BUILDING A COMPETITIVE ECONOMY

NEW ZEALAND BUSINESS ROUNDTABLE
SEPTEMBER 1991

FOREWORD

This collection of speeches and articles is the third in a series produced by the New Zealand Business Roundtable. The previous volumes, entitled *Economic and Social Policy* and *Sustaining Economic Reform,* were published in September 1989 and September 1990 respectively.

The material in this volume is organised in six sections: economic directions, the labour market, the public sector, regulation, social policy and miscellaneous. It contains papers by NZBR consultants Denis Hussey and David Trebeck of ACIL Australia Pty Ltd and Professor Patricia Danzon of the Wharton School, University of Pennsylvannia.

A full list of current NZBR publications is also included.

R L Kerr
EXECUTIVE DIRECTOR

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PALMERSTON NORTH
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CHOOSING CAPITALISM : 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 irresistable. 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, philososphy 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 was 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 any one time is a tiny fraction of the difference that exists between one party's policy today and that same party's policy a few years previously."

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;

- 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 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 sharemarket 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.

CANTERBURY EMPLOYERS ASSOCIATION
CENTENNIAL DINNER

GETTING THE BASICS RIGHT IS THE BEST 'KICK START'

DOUGLAS MYERS
VICE-CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

CHRISTCHURCH
25 OCTOBER 1990

GETTING THE BASICS RIGHT IS THE BEST 'KICK START'

It is a real privilege to have the opportunity to address your centennial dinner. Few New Zealand organisations have survived for a hundred years. Yours must be providing a worthwhile service for its members.

The Canterbury region has shown remarkable resilience in recent times. Surveys have indicated more positive attitudes in the business community here than in other parts of the country. Your firms are less dependent than Auckland firms on the domestic market, and more export-oriented. You have some strong land-based industries and some innovative manufacturers. Industries with genuine competitive advantages, not propped up by protection and subsidies, have to be the way of the future for New Zealand.

As a centennial theme 'Growth and Employment' could not be more appropriate. Both are in rather short supply at the moment.

For New Zealanders used to thinking of their country as stable, secure and possibly boring, the last decade has been both exciting and traumatic. Contrary to popular myth, attempts at economic restructuring to achieve higher growth started well before 1984 when the present government assumed office.

It was a National government in 1979 that began the programme of industry studies and the reduction in protection for manufacturers. The CER negotiations got underway a little later. In the early 1980s we had meat industry delicensing and the deregulation of land transport. The 1982-84 wage-price freeze was an aberration in a general move towards a more open economy.

In the past three years the economy has limped along, suffering from a lack of political direction and dragged down by the weight of too much government expenditure, a badly designed social welfare system and outdated labour market policies. Since 1988, and until the recent policy slippage and the downturn in world economic prospects, it had appeared that the worst of the recession was over. However, there was nothing to indicate a rapid recovery or a substantial reduction in unemployment, and we are now facing a real economic crunch.

The higher oil prices arising from the Gulf crisis are pushing up world inflation and threatening to tip economies like the United States into recession. This is already having flow-on effects to New Zealand. The Institute of Economic Research has reduced its growth forecasts to under 1 percent for the March 1991 year and an average of 1.9 percent until 1995, compared with 3.6 percent for our major trading partners.

The bitter lesson is that we did not do enough in better times to restructure the economy and make it more resilient. We are now being hit at a time when the economy is still weak and the government has lost its grip on its own finances. Having a 'teabreak' and stopping the reform process has caused enormous hurt. Regrettably too many New Zealanders have failed to understand that, as the forthcoming Porter project puts it, 40 years of mismanagement have left problems "so deep and grave" that we literally have to build a new economy. Porter warns that a period of "intense discomfort" lies ahead if we are to escape falling to Third World status.

Not surprisingly all the polls and surveys of business opinion show that virtually everyone is unhappy with the present state of affairs. Some feel the poor results and outlook are the result of 'more market' policies and there is nostalgia for the past. You hear statements that life used to be better. People suggest the government should play a greater role and do some strategic planning - without, they hasten to add, going all the way back to Muldoonism.

But when was this period when life was so good, and what was it really like? Let's go back 30 years to 1960. This was the year New Zealand dropped a Labour government for National which offered less socialism, more freedom for private enterprise and voluntary trade unionism. (I might add that it is taking a while to get there.)

Back then individuals faced punitive gift and estate duties. Personal taxation reached a top rate of 67.5 percent.

Life for business people was very comfortable if you didn't mind being straitjacketed by the government. We had regulations and controls on just about everything that moved. We licensed imports, cinemas, meat works, land transport, service stations and retail liquor outlets. Competition was a dirty word. We had exchange controls and capital issues controls. Companies were effectively prevented from expanding overseas. Outside agriculture, we built no internationally competitive industries.

It took us years to learn that governments cannot sponsor entrepreneurship and industrial winners. Enormous time was spent by business people convincing bureaucrats that they should be allowed to make sensible business decisions. When that didn't work they visited Cabinet ministers to get them to overrule their departments.

Government controlled the business world. And the economy did not perform.

The 1962 report of the Monetary and Economic Council pointed out that during the period 1949-60 "the New Zealand economy has earned the unfortunate distinction of having one of the slowest annual rates of growth of productivity among all the advanced countries of the world." This dismal record continued. Over the 1960-84 period New Zealand's rate of productivity growth was the lowest of all OECD countries. Real wages in New Zealand were no higher in 1987 than in 1960. By contrast Japanese workers' wages went up by 175 percent and even Australian wages rose by 70 percent in real terms. We are now a low wage country.

All this control made for a thoroughly miserable deal for consumers. In 1960 there was barely any television, there was no private radio, choices in the shops were extremely limited and consumer goods generally very expensive. The pubs closed at 6 and the shops were not open in the weekends. Around this time the government decided to get courageous and allow just 10 licensed restaurants. But licensing conditions were tight and prices were extremely high, ensuring only the affluent could afford to dine out and have a glass of wine.

Unless you had a good relationship with the local garage manager you might be told the waiting list for a new Holden or Zephyr was 5 years. Consequently, one year old Holdens and Zephyrs sold for two hundred pounds more than brand new models.

Restrictions on funds for overseas travel and regulation of the international airline business made it expensive and hard for New Zealanders to get out of the country and see how others lived. These travel restraints, our isolation and poor communications meant few New Zealanders realised what a poor deal they were getting and how far we were slipping behind other countries.

Perhaps the 'high' point of intrusive government in New Zealand was the action of a former prime minister in ordering a party of deaf-mute Japanese mountain climbers off Mount Cook. To divert attention from the mounting chaos the same politician had been entertaining us with a long-running international sideshow, which no one could understand, about creating a new Bretton Woods.

Life in this repressive environment sapped the work ethic and fostered mediocrity. A national symbol was the Ministry of Works roadman leaning on his shovel. When I became actively involved in Lion only ten years or so back there were mattresses on the floor in the breweries. People used them to doze off during their regular periods of spelling. Too many New Zealanders had forgotten the meaning of hard work.

Does anyone really want to go back to this sort of environment? One thing that is certain is that, in today's internationally mobile world, any government stupid enough to embark on this course would cause a migration exodus. Those that would be left behind would be the low-skilled, beneficiaries and the elderly who could not afford to move. The tax base would dramatically shrink. We would quickly become like Albania.

If the 'golden years' of the 1950s and 1960s are out of the question, what are the options and is there a middle way? We hear calls for the government to 'kick start' the economy. They remind me a little of the 'cargo cults' in Papua New Guinea. Because American aircraft had brought in supplies during the war, the locals believed spirits would arrange for goods to come down from the sky and they built airstrips to facilitate the process. There are still some New Zealanders who seem to think the government can create wealth. The reality is we are no more likely to see wealth generated by the Beehive than by the spirits in Papua New Guinea.

On the other hand, the government does have a crucial role to play in creating the climate for growth. What should the post-election government do to find that elusive growth strategy?

Wealth is created by the private sector. The government's job is to improve the environment for the private sector so as to enable it to generate income and employment. I believe these are what most people want. I do not hear many people saying they do not want higher wages or espousing some environmentalist notions of zero growth.

There are three critical areas where the government has failed, and the delay in dealing with them has been costly in both human and economic terms.

Central government expenditure is now over 40 percent of GDP on an unadjusted basis compared with 28 percent in 1974/5. With local government added in, the public sector consumes or directs around 45 percent of GDP. The deficit for 1991/92 is climbing above $3 billion, and that is before any new spending proposals. Total government spending is far too high and needs to be rapidly reduced. The alternatives to expenditure reductions are higher taxes and more borrowing. Both are unacceptable if growth is desired. They represent the soft options of the past which got us into the present predicament.

Government debt is 50 percent of GDP, which is high by international standards. Further borrowing will see growing nervousness on the part of international banks, a lowering of our credit rating and higher interest rates. If it is not possible to eliminate the deficit in one year, try two. No responsible government will let the problem drag on year after year as we have done for most years since the first oil shock. We should be aiming at real surpluses in the public accounts to reduce the public debt.

Increased taxation would cause at least as much damage as borrowing. It is pleasing to note that National has unequivocally declared it would not increase taxation rates or introduce new taxes.

The second problem area, closely related to the first, is reform of the welfare state. Reform does not mean abolition. What the Business Roundtable has been advocating is a system that New Zealand can afford and one which ensures that only people in genuine need receive assistance. The thrust of social welfare policy should be to encourage self-reliance instead of dependence. At present the wrong signals are going out. Too many employers cannot compete with the chequebook of the Department of Social Welfare. A more efficient and better targeted social welfare system would not only reduce costs but also increase community support for it and help remove the stigma that is so often attached to the recipients of state benefits.

Its instructive to look at a few statistics. In the early 1970s there were only a handful of people on the unemployment benefit, although there was considerable hidden unemployment. Today the number is over 160,000 and rising.

Anecdotal evidence suggests there are a good number of people drawing the unemployment benefit who haven't felt the need to really try hard to find a new job. A job might involve a change in location or initially accepting something that is less than ideal. The move by the government to increase the minimum age for the dole to 18 is to be commended. It is scandalous that school leavers have been able to go straight on to a benefit rather than into work at wages that reflect their initial productivity. It is also a positive step to ensure that all reasonable efforts are made by the unemployed to find a job or undergo further training. These moves are in line with what most countries have done for many years.

In 1980 we had 7,500 sickness beneficiaries compared with 16,000 in 1989. Has our health system been that bad? And why are sickness beneficiaries so often in the news for active crimes or for trying to attack prospective prime ministers?

When the Domestic Purposes Benefit was introduced in the 1970s, the costs of it were miniscule. Today there are nearly 86,000 beneficiaries and the annual cost to the taxpayer is well over $1 billion. It is hard to believe that society has crumbled at this rate. According to this year's budget statement, only 45 percent of maintenance payments and 40 percent of liable parent contributions are collected by the state. This represents massive theft from the community by irresponsible parents.

The two main political parties have drawn closer together on superannuation policies. Both agree the qualifying age should be moved up to 65, but with different timetables. But National would get rid of the surcharge and would bring in tax deductability for the first $1000 invested in a qualifying superannuation scheme. These two measures would cost about $600 million. The blunt truth is that we can't afford it. The Business Roundtable has advocated greater reliance on private retirement savings, a faster move to a qualifying age higher than 65 and closer targeting of the benefit.

In the long run the only way to support individuals in retirement is to adopt policies which will generate faster rates of economic growth. There is no alternative means of giving most people the opportunity to make adequate provision themselves, and creating the real goods and services which the elderly will need in future.

The third key area for reform is the labour market. I am not going to lecture you on this matter because many of you are more expert than I am. But sometimes even the experts have difficulty seeing the wood from the trees. Most have never known another system. They have lived and worked all their lives in a world of complex national awards, disputes of rights and interest, multi-union bargaining and the like - a chamber of industrial horrors.

The extreme pressures being exerted on industry by the exposure to more competition have caused the system to creak and bend. Unions have done deals which indicate that some flexibility is possible. The recent Metal Trades Award is one example. But let's look at it. The award involves a two percent increase plus one percent for productivity. But the few concessions on work practices are irrelevant for many firms. Even more important, productivity gains by themselves are no basis for higher wages. Wages should basically be determined by the prevailing conditions of labour supply and demand in the particular job, industry or location. A firm or industry with high rates of productivity growth should not increase wages if there is an ample supply of workers with relevant skills seeking jobs. To do otherwise merely lengthens the unemployment queue for such workers.

Flexibility is not about income reductions except where these are necessary to ensure a firm's viability and workers are better off staying with the firm than moving elsewhere, or to correct excessive wage rates that have been extracted through monopoly power. It is about allowing the private sector to perform more productively and be able to pay incomes that, over the long run and as full employment is restored, reflect higher levels of productivity.

