and excessive labour costs. Countries with similar levels of inflation *and* with much higher growth than New Zealand are experiencing nominal rates of wage increase far below ours. Over the past year, earnings increases in the United States were 3.5 percent, in France 3.9 percent, in West Germany 3.7 percent and in Switzerland 3.6 percent. Unless we can keep wage increases below those levels until they can be supported by improvements in our growth, debt and unemployment position, we shall continue to be plagued by instability and the political and economic costs of inflation.

A point that Professor Michael Porter stresses in the studies which you will be discussing is that the route to international competitiveness is not to be found through a soft attitude towards inflation and a depreciating exchange rate. The competitive success of Germany and Japan has been associated with a non-accommodating monetary policy and a firm currency which has forced continuous productivity improvements and compatible increases in real wages. We are starting to see a similar pattern emerge in New Zealand, but much work remains to be done to consolidate it.

An act of devaluation, which some people continue to advocate, is a statement of a need for a country to cut its spending. But if we have to spend less and save more, because we cannot raise productivity fast enough, we ought to do so directly through reductions in real incomes, in particular wages. If it is not possible to reduce incomes directly in this way, there is little prospect of doing so indirectly – by stealth – through a devaluation.

This issue of real unit labour costs – wage and non-wage labour costs in relation to productivity – is the fundamental aspect of international competitiveness. Here the configuration of labour market laws and practices is of crucial importance.

Labour market arrangements play a key role in our ability to improve productivity, to innovate, to compete and to cope with firm monetary policy. Flexible labour markets help achieve high rates of economic growth and low unemployment in the longer term, and they also limit losses in output and employment during business cycle downturns.

The government has done a poor job since 1984 on labour market policy in the private sector. There is virtually wall-to-wall agreement among outside commentators that its performance in this area, along with rising tax burdens, is the Achilles heel of its economic programme. In some respects, in particular by reintroducing compulsory unionism and obstructing enterprise agreements by promoting large unions, it has made matters worse. And there is a real risk that it will compound the problem with proposals for pay equity legislation, forms of imposed arbitration and a return to centralism in the form of a Compact, all of which could set developments in this area back a decade or more.

Together with the poor incentives that have been allowed to multiply in the social welfare system, New Zealand's inflexible labour market arrangements are largely responsible for prolonging the present levels of unemployment. They will continue to undermine any prospect of a decline in unemployment as the current economic recovery proceeds. The haphazard nature of the system will continue to impose large risks and costs on New Zealand's internationally competitive businesses.

Anyone involved in strategic planning is forced to recognise that, pending thoroughgoing labour market reforms, the economy will not reach its full potential. Instead of a trend growth rate of 4–5 percent, we can at best expect real growth of 2–3 percent a year. If, before or after the next election, the government in office does tackle the labour market properly, New Zealand's growth prospects will improve substantially.

However, our job is also to work out how to make the best of the current labour market environment while it continues. Despite the obstacles kept in place by the government, there is a lot that individual businesses can do to negotiate more rational, productivity-enhancing employment conditions with their employees. Individual workers and local union delegates, as opposed to national level officials, are much more favourably disposed towards such deals. These will be necessary if we are going to maintain and increase employment, to reach the 0–2 percent inflation target without another recession, and to improve our international competitiveness.

Another important issue for strategic planners to understand is how the parts of the economy are interrelated. If some New Zealand businesses are sheltered from competition, the internationally competitive ones incur cost penalties. They pay more for their inputs, both directly and indirectly, and their profitability is squeezed.

The government has done a reasonable job over the last few years in opening up many parts of the economy to competition. This has resulted in large productivity improvements. Our internationally competitive industries have done much better than the doomsayers had predicted. However, there are still too many cost penalties. Some industries remain highly protected, there is still too much regulation of domestic industry, and there is effective state monopolisation of major services such as the hospitals sector, accident insurance and higher education.

As strategic planners, we should recognise that the benefits of previous deregulatory measures will continue to flow through over the next few years. This will assist New Zealand's internationally competitive firms to lower their cost structures and expand their output. However, if the government were to push harder to cut high tariffs, to reform the remaining regulation of industry, to accelerate the privatisation programme, and to be more thorough in making its own departmental operations efficient, the outlook would be much brighter.

As things stand, the government's performance in the area of its own expenditure has been flatly discouraging. Government expenditure is the real tax burden, and it has continued to rise inexorably since 1984. In Australia, federal spending has fallen dramatically from 30 percent of GDP at its peak to under 24 percent this year. In New Zealand it has risen over the past 5 years by a similar proportion – to over 42 percent. Much of this expenditure has been of poor quality. The number of New Zealanders dependent on handouts from the state is now enormous. The tax burden this creates is a substantial drag on internationally competing businesses. It will not be reduced to any marked extent until the government is willing to rethink the rationale and design of many of its programmes, as other OECD countries have done during the 1980s. This can be done without compromising the objectives of the programmes, by reducing the disincentives they create, and by improving their targeting. New Zealand has been going against the international trend in the 1980s of smaller government and lower tax burdens.

If we see signs of more discriminating political approaches to social spending, we should upgrade the economy's growth prospects in our strategic plans. However, if there are no such signs, we must continue to build into our commercial assumptions the continuation of a tax burden which inflates our cost structures and drags down our growth prospects. I know of no economy that has achieved a sustained growth record with a high and rising tax burden.

The government has made some important commitments as to its future fiscal plans. If it achieves its target of a surplus before asset sales next year, this will reduce real interest rates. However, we need many years of large surpluses, as well as further asset sales, if we are to reduce real interest rates to levels below 4 percent, which is the norm in stable and balanced economies like Switzerland and Japan. Fundamentally, our high real interest rates are the result of our past inflation performance and of the massive internal and external debt overhang that has accumulated in the past 15 years.

As strategic planners, we need to evaluate the prospects of the government reversing its poor track record on government spending and achieving a sizeable financial surplus in the period ahead. If a surplus is achieved by way of further tax increases, any improvement in our growth prospects will be stunted. We cannot get around the fact that the full benefits of sound fiscal policy can only be fully realised if expenditure cuts are the means of achieving it. The government has not previously succeeded in achieving annual expenditure cuts of the order of a billion dollars, the amount needed to meet its 1990/91 fiscal targets without tax increases. Therefore private sector managers must factor into their thinking the likelihood of further tax increases next year, or an under-achievement of the financial goals.

Taking the economic environment as a whole, there is much that is positive. The reforms of the last few years have improved New Zealand's growth prospects. They have also improved the prospects for inflation and the balance of payments. The Jeremiahs who predicted calamity have been proved decisively wrong. The standard of economic literacy among some commentators is still abysmal. One forecasting group recently changed its economic forecasts in the space of three months by magnitudes that defy credibility. Another was advising its clients to expect a 10 percent devaluation in August! One way that some businesses could reduce costs modestly would be to discontinue the use of such advisory services.

However, large downside risks remain in a number of key areas. There is much that the government should be doing to reduce those risks and to lift our growth prospects further. There has been a fall-off in the quality of some of the government's decisions in areas like tax policy, financial and securities market legislation and the protection of economic property rights – in areas ranging from the rights of secured creditors to Treaty of Waitangi claims.

Despite the undoubted improvements in the short term economic outlook, New Zealand's economic prospects remain risky and at best mediocre. On present policies we are unlikely to achieve more than a below-average growth performance by OECD standards, and there is little chance of significant reductions in our high levels of unemployment. Policy uncertainty and the loss of momentum in economic reforms have made the adjustment process far more difficult than it need have been. As the *National Business Review* recently observed, the cost to business of the last Lange year was enormous. Until both political parties raise their sights and get on with the job of addressing the key problem areas, prudent planners will continue to maintain a hedged position with their New Zealand businesses.

I am hopeful, but by no means yet confident, that public attitudes will continue to force New Zealand politicians to deliver the policies necessary for success. The lessons of what needs to be done have become more and more obvious, as experience from East Asia on the one hand to Eastern Europe on the other has demonstrated.

After a long period of political and economic tension, the 1980s are drawing to a close with the world looking a somewhat more safe and prosperous place. There is a good chance of the world ending the 1990s not with a bang but with a common market. New Zealand has much to gain if we decide to complete the process of becoming part of that global economy.

PACIFIC ECONOMIC COOPERATION CONFERENCE SEVENTH GENERAL MEETING

REFLECTIONS AT THE TURN OF A DECADE

SIR RONALD TROTTER
IMMEDIATE PAST INTERNATIONAL PRESIDENT
PACIFIC BASIN ECONOMIC COUNCIL

AUCKLAND
12 NOVEMBER 1989

REFLECTIONS AT THE TURN OF A DECADE

It is a privilege to have been invited by the New Zealand committee to address your conference. May I add my own very cordial welcome to our distinguished overseas visitors.

As you will all know, the Pacific Economic Cooperation Conference grew out of a Japanese initiative and met for the first time in Canberra in 1980. As the 1980s draw to a close, we look back on a decade of extraordinary change in the region and the world.

Ten years ago, the world economy was reeling from the second oil shock. This was the culmination of the most difficult decade for the international economy in the post-war period. The problems of inflation, volatile commodity prices, instability in exchange and interest rates and unemployment were placing severe strains on policy makers and businesses alike.

International politics too were in a state of flux. The Soviet Union had recently invaded Afghanistan. The Reagan and Thatcher administrations had just assumed office. China was embarking on a programme of economic reform which, we must hope, has only been temporarily interrupted.

Looking back, the turn of the decade clearly marked the turning point in the way the industrial countries managed their economies. Governments set their faces against allowing the second oil shock to develop into a wage/price spiral. They were successful in bringing inflation back to levels last seen in the 1950s and 1960s. Policy shifted from active attempts to manage demand to an emphasis on improving the supply performance of the economy. After the recession of the early 1980s, we have seen a remarkable period of steady growth.

The Asia-Pacific region has been at the leading edge of this economic expansion. The United States has enjoyed a prolonged upturn. Japan's per capita income has now reached European levels. Thailand and, to date, South China, have joined the ranks of the rapidly industrialising countries. Others look set to follow in the 1990s.

The decade has seen a number of significant shifts in views about how economies work. The previously dominant view that there is a trade-off between inflation and unemployment was shattered by the experience of the 1970s. A consensus emerged that, if anything, the long-run relationship is negative: sustained high inflation is damaging to the maintenance of full employment. Hence the efforts made by many countries to get inflation down, and the increasing official interest in achieving price stability in the 1990s.

Economic fine-tuning has been replaced virtually everywhere by a medium-term orientation to economic management. This has called for resolve and credibility on the part of governments to get through a period of adjustment without reversing policy.

To improve the supply performance of economies, policy has concentrated on improving incentives and making markets work better. Policies for privatisation, reducing subsidies to industry, increasing competition, limiting the role of government and reforming tax systems have dominated the policy agendas of governments of all political persuasions.

Another shift in perception is that the prescriptions of sound, old-fashioned economics are valid for rich and poor countries alike. Theories of 'development economics' based on government promotion of infant industries, access by firms to concessional sources of finance and the like have been widely discredited. Instead, agencies like the World Bank emphasise the importance of avoiding price distortions, removing disincentives to savings and investment and encouraging entrepreneurial initiative.

During the 1980s, views shifted about the role of exchange rates in achieving international competitiveness and balance of payments adjustment. Attention focused on the real exchange rate which, as the *Financial Times* recently pointed out, is itself just a euphemism for the cost of labour, adjusted for its efficiency, relative to the prices of output that are set by world competition. What really matters for competitiveness is productivity, reliability, cost control and product quality.

Of course, old habits die hard. Even resolute governments like Mrs Thatcher's lost credibility by treating 4 percent inflation as a triumph instead of pressing on to stable prices (as it promised to). Britain now faces another period of difficult economic adjustment. As *The Economist* recently reported:

> Industrialists are complaining that the pound is 'over-valued', which in plainer English means that they have let their costs rise so are finding it hard to sell profitably in overseas markets.

And it argued in a separate article that:

> For the 1990s, a modest first step is to start exploiting a virtuous circle: the harder governments try to keep inflation down, the easier it is to keep exchange rates steady; and the less they rely on currency depreciation for an occasional fix of competitiveness, the easier it is to keep inflation down.

In New Zealand and Australia, which have been two of the less dynamic Pacific Rim economies, economic opinion shifted in similar directions. Governments in both countries initially took bold steps to open up what had been highly protected economies, deregulate their financial markets, reduce budget deficits and adopt other policies in line with the 1980s consensus. But in both countries the programmes have not been carried through. Australia now appears headed towards serious economic difficulties and New Zealand seems to have got stuck between the old ways of looking at things and the new. In particular the government has been unable to accept that the arguments for widening the scope for competition and consumer choice which motivated the economic reforms apply with equal force to areas like health, education and the labour market where monopoly institutions predominate. The lessons from the successful Asian countries that alternative policies are not only more effective in improving social indicators but are also more egalitarian have not yet been absorbed. In New Zealand's case the problems have been compounded by a steep rise in government spending and tax burdens.

We may hope that there will be further breakthroughs in the 1990s as the electorates in both countries react again to the experience of sustained under-performance. In New Zealand the prospect of an only modestly improved growth performance, continuing high levels of debt and a grim outlook for unemployment is likely to contrast with further dynamic developments elsewhere in the region.

For if the major Pacific Rim governments can maintain and improve the balance that has been restored to their economic policies, resist protectionist pressures, help bring the Uruguay Round to a successful conclusion and promote a free flow of financial and, increasingly, human resources, then their prospects in the 1990s seem bright. The world now seems a safer and more stable place than it was a decade ago. In the countries of the Eastern bloc we may be seeing a shift from closed societies to democratic market systems which is without historical precedent. The 1992 single market should revitalise growth in Europe. As the retiring deputy-editor of *The Economist* suggested last year:

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

Modern telecommunications and broadcasting and the globalisation of business may bring home to the lagging economies on the periphery the penalties of inferior policies.

Business and academic participants in the PECC can play their part by encouraging their governments to adopt policies which will bring greater prosperity to their people. They can help press the case for open markets – for agriculture, manufactures and services alike. They can push for further efforts at structural adjustment. They can also help their counterparts in non-member countries such as the Soviet Union, which I visited as leader of a New Zealand delegation earlier this year, to encourage their governments to press on with market liberalisation and economic cooperation policies which will bring them into the fold.

It is appropriate at the turn of this decade for the PECC to look critically at itself and its performance. Participation has been interesting but has it been really valuable to its members? Has its work made a tangible contribution to better policies and better economic performance in individual countries or the group as a whole? I don't know the answer but I suggest work should be initiated to find out.

To be truly valuable the PECC must become an institution of real influence in the development of policies that will bring about economic growth and cooperation in the region. Such influence can only be exercised on individual governments through PECC national committees. It requires academics, business representatives and officials of the highest standing cooperating to base a case on sound and convincing research.

I suggest more research effort should be focused on identifying the most effective policies to achieve cooperation and growth. There is a goldmine of evidence within our region on policies that have succeeded and those that have failed. Research and comparative studies will show that an outward-looking approach to trade is the single biggest reason why some countries have done better than others. The case has to be made and re-made that liberalisation brings it own rewards, regardless of what others do. The most beneficial decision a smoker in a smoke-filled room with others can make is to stop smoking. If others stop too, so that no one is a victim of passive smoking, there are some extra gains in health. Such evidence is needed to convince politicians of the rewards of eliminating protection and privilege for the benefit of their economies as a whole.

I think it would be fair to say that when the PECC was formed 10 years ago, none of us foresaw that in 1990 we would be looking at oil prices that had returned to pre-1973 levels in real terms, communicating with one another on facsimile machines from our homes and offices, and welcoming the Soviet Union into the global economy.

The next 10 years will be equally unforeseeable. There will be challenges to be faced: trade imbalances and the financial risks associated with them, the drug problem, threats to the environment – and possibly even worse, ill-conceived responses to environmental threats. There are high risks of disappointments, unrest and even civil wars within the Eastern bloc countries if they do not liberalise and restore democracy fast enough. There will be deeper issues in some of our societies: recovering personal freedoms, revitalising the work ethic, changing the psychology of welfare dependency.

But the record of the 1980s has on the whole been encouraging for the liberal market economies. The scorecard for the year 2000 could be even better. I hope that when the PECC meets that year, it will be able to record that it played its part in achieving a better score.

NEW ZEALAND SOCIETY OF ACCOUNTANTS
AUCKLAND BRANCH

MORE MARKET OR MORE MANAGEMENT

SIR RONALD TROTTER
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NEW ZEALAND BUSINESS ROUNDTABLE

AUCKLAND
26 APRIL 1990

MORE MARKET OR MORE MANAGEMENT

At the risk of over-simplification, I want to suggest that there are basically three schools of thought on the economic directions that New Zealand has pursued in the 1980s.