Consider tourism which is an industry most people believe can do a lot better. It is a labour intensive, environmentally sound and regionally based industry. It is already the largest single earner of foreign exchange and provides business opportunities for manufacturers, retailers and transport operators.

What's holding it back? The Business Roundtable studied the industry earlier this year. Its report didn't recommend more incentives or subsidies. It said the industry had to be cost-competitive and use its labour force more productively. Tourism is a 24-hour a day, all-year-round industry. Weekends and irregular work hours are all normal time for the tourism industry. The labour arrangements fail to recognise this reality. They mean that people willing to work on a different basis and people willing to employ them on those terms are not matched up - so tourists go to Honolulu instead.

We need to move quickly to a world of free employment contracting. People who are mature enough to vote, marry, have children, drive cars and go to war are not incapable of deciding their own employment arrangements. They should be allowed to freely negotiate their own terms and conditions of employment (whether individually or collectively) so that no-one is obliged to be out of work because someone wants to 'save' them from 'exploitation'.

Many people will respond to this diagnosis of our economic problems by saying "I will go along with what you have said, but shouldn't the government do more to give the economy a push in the short term? Let's ease up on monetary policy, lower the dollar and get growth now."

I suggest that the elimination of the government deficit, a basic overhaul of the social welfare system and labour market reform would be the best 'kick start' you could possibly give the economy. The message it would send around the world would result in very tangible benefits. It would improve the competitiveness of industry, lower real interest rates, reduce unemployment and give us the prospects of real competitiveness - rather than the short term illusion of competitiveness that would come from a lower dollar without supporting policies.

There is a lot of very muddled thinking about. One politician from the fruitbowl of Tauranga has been trying to con us into believing that low inflation is not compatible with high economic growth. Somehow printing money gets us food on the table. Yet look at the record of Japan and Germany. The latest statistics show their annual inflation rates at 2.9 and 3 percent while annual economic growth is 7.5 and 3.4 percent. If they can have low inflation and high growth so can New Zealand. Just because we haven't matched these countries over the past 40 years doesn't mean to say we cannot do so. That is defeatist claptrap. We have never tried and persisted. The low inflation target is not the problem; it is part of the necessary solution. It is unbalanced policies which are causing the damage.

The devaluation argument often comes from those who either oppose or are not interested in labour reform. This is extraordinary when you consider what a devaluation actually does. If a devaluation is to be successful, real wages have to be flexible. Incomes have to be shifted in favour of profits in internationally competing industries. In practice an effective devaluation is similar to an across-the-board wage reduction and advocates of this course should be honest enough to admit it. The real exchange rate is nothing other than the cost of labour in relation to the prices of traded goods and services. Countries like France and the United Kingdom have explicitly thrown away the devaluation option (by tying themselves to a hard currency) to force their industries to accept the discipline of controlling their own labour costs or face the consequences of unemployment and bankruptcy.

If by some miracle it were possible to achieve a devaluation without any of the extra costs being recovered in the form of higher wages and salaries, there could be some positive benefits. But without changes in our labour market arrangements, this is fantasy. We have inflated and devalued our currency regularly since the 20 percent devaluation of 1967. Even with very high unemployment the record shows that wages still tend to track the cost of living, regardless of supply and demand factors. To become more competitive we must get wages down or productivity up. Growth agreements might achieve the former on a short term basis but only proper structural reform will achieve higher productivity.

A significant fraction of the population has still not figured out what has to happen if New Zealand is ever to join the real world. This was brought out in a recent National Business Review poll on labour relations. The overwhelming majority of employers surveyed supported the introduction of voluntary unionism and moves to enterprise bargaining. But only just over one third said they themselves would opt out of national awards.

On the one hand this poll should give comfort to reforming politicians : in respect of the necessary policy changes it tells them the crowd is on their side - as have many similar polls. It should be of no concern to policy makers that not everyone wants to take up new options - all that is relevant is that they should have the choice. But it is symptomatic of how far many employers still have to go along the learning curve that they think they can run operations of international standard under national awards. Many of those spoken to by the Task Force on International Competitiveness last year suffered from the same delusion. Some will only learn when more innovative firms are allowed to escape from the system or start up outside it, put pressure on their competitors through finding better ways of working, and force them to follow.

If the sort of policies I have discussed sound challenging, it is because they are necessary if we are to survive in an unsentimental world. We lived in a time warp for many years and developed habits and attitudes - like the 'she'll be right' syndrome - which have had disastrous consequences. We tried living off agriculture and insulating the rest of the economy. After the first oil shock we tried 'borrow and hope'. We tried the short cut of 'think big' that cost billions and created few long term jobs. We have been a world laboratory for failed policies. There is no third way between a controlled economy and an enterprise system. The third way is the fastest route to the Third World.

We don't need any more slogans or fancy government schemes to boost business and employment. Getting the basics right is the key for both the government and the private sector. We know that in our sporting endeavours. Why on earth do we think we can make our way in the world by accepting soft options and a lack of discipline in our economic and commercial life?

Since 1980 we have made remarkable progress in improving the efficiency of many parts of the economy. New Zealanders can be proud of what has been achieved in areas like manufacturing, transport, finance and parts of the public sector.

Many of the changes were strongly opposed at the time they were proposed. During the CER negotiations the Manufacturers Federation fought tooth and nail to retain import licensing against Australia after 1995. Now manufacturers have accepted the end of import licensing on all imports. In both Australia and New Zealand it looks as though the 1990s will see the elimination of all tariffs. GST, the removal of restrictions on shop trading hours, transferable quotas for fishing, the auctioning of the radio spectrum - all those and many other changes were once bitterly opposed but have now gained widespread acceptance.

I am reminded of a story about a farewell function for an elderly banker. One of the guests congratulated him on his career and remarked: "You must have seen a lot of changes in your time." "Yes", said the banker, "and I fought every one of them."

We are never going to reach the point where there will be no need for change. Over the past decade the world has rapidly become more integrated and companies more international. Firms are drawn to locations where the economic climate is stable and predictable, tax rates are not oppressive, regulatory burdens are light and the workforce is skilled and productive. Companies that want to increase exports or maintain their share of the local market must constantly look at ways of improving productivity, design, packaging, distribution and promotion. The chances are that last year's methods are not going to be good enough next year.

New Zealand is at another crossroads. Where do we go from here? What I have been saying boils down to this:

- nostalgia is a poor substitute for clear thinking;

- the 'good old days' were a myth;

- we have been attempting reforms for a long time but have backed off when the going got tough;

- once again we are back to the economic brink;

- there is still only limited understanding of how serious our problems are, how dramatic are the changes that have to be made, and how long it will take to achieve them;

- the harsh reality is that New Zealand faces the need for a general reduction in living standards if it is to start to live within its means;

- there are no quick fixes; an incoming government must try again to get the basics right if it is to raise skills, productivity and living standards over the longer term;

- given the ground we have lost since 1987, there is an enormous task ahead and it will involve intense discomfort;

- impatience will lead to palliatives and ultimately more problems and more pain;

- if we do not face up to the task this time the consequences further down the track do not bear thinking about.

Rewards do not only come from short term material comfort. They also come from facing challenges, making sacrifices, overcoming adversity and building for the future. If New Zealanders really want the good life for themselves and their children, they will have to earn their rewards that way in the next few years.

AUCKLAND ROTARY CLUB

THE INFLATION DEBATE

LINDSAY FERGUSSON
GROUP MANAGING DIRECTOR
MAGNUM CORPORATION LIMITED

AUCKLAND
15 APRIL 1991

THE INFLATION DEBATE

For the first time in decades, New Zealanders can look forward to low inflation, a prospect many workers, consumers and business people have never experienced.

The fight against inflation has been a test of nerve and will. It is not over yet. However, I believe the hard part of the war is behind us and the ground phase could be relatively short. We must then apply ourselves to keeping the inflation peace.

Many have argued that the price of the inflation war has been too high. There have been persistent calls from appeasers wanting to call it off. It is true that there have been casualties along the way. But to yield to the temptations of appeasement would have been no less disastrous than a decision by President Bush to yield to the clamourings of the peace movement. Inflation can wreck economies no less surely than Saddam Hussein.

It may be interesting to take a glance at the history of inflation. It is worth noting first that inflation cannot exist in a barter economy. Inflation, through the debasement of coinage or the printing of paper, has only been around since money was invented and monopolised by governments.

The first recorded incidence of inflation involved the clipping of coins to reduce the weight of the gold and silver they contained. This theft was very obvious and people quickly caught on to the process – until paper currency was invented. With this new medium of exchange, and the development of central banks, governments were in a position to secretly appropriate large amounts of wealth from their citizens. The blame for this loss could be placed on the productive sector of the economy which "continually raised prices" to offset the loss from a depreciating currency.

As currencies depreciate, so do societies. To quote one writer:

> "The uprisings of 1789 cost Louis XVI some prerogatives, but four years later a valueless currency cost him his head. Germany's inflation of the 1920s laid the foundation upon which Hitler built. Indeed a runaway inflation is the goal of revolutionists. The maxim of that apostle of revolution, Lenin, was 'Debauch the currency!' "

Those who regard these episodes as historical curiosities would do well to note the contribution of worthless currencies to the disintegration of the Soviet Union and other Eastern bloc countries. Arguably too, the erosion of Mrs Thatcher's authority and standing with the British public was due in some considerable measure to the Lawson inflation of 1987-88. Having won office on an anti-inflationary policy in 1979 and reduced inflation from 18 percent in 1980 to 3.4 percent in 1986, Mrs Thatcher's government blinked. The experience of presiding over an inflation rate which reached 11 percent again in late 1990 damaged her prestige. As John Major put it, referring to the British government's misjudgment at the time of the sharemarket crash:

> "In retrospect, we relaxed [monetary policy] precisely at the moment when we should have made it more severe".

No manager or investor who is under 40 has any experience of working in a low inflation New Zealand. It was not always like this. Mild deflation, not inflation, was the order of the day in New Zealand in the 50-year period from 1860. Notwithstanding some difficult times and the excessive borrowing of the Vogel era, this was a period of remarkable economic progress. By the turn of the century, New Zealand's per capita incomes were around the highest in the world. By itself this experience turns on its head the argument that aiming for price stability is a recipe for economic stagnation.

Perhaps even more graphically, interest rates on New Zealand public borrowings of 3 to 6 percent were common in the last half of the last century and the average interest rate on new mortgages varied in the 3 to 7 percent range from 1920 to 1967. The days of 3 percent Post Office savings accounts may seem a quaint aberration to many of us now, but it is the last 20 years which is the aberration from this historical perspective.

The Deputy Governor of the Reserve Bank of Australia was recently quoted as saying:

> "Prices in Australia in the past two decades... have increased by about five times... I personally don't find that a performance that, as a central banker, I am very proud of."

In the period since 1967 in New Zealand, prices have increased not five times but ten times. Ours has been just about the worst inflation performance of the OECD economies.

It is no accident that over the same period other indicators have confirmed a story of poor economic performance. Most of us in this audience can remember when one New Zealand dollar bought much more than one Australian or United States dollar. In the early 1970s, one New Zealand dollar bought 400 Japanese yen. Now it buys 80 yen, one fifth of that amount. Note that these trends in the exchange rate bear no relationship with the path of interest rates as is often supposed. Beyond the short term, interest rates and the exchange rate are driven by quite different factors.

In New Zealand there has been zero growth in real wages since 1960 – an extraordinary statistic – whereas even in Australia and the United Kingdom wages rose by 70 percent in that period, and by 170 percent in Japan. A useful summary statistic in the latest OECD report on New Zealand is that from 1975 to 1988 New Zealand's per capita GDP slipped from 97 percent of the OECD average to only 74 percent – nearly a 25 percent fall. Yet in that time we were – and still are – continuing to live beyond our means.

The president of the prestigious American Economics Association stated in 1984 that there was no doubt that inflation had been the most important source of economic inefficiency in Pacific Basin countries in the previous two decades. The litany of costs associated with inflation is a long and familiar one. Inflation creates uncertainty in business planning, it shortens investment horizons, it raises the cost of long term contracts, it distorts the tax system, it increases real interest rates, it puts the competitiveness of exporters at risk, it erodes retirement savings and it leads to arbitrary and capricious redistributions of income. In essence, a market economy depends on the price mechanism to function properly and inflation stops it from doing its job well.

There are still some myths in the inflation debate that need to be laid to rest.

The most persistent myth is that the pursuit of a low inflation policy condemns us to low growth. As we have seen, this has it exactly backwards. While other factors were also relevant, New Zealand prospered when prices were stable and stagnated under inflation. The reason is the pervasive distortions to the economy that I mentioned. With lower inflation in the 1980s, most OECD countries experienced an unprecedented expansion. A resurgence of inflation and a tightening of policies has temporarily curbed this expansion – the cost of reversing an inflationary trend is another of the costs of letting inflation get out of hand. As the President of the Federal Reserve Bank of New York testified to Congress last year:

> "Virtually every observable facet of economic and financial history - here in the United States and around the world - tells us that high and/or rising rates of inflation are simply incompatible with sustained economic prosperity".

A related myth is that low inflation comes at the cost of high unemployment. This idea is a hangover from Keynesian economics that is widely discredited today. I am told it is now hard to find a Keynesian economist under 40 in the United States - although they still exist in the ranks of our universities and Radio New Zealand commentators. It is not difficult to find examples of low inflation, low unemployment countries like Japan and Switzerland. A poor unemployment performance can usually be traced to a rigid labour market and/or a welfare system that encourages people to opt for benefits rather than paid work. Over the longer run, inflation tends to be associated with higher, not lower, unemployment. A more valid observation is that the process of disinflation can be more costly in terms of unemployment in economies which lack structural flexibility.

A third myth is that inflation is mainly a problem when it exceeds the rates of our trading partners, and that achieving an inflation rate equivalent to theirs is an acceptable target. But as we have seen, a loss of competitiveness is only one of the many costs of inflation. Regardless of how other countries perform, inflation is always, without qualification, a bad thing. I doubt whether many people would regard an unemployment target equivalent to the average of our trading partners – say 6-7 percent of the labour force – as a good idea. An inflation target derived in this way makes no more sense. In any event, an increasing number of our trading partners seem likely to move towards a price stability objective in the 1990s. The Liberal Party in Australia, which may well form the next government, is committed to a zero inflation target.

Most commentators pushing for the abandonment of the 0-2 percent target believe the costs of that target to be too high. But the cost of an anti-inflation monetary policy is directly related to the divergence of inflation expectations from actual or target inflation. It is naive to believe that increasing target inflation to the average of our trading partners will not also increase inflation expectations. It is hard to see how the costs of an anti-inflation policy in that situation will be lower. Indeed, with New Zealand's track record on inflation over the last two decades, investors would have every reason to believe that the Reserve Bank would not stick to a higher target. While inflation expectations remain around 5-6 percent, the Reserve

Bank must continue to lean against inflation. The adoption of a target linked to inflation in our trading partners would make little difference to its stance in present circumstances.

A fourth myth is that New Zealand cannot achieve low inflation if inflation in our trading partners is running at higher levels. But this is exactly what low inflation countries like Switzerland, Germany, Singapore and Japan have done. This is a myth that has survived from the era of fixed exchange rates. One of the benefits of floating currencies is that an economy does not have to import inflation from the rest of the world.

Fifthly, it is worth noting that gearing monetary policy to a target of 0-2 percent inflation, once achieved, does not require any greater ongoing monetary pressure than gearing it to a target of, say, 5 percent per annum. The main difference is that, technically and politically, any arbitrary target other than a stable price level is difficult to defend.

A final myth is that relaxing monetary policy would get us lower interest rates. The truth is that it would do nothing of the sort. Looser monetary policy could well lower short term interest rates but long term rates would almost certainly rise, and promptly, as markets anticipated higher inflation further down the track. This pattern was demonstrated clearly in Australia last year. It is long term rates that are most important for capital investment and household mortgages.

As the virtues of low inflation were rediscovered by many countries in the late 1970s and early 1980s, so too was an understanding of its causes. In essence, these are encapsulated in the old definition of inflation: too much money chasing too few goods. Price increases can be triggered by higher oil prices or a wage push but they cannot by themselves lead to inflation, that is, ongoing increases in the general price level. The recognition of the monetary origins of inflation has put monetary policy at centre stage in the fight against it. The essential injunction to policy makers is: "don't print money".

As a consequence, OECD central banks have been in the forefront of the fight against inflation since the early 1980s. Policy makers have come to recognise that the only useful role for monetary policy is to achieve and maintain stable prices. Often it has been a lonely and unpopular role. In economies where inflation has become entrenched, there is no costless way to eradicate it. The inflationary expectations of firms, wage earners and investors are hard to change. They are prolonged when the anti-inflation policies of a government lack credibility because monetary policy is not backed up by sound fiscal and other policies. The upshot is often a period of high interest rates, high unemployment, a high rate of business failures and economic and political instability. Nevertheless, countries that have stayed the course have gained the benefits, and ways of reducing the transitional costs are now widely understood.

One way of increasing the credibility of an anti-inflation programme is to strengthen the independence and accountability of the central bank. The merits of moves in this direction in New Zealand are confirmed by some international evidence. As summarised by *The Economist* recently:

> "By and large, the freer the central bank, the lower the inflation rate. Nor was this achieved simply at the cost of higher unemployment. Why? Perhaps

> because the policy credibility provided by independence speeds up the adjustment of prices and wages to the monetary climate, and thus minimises job losses."

One of the costs of disinflation that has attracted much comment and criticism is the high level of interest rates. At this juncture, two points in particular are worth making on this issue. One is that nominal interest rates in New Zealand have fallen substantially as inflation has subsided, and there are good prospects of further falls over the coming year. However, real – that is inflation-adjusted – interest rates remain some 2-3 percentage points higher than in some OECD countries. This premium is entirely due to the risks which financial markets perceive to be associated with lending to New Zealand.

An important part of this risk, which has recently been reflected in a further downgrading of New Zealand's credit standing, arises from the poor management of the government's finances which has led to the present crisis in government spending, borrowing and debt. Another part is our inflation performance itself, and the risk of currency depreciation which investors see as linked to it. A recent study by the Federal Reserve Bank of New York found that the capital cost advantages enjoyed by Japanese and German companies reflected the success these countries had achieved in preserving low inflation and hence a low risk premium in both short and long term interest rates. Countries with the lowest rates of inflation over time have the lowest market interest rates and countries with the highest rates of inflation have the highest interest rates. Those who want lower interest rates should support, not oppose, the Reserve Bank's policies.

There is a lesson here for groups like the Manufacturers Federation and government backbenchers who have called for looser monetary policy and lower interest rates. These calls achieve the opposite of what they intend. If financial markets believe they will be heeded, they will factor in an additional risk premium on investment in New Zealand. As *The Economist* pointed out recently in response to similar calls from British industry and Tory MPs:

> "In the early 1980s, when the French government was periodically devaluing the franc within the EMS, French short-term interest rates were seven to eight percentage points higher than German ones. Today, the difference is less than one point. The gap has narrowed because the French have long since accepted EMS disciplines, and cheaper money (as well as lower inflation) is their prize. That same prize will elude the British for so long as they yearn for it publicly. Careless talk costs jobs."

The absence of a German or Swiss political consensus on inflation means that financial analysts in New Zealand spend an inordinate amount of time monitoring the possible implications of dissension in party ranks, and markets remain nervous. Any sign of policy weakening which would increase the risk of higher inflation drives interest rates up.

I suggested earlier that the war against inflation is being won. In calendar 1990, prices in New Zealand moved up by 4.9 percent compared with 6.9 percent in Australia. Over the past three years New Zealand prices (excluding GST) increased by 16 percent compared with 24 percent in Australia. Favourable factors at present include falling oil prices and interest rates and lower wage increases. Some analysts are predicting inflation will be only about 1 percent in the first six months of this year and could hit a 25-year low for 1991 as a whole. Provided wage movements stay within the declining inflation path and there is no precipitate fall in the currency, we are on track towards the 0-2 percent target for 1993.

I would like to think that the inflation debate is also coming to an end. Most people now understand that you can't get more goods and services simply by printing money. Our cost and price competitiveness is steadily improving through a favourable inflation differential with many of our trading partners and significant improvements in productivity. The Reserve Bank has indicated it would not stand in the way of some nominal depreciation, provided this was associated with the maintenance of a firm monetary policy and resulted in the necessary reductions in real wages and other real incomes. The last factor is critical: too many of those who clamour for devaluation do not seem to realise - or are not honest enough to acknowledge - that they are implying a need to cut wages in real terms.

Most recently the Porter study has also reminded us that competitiveness is not only about price and cost factors, but also about innovation, improved product mixes, better skills and more inspired business strategies, features which are lacking in many of our producer boards and other export firms.

The recent OECD report on New Zealand concluded that:

> "...continued progress needs to be made on achieving price stability. Fiscal consolidation should be pursued vigorously, concentrating on expenditure reductions. The process of microeconomic reform should be continued, particularly in the labour market... To build on the reforms of recent years and to underpin the much-needed improvements in the country's medium term growth prospects, it is essential for New Zealand to consolidate and extend the policy orientation pursued since the mid-1980s."

This prescription is fully in line with the analysis of the Business Roundtable and many other New Zealand organisations. It has been endorsed by the present government. The government's moves on expenditure have facilitated a decline in interest rates and it is already clear that there is massive upside potential for firms, workers and especially the unemployed from the new employment legislation.

If this programme is adhered to, I hope we shall hear less and less from the inflation appeasers. In a *Herald* opinion survey taken last year, a majority of those polled supported the low inflation target of 0-2 percent. Younger voters supported it more strongly than older people. German and Japanese electorates punish governments that are soft on inflation. Preserving the value of the currency should be put on a par with preserving the value of other weights and measures. I do not fancy the prospects of those politicians, whether young Turks or old Turks, who would settle for a 5 percent inflation rate when they front up to their electorates with the proposition: "Vote for me and I will support a policy which will double prices over the next 14 years." Even the Manufacturers Federation favours a 3 percent inflation target. If that is the extent of our differences, what is all the fuss about? Manufacturing businesses like my own should be major beneficiaries of the more stable and competitive environment which we can look forward to in the next few years.

The Porter study argues that we should call an end to the debate about inflation and devaluation and take as read the need for a stable macroeconomic environment. Politicians have better things to do with their time, wage negotiators can focus on real factors that should determine wages, and retailers can cut down on changes in price labels in their shops. Instead governments should concentrate on upgrading New Zealand's skill base, stimulate competition from domestic and international sources, promote immigration, remove monopoly controls on state enterprises and producer boards, cut government spending, deficits and debt and reform superannuation and welfare policies. According to Porter, businesses for their part should move beyond cost-based strategies, become more knowledgeable competitors, focus more on innovation, invest in human resource development, adopt a more global approach to strategy and match themselves against the world's best rivals.

I think he's right. I hope enough people out there are listening.

SUBMISSION BY THE
NEW ZEALAND BUSINESS ROUNDTABLE

NEW ZEALAND ENTERPRISE CONFERENCE

31 MAY 1991

NEW ZEALAND ENTERPRISE CONFERENCE

SUBMISSION BY THE NEW ZEALAND BUSINESS ROUNDTABLE

Introduction

* The New Zealand Business Roundtable was a founding sponsor of the Porter Project in the interests of helping to promote a fuller understanding of the importance of improved international economic competitiveness to New Zealand's economic future.

* It endorses the broad thrust of the Porter report. The analysis and recommendations which it puts forward about New Zealand's economic performance are generally in line with those of our organisation and of the OECD, as set out in its recent report on the New Zealand economy. They contrast with the flawed conclusions of the previous government's Ministerial Task Force on International Competitiveness.

* The report underlines yet again the magnitude of the relative deterioration in New Zealand's economic performance, the acute nature of current problems and risks, and the long haul involved in restoring economic health. It calls for urgent, tough and fundamental decisions by the government in key areas to avert a slide to Third World status.

* The study cogently argues that industries become competitive by competing. International competitiveness is about controlling inflation, eliminating barriers to international and domestic competition thus forcing firms to continuously innovate, reducing government burdens on the private sector, and upgrading the quality of domestic resources, especially human resources. International competitiveness is not about artificial currency depreciation or artificial forms of assistance to industry.

* The Porter team believes that the private sector must undertake the task of wealth creation and commercial decision-making within a stable macroeconomic framework and a competitive environment. This is in accord with the approach of the Business Roundtable. It has not been a supplicant for government help. It endorses the view that the government should play a more limited economic role than has historically been the case in New Zealand and that businesses must take responsibility for determining competitive and innovative global strategies and for their own commercial success or failure.

Focus of Conference

* On the first three items identified for discussion it is submitted as follows:

  Industry Associations

  The view that the prime role of industry associations should not be to lobby governments as in the past is endorsed. The suggested roles of upgrading skills, setting standards, providing information and promoting cooperative ventures are supported where those are deemed useful by industry members. There is no need for the government to be involved in this area. Competition policy should not obstruct cooperative industry strategies in contestable markets.