- The first is that the policies adopted were basically the wrong ones, or that they were introduced in the wrong sequence, or were implemented too fast.
- The second view, essentially held by the government, is that all the key building blocks of a new economic environment are now in place, and that business should be responding with confidence to increase output and create jobs.
- The third is that New Zealand was correct in following the 1980s OECD consensus on measures to stabilise and liberalise the economy, but that the programme has become progressively more imbalanced and key problem areas have not been adequately addressed.

A commentary that can be taken as partly representative of the first view is the recent report of the Ministerial Task Force on International Competitiveness. This was described by one critic as:

> ... an unbelievably shallow analysis of New Zealand's poor economic performance that had not one strand of policy promoting total New Zealand growth, but rather was little more than a call to replace the poor performing policies of the present with the failed policies of the past.

Personally I think that reaction is a little harsh, as the report did have some useful things to say, for example on ports and transport, on skill development and even, if read carefully, on some labour market issues. However, I believe it is a reflection of the increased standards of economic literacy in New Zealand that the report's core recommendations, that the government should take a softer line on inflation and that it should engineer a 10 percent currency depreciation, did not attract any significant support.

Critics of the objective of stable prices and economic growth, to which both major political parties are now in my view rightly committed, seem to believe that low inflation and economic growth are somehow inconsistent. This is nonsense as the international record of the 1950s and early 1960s clearly demonstrates. The lesson of the last 20 years is precisely the opposite of the critics' argument: high inflation is probably the greatest source of inefficiency and the greatest obstacle to long-run growth in a market economy.

Countries that have given up on inflation when the battle is only half won have paid a high price. Australia and the United Kingdom are cases in point. As the *Financial Times* recently wrote:

> Inflation is ... the thread that runs through almost all the Chancellor's problems. Its resurgence is immensely depressing and will take some time to reverse. The question is whether the Government will have the stomach for the fight.

Those who would have the government ease up on monetary policy seem to believe that the result would be a lower interest rate structure. This is also nonsense, as recent Australian experience shows. In the period surrounding the election, short-term interest rates were manipulated downwards by the Reserve Bank. The result was to mark up 5-year government bond rates virtually immediately by over 50 basis points as markets foresaw higher inflation further down the track. We should have learned by now that the only route to substantially lower interest rates is lower inflation and inflationary expectations, and tight control of public finance to get the risk premium down.

Finally, on inflation, it is hard to see at a practical level what the debate is about. The Task Force suggested the inflation target should be the rate of our trading partners, not the government's goal of 0–2 percent by 1992. Forecasters are projecting inflation to be below 3 percent on average in the major countries by 1992. Even the Manufacturers Federation has suggested the inflation target should be 3 percent or less. If that is the extent of our differences, we surely have more important things to argue about.

On the exchange rate, I believe there is also an underlying recognition, even among those associated with the Task Force viewpoint, that what matters for competitiveness is not the nominal value of the New Zealand dollar – which has depreciated enormously over the past two decades – but our domestic cost and price structures relative to those of our trading partners.

Bryan Philpott recently pointed out that for a 10 percent devaluation to work, cuts in real wages of 2–3 percent would be needed. But if we want to improve competitiveness primarily by this route, it would be better for the union leaders on the Task Force to orchestrate real wage cuts through our centralised wage fixing system than to devalue and suffer the accompanying inflation. My own strong preference would be to concentrate on reducing unit costs through productivity improvements under a freed-up system of labour relations. The large productivity gains now being made on the wharves are a foretaste of what is possible.

The second view I referred to holds that the economy is poised for take-off, that the business sector fails to understand what has been achieved, and that it is irrational for businesses to lack confidence.

Long experience makes me worry when I hear New Zealand governments telling financial markets and business people that they are irrational. Financial market indicators reflect the collective judgment of thousands of well-informed decision makers here and abroad. The hallmark of the government in 1984–87 was to take any faltering in confidence seriously, and make greater efforts to overcome policy weaknesses.

Recently the government has been dismissing as “hoary old chestnuts” the arguments that failure to control government spending and to do more to free up the labour market are factors impeding the recovery.

The reasons for higher government spending, it is argued, are the costs of debt servicing, unemployment and deliberate increases in health and education spending. But reasons do not get rid of the facts, which are that there has been a massive increase in both spending and taxation which has to be bad for economic performance. And the 'reasons' for higher spending have been largely within the government's control. It has 'owned' the debt problem since 1984 and, like many businesses after the 1987 sharemarket crash, has not moved quickly enough to deal with it. The reluctance to free up the labour market means that the costs of unemployment are likely to be prolonged rather than transitory features of the fiscal problem. And the increases in health and education spending have gone mainly on salaries with few apparent improvements in performance or accountability.

The government's announcement of measures to facilitate enterprise bargaining in the March statement was a recognition that more needs to be done in the labour market, but regrettably what is proposed is merely further tinkering with a ramshackle system. What we need is a system which gives workers and employers much wider freedom to contract and freedom to associate, along the lines of successful OECD countries. The idea that voluntary unionism is irrelevant in the difficult industrial relations areas is quite wrong, as a forthcoming Business Roundtable study will show. The bottom line facts are that unemployment remains stuck at 7 percent of the labour force, opportunities for greatly improved productivity are not being realised, and over the last few months New Zealand has had crippling stoppages in its major dairy and meat export industries and on the waterfront. These things tell us that we have a system which is not working, and is a massive deterrent to confidence and international investment.

I presented what I identified as the third view on economic directions on a platform with the prime minister recently. He replied that he disagreed with much of my analysis. Fair enough. That is a challenge to try harder. Mr Palmer has recently acknowledged that "you can't stop halfway on the road to building an open economy." The task is to map out the rest of the journey.

Let me make the case for the view that investment confidence is understandably weak at present, and on present policy settings is likely to stay that way. I shall do so from the perspective of business costs and the uncertainties surrounding them.

- First, with government spending not curtailed, there is a serious risk of further tax increases, if not in this year's budget then in 1991.
- Second, businesses are apprehensive that further costs will be loaded on to them by moves such as an extension of accident compensation to include sickness, without reforms to what is a totally unsatisfactory scheme. At the local government level some outrageous increases in commercial rates are being imposed.
- Third, the wage bargaining system still places wage costs outside the control of many employers. Control will be further weakened by the proposed moves on pay equity, equal employment targets and the reintroduction of compulsory arbitration.

- Fourth, major additional costs will be imposed by the proposed resource management law. The prime minister has disputed this assessment. Yet the government's own advisor on the Town and Country Planning Act has expressed the view that "the process may well be more time consuming, more complex and above all it will certainly be more costly." And the Ministry of Agriculture and Fisheries has stated that the agricultural sector will be adversely affected by the proposals.
- Fifth, the programme of business law reform has not reduced cost burdens and has imposed new ones. Competition policy is still driven by confused objectives. There have been some signs that the government has recognised that the statutory management regime and other re-regulatory moves have been misguided, but its agencies are still promoting similar initiatives. The latest is the Securities Commission's absurd proposals to import overseas rules on the disclosure of executive salaries.

More generally, we seem to be reverting to the practice of placing the welfare of special interest groups and electoral considerations ahead of the general public interest. Any such concessions raise costs for other participants in the economy and create uncertainty about whether further groups will get special treatment. Recent examples have been the government's decisions to maintain the Apple and Pear Board's domestic monopoly and the commercial regulations protecting pharmacies from competition. In fairness, I have to say that the National Party does not appear to have faced up to these two rorts either.

Given these threats of higher costs, the weak state of business profitability, and policy uncertainties, which now include the implications of the general election, it is not hard, I believe, to explain prevailing business attitudes.

To summarise, I suggest we need to get the debate back on a forward-looking track. The argument is not about whether governments did the right thing in the 1980s by deregulating the transport sector, establishing CER, reducing import protection, freeing up financial markets, reforming the tax system, privatising public sector enterprises, and moving to eliminate fiscal deficits. Of course those things needed to be done, and I believe there is now something dose to a political consensus on these and other issues such as inflation, monetary policy and the exchange rate.

There is little point in looking backwards and arguing about the sequencing of reforms, even if such arguments have merit, which I doubt. Nor is the real question whether we have made progress – in many respects we have. The real questions are: Should we have done better? Why didn't we? and What do we need to do now to address major problems such as debt, unemployment, welfare dependency and the weak state of business confidence and investment?

To pose the issues in terms of more market or more management is to miss the point. The debate has moved well beyond sterile arguments about intervention or non-intervention. It is true that more still needs to be done to allow suppliers, in markets like higher education or accident or disaster insurance for example, to compete to meet the needs of consumers exercising individual choice. Experience has shown that bureaucratic intervention in that process or monopoly government provision almost always limits choice and increases costs.

But what is needed in most cases is a better body of commonsense law, not the elimination of rules. Markets, which are based on voluntary exchanges, cannot operate in the absence of secure property rights and a supporting legal framework. In the labour market, for example, the requirement in many ways is not to deregulate but to return to the law of contract, to uphold rights to freely associate, and to provide remedies against breaches of contract and damage to third parties. In essence the public policy debate needs to focus on the proper roles for the government and the means of ensuring that it performs its core responsibilities well.

I hope the forthcoming Budget and the election manifestos will provide concrete indications of forward political thinking on these matters. On the basis of current policies I doubt that anyone in the business sector believes that economic goals such as a 3–5 percent growth rate or a halving in unemployment are credible. We have a long way to go to recover from the damage caused when we decided to adopt borrow and hope policies and to almost amputate the invisible hand. Despite some brave surgery we have still not repaired many of the arteries. It is no surprise that the blood is not yet flowing freely and the patient is not feeling cheerful.

CANTERBURY CHAMBER OF COMMERCE

THE MYTH OF THE MIDDLE WAY

SIR RONALD TROTER
CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

CHRISTCHURCH
2 MAY 1990

THE MYTH OF THE MIDDLE WAY

I am grateful for the invitation to talk to you about the New Zealand Business Roundtable and the contribution it seeks to make to national affairs.

I will start by saying something about the organisation itself and deal with some popular misconceptions about our role. I will then briefly outline our position on some current economic issues and look at our vision for New Zealand in the 1990s.

In so doing I want to touch on the concept of ‘The Middle Way’, the title of a book about Sweden published in the 1930s. We hear advocates of a middle way for New Zealand. What relevance does the notion have for New Zealand today?

The charter of the Business Roundtable states that it is committed to the overall development of New Zealand and to promoting the interests of all New Zealanders concerned with achieving a more prosperous economy and a fair society. We are required to take a non-partisan and longer-term view, and not to operate for the benefit of any one group at the expense of others.

Membership is by invitation to the chief executives of major businesses. The organisation is a vehicle which enables business leaders with heavy responsibilities to take an interest in policy issues affecting the future of New Zealand. For ease of discussion, membership has to be limited to around 40 persons. We aim to involve a representative range of industry sectors. Contrary to some accounts, manufacturing industry is strongly represented. The numbers of our support staff are small, around two or three full-time people. We meet for half a day five times a year. The agenda covers current economic issues and policy studies to which members make an input prior to their adoption. We usually invite a senior minister, opposition spokesperson, government official or interest group leader to take part in an exchange of views at each meeting.

We don’t seek to usurp the role of other business organisations such as the Employers and Manufacturers Federations which have specialised roles. We are not a secretive organisation. Our publishing record shows we are very open about our views. The published studies are given wide circulation in the community at large.

With a handful of exceptions at an earlier stage, there has been a remarkable degree of unanimity within the organisation. There has been a striking willingness to put New Zealand’s long-term interests first and to accept some pretty unpalatable short-term consequences for many industries. Not everyone in the business community agrees with all the positions we have espoused; it would be extraordinary if it were otherwise. To me the test is not the number of heads that can be counted in support of a view but the merits of the argument. If our arguments have integrity and conform with the principle of advancing overall national interests, we hope they may have some influence. If those standards are not met, we deserve to be ignored.

I look forward to the day when some in the mass media get over looking for conspiracy theories about whether the government is captured by the Treasury, the Reserve Bank or the business world. This is lazy journalism and is a poor substitute for the hard work involved in analysing economic issues and economic experience both in New Zealand and overseas.

One myth about the Business Roundtable is that it wants a low wage economy which is helped along by the present high levels of unemployment. Nothing could be further from the truth. Low wages are paid in poorly performing economies. Unemployment is a waste and a cause of much social misery. We want to see New Zealand moving towards higher wages relative to the rest of the world. The basis for this must be higher productivity levels.

It may surprise some but I would be extremely happy to see a newspaper headline tomorrow saying “Business Roundtable seeks higher wage and salary levels”. There would be little point in enduring all the pain of economic restructuring if it did not lead to more jobs and higher incomes. No one in their right mind could support policies that resulted in New Zealanders’ living standards falling relative to the rest of the world.

A second myth is that we favour policies that suit large enterprises rather than small ones. This is totally untrue. We seek an environment in which businesses large and small can grow. We favour policies that are neutral between enterprises of different sizes. The major corporate sector, along with farming, has borne much of the brunt of the economic adjustment of recent years. New enterprises rather than established firms in mature industries may well be the major beneficiaries of the economic changes we have supported.

The present environment is particularly harsh for small firms because the costs of complying with regulations, red tape, tax rules and local government bureaucracy bear down heavily on them. Likewise small companies’ inability to influence the national wage setting process disadvantages them. Smaller firms may stand to make the greatest gains from reforms in these areas.

It is two and a half years since the October 1987 sharemarket crash which coincided with a downturn in the economy. There is no doubt that the recovery has been slowed by the debris from failing companies, many of which were incompetently managed in the buoyant years up to 1987. After 50 years of regulation it was perhaps inevitable that in a climate of freedom many would stumble.

However, inconsistent and uncertain government policies over the past two years have not helped. The weak state of business activity and confidence is creating doubts about policy directions. Some people are calling for the government to ‘kick start’ the economy while others would like to see at least a partial return to a regulated environment.

One might hope that the speed of collapse of socialist systems in Eastern Europe has destroyed once and for all the myth that a command economy works better than the capitalist alternative, or that it even works at all. But some would ask whether there is an alternative to the liberal market policies advocated by the Business Roundtable. This is a question some former communists also ask on missions to countries like Sweden in search of new answers.

There are other options. We have tried many of them and they have failed. We protected the oldest infant industries in the world – industries that wouldn't grow up until they were exposed to some real competition. Many have since done a great job. We have tried investment incentives and regional development incentives and export incentives. Companies took advantage of these subsidies because they were there.

We artificially stimulated production in the sheep and beef industry. The process caused enormous damage. The total cost to the taxpayer came to around $3 billion. The policies of the late 1970s and early 1980s caused farmers to pay far too much for their land, postponed labour reform in the meat processing plants and disrupted sheepmeat marketing arrangements. We are still living with the consequences.

The 'Think Big' projects involved short cuts to give priority to government-selected projects that invariably required taxpayer or consumer support. Their politically motivated timetables contributed to gross cost overruns in cases like the Marsden refinery expansion which the consumer is still paying for today.

Special treatment for selected enterprises, regional development incentives, SMPs and freight subsidies are very poor substitutes for a properly run economy. They all involve sleight of hand. They involve taking some money out of everyone's pockets and giving it to a favoured few. That was the philosophy behind so much government policy in recent decades.

In that sort of environment who can blame industry associations who lobbied for increasing quantities of government assistance? Why blame the cost-plus mentality of companies or the union attitude that an annual wage increase was a matter of right? This was the middle way New Zealand-style.

We don't want to return to the confusing signals created by the so-called 'middle way'. The record is clear. A relatively free enterprise system, over the longer term, produces vastly superior results for workers and consumers. This can be seen in the high productivity, high employment countries such as the United States, Switzerland and Japan. All three now have far higher levels of GDP per head than New Zealand. None have features like our centralised wage system.

Switzerland's economic performance has been greatly superior to that of Sweden, which has long been held up as a model by left wing advocates. Unemployment has consistently been around 1 percent, and inflation no more than 2 to 3 percent on average. The Swiss have the highest standard of living in Europe. Their labour market is probably the least regulated in the western world.

Sweden has taken over from Britain as the sick man of Europe. In the last two decades it has stagnated under the weight of an over-expanded welfare system and a bloated public sector.

There are some myths about Sweden that need exploding. Firstly, Sweden is not a socialist country in the sense that the state is heavily involved in industry, or that it is commercially insulated from the outside world. State-owned industry accounts for about 7 percent of the economy, less than half that of Thatcherite Britain. Sweden's free trade record is also better than most of western Europe. Sweden grew rich in the decades up to 1970 basically by following the kind of policies which the OECD in general has been pursuing in the 1980s and which New Zealand has belatedly started to adopt.

Currently, however, inflation and wage rises in Sweden are approaching double digit levels. The tax burden has become unsustainable. Unemployment appears set to rise. The government temporarily fell in February over a package of measures including a freeze on wages and prices. Most Swedes realise things have to change.