R & D and Industry

All forms of innovation including R & D will be stimulated in a less protected environment. The government can help by reducing the risk element in capital costs, reducing the government expenditure/tax burden and promoting educational achievement. Tertiary education reforms, based on making institutions more autonomous corporate bodies driven by clients and funded to a higher degree by them, are important here. The government also has a role in funding, within appropriate criteria and structures, basic non-appropriable research which would not be undertaken by the commercial sector. Close attention should be given to linkages with industry and the commercialisation of such research. Moves to reduce bureaucratic management of government science and encourage competitive supply are supported. They should be extended by opening up the supply of research outputs to international competition, including university research in the contestable funding pool, and introducing private sector management expertise to CRIs.

Competition Policy and Producer Boards

The report's discussion of competition policy is based on an outmoded economic analysis which incorrectly emphasises market structure - the number of actual competitors in a domestic market - rather than barriers to entry and market contestability. Competition in the traded goods sector of the economy is now international as well as domestic. The Commerce Act and the Commerce Commission still do not adequately recognise these changes and policy in this area should be reviewed. The report is also astray in applying a similar analysis to agricultural marketing instead of focusing on the removal of unjustified barriers to competition with producer board operations. The report is correct, however, in identifying producer board structures as a major issue in New Zealand's international trade performance. There is a strong case for an in-depth independent examination of the regulatory environment of each producer board as recommended in the report.

* The issues arising in the fourth area, the contribution of the government's economic reform agenda to competitive advantage, are of greatest significance. This must focus on lowering the costs of the key resources of capital (including by averting a further downgrading of New Zealand's credit rating) and labour (through more flexible use and improved work practices) and on improving the quality and efficient utilisation of all resources, especially human resources. Crucial policy elements must include:

- a clear commitment to pursuing sound, consistent, long term policy objectives in a determined way;

- adherence to a monetary policy aimed at price stability and a market-determined exchange rate by upholding the mandate and independence of the Reserve Bank while ensuring that a firm monetary policy is balanced by other supporting policies;

- reactivation of the lagging privatisation programme, including the electricity sector which is a key input to industry, to allow further debt reduction and encourage foreign investment;

- intensified efforts to improve public sector management performance, and similar efforts at the local government level which remains a source of major inefficiencies. Divestment by local authorities of all commercial activities and contracting out of other services should be vigorously pursued;

- further improvements to labour market performance. The OECD report identified industrial relations legislation, welfare policies and minimum wage laws as the key areas requiring difficult decisions; the latter remains to be tackled;

- progress with regulatory reforms including liberalisation of trans-Tasman shipping, resource management and company and securities law reform, trade liberalisation and international taxation reform, all of which would improve the attractiveness of New Zealand as a competitive investment location;

- reforms to introduce greater competition and choice in education and a substantial expansion of immigration.

* **Above all, the importance at the present juncture of decisive fiscal action to strengthen New Zealand's competitive position cannot be overstated.**

* The Porter study emphasises that "Government crowding-out of private sector investment needs to be reduced through a substantial reduction in the levels of government spending." It also urges the need to reduce debt by "achieving real government surpluses without tax increases."

* These conclusions are strongly endorsed. The forthcoming Budget will be a crucial event. Delivery by the government on its commitments to cut spending and the deficit in a substantial, sustainable way would boost the slowly emerging prospects of a sound, export-led recovery. Failure to do so, or to resort to tax increases, would be a massive setback to investor confidence and would reverse recent interest rate falls. Simple fiscal arithmetic indicates that a positive outcome is dependent on far-reaching changes in superannuation, health, housing and tertiary education policies in particular, as well as severe pruning or elimination of all low-value government programmes.

Conclusion

* Our organisation's goal is an economy which delivers sustainable, non-inflationary growth at high levels of employment and satisfies New Zealanders' aspirations for a turnaround in living standards. The starting point for achieving this goal is an acceptance of the Porter study's conclusion that our economic weaknesses have accumulated over a long period; that we have only just begun the process of rebuilding an internationally competitive economy; that major government policy and business strategy adjustments still have to be faced up to; and that the adjustment process is unavoidably a lengthy one which will be prolonged rather than expedited by recourse to soft options, 'kick start' initiatives and efforts to shelter interest groups from necessary change.

* The configuration of a successfully adjusting economy will see domestic production running ahead of domestic demand for a number of years. The differential will be put into net exports (in the production account) and net savings (in the income account) thereby reducing or eliminating the external and fiscal deficits and reducing net indebtedness. Resources must move from the non-traded sector to internationally competing industries, and the current low level of activity in areas like retail sales, other domestic consumption and housing is consistent with such a process. Visible signs of a successful adjustment would include high volume growth in manufactured exports and strong profitability in the agricultural sector. The key to such outcomes is major improvements in international competitiveness, as argued in the Porter study.

* In respect of government policy, the study's conclusions are in line with commitments made by the government prior to the election, in particular price stability, a balanced budget, a fall in the share of government expenditure and taxation relative to GDP, labour market, immigration and education reforms, competitive business law and the restoration of a Triple A credit rating. It is submitted that these goals should be endorsed and reaffirmed by the conference, and that a follow-up action programme in key areas, involving independent expertise drawn from the private as well as the government sector, should be an agreed outcome.

NEWMARKET ROTARY CLUB

ESCAPING MEDIOCRITY

BOB MATTHEW
VICE-CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

AUCKLAND
4 JUNE 1991

ESCAPING MEDIOCRITY

Thank you for the opportunity to address you today on the subject of the New Zealand economy.

Late last week, the Prime Minister chaired a conference on enterprise policies. I believe the government is absolutely right in emphasising the need for a much more widespread enterprise culture in New Zealand. In the United States, the number one hero is the entrepreneur who succeeds. The number two hero is the entrepreneur who fails. We have to create that kind of enterprise ethic if New Zealand is to escape from its longstanding economic mediocrity.

Only business can efficiently mobilise resources to take advantage of international market opportunities. The recently released Porter study pointed to the improvements in economic and business strategies that are needed to meet the demands of the international market. New Zealand exports currently account for less than 1 percent of world trade. A small increase in market share can mean phenomenal growth for individual companies and for the economy generally.

It is an outcome we must strive for. New Zealand exports are presently only 28 percent of GDP. At least 20 other small and more outward-looking countries have higher export to GDP ratios.

We need to bear in mind the available opportunities in world trade to put in perspective the realities of barriers to market access for some of our exports. Despite attempts by some countries to restrict imports, international trade volumes grew 80 percent over the decade of the 1980s. There is a vast market out there to be tapped. We should be concentrating on international demand for our products, rather than on expedients to engineer demand at home. Almost invariably, these undermine our capacity to be internationally cost competitive, an essential prerequisite for success in world markets.

New Zealand can only improve in economic terms by expanding its efficient export and import substituting industries. The present need is to transfer resources away from the non-traded sector to those industries. It is not a sign of poor economic health in the short term that domestic consumption is weak and industries like retailing and house building are having a hard time of it. The real signs of better economic health will include improved profitability for industries such as farming, manufacturing and tourism, and higher rates of investment in them.

In the past New Zealand has not performed well in exporting. Why should we begin to do so now? Success in any market involves supplying goods that are in demand at the highest standards of quality and delivery and at a competitive price. Are we learning the lessons of success?

Well, there has recently been cause for hope in at least one important respect. The Employment Contracts Act allows employers and employees much greater freedom to agree on employment arrangements which will serve their mutual interests better and encourage more cost effective ways of creating a product or providing a service. In these times of heightened insecurity about jobs and company viability, both workers and management can now seek employment conditions which focus on the key ingredients of competitiveness. In turn that will deliver employees the job security they understandably seek.

It is not surprising that the most recent World Competitiveness Report shows a close relationship between flexible labour markets and the quality and reliability of a country's products. Switzerland and Japan, countries with few restrictions on employment contracting, ranked highly in each category while New Zealand scored well down the table in both. Switzerland and Japan also took top honours for the readiness with which the labour force accepts the introduction of labour-saving technology and the productivity-related motivation of workers. New Zealand scored near the bottom for both factors.

The recent port reforms are a good example of the type of productivity gains achieved by even partial reforms of antiquated labour practices. Labour productivity has increased by more than 40 percent, turnaround times for ships have halved at almost every port and stevedoring charges have been reduced by between 20 and 50 percent. I have no doubt that further substantial gains will be achieved under the new employment legislation and the moves to privatise port companies.

It is not easy to overstate the damage caused by the fortress New Zealand economic management mentality and policies. As the recent Porter study commented:

> "New Zealand management has for too long been trapped in a mindset that the modern global economy has rendered inoperative. It has yet to make the quantum jump necessary to meet and beat the world's best competitors... The 'Kiwi lifestyle' and the low status accorded business have blunted our willingness to make sustained personal commitments necessary to achieve business success in a global economy... Part of rebuilding the competitive position of New Zealand will require fundamentally rethinking our goals as individuals..."

Productivity improvements are still hampered by obsolete plant and equipment, unsophisticated investment strategies, strong resistance to better labour practices, and gross inefficiency in central and local government.

Decades of import controls, occupational licensing, 'poverty trap' tax and welfare systems, monopoly unionism and widespread government ownership and intervention in industry have all worked against competition and fostered a 'make believe' culture divorced from the demands of the international marketplace. Foreign exchange controls effectively blocked joint ventures with overseas businesses and impeded rapid acquisition of technical and managerial skills. The 'cradle to grave' welfare system blunted incentives to work and save. Several generations of savings have been squandered in artificially protected industries, the cost-overruns of the 'think big' projects and the mid-1980s property boom.

We still have a long way to go to throw off this legacy. There is a pressing need for further decisive changes to restore balance to an economic programme which has foundered for the last three years. As a visiting Australian politician recently remarked, New Zealand has paid a terrible price for the way in which reforms were blocked after Prime Minister Lange lost his nerve and left the economy "rudderless in the stormy seas of a deepening recession". In particular, fiscal policy remained largely in conflict with the stance of monetary policy. Hard won gains were abandoned in the 1990 budget, and the incoming government inherited an appalling fiscal outlook. Reducing the spending and tax burden by eliminating the widespread economic inefficiences and inequities in existing government programmes is now the main imperative facing the government. It is not an enviable task but there are no soft options left.

Many New Zealanders do not seem to realise how far we still have to go to become competitive in economic terms. To listen to some commentators one might be forgiven for thinking that New Zealand had become a sort of economic freak that made Hongkong look like a planned economy. Nothing could be further from the truth. For example, the current programme for tariff reductions will still leave New Zealand with higher tariff rates at the end of the programme than the present OECD country average. There is still too little recognition of the fact that protection or assistance to one industry is effectively a tax on other industries. The OECD noted in its 1990 report on New Zealand that:

> "... protection is concentrated on the same sectors as in most other OECD countries, probably neutralising the potential for employment protection, while locking resources into uncompetitive industries and imposing heavy deadweight costs on consumers."

The same comments could be made about other policies. No successful economy has New Zealand's extravagant state pension arrangements, a monopoly state accident insurer (with a no-fault liability regime for all accidents), a tertiary education system where students pay so little of the costs of tuition, or an export sector with controls over as wide a range of exports as those controlled by the producer boards.

The government has made a good start on the road to creating a better environment for enterprise, but it is only a start. Last December's package of welfare cuts and tighter eligibility rules is aimed at limiting disincentives to work and spurring more intensive efforts to find employment. There are already signs that it is having this effect and the new labour legislation will progressively make finding work easier.

However, these measures alone will not mean that economic growth will automatically take off and unemployment will quickly subside. All participants in the workplace will have to face the realities of meeting the challenges of the real world - the international markets. Too many employers and unions seem inclined to carry on with the old system, at least for a bit longer. I am doubtful whether the government has done enough yet to curb the Labour Court's propensity for economic sabotage which it has shown in redundancy and dismissal cases over the last couple of years or so. Minimum wage restrictions still apply at a level comparable to the United States, which has a far higher wage structure than New Zealand. In its report, the OECD noted that these needed to be changed if the government was serious about tackling unemployment. There is a strong case for reducing the statutory minimum wage and placing a limit on the time people may remain on the unemployment benefit.

Other moves are needed to improve the work ethic and upgrade the quality of our labour force, as noted in the Porter study. As a means of injecting new skills and attitudes into the domestic economy, immigration may have a significant role to play. Attracting people to New Zealand who want to work hard, who have language skills, and who know the culture of other markets and can create links with them will be increasingly important.

Education also has a fundamental role in creating a prosperous future for New Zealanders. Limited consumer choice and government dominance of the delivery of education has meant that high standards have given way to an education bureaucracy demanding a curriculum biased against competition and business, emphasising equality rather than quality, and downgrading the role of accurate and objective measures of performance. Education Minister Lockwood Smith's efforts to tackle these problems deserve strong community support.