The country's leading economist recently wrote: "Sweden today has nationalised households, not nationalised firms." The British editor of *Marxism Today* put it more starkly: "The idea of a middle way implies there are two other ways. There are two ways and one of them has disintegrated".

No one argues for an environment totally free of government regulations. There is a role for the government in setting and enforcing the rules and providing genuine public goods. What we should be concerned about is the quality of regulations. If they become too burdensome they will stifle the vitality of the private sector. This is a major problem for business in New Zealand.

Likewise, if the government appropriates an excessive proportion of the country's GDP, tax burdens will be oppressive and the private sector will be hard placed to compete for resources. In New Zealand the government share of GDP is now some 42.3 percent on an unadjusted basis. Taxpayers on average work nearly 5 months of the year before receiving their first tax-free dollar.

It is a serious mistake to see the goal of economic efficiency as involving a sharp trade-off with equity. Equity in my view involves things like giving everyone a fair start in the world, fair rules in the competitive game of life and a helping hand to those in need. This means, for example, basic educational opportunities, adequate health services and an accessible justice system. It does not mean equal results because results are for individuals to determine for themselves. If some people want to work in undemanding jobs the result will be that material rewards are less than for other jobs.

A preoccupation with equality of outcomes will result in a poorly performing economy which will not deliver the goods and services the population wants. The government's so-called employment equity proposals reveal a fixation with results, not equity. The record in western countries such as New Zealand shows that the differences in pay between men and women have narrowed over the past 20 years, and in the case of single women there is scarcely any difference at all. Efforts should now be directed not at the mirage of bureaucratic pay fixing but at removing the barriers to women obtaining employment on terms that suit them.

A freer labour market is an essential prerequisite here. In a competitive market it is in employers' interests to avoid discriminatory employment practices. Any other approach is not good business practice and will ultimately penalise the business concerned.

The proposals for industrial democracy are equally absurd. The idea that you can legislate for constructive employer-employee relations defies logic and experience. This is particularly so when it is remembered that the proposal involves union rather than worker participation in consultative councils. Imagine a company opening its books to a union official who would also be involved with competitors.

In just 10 years we will have reached the end of the second millennium. What sort of New Zealand is this generation going to leave its successors? What are the goals we should be setting for ourselves in the next few years?

There is nothing wrong with the economic goals set by our two main political parties. We ought to be able to get economic growth of at least 3 percent per annum, halve unemployment, achieve stable prices, lower interest rates to single digit levels and reduce government expenditure as a proportion of GDP.

All these goals are probably quite realistic. Unfortunately they are probably unattainable in the present policy environment.

What are the impediments to growth? Why are firms not investing more for increased output? The answer can be supplied by any business manager – uncertainty and lack of profitability. There is a lack of confidence, given current costs including interest rates, that many new investment projects will return a profit.

The Reserve Bank and the government are coming under attack for what is seen as an obsession with getting inflation down. It is argued that the inflationary cure is worse than the disease. While this view may have superficial appeal, the analysis is misguided.

It would be easy for the Reserve Bank to ease up on monetary policy and possibly stimulate a temporary lift in activity. However, the consequences in terms of lower international confidence, outflows of capital and higher long-term interest rates would be extremely damaging. In today's open economy this option would be a recipe for disaster.

What we urgently need is not just a steady move towards stable prices but tighter control of government finances and real efficiency improvements in sheltered parts of the economy. Inefficiencies in these add to the costs of the internationally competitive sectors and hold them back.

I am surprised that economists and others who advocate an easing of the battle against inflation seldom address such problem areas. There is widespread agreement that the Reserve Bank is carrying too great a burden in controlling inflation and that this has some very undesirable consequences. But easing up is not the answer. The key is to get all government policies, including those bearing on the labour market, compatible with the goal of stable prices and higher growth.

Exporters are finding it hard to achieve adequate returns and some call for a devaluation. Some economists go along with this view.

We believe this represents muddled thinking. A devaluation should be recognised for what it is – essentially a transfer of income to exporters through an across-the-board wage reduction. If it worked like that, the idea might have some merit. But we all know that this is not the case with the present rigidities in the economy.

We devalued by 20 percent in 1967 and again by 20 percent in 1984. In between there were several smaller downward movements. If devaluation were the route to greater competitiveness, exporters should be riding high with this amount of depreciation. But many exporting companies are continuing to have difficulties because the offsetting increases in cost structures have undermined their competitiveness.

Instead of playing high-risk games with the currency, the need is for individual companies right across the economy to address their basic cost structures. This might mean more intensive use of capital, reduced overheads, or improved operating methods.

This requires flexibility in the use of all resources, which is the basic reason why the Business Roundtable has placed such a high priority on labour market reform.

What we are looking for is freedom for the employee and employer to negotiate arrangements that benefit both. Employees' interests are much closer to those of their employers than they are to those of workers in competing firms. A prime factor for many is the retention of a job – something that is not at stake for the union official who opposes flexibility in one plant because of the possible flow-on effects to other operations.

The current adversarial system encourages workers to see management as the enemy, an attitude that is totally destructive of the employment relationship. This confrontation mentality should be buried alongside Karl Marx and his band of misguided followers.

New Zealand manufacturers have found the going very tough in recent years. With ongoing tariff reductions the pressure is not going to let up. Manufacturers exposed to international competition have the most to gain from labour market reform. Without it and other measures to reduce tax and cost burdens, far too many are likely to fall by the wayside. This is not necessary as New Zealand should be able to provide a good environment for manufacturing, even with our relatively small domestic market and remote location.

One obvious area that would help manufacturers is transport. We have made some progress on the waterfront but much remains to be done. Under CER manufacturers can effectively extend the domestic market to Australia but they need lower trans-Tasman shipping costs. Reform in this area is now on the agenda in both countries and a major effort should be made to achieve real progress.

The same applies to the meat industry. Having seen sheep numbers soar on a diet of heavy subsidies, we have seen them collapse with their withdrawal. If the meat processing companies and our port operations had been more efficient, farmers would have maintained their stock numbers at a higher level. Instead of the export lamb slaughter falling from 39 million lambs in 1985 to 24 million in 1990, the level might perhaps have stabilised around 30 million.

It is easy to see how total meat exports could be significantly higher than the present level with major flow-on benefits to the rural community and more broadly. But this won't happen unless we get productivity levels up and costs down. The necessary returns are not likely to come from price increases in international markets.

This will require a realism not yet demonstrated by the New Zealand Meatworkers Union. The country's largest meat company has been crippled by an extended strike about a redundancy agreement that didn't exist and isn't urgently needed because no one is being made redundant. Outdated union attitudes have inflicted enormous damage on their members and the whole community.

For many employers a freer labour market will involve new responsibilities and risks. It will mean an end to sheltering behind employer bodies. It will mean taking a constructive and positive approach to the setting of wages and conditions.

Employees will have to make decisions about their own employment contracts, and about whether they want the services of a union, and if so which one. New thinking will be called for by everyone, including union officials who will have to learn how to sell their services to members.

The 1990s offer some exciting challenges. The way ahead has been charted by the decisions taken over the past half decade. This is a time to be positive and realistic. But it is not enough to set targets and paint attractive scenarios. To achieve them governments must remove some major roadblocks and businesses must learn to compete with the world's best.

MASSEY UNIVERSITY MBA LECTURE SERIES

CHOOSING CAPITALISM: PROBLEMS AND PROSPECTS

SIR RONALD TROTTER
CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

PALMERSTON NORTH
28 SEPTEMBER 1990

CHOOSING CAPTIALISM: PROBLEMS AND PROSPECTS

The task I have been given is to talk to you about business perspectives on New Zealand's economic future, the work of the New Zealand Business Roundtable and any other subject I thought appropriate. That is a very open brief.

What I propose to do is to put before you some thoughts on the nature of the global economy into which New Zealand now fits and in which you will be operating as MBA graduates. I will say something about the post-election environment in New Zealand, and the Business Roundtable's assessment of what needs to be done to deal with an increasingly dangerous economic situation. I will not have anything to say about immediate political issues, as our interest is in policies not politics.

Perhaps the single most important global development shaping today's business environment is the revalidation of capitalism as an economic system. 1989 will clearly go down in history as one of the landmark years of the 20th century. The collapse of collectivist regimes in the Soviet Union and Eastern Europe marked the end of a century in which socialist doctrines were a powerful intellectual influence. Marxist texts now being remaindered in bookshops should bear the label 'Best before 1989'. The superior wealth-creating potential for all citizens of capitalist economies based on private property, competition and individual responsibility has now been conclusively established.

I had the opportunity to observe the ravages of central planning on a visit to the Soviet Union last year. The Soviet Union is now a third world country. The shops are empty and queuing is a way of life. The work ethic has been extinguished. Environmental pollution is far worse than anything in the West. A system allegedly based on notions of equality has produced vast disparities between the privileged classes and the masses. The gradualist programme of perestroika has only served to make things worse. Parts of the Soviet Union now face the prospect of famine.

The situation in Eastern Europe is little better. I was in East Germany last July. In that country, the jewel in the communist crown, the cities are derelict, the roads are potholed and the telephones don't work. Western businessmen are finding that most enterprises are beyond salvaging. Now that Western goods are available in the shops, East Germans have simply stopped buying local products.

The only mystery in all this is why Western intellectuals and other observers shut their eyes to the palpable economic failures of these countries for so long. In retrospect, it is obvious that centralised planning was a bankrupt system which could not be made to work, and that even in the absence of democratic politics, pressures to abandon it would become irresistible. One thing that is clear in the current transition is that there is no constituency for reformed communism or its modified socialist versions. As one Moscow T-shirt puts it: 'The Party is over'.

The ex-communist countries are now engaged in the immensely difficult process of re-creating capitalist economies. The adjustment problems that face them are like those of New Zealand in recent years but on a far larger scale. Their pricing systems are totally distorted by controls and subsidies, bearing no relationship to world prices. Basic legal codes have to be developed. Most businesses, farms and houses are owned by the state and have to be privatised. Some of these countries have serious inflation and debt problems. In all cases national income is likely to fall and open unemployment – replacing disguised unemployment in state enterprises – will soar. The strains on the political process will be acute.

The jury is out on whether these countries will achieve a successful transition and the verdict will not be returned for many years. At this stage the prospects seem doubtful in most cases. Naive expectations that the mere overthrow of communist regimes would see the arrival of the good times are widespread. The centre-right Hungarian government has set its face against a rapid shift to a market economy, believing like the early Gorbachev regime that it can take its time. The centre-left is calling for faster movement. Proposals for a 'third way' between central planning and the market economy are sometimes advanced. Such a third way does not exist – as the Czechoslovakian minister of finance, Vaclav Klaus, recently put it: 'The third way is the fastest way to the Third World". He added:

> We want to achieve the transition from a state-dominated economy to an economy based on the private sector, private initiative and private entrepreneurship ... We are increasingly convinced that our country, or any other, is less unique than is often claimed ... The basic economic laws are valid across continents, economic systems, as well as ideological beliefs.

Klaus went on to make some remarks which are highly pertinent to the adjustment difficulties New Zealand has been experiencing. He stressed that a partial reform is much worse than a non-reform: "The partial reform in a distorted economy is a tremendous mistake." An economic programme must be coherent and consistent even if all the steps are not known in advance. He argued that restrictive monetary and fiscal policy is the precondition for any successful economic reform. The Czechoslovakian programme envisages a budget surplus this year, a target zero rate of growth of the money supply, and rapid privatisation. "We must start work with the bulk of enterprises and privatise them in a few months' time. No other possibility is viable." The government's present thinking is to give vouchers to all Czechoslovakian citizens which will entitle them to buy shares in any state business.

It will be a mammoth task for Eastern European reformers to persuade people that, as Mrs Thatcher once put it, "There is no alternative" to an uncompromising move to an enterprise economy. That lesson was forgotten in the United Kingdom when the government softened its anti-inflation stance and lost momentum in other areas. Britain is now experiencing the re-emergence of many of its former problems.

In the case of the Eastern European countries, what will be involved is not just the writing-off of a stock of useless physical capital embodied in plant and machinery but also a stock of human capital associated with central planning which is redundant in a capitalist system. The schools and universities have taught nothing but Marxist economics, philosophy and history. MBA programmes do not exist. There is no entrepreneurial class.

Enterprises have been run by party bureaucrats. There have been no accounting systems that provide meaningful data on the financial position of enterprises. There is no business constituency to help sustain a market-oriented reform programme.

The problems of the Eastern European countries in moving from highly distorted, centrally planned systems to competitive market economies help us to understand why New Zealand's efforts to make a similar transition are proving so difficult. Those involved with the Business Roundtable from the time it started to acquire its present shape in the mid-1980s foresaw the need to develop a strong private sector constituency for change and sustain it over a long period if New Zealand were to achieve a successful transition. Around that time a number of business leaders had concluded that New Zealand had been on a road to nowhere and that major changes in direction were necessary. Previously most business organisations had been part of the fortress New Zealand consensus. They had tended to lobby governments for policies which benefited their particular sectors rather than the economy as a whole. Our approach has been to take an economy-wide perspective and advocate the development of long-term policies to make New Zealand a better place in which to live, work and do business.

We had no illusions that this would be an easy or popular vocation. The anti-capitalist mentality in New Zealand is deep-seated. Perhaps understandably enough, given its protectionist past, business has been viewed with suspicion. Many sacred cows have had to be dealt with. Any reform programme involved challenging many vested interests. Our resources as an organisation are modest, falling far short of those of established organisations such as the Manufacturers Federation or the Council of Trade Unions. Busy chief executives under pressure in their own organisations can devote only limited time to national affairs.

We concluded at an early stage that the only way to cope with these difficulties was to take a long-run view and base our advocacy on principled arguments and professional research. Our thinking was that if standards of integrity in our analysis were upheld, so that positions taken genuinely reflected national rather that sectoral interests, then over time our efforts might have some influence; if our work did not meet those criteria, we deserved to be ignored. To the extent that we have had any influence, I believe it is because those standards have so far been met. We have not, for example, argued for industry protection or subsidies. We have not supported tax concessions for the superannuation industry. I could not see us advocating preferential tax treatment for the forestry or oil industries. Members have been prepared to support policies that are in the overall national interest even when they have had negative short-run consequences for their own organisations.

Adherence to consistent standards of advocacy has, I believe, added weight to the cases which we have put forward on various topics. It would not have been possible, for example, to argue credibly for the deregulation of the labour market without accepting the case for competition in other markets. Our current examination of the regulation of agricultural marketing has been criticised by some producer board representatives on the mistaken grounds that we have not been prepared to support competition in the business sector. The fact that we have taken consistent approaches to monopoly and competition issues will, I believe, increase the credibility of whatever conclusions we reach on that project.

The progress that has been made so far in changing economic directions would not, of course, have been possible without a much broader constituency for such changes. It is highly relevant that the general thrust of policies which we have advocated has also been supported by groups such as Federated Farmers, the Employers Federation, the Chambers of Commerce and the financial services industry. Even more important, it has had the backing of major elements of political opinion and the electorate at large in 1987.

This is a source of immense frustration to people like the 'Frontline' team who believe in conspiracy theories and subscribe to 1960s economic doctrine. What especially infuriates such people is the realisation that both main parties have shifted to similar, market-oriented policies – this they regard as capture of the political process. They fail to understand that the democratic contest rarely throws up basic philosophical differences between serious contenders for office. As the leading financial commentator Samuel Brittan has observed with respect to the United Kingdom:

> ... the difference between the two parties at anyone time is a tiny fraction *of* the difference that exists between *one* party's policy today and that same party's policy a few years previously.

All political parties and interest groups that are not rigidly wedded to dogma adapt to ideas and experience. The policy differences that remain (which can be important), the prospective quality of competing teams in implementing policies, and the electorate's assessment of their capacity to stand up to vested interest groups are more typically the stuff of today's election contests.

There is in fact a remarkable consensus in the community about our economic predicament. There is a general recognition that:

- the economy is in a very serious state made worse by events in the Middle East;
- the fiscal deficits that are projected are untenable and must be cut without increasing taxes;
- interest rates are reflecting concerns about policy directions, the government's financial position and inflation risk;
- unemployment is far too high; indeed there is no reason why we should have any involuntary unemployment; and
- the policy mix must aim for economic growth with low inflation.

Few people believe that political targets of higher growth and lower unemployment are achievable under present policies.

The current economic predicament has not arisen suddenly; it is a product of the drift and inconsistency in policy that set in after the reformist period of 1984–87. New Zealand's experience conforms precisely with the proposition that a programme of partial economic reform is a very dangerous and volatile recipe. Two years ago the Business Roundtable was warning that New Zealand was slipping back towards the brink and that an incoming government in 1990 could inherit an economic situation that was even worse than in 1984. A further downgrading of our credit rating in the next 12 months is a real possibility.

The chief inconsistencies in New Zealand's reform efforts have been the growth of government spending and taxing and the failure to abandon a centrally planned market for labour, an absolutely crucial production factor. It is a myth, given those weaknesses, that the overall programme has been genuinely market-oriented. The best rough measure of government intervention in any economy is the share of national income appropriated by the public sector. By this measure the scope of government intervention has risen and, taking central and local government together, now stands somewhere around 45 percent. With further tax increases or increased borrowing and debt a real prospect, it is little wonder that economic activity and most components of private sector investment are flat.

Similarly, it is no surprise that, despite hard-won progress in some industries, aggregate productivity growth remains low when businesses are hamstrung in deploying their most valuable and expensive resource, labour. The primary issue is not, as is commonly believed, the level of nominal wages and hence the remedy is not to be found in proposals for centralised accords which would limit wage increases to 2 percent or any other arbitrary figure. The basic problem with accords, as with all central planning, is that they do not work. Since the Australian Accord was introduced in 1983, productivity growth in that country has been effectively zero. Certainly real wage reductions will help employment and competitiveness, but with deteriorating terms of trade these are needed anyway. Mandating any wage increases at a time when New Zealand is facing real income losses from higher oil prices is irresponsible. The only way New Zealand can cope with a new oil shock is to accept a fall in living standards, shift more resources to the export sector and get serious about raising productivity.

Seeing a prime minister and union leader jointly announcing a major initiative was like a flashback to the days when trade union leaders camped in Downing Street and ran the British economy. Those days are long since gone in Britain; Mr Kinnock has been at pains to distance the Labour Party from the trade union movement and to make it clear that the basic trade union reforms of the 1980s will not be revoked. There is not the slightest doubt that New Zealand will also move to a voluntary, decentralised system of employment relations in the 1990s, despite the resistance of the old guard in union, employer and academic circles whose human capital tied up in the current system will be made redundant. Attempts at fear-mongering about the consequences of change are almost comic in the face of polls which show overwhelming majority support for reform. Most New Zealanders now accept that people who are mature enough to vote, marry, have children, drive a car and go to war are fully capable of entering into employment contracts, individually or collectively, without the encumbrances of our present archaic law.

Beyond these major weaknesses in a coherent economic programme, there remain large gaps between New Zealand's economic arrangements and those of dynamic, flexible economies. The state monopoly on the provision of accident compensation has no counterpart in successful economies. Our public pension scheme remains extremely generous by OECD standards, as do other social welfare policies. Over the last two years there has been a trend back towards re-regulation in areas ranging from capital markets to pay equity which has raised the cost of doing business in New Zealand. We still have very high levels of protection for some industries. As in the Eastern European countries, I believe there is only a limited appreciation of how far we still have to go to lay the foundations for economic success. New Zealanders may not like some of the implications of the process, but they will like it even less when more and more of our businesses and golf courses end up in foreign hands and more of our young people migrate to more exciting places.

The next 18 months are going to be critical in determining how New Zealand evolves for the rest of the decade. At present most business people and investment analysts are bearish. They do not see the stated policies of the two main parties as an adequate response to the economic imperatives that are pressing upon us. Overseas investors are becoming more nervous about New Zealand (and Australia) although financial market reactions have paradoxically been offset so far by greater anxieties about developments in the Middle East. But confidence could easily collapse with any weakening of resolve in the months ahead on our inflation goals or any failure to decisively address the looming fiscal problem. We could then have the makings of a full scale financial crisis.

There are plenty of siren voices who would lure us down the path of soft options. Many would tolerate a little more inflationary 'sin' as though printing money somehow produces real growth in output. Others believe that our ills could be solved by tweaking an interest rate here or an exchange rate there, independently of the underlying problems that these key prices are reflecting. Their codewords are the calls for more 'realistic' or 'pragmatic' policies, and an abandonment of 'economic theory'. But any economic proposal is based on a view or theory about how the world works; the issue is the merits of the theory. Rarely do the siren voices spell out that what their proposals really imply is more inflation, more government intervention and a return to a soft environment where managers do not have to face up to hard decisions, continuously innovate and meet competitive challenges. That route would take us down the Argentinian path, but it is not a scenario that can be ruled out.

On the other hand there is the possibility that the electorate will maintain the pressure on politicians to complete the process of reversing New Zealand's long-run decline in relative living standards. While many New Zealanders may be weary of change and have suffered a lot of pain, I believe that underneath they are also realists. They know that our economic situation is precarious and they have given past governments a mandate to remedy it. An incoming government that told the country the truth and sought its support for decisive action could, as in 1987, find that it was forthcoming. At present, for example, our politicians are shying away from indicating how they would curb government spending to deal with a 1991/92 deficit which seems likely to grow above $3 billion. Yet in a recent survey, 61 percent of those polled preferred cuts in government spending to higher taxes or more borrowing. Political parties should be seeking a clear mandate to deal with issues like labour market and social welfare reform which the average New Zealander recognises as issues crying out for attention.

As in the Eastern European countries, the jury in New Zealand is still out on our future prospects. Fundamentally, they are likely to turn on the extent of community understanding in New Zealand about what needs to be done. There have been improvements in the quality of the economic debate in recent years, but there are no grounds for undue optimism. Despite the lessons from the 1970s oil shocks and the 1987 share market crash of the folly of policy loosening as a response, many voices are advocating just that. As the Australian treasurer Paul Keating has been telling Australian business organisations, if business and the community lobby governments for flaky economic policy, that is what they will get.

Take the issue of trade policies. Protectionist instincts are never very far below the surface in New Zealand. The Sutchian argument that New Zealand has to protect itself because other countries do not play fair with agricultural trade is still frequently rehearsed. The fallacy in the argument is obvious from a simple analogy. Suppose an American pharmaceutical company were to discover a cure for heart disease and a Japanese competitor one for cancer. Suppose also that the Japanese government were, for some inscrutable reason, to keep the American cure out of Japan. Would it then be sensible for the United States government to keep the Japanese cure for cancer out of the American market? The answer is self-evident, but I do not expect that protectionist arguments will suddenly go away.

You will be part of the future business community that will help determine what policy choices will be made and hence whether our prospects are for growth or for ongoing decline. If you are to do your job well you must become citizens of the world. As MBA graduates you must understand the global environment in which New Zealand has to make its way. You should visit Eastern Europe to learn why economic policies there have been such a disaster. You should spend time in Japan to see what tough competition is all about and why its central bank gets twitchy whenever inflation looks like rising above 2 percent. You need to understand why the Swiss never adopted Keynesian policies or an extensive welfare state and why they consistently throw out proposals to reduce the working week. From Americans you can still learn why their forebears distrusted government power and why they have remained the foremost defenders of individual freedom and responsibility.

If you do these things you will be in a better position, as part of the next generation of business men and women, to help provide the kind of leadership in business and national affairs that New Zealand badly needs.

THE NEW ZEALAND INVESTMENT CONFERENCE 1992

THE FUTURE

SIR RONALD TROTTER
CHAIRMAN
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AUCKLAND
10 APRIL 1992

THE FUTURE

In thinking about this closing session of the conference, it struck me that the week's proceedings have much in common with the task we all face these days in our businesses, that of communicating with our shareholders and our markets.

Shareholders and those who advise them want to know about the good things that are going on in their businesses. But they also want to know about the weaknesses, the threats and the risks. It pays businesses to disclose bad news as well as good. If they don't they will be found out sooner or later. Markets will discount for uncertainty.

This week has been a presentation of New Zealand Incorporated. There is much good news to report about this new listing. The stories you have heard are genuine. Basically, they have described the emergence of a much more productive and efficient competitor in the world's markets, an economy which, for the first time in many years, is looking at a promising future. But you should also go away with a sober appreciation of where we have come from, how far we still have to travel and the risks and obstacles that lie ahead.

New Zealand is an economy in transition. Unlike many other countries at the present time, it is not a transition from an official policy of socialism to a market economy. But as an early European visitor observed, the development of the New Zealand state around the end of last century effectively took the form of "socialism without doctrine".

The manifestations of this doctrine in our economy were pervasive – barriers to trade, restrictions on capital movements, centralised wage-fixing, state-owned industry, regulation of agricultural marketing and a general politicisation of economic life. In the social sphere they included an extensive government role as benevolent provider of many basic services including health, education and welfare. We set out on our own road to serfdom.

Straightforward economic lessons need to be widely understood if a country is to make economic progress. I have just returned from an official investment mission to Asia – or more specifically to Singapore, Hong Kong, Taiwan, South Korea and Japan. Those countries chose a different path from New Zealand, one that an increasing number of countries now recognise as a better path to the future.

It is hard not to have a profound admiration for the achievements of those societies. From grinding poverty and economic destruction at the end of the war, Japan now has a per capita income twice our level. All the rest have overtaken New Zealand or are likely to do so by the turn of the century, even with a pick-up in our performance.

Other countries in Asia are following in their wake. Last year nine of the 10 fastest growing economies were in the Asian region.

New Zealanders tend to take the wrong lessons from the Asian experience. They note the role played by MITI in Japan in the 1950s and 60s and dirigiste elements in South Korea and Singapore, and put their success down to state intervention and control. Generally speaking, the truth is almost the reverse. They have prospered because of the large role played by the private sector within a sound policy framework. The government share of income in Asian economies is typically 30 percent or less. Hong Kong, perhaps the star performer, has had the least government of all.

Each of the dynamic Asian economies experienced a period of crisis and great change before the rapid growth phase. This led to a strong social consensus in favour of growth. Governments allowed most key markets to operate relatively freely and normally avoided interventions which impeded growth. They were strong enough to resist special interest pleas. Growth was sustained by vigorous competition and an outward economic orientation.

The crucial factors in those economies have been reducing barriers to trade, low inflation, flexible labour markets, low taxes and rigorous and competitive education systems. Contrary to popular belief, specific policies to promote industry and savings have not played a key role. Interventionist industry policies seem to have been a mixed blessing. And with the exception of Japan, savings rates were low in the early stages of growth; the growth in savings has accompanied the rapid growth of incomes, and personal savings have not been crowded out by high taxes and expansive welfare systems.

We have been moving towards the kind of economic policies that have brought success in Asian countries. I am convinced they offer a better future for New Zealand. But this view is not universally shared, as protests surrounding this meeting have shown. Which view prevails must greatly affect your perceptions of New Zealand as a place in which to invest and do business.

It is interesting to consider the record in Asia in relation to two of the main concerns voiced this week, namely unemployment and privatisation.

In all of the countries which we visited, unemployment is not an issue. Hong Kong, which has perhaps the freest labour market in the world, has maintained virtually full employment despite massive initial immigration and later structural change. In Japan, one of the major concerns of industry in the period ahead is labour *shortages.* Government work schemes and regulation of wages, as advocated by critics in New Zealand, are virtually unheard of in Asia. Asian experience would suggest you can have such policies or you can have full employment, but you can’t have both.

Similarly privatisation is not an issue in Asia. Japan and Hong Kong had few state businesses to start with, and Japan has privatised the two main exceptions, railways and telecommunications. Singapore has also moved towards privatisation to encourage entrepreneurship. And we heard a lot of talk about privatisation in Taiwan.

Around the world, the belief that the state is a good owner has been destroyed by the harshest of tests, real life. It is not easy to explain to Asians – or even these days to Russians, I suspect – that in New Zealand the government is still the largest housing landlord, runs state farms and owns the second largest computer company.

The case for privatisation is simple, and needs to be put patiently but insistently. Firms perform best when they are subject to market disciplines. They are forced to cut costs and innovate. Businesses in government ownership are inevitably subject to political pressures. Special interest groups lobby to influence pricing and investment decisions in their favour. Business growth is stunted because governments are loath to commit new equity. The organisations are trapped in their existing activities and cannot exploit other opportunities. Taxpayers are needlessly exposed to commercial risk. Politicians lose face if businesses fail, so end up bailing them out.

Governments around the world have failed to run state businesses successfully. It is idle to believe that New Zealand can do better over the long haul. But we are still having trouble absorbing the lessons of worldwide experience. Partly for this reason, and despite its general policy of getting the state out of business, the government's privatisation programme has stalled. While we are mired down in such debates the rest of the world is continuing to pass us by.

Other barriers that are holding New Zealand back were highlighted on our Asian trip.

- First, many of the same people who are concerned about privatisation also oppose foreign investment. Asia has welcomed foreign investment. As well as supplementing domestic savings it brings advantages such as technology and market outlets. Taiwan has a very active unit promoting inward investment despite having the largest foreign exchange reserves in the world. Foreign money is pouring into China. Those concerned about New Zealand's economic sovereignty should be concentrating instead on the debts we have incurred in the past 20 years, and ways of reducing public spending and borrowing to repay them.
- Second, some tax arrangements in New Zealand are a serious deterrent to investment. The one that stands out is the excessive effective rate of tax on equity-financed foreign investment. I am hopeful that the government will soon move on this, as it has on the non-resident withholding tax on interest. Beyond this, we need to recognise that income taxes, particularly on capital, are coming under increasing pressure around the world. High taxes discourage mobile factors of production. The only sound way of dealing with this problem is by reducing government spending and taxation. Bribing investors – especially foreign investors – with tax incentives, as some bureaucrats are still advocating, is not the answer.
- Third, we still have a very ambivalent attitude towards immigration. Human movement is a feature of our times. The government has articulated a more welcoming attitude towards immigration but this is

not yet reflected in its administration. We learned in Hong Kong that you can't even get a form to get a visa for New Zealand, let alone a visa itself, until you have bought an air ticket. A member of the mission who is one of the country's very successful entrepreneurs discovered that, under the new points system, he would not have qualified as an immigrant to New Zealand well after his business had been fully established. This is nonsense: New Zealand stands to benefit enormously from entrepreneurial, energetic people who can bring new ideas, attitudes and contacts.

- Fourth, there is a key area of the New Zealand economy where foreign investment is substantially blocked. In large parts of our agricultural sector, the various monopoly powers granted to the producer boards, combined with their producer ownership, invariably act to discourage non-producer equity. In some cases, such as dairy, the lockout is both intentional and complete. Such structures may have suited an era of commodity trading but they do not suit the requirements of today's consumers. If we are to get innovation and added value in these industries, they must be opened up to competition, outside investment and the ties it brings with world markets.
- Fifth, I gained a deeper appreciation of the importance of tourism, and its links with trade and investment. People may travel for leisure, but they often stop or come back to buy or to invest. Just as a distant country must do everything possible to reduce barriers to trade and investment, we must keep working on barriers to tourism. Some of these are direct, such as the removal of visa requirements from countries like Taiwan and South Korea. Others are indirect. For example, we learned that wealthier Asian tourists are looking for a better class of holiday and want to hire a car rather than go on a standard package tour. Our tourism industry must adapt its product and provide what the customer wants.

I have given you these examples of work that still needs to be done because you will have discovered most of them for yourselves, and New Zealand gains nothing by trying to conceal realities. It should be more reassuring for you to know that both the business sector and, I believe, the government, are conscious of the outstanding agenda. People like yourselves with experience elsewhere can help us make progress with it.

You should not go away with any illusions that New Zealand is about to perform like a dynamic Asian economy. Many changes are still needed both in policies and social attitudes. What impresses any visitor to Asia is the difference between a society in which many people were brought up to believe that everything comes from the state, and one whose culture has been based on self-reliance, hard work, parents looking after children and children looking after parents. Not for them the apparent maxim of some superannuation lobbies in New Zealand: “Blessed are the young for they shall inherit the national debt”. Nor the belief of many educationalists that raising education standards is about throwing more money at schools: Japan's widely admired education system, with a secondary school year 50 days longer than New Zealand's, absorbs a somewhat smaller fraction of national income than our own.

Despite the hurdles still to be overcome, I want to tell you that I am more positive about the future of New Zealand than at any time in my business career. The time to be negative about New Zealand was the 1970s and early 1980s when the economy ground to a halt and our politicians lacked the courage to back away from failed policies. There has been a revolution in mindsets. New Zealanders are becoming more realistic, more hardworking, and less inclined to see the state as the solution to their problems.

Today our economic fundamentals are in far better shape. The government's policies are much better balanced. There is clearly an economic recovery underway, which will steadily strengthen provided the government keeps moving forward, especially in dealing with its own spending and debt. And within our firms there is a new generation of managers coming through with the kind of skills needed to foot it in a competitive world.

Changing direction has been hard for many New Zealanders. Some are still not persuaded of the benefits, as you will have gathered from the diet of interviews on the national radio programme each morning. But a recent opinion poll showed a majority of New Zealanders believe the country is heading in the right direction. That is an important indicator of national sentiment.

New Zealand will not end the century as it began it, around the wealthiest country in the world. We learned to our cost that countries that put up barriers will no longer be part of any world community.