A broader and more consistent economic programme needs to be built on the promising start that the government has made. Business confidence is fragile after the previous government's reform programme was aborted in 1987. Governments trying to raise credibility from the ashes have to show even greater consistency of policies each time past reforms have been abandoned.

The National Party outlined its goals during last year's election campaign. They were:

- achieving at least 3 percent growth by the end of its first term
- halving unemployment levels
- inflation in the range of 0-2 percent
- single digit business and mortgage interest rates
- a balanced budget
- a reduced share of government expenditure and taxation as a percentage of GDP.

These are challenging commitments. The inflation and interest rate targets look to be within reach but others are not without major policy changes. Obviously, the government will be judged at the next election on how well its record compares with this set of commitments.

In the eyes of the business community the factor that is now absolutely critical to restoring business confidence and business activity is action by the government to get its own house in order. Successive governments have been trying (with varying levels of enthusiasm) to reduce or hold expenditure levels for two decades. Yet during that time government expenditure has risen from under 30 percent of GDP to over 40 percent and public debt has climbed to dangerous levels. Our politicians simply have to kick the habit of fiscal irresponsibility.

The fiscal picture for the next three years indicates that there is no room for adopting mediocre policies or allowing strong policy plans to drift away from their initial purpose. Inadequate action in the forthcoming budget would destroy in one blow the credibility so far earned. Declining interest rate trends would be reversed and business confidence would be in danger of collapsing further.

Simple fiscal arithmetic indicates that most of the necessary decisions lie in the social policy area. Only consistent, principled and far-reaching reform of superannuation, housing, health and education policies will demonstrate that the government is absolutely committed to pursuing policies for the good of the community rather than the appeasement of special interest groups. Enormous courage and conviction will be required simply because of the comprehensiveness and complexity of the reforms that are now essential. They will take time to implement and have full effect, and politicians will be vulnerable to another round of claims that people's lives and welfare are being put at risk. The reality is that failure to grasp the nettle will jeopardise the capacity of the economy to sustain any meaningful welfare system whatsoever in the longer run.

I think most New Zealanders appreciate the seriousness of our current economic situation. Even popular magazines like *North and South* are now carrying quality features on the economic destruction that has resulted from out-of-control welfare policies. An excellent piece of journalism in the May issue made the following points:

* More than 30,000 liable parents, mostly fathers, owe the Social Welfare Department $400 million towards the cost of the domestic purposes benefit for their former spouses and children. Only 40 percent of liable parent contributions are collected, and these cover only 8 percent of the DPB's cost.

* Welfare payments this financial year will cost $25 million more than the government expects to collect in PAYE income tax. Only 1.2 million New Zealanders still have full-time jobs - just 80,000 more than the number living full time on welfare benefits, including the pension.

* National superannuation, or 'guaranteed retirement income' as Labour renamed it, will cost $5.1 billion this year, twice as much as the dole and the DPB combined and more than is spent on either health or education.

* A quarter of all children are now raised in single-parent homes, including half of all Maori children. The number of sole parents paid the DPB doubled between 1975 and 1980 and doubled again by 1987. It has risen more than another third since.

* Until the 1 April benefit cuts, the dole for a married man with two children was higher than the wages paid under at least 29 awards. Even with the recent cuts the dole is still 74 percent of the average wage.

It is hard to overstate the importance of the government formulating clear goals, developing a consistent framework for the design of individual policy initiatives, setting legislative timetables and fiscal targets, and selecting people with the commitment and ability to implement radical changes. To avoid the fate of the botched Picot reforms in education, close attention to detail and timing will be needed to minimise the risks of essential reform programmes being derailed.

A theme of all policies in the social services field should be to open as many areas of government provision as possible to competition, to create a quality environment of individual or family responsibility, and to target assistance to those who really are in genuine need. On this basis, I believe there are a number of key criteria for judging the forthcoming budget:

* Bold decisions on benefit and eligibility criteria for superannuation need to be made. Benefits should be set at levels designed to provide a basic safety net, universal provision must be replaced by a targeted scheme and the age of eligibility should be lifted to somewhere in the 65+ age range. The transition to the new arrangements should be as short as possible.

Superannuation is the single largest area of government spending. Failure to tackle this issue would simply require much harsher decisions in housing, health and education.

* The second area where substantial fiscal savings can be made while improving the quality and responsiveness of services is health. A first step would involve the corporatisation of public hospitals to achieve the efficiency gains identified by the Gibbs Task Force, which were sadly ignored by past Ministers of Health. There is then a good case for shifting the financing role to competing private insurers, subject to a minimum level of coverage and with targeted assistance to people on low incomes or with high health costs. Any reasonably informed observer can see that the present health system is on the verge of collapse and major structural changes are needed.

* In the education sector there are strong arguments for increasing rather than reducing tertiary fees. Tertiary students benefit from higher lifetime earnings and so-called 'free' tertiary education is overall a massive transfer from poorer to better-off groups. To their credit, the polytechnics have taken a lead in the debate by recognising the need for greater productivity in individual institutions, canvassing extensions to the academic year and teaching day, and advocating higher student payments. They should be applauded for their stand and the universities would do well to support similar moves instead of pandering to student unions.

* At the school level, moves to bulk funding of teacher salaries would get the process of creating autonomous and self-managing schools responding to consumer choice back on track. The problems in education will not be solved by throwing money at them. Education spending grew by 29 percent in real terms between 1985 and 1989 with little apparent effect on education outcomes. Structural changes and competition within and between the public and private education systems must be the way forward.

* Targeting strategies need to be applied much more broadly. Electorates world-wide are coming to realise that there is little point in recycling large slices of middle and upper income earners' tax revenues through the fiscal system to spend on goods and services which they could purchase themselves if taxes were lower. The culture of the Department of Social Welfare, in particular, must be changed. As *North and South* pointed out, it has become a constituency for spending increasing amounts of taxpayers' money without regard to the nation's economic crisis or the effect on those on benefits.

* The SOE/privatisation programme must be given a fresh impetus. Markets will be looking for concrete decisions on the major outstanding state business sales, particularly the Electricity Corporation and the Housing Corporation.

* There must be fresh initiatives to hold local bodies to account for the quality and quantity of their expenditures, and to encourage if not require them to privatise their commercial activities and contract out other functions to private enterprise. Too few local authorities have yet recognised that they

have no comparative advantage in running commercial ventures and that they should not be exposing ratepayers to business risk.

* The three year fiscal projections are important for focusing attention on the sustainability of government policies. Assessing the true fiscal implications of budgets is difficult at the best of times. The practice in New Zealand typically involves hiding contingency claims, delaying expenditure (particularly on maintenance items), bringing forward revenue items, hijacking SOE dividends and counting one-off capital items (such as forestry cutting rights) above the line. Nowadays such creative accounting is rapidly exposed by analysts here and abroad and the credibility of ministers of finance can only suffer.

* The government should re-commit itself to tax reductions by the end of its term, and remove those taxes such as withholding tax on non-resident incomes that effectively penalise economic efficiency to a high degree.

A budget which broke the mould in New Zealand in this way would give us a real chance of escaping from mediocrity and enjoying the benefits of an enterprise economy. It would give a substantial boost to the tentative signs of an improved outlook that have recently been emerging. The economy is currently showing bottom of the cycle behaviour but the period ahead will remain difficult. However, slow is best, as only attention to the fundamentals, not a dose of economic steroids, is going to get us into competitive shape for the longer haul.

Businesses will respond to an improved policy environment if they have confidence in it. But business decision makers are rational about both political and economic factors. It was idle for David Caygill to lament in early 1989 that he had inherited an efficient economic vehicle which was unaccountably stalled at the traffic lights. Businesses did not "get on with the job" for what turned out to be totally justified reasons. They remained cautious and defensive; they would have been negligent to their shareholders to have behaved otherwise. Confidence can only be earned by solid, integrated, sustained policy decisions. 'Trust me' statements, especially from politicians, will not get New Zealanders saving and investing for economic growth.

In other countries restructuring took up to ten years to produce benefits in the form of strong growth in profits and investment and sustained output expansion. New Zealand is only a few years into the process and regrettably there have been some serious mistakes, including stopping for cups of tea. The current government now has the opportunity, and probably only one opportunity at that, to chart a new course. If it fails, a fall to a Third World credit rating, and sooner rather than later, would be a near certainty.

At that point, ladies and gentlemen, the Argentinians will be entitled to cry for us.

NEW ZEALAND CREDIT AND FINANCE INSTITUTE

WHY NEW ZEALAND NEEDS A RESPONSIBLE BUDGET

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AUCKLAND
17 JUNE 1991

WHY NEW ZEALAND NEEDS A RESPONSIBLE BUDGET

Your letter of invitation asked me to comment on the role of the New Zealand Business Roundtable and its interest in public policy issues, particularly as they relate to business. I shall also say a little about our current preoccupations, the most important of which is the forthcoming budget.

The Business Roundtable arose out of an informal grouping of business executives in the early 1980s who met periodically to discuss issues of common interest. It currently has around 40 members who belong by invitation. Most are the chief executives or chairmen of leading business enterprises, including current and former SOEs. We meet five times a year. There is a regular communication flow from a small Wellington office. Members suggest topics for study and determine our policy approach.

The Business Roundtable is not like some other interest groups which tend to pursue rather narrow and self-interested agendas. Such groups have had the habit of seeking favours from the government on the basis, of course, that acceding to them would advance the national interest. Over the decades governments gave way to much special pleading. Ten years ago we had a maze of subsidies and protection affecting most parts of the economy. These strangled the internationally exposed sectors which were then subsidised to compensate. In addition we had high tax rates because all the concessions and subsidies undermined the tax base.

As you will recall, the cumulative effect of this mismanagement was abysmal economic growth and continuously rising overseas and public debt. Furthermore, by mid-1984, after a two year wage and price freeze, the government deficit was a massive 9 percent of GDP and the financial crisis triggered by the election caused the foreign exchange markets to be closed.

It was this experience that made members of the Business Roundtable appreciate that continuing with the old ways would mean a continuing steady decline for the nation. They realised that the future growth and prosperity of their enterprises required a well-run economy. If you like, this involved an element of self-interest because large businesses cannot grow while operating in an economic backwater. Quite clearly policies that are good for the nation will also in the long run be good for businesses - or at least those businesses that do a good job - even though they may cause short term hardship for some.

This forced us to go back to basics - to analyse why the economy was not performing and to come up with policy ideas to break out of the low growth/high debt trap that New Zealand had slid into over the previous two decades.

The decision was taken at an early stage that we would not comment on issues unless we had first done our homework. Since 1986 I suspect we have commissioned and published more research on a wider range of subjects than any other New Zealand business organisation. We are very open in our operations. Early versions of studies are usually sent to a wide range of national and international specialists for comment. We have often been attacked as an organisation, but the professional standard of our work is seldom challenged.

We have produced over 50 publications and made many submissions to the government, the opposition and parliamentary committees. Areas covered include the Commerce Act, privatisation, labour market reform, telecommunications, social welfare, education, and immigration. During the next year we expect to publish reports on agricultural marketing, health, housing, central banking and local government.

You may be surprised that we have tackled such a wide range of subjects, including some that many would consider beyond the brief of a business group. There is a very deliberate reason for the broad approach. The economy is not a series of sectors operating without reference to each other. The operation of every sector impinges on others.

Obviously the efficiency of the Cook Strait ferries affects the ability of Canterbury manufacturers and arable farmers to compete in the Auckland market against imports and local suppliers. Much less obvious is the impact that sectors such as education and health have on business.

Resources consumed by these two industries total more than 10 percent of GDP. The issue here is whether we are getting the best value for money for this large outlay. Is the health consumer getting what he or she wants? Are the products of the education system able to make a positive contribution to the workplace and society?

Once you think about this you realise that health and education services are far too important to be left to those in the system who have their own interests and agendas. So many parts of the economy which were supposedly regulated in the national interest were in fact controlled by the providers prior to the recent changes. Health and education are no different. We will continue to take a close interest in how public policy evolves in both areas.

One of our priorities for the next year is local government where there is enormous scope for further efficiency gains. Local authorities account for around 3 percent of GDP and through their regulatory powers influence a great deal more economic activity.

The problems some local authority bus companies have had in winning contracts under the new competitive arrangements have exposed gross inefficiencies in their operations. The position with port companies was the same. They have made great strides towards achieving international standards of efficiency, but still have a long way to go. Similar gains have yet to be made in many electricity distribution companies.

In addition to radically upgrading their efficiency, terminating inappropriate activities and eliminating differential rating which penalises business, we believe it is important that the regulatory role of local councils is also reviewed so that unnecessary costs are not imposed on commerce. The approach we take when analysing laws and regulations imposed by either central or local government is that the benefits must be clearly shown to outweigh the costs.

Within the next six weeks the government will deliver its first and probably most important budget. The previous government had instituted reforms in many key areas but had stalled on the labour market and failed to control government expenditure. The result of this policy imbalance was to squeeze the internationally competing sectors of the economy. The policy mix undoubtedly cost thousands of jobs.

As the numbers out of work grew, so did those on our relatively generous social welfare system. At present the ratio of beneficiaries (including GRI) to full time workers is approximately 2 to 3. Welfare payments exceed the amount spent on health and education. They cost more than the government collects in income tax. We spend 13 percent of GDP on welfare compared with 7 percent in Australia. The system is clearly out of control.

The projected fiscal deficit for 1991/92, as estimated last December prior to the welfare cuts, was $2.1 billion rising to $5.2 billion in 1993/4. That was unsustainable and would have added to our already large debt burden. Every week action was delayed would have meant the problem got worse.

The steps announced on 19 December to cut benefits and reform the labour market have produced major benefits. Interest rates are down nearly 5 percent since last October, inflation and inflation expectations are lower, the competitiveness of industry has improved, business confidence has lifted a little and we can at least see a glimmer of light at the end of a rather long tunnel.

If the government is able to cut its expenditure and increase the efficiency of all government services, the recovery will gather strength. In 1992 it seems likely to be helped by an upturn in the international economy. But we must keep sober. Farming is having one of its worst years on record. Previous signs of optimism over the last 3 years have been dashed by governments that found fiscal decisions too tough. The government's goal is to balance the budget in 1993/94. It is sobering to recognise that even that difficult target is not enough. We must work to achieve genuine budget surpluses in order to repay a stock of public debt which, despite asset sales, remains well above the OECD average.

There are some who think the prescription we support is too harsh on many people. The reality is that the sort of policies promoted by the Business Roundtable are not only in line with sound OECD practice but will also produce better results for the average person. For people who are less advantaged the cruellest policies are those that do not reflect reality. They will be the real victims of any further postponement of difficult decisions, reliance on more borrowing, or tax increases. We support as a priority welfare targeted to the genuinely needy and policies aimed at helping people out of welfare-dependent life styles, but policies which increase the number of people in this group are clearly irresponsible. Hence we must urgently apply ourselves to creating an economy of growth with increasing employment opportunities.

I find it amazing that some people still think the answer to the government's financial problem lies in increasing taxes. Central government taxation already amounts to around 37 percent of GDP. When you add local authority rates the total comes to around 40 percent. On top of that we have a gap between spending and revenue of another 3 percent. Increasing tax rates would snuff out private sector recovery just as the GST increase did in 1989. Company tax revenue is down by a third on last year's budget estimates. To haul the economy out of recession the private sector must have greater access to cash flows, not less.

An increase in tax rates would send the worst possible signal to the business community and international investors. It would suggest the government had given up the struggle before it had even started and that the New Zealand political system is incapable of getting its fiscal house in order.

The minister of finance is right in saying that the government must grasp the nettle on spending. This is not an easy exercise. Many governments have tackled the area and made little progress. The bureaucracy has plenty of self-defence mechanisms to ensure that ministers "do not go too far."

Rather than simply wielding an axe, the government should analyse its functions and reduce them to an essential core. Anything that is not absolutely necessary, or is something that the private sector can do better, should be cast off.

Can anyone explain to me, for example, why the government is still supporting a Trade Union Education Authority? The organisation should prove its worth by openly competing with other educational groups and raising its own income, not rely on the taxpayer. Having determined what is appropriate for the government to do, the next question is the efficiency of the operation. As far as is possible the public sector must face disciplines that ensure its employees produce services in the most efficient manner. Wherever possible the role of providing services should be separated from the financing role and made contestable. The indications are that something like this sort of approach is at last being followed.

The government has taken a lot of criticism, including from some in its own ranks, about the steps that have been taken and those that are foreshadowed for the budget. It needs to be pointed out that some of these same critics were saying just a few months ago that the administration's monetary policy was the cause of high interest rates which were strangling the economy, and calling for the Governor of the Reserve Bank to be sacked. Where are these critics of monetary policy today? They are silent because they have been proven wrong.

The Reserve Bank had previously carried the burden of controlling inflation because the government was unable to control its own expenditure. Once it showed it was prepared to start taking tough and unpopular decisions, the markets responded strongly. Interest rate reductions can at least be sustained if the minister of finance is given the support she deserves. If not, rates will surely rise again.

It was interesting that at the recent enterprise conference in Wellington there were few calls for kick starts to the economy, artificial devaluations or changes to monetary policy. There was a general consensus in support of the Porter study's conclusions about international competitiveness and of the government's broad directions. This is very encouraging. The most obvious threat to this, as one financial analyst recently noted, is now the National Party caucus. This may yet torpedo the government's fiscal resolve, thereby producing a higher risk, higher interest rate and slower growth environment than is beginning to look possible.

I believe some commentators and politicians have taken to a very selective reading of the National Party manifesto. Nation's Economic Vision released last year said that by the end of its first term a National government would achieve "a fall in the share of government expenditure and taxation as a percentage of Gross Domestic Product". It went on to say "National will reduce the government's claim on the community's savings by lowering the tax burden and eliminating the government's need to borrow. This will encourage lower interest rates and higher levels of investment". And later it said "National will attack the root cause of rising taxes by checking and then reducing the share of government spending to national income."

Those commitments are unambiguous and should be honoured, not just because they were promised by all National candidates who stood for election but because they are the only way to remove the obstacles to economic growth. Other promises of a more specific nature such as those on superannuation must be subservient to the basic policy. If one abandons core principles one is lost. A tough budget is needed to stop our generation from continuing to pile up debt which will have to be repaid by our children. Far too much inter-generational robbery has already gone on. It must be stopped.

Critics of changes planned by the government should address how the basic policy goals can be sustained. To be credible they must come up with constructive, real world answers.

In the Business Roundtable's view, there is a fundamental conflict between National's economic goals and the range of commitments relating to superannuation. We made this view known before the election. In our view there is scope to reduce the level of GRI without causing hardship to those who are wholly dependent on it; there should be an income and assets test; the age for qualifying for the GRI should be increased more rapidly than proposed to at least 65 years; and the proposed tax concession cannot be afforded. While these decisions are difficult, the alternative is an economy a few years down the track which has been abandoned by the energetic and the enterprising on whom the retired generation depends. An aging population in a stagnant economy is not an attractive prospect. We support the government's objective to create a certain and sustainable environment for superannuation and take it off the political agenda.

The framers of the budget are going to have to make choices. Do they want an economy that will grow under a less oppressive tax burden, create jobs and reduce the number of beneficiaries - the economic vision on which they were elected? Or do they want more of the stagnation and mediocrity that resulted from taking soft options in the past?

To conclude, the 1991 budget is the most important this administration will deliver in its first term. The steps that have been taken so far to deal with the financial crisis which it inherited are correct and courageous. The critics have been proven wrong about monetary policy. They will also be proven wrong about fiscal policy if the government delivers a tough and responsible budget with a forward programme which will eliminate the deficit without increasing taxes. On budget night it will only take a few hours, at most, for analysts and investors around the world to ascertain whether the government has taken the necessary action. If it fails to make the grade it will have sold the electorate short.

PUBLIC RELATIONS INSTITUTE OF NEW ZEALAND

WHAT CAN PUBLIC RELATIONS OFFER NEW ZEALAND BUSINESS?

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AUCKLAND
28 JUNE 1991

WHAT CAN PUBLIC RELATIONS OFFER NEW ZEALAND BUSINESS?

I want to begin by giving you some background on the New Zealand Business Roundtable, of which I am a member.

In the early 1980s a group of business executives met together on a casual basis to discuss common business issues.

The Business Roundtable has grown from this loose group into an incisive think tank, constantly researching and assessing its own business viewpoints. Like us or not, we are contributing in a major and constructive way to the decision making processes and vision of our society.

Our charter commits us to promoting overall New Zealand interests, including a more prosperous economy and a fair society.

Membership is by invitation to the chief executives of major businesses, and is limited to around 45 persons.

Every member of the Business Roundtable shares a vivid picture of the potential of our country, and willingly devotes time and effort to help realise it. Our individual prosperities and the partisan viewpoints of sectoral groups have been set aside for the goals we seek collectively for New Zealand.

Although we have advocated the opening up and restructuring of the economy and the need to make tough political choices, we examine every issue as it arises.

In 1984, when financial crisis loomed as a result of the snap election and the foreign exchange markets were closed, an increasing number of people in business began to sense that a continuation of the same economic agenda of subsidies, protection, budget deficits, inflation and stop-go policies would prove terminal.

We were not content - as we have never been content - with mere conjecture. We have engaged New Zealand analysts and other professionals to help us understand the problems and advise on how they can be fixed. A cardinal rule within the organisation is that we will not commit ourselves to a policy position unless we have first done our homework.

We have now done our homework for several years. We have commissioned over 50 publications - studies into key areas of the New Zealand economy. Many submissions to the government and to parliamentary committees have been made.

We have looked at the Commerce Act, privatisation, labour market reform, telecommunications, social welfare, education and immigration.

Over the next year, we shall be publishing reports on agricultural marketing, health, housing, central banking and local government.

In the course of each investigation, we solicit information and comment from national and international specialists. Although the work frequently comes under attack from interest groups who feel threatened by its conclusions, it is seldom challenged for its quality or integrity.

We defend free speech and free thought as vital to a healthy democracy, particularly in a country that has had to accept the need for radical changes to make its way more successfully in the world. In response to our steady compilation of economic thought, we believe there has been a sea change of public opinion towards the views we have put forward.

More people are reading our research - which is available to you and any other group. They are concluding that it is challenging and probing - not easily dismissed.

There is a real role for professionals like yourselves in understanding and analysing what makes countries prosper, which policies work and which don't, and why.

More than anyone else, public relations practitioners are in a position to catch new currents of private and public opinion, and to communicate them.

It is your role to identify these trends and communicate them to your clients for measurement, interpretation, and competitive application.

In this way, public relations can act as a key change agent in a world that is not about to stop changing. Politicians and editorialists may yearn for teabreaks, stability and a return to the graveyard calm that was New Zealand. But as we have learned, we succumb to those temptations at our cost, and the rest of the world continues to pass us by.

You have a major role to play in bringing New Zealand into the twenty-first century restructured, competitive and positioned to give our young people the chance of a better future.

But I'm getting a little ahead of myself. Before I talk about how you can do that, I want to briefly examine your current role. I will then suggest to you ways in which you have more to offer New Zealand business, particularly in the context of an open and competitive economy.

There is no doubt that public relations is a little understood profession. To a certain extent you, as practitioners, must be held accountable for that.

While the public policy role of public relations is well established in most overseas countries, it remains relatively under-developed in our own.

What is more, in the eyes of many you continue to sit uncomfortably alongside New Zealand business.

Corporate managers still view public relations with scepticism. Although the public relations professional's role is to cast doubt on assumptions, business still interprets this as a lack of belief in the product.

Sitting on the other side, the media - and to some extent the public - still see you as serving the interests of your paymasters.

The true role of public relations should be somewhat different.

From the public's point of view, the public relations professional should be the can opener to the life, thoughts and values of corporate clients.

Commerce is naturally pre-disposed towards self-protection. In bad times, it simply bunkers down.

Lacking an independent viewpoint in tough times, businesses often fail to distinguish between the kind of communication that reaches out for interchange with new audiences - that expands new horizons - and the kind of information that must remain private.

Life in the corporate can is safe and protected - but it is also dark.

The very best public relations turns the light on.

Whether business likes it or not, commercial activity is both public and private. The lifeblood of commerce is public support. No corporate entity can function without the goodwill and understanding of its wider community.

This understanding is partly built around the formal exchange of information - through the annual report, or media relations, or newsletters.

It is also built on every piece of communication taking place, noticed and unnoticed, at every level of the organisation. The very way an organisation conducts its business is in itself a communication.

But there is a further way in which public relations practitioners can play a role in New Zealand business. This role is far wider than any I have mentioned thus far.

Next month, the National government will deliver its first budget.

A government is never in a better position to spell out its vision, and its strategy to achieve it, more clearly than in its first budget. For a moment, the community will stop and turn its full attention to that communication.

It is a chance to wipe the communications slate clean and start again. If the government does its job well, there will be a deeper appreciation of the truth about New Zealand's parlous economic state. If the facts are put before it, I believe the electorate will accept that the economy is in a mess and that the road ahead is long and tough.

But the government must also provide a realistic basis for hope. This budget - more than any other - gives National an opportunity to paint an exciting picture of the future of New Zealand. They must use it to create a climate where optimism and growth are possible.