There are still barriers to be pulled down. I have referred frequently to Asia but that region should not be an exclusive focus for New Zealand. We have very important ties with Europe and North America, as well as with Australia. We are now getting close to establishing a barrier-free single market with Australia. The next step I would like to see is the association of both Australia and New Zealand with a North American Free Trade Agreement. This too should be outward looking. New Zealand depends on an open, international trading system. No country has more at stake in the current Uruguay Round, and successors to that round.

What, then, does a realistic future for New Zealand look like?

There is no doubt in my mind that the opening up of the New Zealand economy is unleashing a much faster rate of advance in our productive capacity. This is not simply of materialistic interest. Greater economic capacity makes possible a more positive relationship with our regional partners, improved environmental protection, more compassionate standards for those who genuinely need help, and greater choice and freedom for New Zealanders in all walks of life.

Already New Zealand is a far better country than it was only a few years ago. This is not only because it is more efficient and less repressive. Even more important, the vision of the liberal economy here and around the world has won the day because it is essentially humane. It depends on the central value of individual liberty against the power of the state. It is thus fundamentally about people. The alternative, socialism with or without doctrine, is about power. It is about government of the busy, by the bossy, for the bully.

As time goes on, I believe more and more New Zealanders will come to share the vision of economic freedom, private initiative and limited government, in partnership with other citizens of the world. It is a vision worth striving for.

INSTITUTE OF DIRECTORS
AUCKLAND BRANCH

BETTER BUSINESS LAW: THE ROLE OF THE INSTITUTE OF DIRECTORS

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AUCKLAND
13 JULY 1994

BETTER BUSINESS LAW: THE ROLE OF THE INSTITUTE OF DIRECTORS

I want to start by reading you an interesting letter which appeared in *The Economist* last year.

> It is the role of "mavericks" to extend the boundaries of debate and ensure that the unthinkable becomes not only thinkable but policy. The Institute of Directors is proud of its record of promoting causes so far ahead of their time that they have been deemed incapable of inclusion in any political agenda, only to see them become received wisdom, and find their way on to the statute book.

The letter went on to ask:

> Could telephones, gas, electricity and even water be privatised? Could trade unions be brought within the law? Could the top rate of income tax be reduced from 98% to 40%? Could inheritance tax on business assets be abolished? Could wages councils be abolished? Fat chance.
>
> And the sceptics are still at it. Can the Bank of England be independent? Can the hard ecu be the common currency for Europe? Can public spending be cut? Fat chance.

And the letter concluded by saying:

> When the day comes, sooner rather than later, that public spending is cut, and its growth is contained at less than the rate 6f GDP growth, then some taxes, whether on spending or income, can be abolished in time. Income taxes? Every chance!

The writer was Peter Morgan, Director-General of the Institute of Directors in the United Kingdom. As the letter indicates, the IOD in Britain has played a prominent role in promoting the economic reforms in that country in the last 15 years. Among business organisations it has been foremost in arguing for changes that seemed radical at the time, and its thinking and approach have been similar to those of the New Zealand Business Roundtable in this country. It has published a good deal of research, including a recent paper on New Zealand's economic turnaround.

Tomorrow is the tenth anniversary of the 1984 election which marked the beginning of New Zealand's economic reforms and the improvement in our fortunes that is now apparent. The Economic Summit of that year, of which I chaired the Steering Committee, reviewed New Zealand's 30-year record of poor growth, rising unemployment, a decline in social services and increasing social discontent. We need to remember the diagnosis made at that time when people attribute such ills to the changes of the last 10 years.

The Summit said that "Continuation of this trend would be intolerable and policy should aim to reverse it permanently." It reached a consensus that New Zealand had to adopt a coherent, medium-term economic strategy to enable it to become outward-looking and compete in the international market place. Although that consensus has been severely tested on many occasions in the last 10 years, I believe it now commands widespread support in the business community and polls show most New Zealanders think the country is on the right track. It has to be said that the Institute of

Directors has not played a significant role in the reform programme and I think that is a pity. I believe that the directors of our major public and private companies have just as much a responsibility to interest themselves in national affairs and make a constructive contribution as the chief executives represented on the Business Roundtable.

By comparison with its British counterpart, the focus of the IOD has been very narrow. I have seen little coming out of it on tax, labour law, privatisation and the other topics that Peter Morgan mentioned. Secondly, and again unlike the IOD in Britain, it has not gone in for serious research as a basis for its policy views. And thirdly, in the relatively narrow fields in which it has operated, I believe it has too often backed the wrong horse.

Although I was a founding member of the IOD, I resigned without fanfare a few years ago as a silent protest against the pattern of poorly thought-out and self-serving demands which the Institute was pressing on government ministers. The last straw for me was a proposal that membership of the Institute should be made compulsory for directors. At a time when the business sector was calling for deregulation of the labour market and an end to closed shops, the IOD was urging the creation of a new one!

The context of this initiative was the aftermath of the 1987 sharemarket crash, an event which called for calm analysis not knee-jerk reactions. Without such analysis, and, as far as I can recall, without even consulting its members, the Institute's name was attached to a series of rather ill-considered ideas which added to the panic of the politicians. Remember the claims at the time: New Zealand was a wild west market, overseas investors had no confidence in our business laws, no new equity would be raised unless we changed them, and so forth. All were hyperbole, as subsequent events showed.

Roderick Deane, chief executive of Telecom, reflected on the chequered history of the corporate law reform process at a conference of lawyers and accountants earlier this year, and I have brought copies of his address with me. There is little in it with which I would disagree and much that could be added. The thrust of his argument was that while there are some good aspects to the reforms, we have also introduced a great deal of legal complexity and uncertainty. He suggested that instead of concentrating on their prime job of increasing shareholder wealth, directors may have to spend inordinate amounts of time trying to work out whether or not they are in conformance with the law. If so, we may have ended up going backwards rather than forwards.

Others have disputed this assessment. There is a provisional market place test of the competing views, namely the choices the business community is currently making. I understand that the company registration figures for June showed an enormous bulge, and that registrations under the new Act this month show a corresponding scarcity of people who were anxiously awaiting their chance to take advantage of the new law's benefits. On the theory that the ultimate test of good and bad countries, and the ultimate test of an allegedly helpful law, might be similar, namely whether people are clamouring to get in or to get out, it is strange indeed that there was not a pent-up flood of registrations on 1 July. Instead there was a rush to secure for the three remaining years the supposed disadvantages of the existing law.

One issue on which there is a clear consensus is that the law on directors' duties has been changed very substantially. It is expected to increase directors' liabilities for misjudgment, which is likely to be regarded by the courts, with the benefit of hindsight, as carelessness. Liability may result even for business decisions to take significant risks which are proper because of the prospects of correspondingly larger gains. This outcome is consistent with the advice the Business Roundtable received from a top Australian academic and a leading New Zealand company lawyer when it evaluated the Law Commission's original proposals.

Astonishingly, the IOD urged haste with the law, although it expressed some reservations in the submissions it made to the select committee. In public statements it castigated those it considered responsible for the delays, in contrast to the warnings of bodies such as the Law Society about unresolved problems. The Institute's position also contrasted with the position adopted by its British counterpart on similar changes eventually rejected by the United Kingdom parliament. A look at its submissions to the select committee reveals that no attention was paid to the very substantial economic scholarship that can be brought to bear on corporate governance issues. There was little appreciation of the costs to shareholders of the inevitable recourse to expensive insurance, and of the routine back-covering involvement of professional advisors in hard decisions. The chickens are coming home to roost, and I see the IOD is now pressing for higher directors' fees in recognition of the increased risks. This seems to me an issue on which it has let down its members and shareholders generally.

Another such issue, and one that is still alive, is takeover regulation. In one sense it is not surprising that an organisation representing directors has joined those clamouring for takeover law. Around the world incumbent managements and boards are usually keen to erect barriers to takeovers in the interests of self-protection. Such laws buttress their position against the rights of shareholders to sell out freely to people who might bring about changes. But if it is good enough for the Business Roundtable, an organisation of chief executives, to take a view based on serious research on the subject and on the interests of shareholders and the wider economy, it ought to be good enough for the IOD to do the same.

In New Zealand the debate has been clouded by a good deal of ignorance. Few New Zealanders realise, for example, that in the most significant jurisdictions of the United States, major shareholders are free to transfer controlling shares privately. There is no automatic requirement to make a simultaneous offer to small shareholders. There is no rule requiring the payment of equal prices to all shareholders in a takeover. Yet the impression has been created that New Zealand is internationally out of line, and even likely to become a pariah for not having such rules. They are, in fact, distinctive features of takeover law only in Australia and a handful of other countries. Not many of us would look to Australia as a model in commercial law.

Much has been said about protecting minorities, but research shows that most New Zealand takeovers make minorities better off. Some people have suggested that takeover regulation is essential to restore overseas confidence in our market. Such confidence is hardly a matter for concern when the facts are that overseas investment in New Zealand shares has doubled over the past four years and now represents about 50 percent of the total equity market. Institutions are accused of pursuing self-interest when they support a more open takeover regime. However, institutions are the 'lead steers' in establishing share values and they have the greatest incentive to monitor company performance, to the great benefit of minority shareholders. The concern for the interests of minority shareholders is legitimate, but the best safeguards for them are sound commercial laws of general application and an open market for corporate control.

Takeover law has been the wrong focus of attention in the battle against fraud and other forms of looting. This has been confirmed by none other than the chairman of the Takeovers Panel, with reference to the London Pacific case. By confounding the two issues we run the risk of adopting a takeover law to deal with fraud, when in fact fraud should be tackled wherever and whenever it occurs.

The Institute made a flimsy two and a half page submission on the draft takeovers code compared with a 50-page submission and four separate papers by the Business Roundtable. I understand that the Institute also felt able to conclude that the choice the Stock Exchange now proposes to give to shareholders "is not workable" without making any enquiry of the Exchange as to its experience with the administration of analogous provisions since 1989. Many of you will have seen only press reports of the proposals of the Exchange. I have obtained for you copies of the rather thoughtful explanatory statement prepared by the Exchange when it released its proposals for discussion, and a useful article on the debate by Amnon Mandelbaum. I commend these for your careful attention. In my view, the general thrust of the proposals is sound, and they represent a more satisfactory, New Zealand market-based approach to the problem than one modelled on the London code.

It is, of course, the case that people often start with different perspectives on business law and other economic policy issues. Within Fletcher Challenge, for example, there are different views on takeover regulation. The only way to get to the bottom of an issue is by research and careful analysis. During my time as chairman of the Business Roundtable, we began the process of bringing to bear on policy issues the best research and expertise we could lay our hands on. Usually this provided a reliable guide to policy conclusions and, as in the case of the IOD in Britain, it has contributed to shaping the public debate.

I agree with Roderick Deane's conclusion that, with a set of major law changes now behind us, the immediate task is to make them work effectively while taking stock of the outcomes and analysing their weaknesses. He called for the New Zealand Stock Exchange, the Business Roundtable and the Institute of Directors to initiate joint projects in order to identify problems as they emerge and propose remedies. I endorse that suggestion. There are many specific issues crying out for intelligent and objective review.

For a start, there are the new personal liabilities imposed by the Resource Management Act and the Health and Safety in Employment Act, as well as the Companies Act. Is potentially unlimited personal liability a sensible way to enhance health and safety, or does it lead to a waste of resources in transfer payments to insurers and to lawyers and other professionals who profit from the resolution of claims? Does it foster a level of precaution and risk avoidance that bears no relationship to the priorities which people (including potential victims of carelessness or dangerous premises) would attach to the various remedies?

In another area, all managers of businesses should be concerned about the impossible position created by the judges in labour disputes. We are now personally liable if we allow those under our authority to continue to perform their roles when we have any reservations about their competence or willingness to comply with policies and instructions. On the other hand, the Court will afflict us and our companies with very serious costs if we fail to follow a charade of procedural steps to demonstrate ‘fairness’ in dealing with an employment problem. The Court may think it is protecting the interests of workers by making such decisions. The reality is that workers (and the unemployed) as a whole are penalised as firms factor these employment risks into their decision making.

Jenny Morel, the president of the Wellington branch of the IOD, added to this list in a recent talk. She spoke of the “daunting” compliance costs also arising from the Building Act, the Financial Reporting Act, the Fair Trading Act, the Privacy Act and the Consumer Guarantees Act.

Finally, and perhaps of greatest substance, there is a case for a review of the overall quality of the output of our legal system and its size. Something is wrong when the number of lawyers increased by 50 percent during the last decade when New Zealand’s economy hardly grew. As responsible business people and responsible citizens, we should be asking what is happening to the certainty and commonsense predictability that used to be the hallmark of our English-derived law. Should we be urgently looking at the implications of the removal of our right to appeal to the Privy Council if our own legal system has ceased to inspire confidence even among lawyers?

I suggest there is a large agenda for the Institute to get its teeth into. The cost and quality of our business laws are important factors in making New Zealand a competitive economy and an attractive location for investment. They are within the power of our own policy makers to determine. The Institute has rejuvenated itself in recent years with its educational programmes, publications, seminars and a healthy rise in membership. I hope it will do the same in its role of contributing to the development of better business law.

WORLD BANK CONFERENCE MAJESTIC CENTRE WELLINGTON

FROM BASKET CASE TO CASE STUDY
NEW ZEALAND 1984–96

SIR RONALD TROTTER
MEMBER
NEW ZEALAND BUSINESS ROUNDTABLE

WELLINGTON
9 DECEMBER 1996

FROM BASKET CASE TO CASE STUDY NEW ZEALAND 1984–96

It is a great pleasure to be opening a conference which will feature contributions by so many of the people who have helped transform the New Zealand economy and give our country a future. Since 1984, New Zealand has seen a remarkable period of economic change. It has been a transformation which has not gone unnoticed in the rest of the world. But while the reforms have won much international acclaim, some people in New Zealand have short memories. They have forgotten that for 25 years or more prior to 1984, New Zealand's economic performance was a disaster.

New Zealand once had the third or fourth highest average living standard of any country in the world. By 1984 we were 23rd in the Organisation for Economic Cooperation and Development (OECD), and continuing to lose ground relative to both the developed and the newly industrialised economies. Our productivity growth had for decades been the worst of any OECD country, as had our per capita economic growth. Unprocessed pastoral products still accounted for the bulk of our exports, and our manufacturing sector was grossly inefficient. Since the first oil shock economic growth had slumped, and unemployment had begun trending upwards. At the same time we were failing to live within our means as a country and were seeing a rapid build-up in both foreign and domestic debt.

This outcome was due to economic policies that were arguably the most interventionist outside of the third world and the Iron Curtain countries. We were a highly protectionist economy: high tariffs and import licensing were articles of faith. Domestic competition was severely restricted, if it was allowed at all. Almost every significant sector was extensively regulated. Thanks to the political clout of our dairy industry, you needed a doctor's prescription to buy margarine. When shops were finally allowed to open on Saturday morning – after bitter opposition – this was considered a major liberalising move. Tourists joked that they came to New Zealand and found it shut. To cap it off, we had one of the most inefficient and inflexible industrial relations systems in the developed world – craft-based trade unions and a national award system that applied to all workplaces regardless of their individual circumstances.

Almost every economic policy was shaped by the specific interests of a pressure group. Indeed, our economy was one huge interlocking grid of special interests, walking around with their hands in each other's pockets. Manufacturers were vigilant at clinging on to their protected status. The resulting cost structure meant that exporters were often struggling. However, rather than reform the domestic economy, the government's response was to subsidise exporters. The unions guarded their own privileges jealously and often used their monopoly power to obstruct more productive work arrangements. Management tended to acquiesce in this industrial vandalism; it was much simpler to fly to Wellington and lobby the government for special favours than to make their own workplaces more productive.

Naturally we all learnt to play the lobbying game – even those who realised the rules were absurd. I well remember when Morrison Industries – a company with which I was associated – obtained the right to manufacture bicycles. We put our case before the Tariff and Development Board – the words 'tariff' and 'development' went together in those days – and won. Bicycle imports were reduced to a token level. The officials became quite enthused about this great new manufacturing 'winner' they were picking. It was not hard to pick the loser in this deal – the consumer. The consumer lost out every time.

New Zealand's state sector fitted this environment of special interest politics like a glove. Most government services were monopolies. Almost all were inefficient and overstaffed; they had no incentive not to be. The poor quality of their services constituted a burden on the private sector. For instance, a new business starting up had an average wait of six weeks just to have a telephone installed. But there was no question under our old economic regime of making government trading organisations more efficient. We had to protect the 'jobs' of people 'working' in these departments. They constituted a powerful special interest of their own.

The late Sir Robert Muldoon – whose tenure as prime minister can tactfully be described as idiosyncratic – raised the policies of government intervention almost to an art form. Finding something in the economy still moving in 1982, he slapped a comprehensive freeze on all wages, prices and interest rates. His tenure was abruptly cut short by a snap election which he lost.