While the budget will inevitably try to wean New Zealanders away from our longstanding dependence on the welfare state, it must also create a business climate in which enterprise can be nurtured. The vision must be strategic, long term, bold, articulate and arresting.

Picking up the vision will be people like yourselves.

You too must play a role in helping make New Zealanders believe in a competitive and entrepreneurial future. Business is society's wealth-creating process. Cast a vote against enterprise and you vote for life in an economic backwater.

Through your work many individual enterprises already enjoy a high reputation. But public relations contributes little at this stage to the overall perception of commerce in New Zealand.

Business is still not regarded as a priority by most New Zealanders - perhaps at best a necessary evil. We do not have a passion for service, for quality, for finding out and satisfying the needs of the world's most demanding customers.

We are not yet preoccupied with ourselves as aggressive traders in the world's market places. Instead, we are preoccupied with our isolation. We see ourselves as an inconsequential country at the end of the world.

A recent Massey University study found that we did not connect effort with prosperity. While we wanted high levels of comfort and security we did not believe in the hard work needed to achieve them. As one of the authors put it: "New Zealanders want more than they are prepared to work for."

The huge challenge for public relations in New Zealand is to take the image of business as boring and mundane and turn it into something creative and dynamic, something that is recognised as being at the very core of a successful society - the way it is in Asia, for instance.

We in business know we have to earn that kind of standing. Business has been tarnished in recent years. Much opprobrium has been heaped on business heros who turned out to be less than heroic. In most cases, however, the true greedies in my view were those who chased high interest investments or a quick turn on their shares. Business is risky, and if you like high risk investments don't cry if you get burned.

Lessons have been learned from that experience, and they will stand us in good stead. Little by little we are building a new economy and a new class of business manager. We need to encourage and celebrate world class business men and women - and seek greater community recognition for their achievements. The task is not hopeless, despite the anti-business mentality that has prevailed in New Zealand. Polls tell us that the community's rating of business is not good, but it is better than that of the media, politics and the trade union movement.

There are other ways in which the public relations industry can help lead New Zealand out of the economic fortress.

The recent Porter project - which the Business Roundtable co-sponsored - concluded that we had not clearly identified or established our competitive advantages as a nation.

Fortunately, the report also offered a few helpful suggestions. For example, it repeatedly directed us to look at our own "clean, green, unspoiled" image to help differentiate New Zealand in marketing agricultural products. This calls for creative public relations strategies. You - public relations practitioners - can help build such competitive advantages.

At the end of the Porter report, the authors wrote: "There is nothing inevitable about New Zealand's economic decline... Unlike many nations, we still have the luxury of a choice."

The Business Roundtable has been engaged in researching that choice. We have been speaking at functions like this; we have been catalysts for change.

The outlook for New Zealand is swinging on a hinge. A failure of nerve by the National party caucus could undo all the hard work of recent years and set back our prospects for a decade. Tough and determined action could break the mould. I believe international investors would then look at us through new eyes, and the business community would shift to a much more confident and expansionary mode.

I am hopeful that there will be a positive message for your industry to communicate in the near future. If you do the job well you have the capacity to profoundly influence our commercial direction, and a great deal to offer New Zealand business.

I urge you to pick up this positive challenge.

MAJOR AND MULTIPLE STORES CONFERENCE

GETTING NEW ZEALAND OUT OF THE SURVIVAL FRAME OF MIND

ROGER KERR
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE

WELLINGTON
22 JULY 1991

GETTING NEW ZEALAND OUT OF THE SURVIVAL FRAME OF MIND

I may be wrong, but something tells me things are looking up. The title of this session is one indication. The Institute of Management is organising a Business Forum on 'Growth Through Optimism'. Similar conference themes are becoming more common.

On the other side of the ledger, a group of academics from Auckland University recently warned the government "in the strongest possible terms" that, "in the present state of the economy and in the midst of an international recession," the deficit cutting strategy was fatally flawed and would depress the economy further. We can perhaps take some comfort from the fact that 364 prominent economists in the United Kingdom put their names to a celebrated letter with similar advice to Margaret Thatcher in 1982. This was almost exactly the moment when, thanks to persistence with tough fiscal policies, the United Kingdom economy began its longest post-war expansion.

Other economic commentators have also staked their reputations on predictions of doom and gloom, and no doubt we have not heard the last of them. As a respected Australian policy adviser once noted, many aspects of the supply side of the market in economic commentary resemble those in, say, cabbages. For example, entry is rather easy and there is a sizeable fringe of subsistence growers. We also suffer from periodic gluts and, as distinct from the market for cabbages, we do not have intermediaries such as yourselves to cull out inferior products before they reach the general public. Another difference is that not many cabbages are produced in the public sector, whereas academic commentators in our public universities do not have to face normal competitive tests of survival.

Fortunately the public does have access to assessments which carry authority and credibility. Earlier this year the OECD urged the government to pursue price stability, reduce the fiscal deficit by cutting its expenditure and carry on the programme of microeconomic reforms, particularly in the labour market. It concluded:

> "To build on the reforms of recent years and to underpin the much-needed improvements in the country's medium term growth prospects, it is essential for New Zealand to consolidate and extend the policy orientation pursued since the mid-1980s."

The Porter study emphasised that countries can only become competitive by competing, not by cocooning themselves from world prices. As Porter told an Australian audience, competitiveness does not come from "one or two silver bullets like the exchange rate or some marvellous tax change." By comparison with other countries, he was clearly struck by the extent to which the New Zealand social welfare system had removed incentives to upgrade skills and to work and save.

More recently the rating agency Moody's confirmed New Zealand's current credit rating, citing the government's economic reform programme, and in particular its labour and social welfare reforms, as the basis for its decision. Moody's wrote that:

"The present moment provides a key political opportunity for the National Party, after its clear mandate in the elections of October 1990, to regroup the political consensus that had been lost in the later stages of the Labour administration."

The agency saw "a large share of support across various sectors for the current policy framework," but warned that:

"...the main benefits will only become evident after two or three years of slow growth and rising unemployment, so the strategy remains vulnerable to a loss of political support."

In other words, we are still living on borrowed time.

Of course, according to one school of demonology, the OECD, Porter and Moody's are just the latest recruits to the Treasury, Reserve Bank, Business Roundtable, Federated Farmers, Employers Federation, IMF, University of Chicago, New Right monetarist conspiracy. It must be demoralising to some that the demons are steadily multiplying and that the non-demon population is becoming something of an endangered species.

It was always idle to believe that years of fortress New Zealand policies, fiscal deficits, double digit inflation, accumulating debt burdens, rising unemployment and deteriorating credit ratings could be put right in a short space of time. Even a bold and coherent programme that is unwaveringly adhered to will take years to pay off, as the Eastern European countries will discover. In New Zealand's case, of course, a teabreak was called on an incomplete programme. As our organisation and many others warned, the costs of that decision in terms of increased unemployment and hardship have been immense. The incoming government inherited a set of problems which require extraordinarily difficult political decisions to resolve. A further loss of nerve and patience would be catastrophic.

Speaking in Australia earlier this year, the editor of *The Economist* suggested that transforming an uncompetitive economy like Australia (or New Zealand) would take much more than a decade, and might well take two decades or three. He mentioned that after the eleven year era of Margaret Thatcher, one of his colleagues had said to him: "Wouldn't it be nice now if we had a bit of a breather." His response was: "We need three Thatchers in a row before we get the economy right." Regrettably, Mrs Thatcher's government also lost its grip on policy, which contributed to her downfall, and Britain does not appear destined to have even two Thatchers in a row.

In the OECD area as a whole, however, and despite some aberrations, the consensus on economic policies that developed during the 1980s is holding firm, with the result that the world economy now appears poised for a solid recovery. The dangers of unsustainable growth achieved merely through whipping up demand have been well absorbed. A number of countries loosened policy excessively after the October 1987 sharemarket fall, leading to overheating and an acceleration of inflation. But governments and central banks clamped down fairly rapidly, with the result that inflation is falling again and growth in the OECD area is expected to pick up to around 3 percent in 1992.

Overall, the OECD's latest *Economic Outlook* suggests economic fundamentals are as sound now as they were during the 8-year expansion in the 1980s. In particular, monetary regimes are more credible and there is a renewed emphasis on medium term fiscal policies. Unemployment remains a problem; the OECD's forecast is for an average rate of 7 percent in the coming 18 months unless significant labour market reforms are implemented. It calls for a shift away from labour market programmes which induce long run dependency on benefits and from wage bargaining structures which push up real wages and retard job growth. But overall, as a leader in last week's issue of *The Economist* puts it,

> "The next ten years hold out the promise of extraordinary, perhaps unprecedented, economic progress for the world."

The improving international economy will help New Zealand's recovery, even though no short term pick-up in our terms of trade is likely and the Australian economy seems set to suffer from a continuing period of policy hiatus. There is no shortage of potential demand for what we can produce, despite market restrictions. World trade expanded in volume by 80 percent during the 1980s, and imports into many countries in the Asia-Pacific region continue to grow rapidly. The basic task for New Zealand must be to improve its competitiveness and gain a larger share of that growing market demand.

There is good news on the competitiveness front. Relative unit labour costs are estimated to have fallen by around 4 percent since late 1988, and seem likely to fall by a similar amount in the year ahead. This trend has been driven by major productivity gains in areas such as manufacturing, ports and state-owned enterprises. Productivity gains should be strengthened with a recovery in activity. Following the June quarter CPI result, inflation is at a 25-year low and seems likely to stay that way. With the fall in interest rates and rise in the sharemarket, the nominal cost of capital to New Zealand firms has declined sharply. A further fall in real terms is likely if strong fiscal policy action is taken. Even those who have seen salvation in a lower dollar have had their share of the action. As the National Business Review pointed out on 5 July:

> "Against the US dollar the kiwi...is down 22% over the last three years. On the TWI the kiwi has eased 2.8% this year and 7.2% in the last 18 months. Would someone please tell Dairy Board chairman Dryden Spring."

In the last fortnight, the currency has fallen further. But we need to remember the economic fundamentals: currency depreciation counts for nothing if domestic costs, particularly wages, are not held. Last year, despite high and rising unemployment, real wages as a cost to employers still grew by around 2 percent. It is no use wringing our hands about unemployment and unprofitable export industries if past wage-setting practices re-emerge.

There are other signs of an economic turnaround. We have almost had an overdose of surveys indicating a pick-up in business confidence, not necessarily the most concrete or reliable of economic indicators. But manufactured exports are doing well, investment intentions seem to be on the rise, the number of people on welfare benefits has dropped sharply and the Telecom float has seen an international vote of confidence in New Zealand. These are signs of improving economic fundamentals.

There is now a good deal of market confidence that the government will deliver a budget that will strengthen this improving outlook. The backing which the prime minister has given to the need for tough and responsible decisions has been crucial in this regard. Attention will focus on the government's success in reversing the upward trend of spending relative to GDP, and to establishing a path which will yield a financial surplus by the mid-1990s. The quality of individual decisions will also be closely scrutinised. The efficiency gains available from structural reforms in areas like health, education, accident compensation and housing could easily surpass those achieved in state-owned enterprises in recent years.

The macroeconomic test of the budget will be whether it further eases pressure on monetary policy and inflation and consolidates the prospects of a recovery led by the traded goods sector of the economy. It is unlikely to do much in the short term to boost the domestic economy. The domestic economy is quite depressed, and there is still considerable restructuring to be done in both the public and private sectors. Tight policies will constrain growth in disposable incomes and hence consumption.

However, beyond the short term, I would put it to you that this is good news even for the retailing sector. The last thing we need is a recovery led by domestic consumption or investment in sectors such as residential housing. That would be simply unsustainable. A move to longer run growth must be based on a shift in resources to export and import-replacing industries, driven by further improvements in competitiveness and higher profits in them. If manufactured exports are increasing at double digit rates of growth in volume terms in a year or two's time, that would be one of the surest indications that policy is on track. By then, the benefits for the domestic economy would be starting to show up.

If the government delivers a further instalment of policy reform in the budget, it has every chance of achieving at least 5 of the 6 economic goals that it committed itself to prior to the election, namely:

- 0-2 percent inflation
- single digit business and mortgage interest rates
- a balanced budget
- a fall in the government share in the economy
- a growth rate reaching 3 percent by the end of its term.

The more problematical goal is a halving of the level of unemployment, but it is to be hoped that the government does not throw in the towel on this too easily. Employment grew by 3.8 percent or 47,000 in 1984/85 as the benefits of the wage freeze came through, and unemployment dropped by around 2 percentage points a year in the 1980s in several OECD countries as they emerged from a period of structural adjustment.