Such was the state of the economy inherited by the man who will be speaking next, Sir Roger Douglas. The day after winning the general election in 1984, the Labour government was informed that it faced a foreign exchange crisis. Within days the situation had escalated into a constitutional crisis. Decisive corrective action was required and was boldly taken. The currency was devalued and interest rate controls were removed in order to allow monetary policy to defend the new exchange rate. Price controls were quickly removed.

Two enormous tasks followed. The spiral of fiscal deficits, public debt and credit downgrades had to be reversed, and markets had to be freed up to allow the private sector to generate sustainable economic growth. These twin tasks of stabilisation and liberalisation took most of the next decade. The programme constitutes what a former OECD senior official, David Henderson, has called "one of the most notable episodes of liberalisation that history has to offer".

Before summarising for you some of the principles driving the reforms, I want to take this occasion to comment on how this remarkable episode occurred.

In my view it resulted from an extraordinary constellation of events, ideas, courage, vision, leadership and ability to execute. The critical trigger was the external debt crisis. As Mancur Olson has noted, successful domestic reforms often appear to follow from severe external threats and shocks. New Zealand's experience appears to fit this mould.

There is more to it, however. For example, New Zealand's 1938 foreign exchange crisis moved policy in an inward-looking, defensive direction. This was exemplified by the adoption of import licensing as a 'temporary measure'. Why did New Zealand move in the opposite direction in 1984?

The need for fundamental change had long been obvious to many politicians, including many in Muldoon's cabinet, many business leaders, the government's key policy advisers and many practising economists. Roger Douglas published a book in 1980. Its title adequately captures its spirit. It was *There's Got to Be a Better Way.*

These politicians provided the leadership, vision and courage for what was to follow. Key figures in the 1984–87 period were the prime minister, David Lange, the minister of finance, Roger Douglas, and those assisting with the finance portfolio, Richard Prebble and David Caygill.

Treasury, which had been unsuccessful in the battle against Muldoon's disastrous 'Think Big' government investment projects and the two-year wage and price freeze, had clear views on what needed to be done. Those views were pulled together as a post-election briefing for the incoming government in the few weeks following the announcement of the snap election in mid-June 1984.

Published some months later under the title of *Economic Management,* this briefing provided the intellectual basis, the strategy and the blueprint for the subsequent reform programme. Graham Scott in the Treasury oversaw the preparation of this briefing and Roger Kerr was his right hand man.

The story was much the same at the Reserve Bank, except that its views were better known through its research publications and the prominence of Roderick Deane. The three public servants I have just mentioned made outstanding contributions to what was to follow.

Meanwhile, and entirely independently, some leaders in the business community had decided that they had had enough of the old ways. I am proud to be associated with those who set up the New Zealand Business Roundtable, an organisation of chief executives of New Zealand's larger companies. It is unusual among business groups in that it has been dedicated from the outset to the proposition that the interests of the business community are likely to be best served by policies which are in the long-term interests of consumers and the economy overall. This means open and competitive markets and smaller rather than larger government.

The organisation's role is to commission, publish and disseminate the best possible research and analytical contributions to public debate. It is not a lobby group but relies instead on the power of ideas. Roger Kerr was appointed as our executive director in 1986. He has conceived and executed a large work programme including many contributions by international scholars. His influence has been immense. The importance of basing reforms on a strong and consistent intellectual framework, articulated in a way that can be widely understood, cannot be over-emphasised.

However, it would be wrong to give the impression that other organisations were not also moving with the times. Under the leadership of Ian Douglas, manufacturers were moving to support free trade with Australia. That was the start of an enormous shift in thinking *for* the Manufacturers' Federation. Today this formerly most protectionist of the business organisations stands with the Business Roundtable and Federated Farmers in supporting the elimination of all tariffs.

One of the most notable stories is that of Federated Farmers. This organisation had to cope with the prospect of widespread bankruptcies among farmers early in the reform programme. The problems arose because the elimination of farm subsidies coincided with high real interest rates and a sharp increase in the real exchange rate. The last of these arose from increases in government charges and the large and unfortunate surge in wage rates which followed the ending of the wage and price freeze.

Under Peter Elworthy's leadership, Federated Farmers resisted pressures from its members to call for a reversal of these policies and a return to subsidies, lower interest rates and an artificially lower dollar. Instead it called for an extension of the reform programme.

It is a reflection of those times that the Labour government responded in a manner which would previously have been unthinkable. In December 1985 it issued a statement of policies to support farmers – by lowering tariffs and phasing out import licensing.

Interestingly, one group which had little to do with the reform programme and in general remained wedded to outdated economic thinking was the academic community. As David Henderson has noted:

> ... academic economists in New Zealand appear to have been not only more divided about reforms ... but actually on balance hostile, possibly to a greater degree than in any other OECD country.

It is difficult to communicate today the enthusiasm generated in the mid-1980s between the public and private sectors by the government's evident commitment to policies likely to serve New Zealand's best long-term interests.

Richard Prebble reported in his recent book, *I've Been Thinking,* that when he was minister of state-owned enterprises he approached 200 top business people to serve on their boards. Their potential legal liabilities would be enormous, and the annual remuneration he could offer represented about one day's pay in terms of their opportunity cost. Yet only three of these 200 turned him down.

Following the 1987 election and the collapse of the Lange-Douglas administration, we must give credit to David Caygill and Ruth Richardson as key supporters of the path breaking Reserve Bank of New Zealand Act 1989 and continued tariff reductions. After the change of government in 1990, other vital reforms were the Employment Contracts Act 1991, introduced by Bill Birch, and the Fiscal Responsibility Act 1994, which was the work of Ruth Richardson.

The reform programme has been sustained during the terms of four prime ministers and four ministers of finance. It now faces the test of the first Mixed Member Proportional (MMP) parliament. This parliament has no mandate to alter the basic policy framework.

How is it that a reform programme can be so robust?

The two dominant figures in those respective governments, Roger Douglas and Ruth Richardson, will shortly be giving you their own analyses of the situation. I will content myself with stressing some of the broad principles which drove the reforms. It was the consistency with which these principles were implemented – across a wide range of areas – which distinguished the New Zealand liberalisation programme.

First, our reforms were from the start focused on the medium term. Ad hoc responses to short-term problems – which had bedevilled economic policy making in New Zealand – were largely rejected. The attitude adopted was that if a policy was not good for the medium term it was not good – period. The new focus was especially apparent in macroeconomic policy. In the past, monetary policy had often been subordinated to the short-run goals of boosting economic activity and jobs – usually in an election year. The result was predictable: high inflation, big fluctuations in output, but hardly any growth. After 1984, monetary policy settled into its proper medium-term role of ensuring price stability. Fiscal policy had likewise been aimed at propping up economic activity in the very short run, with serious consequences for debt and interest rates. Under the reforms, fiscal policy took on an increasingly medium-term orientation, aimed at controlling, reducing and eliminating the fiscal deficit.

A second principle of the New Zealand reforms was that special interests should no longer be allowed to dominate over the wider interests of the community. Every New Zealander is, ultimately, a consumer, and will benefit in a policy setting where resources are used in the most efficient manner. In the end, enough sector groups realised that everyone would benefit if we had an economy in which no one's special interest held the legitimate interests of others to ransom.

A third principle that drove the reforms was the recognition of the central role of competitive markets in creating wealth. The incentives in markets far surpass those that operate within a centrally planned system. And the ability of markets to harness and coordinate widely dispersed information, through the mechanism of the price system, vastly exceeds the capacity of central planners. Mainstream economics has long known these truths, and they have been repeatedly demonstrated in recent history by the success of market economies. But in New Zealand prior to the reforms, even many business people had an instinctive distrust of market forces and believed that markets needed to be heavily regulated.

A fourth principle behind our reforms was the conviction that New Zealand needed to open itself up to international competition and to international influences generally. The insular assumption that New Zealand industries could not compete, and had to be protected, was progressively abandoned. We discovered we could compete on world markets if the government addressed the inefficiencies elsewhere in the economy which had raised costs and compromised productivity. The last few years have seen a rapid growth of high value-added manufactured exports, and defeatist attitudes are now a thing of the past. New Zealand has become more integrated with the rest of the world in many other ways. Foreign investment has flowed into the country, and immigration is bringing people with important skills and links to overseas markets.

A fifth principle of the reforms was that there is no economic logic in viewing the labour market fundamentally differently from the way we view any other market. There is nothing in this crucial market which stops the laws of supply and demand from operating. On the contrary, labour markets work best for both workers and employers where employment contracts can be freely negotiated and where policy makers resist the temptation to 'help the worker' by imposing statutory monopolies or privileges on unions. That is the lesson from countries with relatively flexible labour markets such as the United States, Switzerland, Japan and the Asian tigers. With the passing of the Employment Contracts Act 1991, New Zealand joined this group.

A sixth principle of the New Zealand reforms was a recognition that, while market failure sometimes occurs, government failure is also a very real feature of the world and cannot be ignored when designing policy. Government failure can occur when the political process is captured by interest groups, or when governments substitute short-term political goals for sound medium-term policies. Implicit in virtually all of the New Zealand reforms was a realistic appreciation of the potential for this type of failure. In our new monetary and fiscal policy framework the recognition of the potential for government failure probably went furthest. Thus we have the Reserve Bank of New Zealand Act 1989 which entrenches in law the explicit goal of price stability. We also have a Fiscal Responsibility Act 1994 that sets down criteria for fiscal disclosure and principles of responsible fiscal management – such as running a balanced budget and achieving a prudent level of debt – which a government must follow over the medium term.

A final principle of the reforms was a recognition that, if a government wants to redistribute income, it should take the direct and obvious route of using the tax and social welfare system for that purpose. Prior to our reforms, many features of our economy involved implicit redistribution between one group and another. Partly through confused notions of what was 'equitable', our whole economy had become a network of cross-subsidies. For instance, many goods and services produced in the state sector were underpriced, with obvious consequences for resource misallocation. The reformers realised that in the end such an economy made everyone poorer.

These, then, were some of the key principles behind our reforms. Their benefits are now undeniable. After a difficult five years following the 1987 sharemarket crash, the New Zealand economy has performed well since real gross domestic product bottomed in June 1991. Growth has averaged around 4 percent per annum. More importantly, New Zealand has demonstrated the capacity to grow in a sustainable fashion. Inflation has been controlled within or near its 0–2 percent target range. In place of running large fiscal deficits, we are now producing sustained fiscal surpluses – a development which has enabled the government to repay all of its net foreign currency debt while simultaneously cutting personal income tax. New Zealand's international credit rating has overtaken Australia's. Unemployment has fallen from its peak of 10.9 percent to 6.3 percent today – one of the lowest rates in the OECD.

It would be wrong, of course, to imply that all worthwhile reforms have been implemented, and that policymakers can now put their feet up and enjoy the gains. Life is not like that. The world does not stand still. While New Zealand pauses to negotiate a coalition government – with the prospects of more spending here and greater compulsion there – many other countries are moving ahead. New Zealand is still a highly taxed country relative to its Asian trading partners, and others are moving more quickly to restrict the scope of government activity so as to allow more scope for private enterprise.

We continue to wallow in mediocrity in our systems for the delivery of health and education. Community dissatisfaction now focuses on these sectors which, almost alone in the economy, are characterised by dominant state providers and a lack of competition.

An even bigger issue for western nations like New Zealand is the future scope of the welfare state. Far too many able-bodied people live on welfare, and the talk is of adding to this by raising, rather than abolishing, the minimum wage. The welfare system subsidises those who have more children than they can afford to bring up and rewards men who abandon their responsibilities. The breakdown of the family unit is one of the most distressing statistics of our times.

Our system of accident compensation is a debt-ridden and divisive national disgrace. And because a few throw themselves on the mercies of others when it comes to retirement savings, it is seriously being contemplated that the savings of all of us must be regulated because big brother knows best. A compulsory savings scheme, if implemented, would be another enormously costly regulatory monster.

In recent years, as in many industrialised countries, there has been an orgy of overambitious regulations of a social engineering nature. The Employment Court, the Bill of Rights Act 1994, the Human Rights Act 1993, the Fair Trading Act 1986, the Securities Amendment Act 1996 on insider trading, the Health and Safety in Employment Act 1992, the Privacy Act 1993, the Treaty of Waitangi legislation, the Resource Management Act 1991, the Biosecurity Act 1993, the Commerce Act 1986, various tax rulings and countless other pieces of legislation are frustrating and bewildering commerce in innumerable ways. Meanwhile government expenditure has resumed its menacing upward creep. Add to these problems wage pressures in the non-traded goods sector and the danger signals for New Zealand's external competitiveness are obvious.

While New Zealanders can take real pride in the quality of the past reforms, we cannot eat last year's bread. The baker must return anew to the ovens each day, and so must any country that wants to raise its living standards. We have with us in this conference some who have excelled as reformers in the recent past. We can learn from their wisdom, but the task of moving ahead is a fresh responsibility and a shared one. New Zealand is still operating well below its potential and can do far better yet, given political leadership and informed public opinion. The same goes for most other countries.

HARBOUR CITY ROTARY CLUB

THE NEW ZEALAND BUSINESS ROUNDTABLE AND WHAT IT STANDS FOR

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MEMBER
NEW ZEALAND BUSINESS ROUNDTABLE

WELLINGTON
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THE NEW ZEALAND BUSINESS ROUNDTABLE AND WHAT IT STANDS FOR

I am delighted to be here today to talk to you about the New Zealand Business Roundtable. It's an organisation I am very proud to be associated with. Its mission of promoting better public policies relates to the welfare of all New Zealanders.

The Business Roundtable is an organisation that believes in an open economy and it operates in a very open manner. It bases its arguments on careful analysis and well-established economic principles. Because some interest groups and politicians have felt threatened by its proposals they have tended to attack the organisation rather than debate the ideas. As a result, many myths and misunderstandings have been created. I hope to dispel some of them today.

The Business Roundtable began in the early 1980s as an informal, loose association of business leaders who had started to rethink the old ways of doing things. Most of you will vividly recall the features of our economy in those days: a mass of government interventions largely driven by the interests of various pressure groups.

Most business people at that time were pushing business or sectoral interests. I was one of them. Let me give you an example from my time with Fletcher Challenge. The company was a major exporter and a large employer. But high domestic costs resulting from the protected economy and a corporate tax rate of 45 percent meant we and many others struggled to make a profit on our exports. It didn't really occur to us to question the whole structure of the economy. So what was the solution? The government, with the encouragement of business, provided export incentives. Fletcher Challenge didn't have to pay tax for several years; export incentives were worth about $40 million a year to the company.

Like many other business people at the time, I was a defender of export incentives. They seemed to be the only way of keeping export industries viable. But the reality was that while Fletcher Challenge was one of New Zealand's leading businesses and seen as a major contributor to the economy, it was in fact a corporate welfare beneficiary.

Likewise, I was one of the thousands of farmers who benefited from tax incentives and transport subsidies, supplementary minimum prices, livestock incentives and land development loans. I used a land development grant to clear some gorse. With tax deductions and loan write-offs, it cost me nothing and the taxpayer footed the bill for an exercise that was probably totally uneconomic. Thus I was among the few who were lucky enough to get a larger share of the cake, without noticing that the cake was barely growing.

Along with farmers, the most powerful pressure groups in those days were the Manufacturers Federation and the unions. All three sectors lobbied for their particular benefits and so the elaborate network of import controls, exchange controls, wage controls, price controls and subsidies was created. It was one huge interlocking grid of special interests. And, as we all know, in the mid-1980s the whole shaky structure fell over.

The catalyst that really sparked the formation of the Business Roundtable in its current form was the Economic Summit held in 1984, shortly after the election of the new Labour government. This event brought together representatives of all sectors of the economy and society who met in the parliamentary debating chamber to discuss the problems the country was facing and the need for new directions. I was chairman of the organising committee. It was a fascinating and rewarding experience.

A lot of information on the state of the economy was distributed beforehand and at the end of two days those present signed up to a joint communiqué that set the stage for reform.

Many senior business people involved in the Summit saw it as being in our own interest for the distortions and costs of subsidies, protection, debt and inflation to be removed. We saw that, long term, our prosperity was inextricably linked to the growth and prosperity of New Zealand.

We came together afterwards to form an organisation that would promote the development of policies for a more prosperous and growing economy. The Business Roundtable was formed with initially about 25 members and in early 1986 we engaged Roger Kerr as our executive director.

Today, the organisation numbers around 50–60 chief executives of major New Zealand firms. Our mission remains unchanged. Let me read an extract from our founding document – our statement of purpose:

> The NZBR is committed to contributing to the overall development of New Zealand and to promoting the interests of New Zealanders concerned with achieving a more prosperous economy and fair society... . In an open and free domestic and international market environment, the interests of the business sector are closely aligned with those of the community at large.

Over the past 13 years, we have stuck firmly to those principles. We have not promoted special interests, and there has been no pressure within the membership to do so. In the early days, a few members who found they did not fully share these views simply resigned. Today, even though some members occasionally find our views run counter to what may be good for their business, they continue to be committed to putting the national interest ahead of any private or sectoral interest.

Our specific goals are simple: we want a better New Zealand; we want to see a growing, dynamic economy; we want smaller government – not for its own sake but to facilitate that outcome; and we seek broad consensus on sound policies.

How do we pursue these goals? Our basic tools are debate, research and published material.

We meet for half a day five times a year. At these meetings members identify and discuss the issues of most concern. Our membership is by invitation but it is a very representative cross-section of major businesses.

Usually about half our members are able to attend each meeting, so that means everyone can literally get together around one table to air their views. Our office has a total full-time staff of four and a budget similar to other business organisations. It uses outstanding academics and consultants from New Zealand and overseas to work on our projects.

We invite two or three speakers to each of our meetings to brief us or present views on issues of interest to members. We plan an annual work programme and commission research and analysis on a range of topics. Throughout the year we publish a number of books, reports and papers, and produce a steady stream of submissions and statements on issues we regard as important. Where appropriate, we organise seminars and forums and bring out top-quality international academics to stimulate and contribute to New Zealand debates.

An example is the visit in a fortnight's time of Richard Epstein, professor of law at the University of Chicago and an outstanding law and economics scholar. During his week-long visit, we will be taking him to Auckland, Wellington and Christchurch where he will address groups and deliver lectures on topics such as takeover regulation, employment law, telecommunications regulation, MMP and educational theories.

We place a very strong emphasis on high-quality, objective analysis. Roger Kerr is ultimately responsible for maintaining our standards and is highly respected internationally for his work. Quality is particularly important in view of the fact that we do not seek to work through personal lobbying of politicians. Naturally we meet periodically with politicians and we try to maintain good relations with all major political parties, but we prefer to rely on our published material and analysis for influence. That does not mean that we are afraid to persist with arguments that initially encounter opposition. One cannot underestimate the power of ideas. It may take time, but in the end good ideas will count more than the vastly exaggerated power of vested interests. It is interesting to see policy ideas that are at first widely rejected reappearing later as someone else's proposal.

We will continue to critically question the way New Zealand does things and ask whether existing practices and structures are helping to make this country competitive. Our stance on producer boards is an example. There we have taken on some of New Zealand's most sacred cows. We have argued for the elimination of unnecessary regulation and the inefficiencies associated with monopoly structures. If the government moves to introduce competition and create a normal commercial environment in this important sector, it will be good for everyone – growers, farmers and New Zealanders as a whole.

Producer board reform has very little to do with the core business of our members. In fact, probably only one Business Roundtable member company could be seen as a competitor to any of the boards. Our determination to pursue this issue is based on our view that deregulation would be good for New Zealand as a whole. That's why it was very disappointing to see the government back away from its agenda last year in the face of opposition from the boards. It's the same old problem of the electoral power of interest groups, all the more so under MMP.

Producer board reform is one of a number of issues we've been chipping away at for some years now. At the beginning our position was considered extreme. That's been the pattern with many of the issues we've pursued, such as port reform, the Reserve Bank Act, deregulation of the labour market, and changes to retirement income policies. Today, the results of these reforms are a fact of life – benefits we now take for granted from changes which a few years ago would have been considered unthinkable or outrageous.

Encouraging the state to get out of running business enterprises is another example. We were advocating this at a time when, for many politicians, 'privatisation' was a dirty word and evoked images of the family silver heading overseas. Now the results speak for themselves. Look at the advances in telecommunications and airline services, to name but two. Not even the most committed statists appear to be advocating a return to the bad old days of state ownership.

None of these changes – all radical ideas at the time – has been easily won. But when you challenge sacred cows, you can expect opposition. New ideas will always be suspected and vested interests won't give up their privileges without a fight. Criticism is not something that bothers us if we are satisfied our thinking is sound.

Of course, the Business Roundtable has not been solely responsible for these changes. Many politicians, organisations and individuals have promoted similar ideas in New Zealand over the last 15 years, and their thinking has been in tune with worldwide trends. What is noteworthy, however, is that over the years virtually the whole of the business community has moved to policy positions similar to our own.

The notion of a group of leading business people promoting overall national interests has been difficult for the public to grasp, especially given the behaviour of business groups in the past. There have been plenty of emotive accusations of greed and self-interest, as well as political and ideological labels. However, the Business Roundtable is a strictly apolitical organisation and we are comfortable with any political party which shares our general perspectives. Thus, in the 1980s our thinking was broadly in tune with the economic liberalisation programme of the Labour government, while in the 1990s it has been more in line with that of the National government, at least during the early part of the decade. But the government's lack of positive direction in the last two terms of parliament has become a serious concern. The country has been drifting for too long and lost much of the momentum achieved in the early 1990s.

Our message to the government is quite simple: get the economy back on course. While the current upturn is pleasing, the outlook is not exciting and the country is still not where it should be. Serious underlying problems reflected in the large current account deficit and the growing unemployment rate are crying out to be resolved. The recent trends towards greatly increased government spending and ever-growing regulatory activity are not the solution. We are losing our competitive position and other countries are out-performing us again. New Zealanders don't deserve more pain after toughing it out through years of reform and restructuring.

Many unresolved issues require urgent attention. They include, for example, the problem of our ageing population, roading reform, the need for further privatisation in central and local government, politicised health and education systems, and social welfare expenditure which is costing $32 million a day. The government must get its house in order and look carefully at the quality of its spending and where it intervenes. We cannot create a strong economy and society without government, but that doesn't mean the government should be involved where the private sector belongs.

So, what messages can I leave with you today?

Think through the implications of government policy proposals: you will be paying for them. Every extra dollar the government spends not only diverts a dollar of income from New Zealand households but also cuts around 30 cents off total national income – because of the costs of raising taxes. Every badly conceived regulation reduces your living standards.

Support the political process and have your say. Help dispel the view held by many New Zealanders that more government equals a more caring society. We must refuse to allow governments to do anything that we can adequately do for ourselves and our communities. Only when the majority of New Zealanders support that view will we have a low tax rate, a high growth rate and low unemployment. But remember, you too must be prepared to give up the benefits that governments over the years have used to seduce you, like national superannuation for those who can afford to save and free health for those who can afford health insurance.

I hope I've helped dispel some of the popular myths about the Business Roundtable and what we stand for. I hope you share our ambitions for a better New Zealand. I hope you agree with our view that there is a large gap between the country's present position and its true potential. If you do, I hope you will think about how that gap could be bridged, consider our ideas for doing so on their merits, and support them if you find them sound.

ROTARY DISTRICT 9970 CONFERENCE 2000

SOCIAL COHESION: LESSONS FROM THE PAST

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17 MARCH 2000

SOCIAL COHESION: LESSONS FROM THE PAST

Over the past 15 years, much of the political debate about ‘old’ New Zealand has focused on the economy. New Zealanders came to understand that since the Second World War, and particularly by the 1970s, the country’s living standards were not keeping pace with those of leading countries. David Lange spoke of the ‘Polish shipyard’, the heavy hand of government control that extended into almost every recess of commercial life. The business sector suffocated under a tangled web of regulations and subsidies that all but snuffed out its capacity for wealth creation.

We joke today about many of the more eccentric features of the fortress New Zealand era. Many imports were simply banned. It was against the law to make carpets from anything other than wool. To buy margarine you had to get a doctor’s prescription. Until 1967, hotel bars closed at 6 o’clock. You weren’t allowed to truck goods more than 40 miles. To buy Australian shares you had to apply to the Reserve Bank. You bought 5 shilling British postal notes to subscribe to overseas magazines.

I won’t go on. Most New Zealanders, whether enthusiastically or grudgingly, came to accept that New Zealand could not survive as an economic museum. Many, however, do not realise to this day how many relics of old New Zealand are still around us. It is still not legal, for example, to sell apples and pears and dairy products to a foreign buyer without a permit, or to own more than one pharmacy. Governments still take and spend about 40 percent of national income compared with about half that ratio 50 years ago. Many people have not noticed that while New Zealand just sat on its hands for most of the last two parliaments, other countries like Australia kept reforming their economies and are now outpacing us again. And the new government seems to want to turn back the clock in all sorts of ways, ranging from restoring the state monopoly in ACC to bringing back area health boards, repealing the Employment Contracts Act 1991 and making trans-Tasman shipping a closed shop again.

However, I don’t wish to dwell on the economy, past or present. If New Zealand continues to ignore the lessons of economic success here and elsewhere, the public will sooner or later recognise the mistakes and press for changes, although the cost will be slow growth in incomes and needless unemployment in the meantime. Instead, I want to explore some other aspects of old New Zealand which I believe have lessons for the future.

Many people think we have lost some of the things they valued about New Zealand in earlier days. They use words like the “decent society” and “social cohesion” to describe them. They are disturbed by the incidence of family breakdown, unemployment and crime. They see too many people, especially Maori, as trapped hopelessly in poverty. They remember a time when New Zealand did not seem to have many of these problems, and they don’t see why we should tolerate them today.

I have a lot of sympathy with these concerns. Where those who express them sometimes go wrong is in linking them to the changes of the last 15 years. New Zealand was not a happy, prosperous, cohesive society by the

1970s and early 1980s. I was the chairman of the Steering Committee of the Economic Summit that met in 1984. The communiqué of that summit spoke bluntly of “an unacceptable level of poverty”, people with “major difficulties with housing, health care, and meeting essential family needs”, “a decline in social services” and “increasing social discontent”. By 1984 any illusions that we were ‘a land of milk and honey’ or living in ‘God’s own country’ had long been shattered. We wouldn’t have needed that summit if it had been otherwise.

I am old enough to have lived through the period that some look back to with nostalgia. I grew up in a farming community during the depression years. Large numbers of people were wandering about the country looking for work, and there was often a swagger in our woodshed. However, my parents never locked the door of the house, because neighbours might have wanted to pop in to use the phone or make a cup of tea. Despite unemployment and hardship, the crime rate was far lower than it is today.

I can just remember the first Labour government which was elected in 1935 and the social security measures of 1938. Some people today seem to regard the government of Michael Joseph Savage as one that launched New Zealand into big government and large scale welfare. Nothing could be further from the truth. In an editorial last year, the *Evening Post* correctly observed:

> It’s an unpopular view, but the Welfare State founded by the First Labour Government of Michael Joseph Savage is more in tune with the current philosophies of the National and Act parties than those of Labour and the Alliance.

Even though Savage’s government boosted government spending, it still amounted to only 16.6 percent of gross domestic product (GDP) in 1938. Savage and Nash were fiscal and moral conservatives. Welfare was seen as a temporary hand-up, not an open-ended handout. Savage insisted that pensions should be means-tested, not paid on a universal basis regardless of wealth. His government was very conscious of the risks of state welfare undermining the role of the churches and charities. Many of its members had grave misgivings about introducing compulsory unionism in 1936, fearing that it would make unions domineering and unaccountable. By the late 1940s these fears were proving to be well founded.

The 1950s were often seen as the high point of the ‘good old days’ for New Zealand. Export prices were high and the adverse effects of Fortress New Zealand policies were only just starting to bite. It was a time of full employment when firms were free to hire and fire people provided they observed ordinary contracts. Things like today’s so-called unjustified dismissal laws, the Employment Court and the Human Rights Commission had not been invented.

By today’s standards, welfare dependency was minimal at that time. People accepted an obligation to find work. They looked first to family, friends, charities and churches for help and support – not the state. Most hated going on the dole and only did so as a last resort. Adoption was usually seen as a better solution than sole parenthood. Thrift was regarded as an important value. People expected to have to save for their own retirement, with the pension being a residual safety net. Until 1960 the Universal Superannuation payable without a means test to all over 65 was a small sum. Before the fads and fashions of the last 30 years, education focused on the basics.

Consider too some of the moral values that were reflected in the laws of the time. The law frowned on public drunkenness and loitering. It was an offence to have “no visible means of support” – a far cry from later attitudes towards welfare. Criminals were not generally seen as “victims of society”; previous generations expected citizens to be law-abiding and supported laws, policing and penalties that kept crime to low levels. It would have been unthinkable to hear a minister of the church condoning theft in those days. Students going overseas to escape debt obligations would have been regarded as morally bankrupt.

I do not look back on that period with rose-tinted spectacles. The New Zealand economy was already starting to seize up by the 1950s with lower productivity growth rates than our trading partners, for reasons that include things like the introduction of import licensing and exchange controls in 1938. Some of the social legislation of the time was unduly harsh. Some children did not get good educational chances. There was a certain grey conformity and repressiveness in the national culture. As late as 1961 there were only three licensed restaurants in Auckland. BYOs were illegal everywhere. The film of James Joyce’s *Ulysses* could only be shown to segregated audiences. Many practices held women back: for example, they often had to get their husband’s permission to open bank accounts. I marched against the Springbok tours.

For all that, there was much more that was good than not about the environment of the middle years of the last century. The worst mistakes came later. Governments abandoned fiscal conservatism and greatly over-reached themselves in bidding for votes without acknowledging the consequences. Government spending and taxation grew enormously. With higher taxes, people found it more and more difficult to provide for needs such as housing or saving for retirement. Governments then started to spend more on things like housing and superannuation themselves, which only raised the tax burden further. Married women entered the workforce not just as a matter of choice but in order to help make ends meet. This put more pressure on families. The terminus of this process is today’s calls for childcare subsidies and paid parental leave – ordinary families become wards of the state.

The need for state welfare should have fallen sharply after New Zealand recovered from the depression years and with the prosperity of the 1950s and 1960s. Instead, welfare grew with more expansive programmes such as ACC, the domestic purposes benefit and National Superannuation being introduced in the 1970s. In the process, the social roles of organisations like the church and charities were displaced.

Some people say that the sacrifice of freedom associated with the welfare state is a price worth paying to obtain more security and more social cohesion. The history of the last 30 years has shown, however, that as the expansion of government expenditure becomes increasingly unaffordable, the welfare state provides no more security than quicksand. Nearly a million people – one in four New Zealanders – are now dependent on the state, that is, on the taxes paid by other people, for income and employment assistance. Rather than strengthening social cohesion, the welfare state has become a source of discontent. The politics of social welfare now seems to be concerned primarily with actions by various groups to exercise their political muscle to preserve what they have come to see as 'entitlements'. Savage and members of the first Labour government would not recognise today's welfare state. There is a crying need for debate to be refocused back to the question of how to provide effective help to the people in most need of assistance at least cost to the broader community.

The underlying belief during the last 30 years has been that bigger government enhances social cohesion. This view lay behind the expansive recommendations of the 1972 Royal Commission on Social Security with its language of participating and belonging. Supporters of this view favour greater public spending and taxation in the hope of reducing income gaps. They prefer universal subsidies to services such as health and education, regulation of the labour market and minimum wages, and more funding for things like culture, Maori grievances and declining regions.

The practical difficulty with this view is that bigger government approaches to social cohesion have been tried time and time again. We have at least 40 years of experience with them to reflect on. They have not worked; indeed they have contributed to the present discontent. The more fundamental difficulty is that big government uses force to suppress alternative choices. This is inherently divisive. So too is the modern tendency to legislate to deprive individuals of the freedom to make moral choices: too easily it leads to the tyranny of political correctness. Ultimately, as governments have over-extended themselves, we have seen a decline in public support for democratic institutions, and for the idea of one rule of law for all.

Those who think New Zealand enjoyed greater social cohesion before the big government era are right, and we need to relearn some lessons from the past. We find the same lessons from the Asian societies where levels of government spending, taxation and welfare are much lower than ours, and which enjoy lower rates of unemployment, less family breakdown, fewer out-of-wedlock births and less crime. Another lesson comes from the United States where in recent years a strong economy, a falling ratio of government spending, flexible labour markets and reforms to make state welfare more restrictive and conditional have led to improvements in virtually all social indicators. A *Wall Street Journal* editorial recently observed that doing well in the new economy "increasingly means fidelity to the old verities: stable families, a decent education, and a willingness to forgo immediate indulgences for future (compounded) benefits."

Socialist rhetoric derides those who favour smaller rather than bigger government in promoting a decent society as "rampant individualists" who lack a "sense of community". However, the proposition is absurd: one of the first modern proponents of limited government, Adam Smith, wrote that "In civilised society [man] stands at all times in need of the cooperation and assistance of great multitudes, while his whole life is scarce sufficient to gain the friendship of a few persons." Smith stressed the importance of markets and civil society for social cohesion. He saw "improvements in art and industry", "civilisation", "order and good government" and "the liberty and security of individuals" as positively linked together. This is a vision of peaceful co-existence among people who do not strive to exert coercive power over each other.

Achieving greater social cohesion means reconstructing the values and institutions that helped produced it the past. It means strengthening the institutions of civil society – families, firms and voluntary organisations – and shrinking political society. It means emphasising the rule of law and the role of markets, competition and choice. In the free marketplace, people are not forced to do anything but they have to cooperate to succeed. Achieving greater social cohesion also means recognising that there are no rights without responsibilities and that actions have consequences, and it means rewarding and honouring the virtues of honesty, decency, self-reliance, charity, thrift and hard work.

Above all, achieving a cohesive society means upholding the freedom and responsibility of the individual. Cohesion will never be built on coercion, as the devisiveness of socialist societies demonstrates. When people are compelled to do things they inevitably resist. Nor can the state make individuals morally responsible. These beliefs lay at the heart of the founding of America, and although they have been battered and eroded over the years, they are still what makes America strong. The main theme of President Clinton's millennium address was that "The sun will always rise on America as long as each new generation lights the fire of freedom". Any US president would have said the same thing. By contrast the word 'freedom' did not feature in Helen Clark's millennium address. The prime minister spoke of poverty, equality, security, identity, justice, fair play and the environment, all of which I can relate to. But never once did she speak of freedom. I suspect that the value of freedom might also have been overlooked if Jenny Shipley had been giving the address.

A theme of your conference is continuity, and my contention is that there has been a loss of continuity in upholding a commitment to freedom and responsibility in our society. The older generation in New Zealand had a better understanding of freedom: they went to fight in foreign wars to preserve it. At home, although they looked to the state to undertake many core functions, they kept it within limits, even up to the 1930s. They knew that bigger government meant less personal freedom. They understood the connections between freedom and responsibility. The true father of the Alliance, and Michael Joseph Savage's archrival, John A Lee, did not. He wanted the state to make people behave responsibly, saying, for example: "If there's one thing that New Zealand will live to regret, it's the abolishing of the six o'clock closing system". Few, if any, would agree with him today. With greater freedom in drinking has come greater responsibility, if still not enough; bad habits take time to change.

Yet the same statist thinking came through in the previous government's attempt to introduce a Code of Social and Family Responsibility. There was nothing much wrong with what was in the proposed code; the problem was that it was a state initiative. And the problem with the reaction of church and welfare groups was that they did not tell the government to butt out and reclaim this ground for themselves; rather, they accused the government of having a hidden agenda to offload its welfare responsibilities.

So the final thought I want to leave with you is this: in rebuilding social cohesion the institutions that lie outside the realm of the state must once again have a leading role. Rotary Clubs are part of civil society. So too are churches, charities, community organisations, private schools, hospitals and businesses. In countries that have tried harder to limit the role of government, such as the United States, support for these institutions has remained much stronger.

The institutions of civil society must ask governments to help them recapture the lost ground, for example by funding government and independent schools on an equal basis and by lowering taxes so that people can take more care of themselves and others. They should encourage young people to join organisations that help people in need, encourage charitable giving – Americans typically give a week's income to charity each year – and encourage wealthy people to engage in philanthropy. Above all, they should encourage a society of free and responsible individuals.

All this, I believe, is fully consistent with the charter of the Rotary movement. Membership of political parties and belief in big government as the way to a decent society are in decline worldwide. Membership of institutions of civil society like Rotary, and the promotion of their values, are, I believe, the way of the future.

ELECTRA BUSINESS FORUM

GETTING SERIOUS ABOUT ECONOMIC GROWTH

SIR RONALD TROTTER
HONORARY MEMBER
NEW ZEALAND BUSINESS ROUNDTABLE

PARAPARAUMU
2 OCTOBER 2002

GETTING SERIOUS ABOUT ECONOMIC GROWTH

I want to talk today about economic growth.

Our politicians also like to talk about growth. They especially seem to like talking about growth targets.

When politicians stand up to talk about lifting New Zealand's growth rate, or getting New Zealand back up the OECD league tables, we typically get a speech that is long on generalities, objectives, targets and – let's face it – wishful thinking. We have set plenty of growth targets in New Zealand, and have achieved a fair measure of consistency in missing them.

In the political domain, setting targets is a bit like a bidding round in a hand of poker – but one where everybody is bluffing.

Our experience of playing this game of poker goes back a long way. In the early 1970s I was involved with the National Development Conference, which opened the bidding with a 4 percent growth target. Later in the '70s, after the first oil crisis, the Planning Council, no doubt sensing New Zealand held a weaker hand, lowered its bid to 3 percent.

Following the hard work done by the Labour government between 1984 and 1988, the Bolger–Birch government raised the target to a 3.5 – 5.0 percent range. In his time as Treasurer, Winston Peters raised it again to 6 percent. He was clearly bluffing, and in fact dropped most of his cards along the way. He was eventually asked to leave the table.

Not to be outbid, Jenny Shipley matched Winston at 6 percent – another outrageous bluff on a weak hand. Bill English more or less folded by dropping National's target back to 4 percent. We should give him credit for being realistic, given that National's recent approach to policy has been singularly unadventurous and, like Labour's, has no show of really lifting the trend growth rate.

Political talk of growth targets is pretty much a code word for avoiding the issue. Talk is, we might say, inexpensive.

And so we find the current government indicating that its top priority for this parliamentary term is to raise New Zealand's economic growth rate, a commitment that was highlighted in the Speech from the Throne at the opening of parliament recently.

But targets and intentions are of no value without policies to achieve them. A recent Tremain cartoon made the point rather well. One bystander at a gymnasium looking at a rather puny-looking Michael Cullen behind a set of weights labelled '4 percent growth' says to another, "Don't you wish he'd stop all the flexing and just step up and get on with it?"

In spite of our justifiable scepticism, we should hold our politicians to account. We must push and prod them to demonstrate that beneath the packaging there are policies of substance. Because the stakes are high. If we revert to another decade of second-rate performance, the outflow of talent we have seen will turn into a torrent.

Let's define a few terms. Growth is all about expanding output, the production of goods and services that people value and are prepared to pay for.

If output expands, so too, generally speaking, does national income. In fact output and income are opposite sides of the same coin. In national accounting terms, they are an identity: output equals income. So we can talk of New Zealand's growth performance in terms of output growth rates, or in terms of growth of national income.

Back in the 1950s we were not too far from the top of the international league tables for average income per person. But in the three decades to the end of the 1980s, real gross domestic product (GDP) per head rose by only 0.8 percent per annum, well below average OECD rates. This meant our relative incomes fell up until the beginning of the 1990s. Moving permanently overseas began to look increasingly attractive to many New Zealanders.

This relative decline was halted in the 1990s, a decade in which our average per capita income grew at nearly the OECD average. Contrary to all the nonsense spouted about "the failed policies of the 1990s", we were well up with the pack. In other words, the painful policy changes from the mid-1980s halted the decline, and we are now at least managing to hold on to our new, albeit more lowly, ranking.

How low is it? Well, in 2000 New Zealand's average per capita income on a purchasing power parity basis was about US$20,000. Australia was about 30 percent ahead of us, at US$26,300. And about 40 percent ahead of Australia was the United States. Despite all the anti-Americanism you hear from the world's cultural elites, it is no wonder that the United States is the number one country of choice for most of the world's migrants.

But why is it that most developed countries have a per capita income that is higher than ours? The answer comes down essentially to *productivity* – higher output per worker. Ultimately, the trend decline in our relative income reflects slower productivity growth than other countries have achieved.

So why is this? The answer is that, compared with New Zealand, the average worker in the United States and many other industrial countries:

- works with more and better capital ;
- is better educated, and thus is better able to utilise that capital;
- is surrounded by good physical infrastructure (eg efficient ports, airports, telecommunications, road and rail transport, and health systems);
- works in a relatively low-cost regulatory environment;

- in part of a labour market where businesses are able to quickly hire and fire, and thus can organise their operations at lower cost; and
- has a strong incentive to work because the welfare system is a low-slung safety net and the tax system does not massively erode the take-home pay of the average worker.

These are some of the key factors underlying productivity growth. Using them, let me briefly try to interpret for you New Zealand's slide down the income rankings until the 1990s. Later I will use this framework to look at what needs to be done now.

The decline in our real incomes relative to the rest of the world didn't just happen. It had reasonably obvious causes.

Firstly, New Zealand industries were sheltered behind high import licensing and tariff barriers for much of that time. Businesses had the incentive to invest in activities that were never likely to be internationally competitive. Thus much of our business capital spending was misdirected – into, for example, car and television assembly industries that were ultimately doomed. Fortress New Zealand resulted in the average worker working with second-rate technology and capital equipment. Protected markets have an immediate cost to consumers, but they have an even higher and longer-lasting cost by channelling business investment into socially wasteful activities.

The lack of international competition allowed obsolete organisational practices to linger on. The worst was the labour relations system we inherited from Britain – a huge drag on productivity. Recall the decade-long construction saga associated with the BNZ head office building in Wellington and the endless industrial disputes in our forestry, meat, ports and shipping industries.

Over this 30–40 year period, the New Zealand worker faced an ever-larger tax grab from the government, while welfare policies got more and more expansive, making not working and not saving easier options. So dramatic has been this expansion of the welfare state that the Savage and Nash governments of the 1930s and '40s would have more in common with the ACT party today when it comes to welfare policy. Savage was concerned that welfare be a hand-up, not an open-ended handout. He insisted that pensions should be means-tested. Total government spending was under 20 percent of GDP in 1938, compared with around 40 percent today.

Singapore, by contrast, chose a better path. Lee Kuan Yew writes of watching the ever-increasing costs of welfare in Britain and Sweden and deciding that Singapore must avoid such a "debilitating system". In his words:

> People did not have to work for their families' well-being. The handout became a way of life. The downward spiral was relentless as motivation and productivity went down. People lost the drive to achieve because they paid too much in taxes. They became dependent on the state for their basic needs.

We used to give foreign aid to Singapore. Now there are plenty of Kiwis working in Singapore enjoying much higher incomes than they could achieve in New Zealand.

Looking back at our experience, it is perhaps a wonder that New Zealand was not even poorer by the 1980s. Part of the reason is that such decline happens at the margin, as capital depreciates and old attitudes of self-reliance gradually decay. Unfortunately, the same is true when you are trying to catch up – you start with your existing capital stock and your new soft-minded attitudes and habits.

Merely stopping the relative decline is not good enough. New Zealand has to find policies that will allow us to catch up, and to recover the losses of the past half-century. And we need to do this in a world where other countries are energetically trying to do the same – more energetically than we are in most cases.

In spite of this, catching up is not a forlorn hope. There is not the slightest need to be defeatist about it. There is so much, so easily identifiable, to be done. We just have to get serious again – as governments were for brief periods in the 1980s and '90s.

An obvious starting point is to focus on the things that lift productivity growth.

– Allocation of capital

Consider the capital that workers use. This is all about the scale of business investment, and the allocation of it. Capital is scarce and thus costly – which is why the government must stop wasting it. To allocate capital well, we need to continue to open the economy up to the world. We must work to reduce the burden of compliance costs that businesses bear. The more labour-intensive service sector is particularly sensitive to the regulatory environment and to labour market laws.

Where are we headed at the moment? Absolutely in the wrong direction. Tariff reductions are stalled and central and local government are wasting scarce capital by engaging in futile gestures with industry subsidies and uneconomic investments such as Kiwibank and rail schemes in Auckland. The regulatory burden is getting more oppressive, taxes have risen and become more complex, and employment is becoming more and more a hazard for employers who are not high court judges. All these trends unambiguously slow productivity growth and need to be reversed.

– Infrastructure

Two words exemplify the nature of the problem: Auckland roading. Australia is well ahead of New Zealand in operating infrastructure industries like roading and water on a commercial basis. Anyone who has travelled widely overseas is well aware of the scope for toll roads, public-private partnerships and user charges. These are areas where central and local governments are the problem, and they need to step out of the way. We need a major kick-start to privatisation, which has stopped and even reversed. Electricity is predominantly a private sector industry overseas, but in New Zealand is still state-dominated. Other countries have shown we need to move further – even countries like Germany and Sweden have privatised postal services, hospitals and universities.

– Education and health

Education and health are also part of the infrastructure of the country.

A progressive lowering of educational standards is affecting literacy and numeracy, arguably with a bigger impact on families in lower socio-economic groups who can't escape under-performing local schools. Much of this reflects the typical problems of a public monopoly. Labour relations in these state monopolies have a time-warp feel to them, an unpleasant reminder of what things were like back in the 1970s and '80s.

Why do we have this absurd fetish about governments running our schools? Plenty of countries don't have the old public sector model. In Ireland most schools are private but publicly funded, and the Netherlands, Denmark and Sweden have all moved away from a state monopoly education system. In the United States the school choice movement is gaining ground. Even in Australia, 30 percent of children attend non-government schools. The story is much the same in tertiary education.

Our monopolised health industry is a shambles and a disgrace. Better models for New Zealand are those of some European countries where private insurance plays a significant role, and where there are many private providers. In France one third of hospitals are private, in Germany half, in the Netherlands 85 percent.

The government seems pathologically hostile to the very idea of private schools and hospitals. The convictions of most of its members seem to date from the liberal-left politics of the 1960s and '70s. They are the survivors of an ideological shipwreck, leaving generations of students floating on the wreckage of their devotion to the concept of a monopolised state education system. In the health sector patients are still waiting in queues for the lifeboats, with the ships listing badly.

The problem is well analysed; there are plenty of successful international precedents for a private sector role. Why the government refuses to consider experimentation must be more a psychological question than an empirical one.

– Regulatory environment

New Zealand businesses face a bewildering thicket of intrusive regulation. The statute book contains around 2,000 public, local and private acts, comprises 89 volumes and about 65,000 pages. We must now be approaching ten thousand commandments. Most of them reflect the political success of special interest groups rather than the overall public interest. The resulting environment is a spectacular productivity killer, greatly increasing business costs and uncertainty, and wasting vast amounts of time, energy and capital. The Resource Management Act stands out as a massive roadblock to development. All New Zealanders lose from excessive regulation. One wonders how many times we have to shoot ourselves in the foot before the painful message finds its way back to the brain.

– Labour market

Labour relations are crucial to the productivity story. When the Employment Contracts Act came in we saw spectacular gains in productivity – in spite of the efforts of the Employment Court. Unemployment fell and real incomes rose strongly in the latter half of the 1990s. The Employment Relations Act was a backward step, and some of those gains will inevitably be lost.

Opponents of a freer labour market do not seem to understand that if it is easy to fire people, businesses will enthusiastically hire them. In a growing economy there is a lot more hiring than firing. But if policy makes it costly for a business to downsize when necessary, employers will be reluctant to hire. The survival instinct is strong, so firms will put people on short-term or part-time contracts, and will substitute capital for labour where possible. This is fine for those still employed, but not so good for those wanting a job.

Labour market regulation is one of many areas where good intentions – the desire to protect particular workers – typically lead to disastrous results for the community at large. Even Australia's labour laws are now better than ours in many respects, and that is a serious issue for trans-Tasman competitiveness.

– Welfare and tax policies

We are also going backwards with tax policies and welfare. Taxes have risen already, and with the government's enthusiasm for spending, assisted by the need under MMP to placate coalition partners with their pet programmes, the drift of the overall tax burden can only be upwards.

Our welfare policies are going in the opposite direction to those of the United States, Australia and other countries. The core feature of the US welfare reforms has been the conviction that work, not welfare, should be the norm. Intensive efforts to get beneficiaries back to work, coupled with time limits on assistance, have halved welfare rolls and improved social indicators across the board.

In respect of pensions we should, like Australia, ensure that they are a safety net that is targeted, not universal, with both income and asset tests.

Where to now?

The government has a reputation – and a deserved one – for moving in a measured, predictable, and single-minded manner. There is a steady hand on the wheel. It is just a pity we are headed in the wrong direction. My real worry is that the government doesn't seem to realise it yet.

The economy is still benefiting from the reforms of the past 15 years or so, and we have had a boost from a relatively strong world economy and high export prices over the past few years. The golden weather, however, looks to be ending. And in economic management, the costs of bad decisions, like the benefits of good ones, take time to show up.

We know that most of the countries whose income levels we aspire to, and to which our citizens are migrating, are moving ahead with much of the reform agenda I have outlined. On current policies, our income levels, after holding their own for the past decade, will resume their decline relative to countries like Australia and the United States.

If we continue on this path for another decade, we may find our living standards not 30 percent behind Australia's, but 50 percent. And if that happens not many energetic people will want to stay.

Ironically, it was a Labour government in the mid-1980s that started the reforms that helped arrest New Zealand's relative decline. It looks like being the singular achievement of its successor to put New Zealand back on a declining path.

My vision of the future for New Zealand is not as a rest home for the retired and a trap for the unsuccessful, with a sideline business as a picturesque, low-cost theme park for the wealthy from overseas.

We can do much better than that.