Moreover, the government can rightly argue that, in contrast to inflation for which it has sole responsibility, it cannot directly influence what happens to unemployment. Much will depend on whether public and private sector employers and their employees adapt rapidly to determining pay on the basis of labour supply and demand factors or whether old habits of automatic increases and relativities persist. Pay should essentially be based on what is needed to get and keep staff. In a more productive and growing economy, the market will force up pay rates over time. However, the government also has a role to play. While it has greatly improved the framework for employment contracting, more needs to be done following the budget if it is to achieve its employment goal.

The key here is clearly not a raft of so-called job creation schemes, which do nothing of the sort. It would be futile to adopt a politically motivated strategy aimed at achieving the target in ways that were unsustainable. Instead there needs to be an all-out attack on all the impediments to training and employing labour. In the labour relations area these range from some of the extraordinary decisions of the Labour Court, which the Court of Appeal has recently moved to check, to the problem of a minimum wage pitched far above safety net levels. Some unions and people in secure jobs will claim that offering people work at initially low pay rates is exploitation; in reality callousness consists of leaving the unemployed to their fate. There is major work to be done in the area of non-wage costs such as accident compensation. The process of making the education and training systems more relevant and responsive to labour market needs will need sustained effort. The Vice-Chancellor of Victoria University is on public record lamenting the fact that too many students want to go to his institution. Any other business would be delighted with burgeoning demand. More resources would be applied to satisfying the customers. Yet almost alone among OECD countries, our universities have a complex about policies which involve tuition fees plus protection for students who would otherwise be excluded on financial grounds. By comparison New Zealand polytechnics are becoming much more entrepreneurial and market orientated.

More generally, there is an enormous agenda still to be tackled in areas of microeconomic reform. Many New Zealanders who have not lived and worked in successful countries overseas still do not appreciate the scale of the changes in policies and attitudes that are needed if we wish to aspire to their living standards.

For example, the head of a Japanese forestry company recently pointed out that our planning laws in Carterton are stricter even than those in Tokyo, and that construction of a mill here takes far longer than a similar project in Japan. Our largest mining company has recently stated that it takes on average about four years to get a mining licence in New Zealand, a process that is slower and more difficult than in even the most anti-development state in Australia. With few notable exceptions, local government remains an area of massive inefficiency. Electricity Supply Authorities have made only a fraction of the efficiency gains achieved by Electricorp, and they seem to be the latest group to be offering extraordinary salary packages - Warren Cooper please take note. Yet they were the first to criticise the Corporation's proposed price increase, and the resulting public clamour for government intervention and a return to politicised pricing was the stuff of a banana republic. Effective rates of protection to the motor vehicle industry are currently of the order of 150 - 200 percent; a rate of 100 percent means the industry receives a subsidy of a dollar for every dollar of value added. In your own sector we have restrictions barring supermarkets operating pharmacies and a marketing board monopoly on domestic apple and pear sales - restrictions which I venture to suggest are unheard of in other OECD countries. The list goes on and on.

We must keep sober about the economic outlook. The farming sector is having one of its worst years on record. There is a major shake-out ahead in the meat industry, and massive losses to farmers from the Meat Board's investments in recent years are going to have to be taken on the chin. Even if employment picks up, unemployment is likely to rise for a period as more people seek work. The next couple of years will be extremely difficult, but for the first time since 1987 they hold the prospect of moving forwards rather than sliding backwards. This was the conclusion of this month's review of New Zealand by the London *Financial Times*:

> "Thanks to the structural adjustment of the past seven years", it wrote, "the outlook for the economy looks more promising than for several decades, but more pain will have to be inflicted before the results of greater competitiveness start to flow through."

The period immediately ahead will certainly be difficult for retailing, although the industry's fortunes are not entirely outside your own control. You too have a job to do to innovate, cut costs and make the consumer's dollar go further, and to contribute to the competitiveness and attraction of industries such as tourism. There has been no shortage of such innovation on the part of many of the major operators, and no lack of response to the opportunities opened up by the deregulation of shop trading hours, another success story in the moves away from a controlled economy.

The retail sector has never been afraid of competition and change. It has not been one to seek government handouts. Its voice will need to be heard in the period ahead when sectors of the economy that have not faced competition and change will be arguing that they should not have to. Television and Radio New Zealand can be guaranteed to feature a procession of post-budget commentators telling the public why the government should have gone for softer options. Some of the Auckland University academics may well be among them. But if the government maintains its commitment to its economic goals over the next couple of years, I believe the good news will be that their bad news is wrong. In that event, in this era of accountability, I trust the university authorities will hold them accountable for their performance.

THE LABOUR MARKET

THE EXAMINER

THE ECONOMICS OF THE GROWTH AGREEMENT

ROGER KERR
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NEW ZEALAND BUSINESS ROUNDTABLE

25 OCTOBER 1990

THE ECONOMICS OF THE GROWTH AGREEMENT

Last month the government announced an Agreement on Growth with the trade union movement. This involved a commitment to restrain wage increases to 2 percent in the current award round, with any additional amount being dependent on productivity gains.

How should we think about the agreement as a component of an economic strategy?

The wage accord can be seen as part of a family of initiatives over the years in New Zealand to regulate wages by central decree. These took forms such as general wage orders, remuneration tribunals, wage guidelines, wage/tax trade-offs and the wage freeze implemented at the end of the previous government's term of office.

Wage (and price) controls were employed by a number of OECD governments during the 1970s to try to combat inflation and the effects of oil price increases, but have largely fallen into disuse. Australia is the only OECD country currently operating an institutionalised wage accord.

The basic lesson from OECD experience with incomes policies is that while they can have some favourable short term effects they generate increasing pressures and distortions the longer they remain in place. For this reason they harm long term economic growth.

Governments have also tended to employ incomes policies when other economic policy settings have been inadequate. Typically such accords are unable to compensate for the effects of bad policies. They usually make it more difficult to effect the necessary changes and other policies tend to become compromised over time.

Australian and New Zealand experience bears out these observations.

There has been a significant reduction in real wages since the mid-1980s in Australia, and an impressive growth in employment, especially in part time and female employment. There is some dispute as to whether this has been due to the Accord or to underlying economic conditions and the lessons learned from the 1981 wage blow-out, which resulted in unemployment rising from 7 percent to 10 percent of the workforce in just over 3 months.

In any event there is now widespread agreement in Australia about the relationship between real wages and employment - both the negative effects of excessive real wages growth and the employment-creating effects of real wage reductions. The debate about this relationship which was fiercely contested in the 1970s has now been largely resolved.

However, the counterpart to central wage fixation has been the perpetuation of the micro-level rigidities in the Australian labour market, with the result that productivity growth since 1983 has been effectively zero. Labour deepening has occurred, as theory would predict, but the environment has not been conducive to innovation and industrial flexibility. New variations of the Accord have not prevented Australia from sliding into its current economic predicament, and unemployment, which is at similar levels to New Zealand, is on the rise again.

Moreover, economic policy initiatives which are widely recognised as necessary in Australia have become hostage to the Accord. The Australian Council of Trade Unions vetoed the introduction of a goods and service tax, and only recently has the Hawke government managed to take the first tentative steps towards privatisation.

Experience with the Muldoon government's wage freeze was not dissimilar. Initially employers welcomed the reduction of wage pressures. As the benefits of real wage reductions came through, employment grew by over 40,000 during 1984 and 1985, the only significant period of job growth in the 1980s.

The difficulties came further down the track, when the distortions that had built up during the 20 month freeze had to be unwound. The unions did not accept the further cut in living standards necessitated by the 1984 devaluation, and demanded a catch-up for losses in the 1985-86 wage round. The result was a significant increase in real wages through 1986-87, a steep rise in unemployment and a loss of competitiveness from which the economy has still not recovered.

It is certainly a positive feature of the growth agreement that the link between wages and employment and the economy's weak competitive position appears at last to be recognised. Only a couple of years ago the Council of Trade Unions was arguing for wage increases on the basis of old-fashioned Keynesian notions of 'maintaining purchasing power'.

There may be a growing understanding about the demand side of a small economy, namely that tapping the enormous potential of international demand is dependent on being competitive in all respects and that effective domestic demand is assured by a stable monetary policy that facilitates real output increases, not inflation.

The reality of our weak competitive position is that across both the tradeables and non-tradeables sectors of the economy, our wage structure is generally too high relative to productivity. The problem is particularly acute at the low-skilled end of the market.

The downturn in key export prices and the new round of oil price increases has heightened the need for wage and productivity adjustments. Some employers appear to view the 2 percent benchmark as a welcome response. Given the coming economic crunch, however, it is arguable that no such floor should be put under wages and that market conditions would dictate lower outcomes in many circumstances. Colin Clark of the PSA has stated that several unions supported the agreement because "they doubted whether even a 2 percent increase could be achieved in some awards in the coming round".

The productivity leg of the agreement is also troublesome. Productivity improvements by themselves are not a basis for higher wages. Wages should basically be determined by the prevailing conditions of labour supply and demand in the particular job, industry and location. Productivity improvements should not lead to wage increases if there is an ample supply of workers with relevant skills seeking jobs. To do otherwise merely lengthens the unemployment queue for such workers.

Instead higher productivity and profits should be a signal to existing firms to expand and for new firms to enter the industry. Such firms would hire the available labour at prevailing wage rates until supplies become scarce and it becomes necessary to bid up wages to attract additional workers. That is the only way unemployment can be reduced.

Current labour market conditions in many industries do not justify wage increases. A new meat plant in Dunedin recently received 5 times as many job applications as the number of positions it was seeking to fill.

Productivity bargaining is in any case greatly hampered by the present award system. As a general rule, sensible deals are only possible at the level of specific enterprises, not on an industry or occupational basis. For example, the agreement in the recent metal trades negotiations to allow working beyond standard hours at ordinary time rates and to permit two rest periods in the day instead of three will be meaningful for some firms but irrelevant for others. It is economically damaging to incorporate a general productivity element in wages in these situations.

More generally, a regrettable feature of the wage accord is that it sees the government intruding anew into wage fixing after a period of disengagement which brought new attitudes and realities into employment relations. It will reduce the impetus which the government has been encouraging towards a wider, more market-related dispersion in wage settlements and towards new bargaining arrangements. It also reintroduces a form of two-tier bargaining, contrary to the intentions of the Labour Relations Act. Because no parties are bound by the accord, and employers are not even involved, there is every possibility of breakdowns. In that event there will be pressure for greater coercion or for the government to retreat from other economic policies.

Assuming that it remains in place, past experience with incomes policies indicates that a full evaluation of the effects of the agreement will not be possible for some time, perhaps 2-3 years. Because of this uncertainty, long term interest rates are unlikely to be reduced in the near future.

One acid test of the agreement would be the response to an exchange rate depreciation which, to be effective, would necessitate a further reduction in real wages. Another will be the response to the commitment to substantially reduce the projected budget deficit, a key commitment which has not yet been backed up with detailed plans. Unless this is to be achieved through tax increases, it will necessitate spending cuts in areas that are sometimes regarded as the 'social wage'.

One thing that is certain from all past experience is that over the long run central planning, including in the labour market, does not work. Economic growth depends on allocating all our resources to their best uses and using them productively. The labour market is a crucial allocation mechanism; labour accounts for some two thirds of the value of productive resources used in the economy every year. In a market economy, wage rates, along with interest rates, exchange rates and prices in general, are the signaling devices on which efficient economic activity depends. Suppressing by central decree the role of wages in adjusting supply and demand in the labour market, and in providing incentives for skill and effort, can only impair economic performance.

It is for these reasons that even advocates of incomes policies such as Professor Bryan Philpott see them as short term measures which need to be backed up by basic micro reforms in the labour market. This has been a key missing ingredient in the government's economic strategy and there are no indications of plans to implement significant reforms.

Even before the intervention of the accord, Rob Campbell had observed that "Over the full range of issues, we now have a more regulated labour market than in 1984". The fundamental gains from deregulation arise from the ability of employers and workers to continuously strive for more productive working methods in ways that are blocked by a centralised system. Whatever else the 'growth agreement' may achieve, it will not achieve growth until comprehensive labour market reform is moved to the top of the policy agenda.

H R NICHOLLS SOCIETY MEETING

COMMON LAW AND COMMON SENSE: THE EMPLOYMENT CONTRACTS BILL

ROGER KERR
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE

MELBOURNE
13 APRIL 1991

COMMON LAW AND COMMON SENSE: THE EMPLOYMENT CONTRACTS BILL

> "The property which every man has in his own labour, as it is the original foundation of all other property, so it is the most sacred and inviolable. The patrimony of a poor man lies in the strength and dexterity of his hands; and to hinder him from employing this strength and dexterity in what manner he thinks proper without injury to his neighbour, is a plain violation of this most sacred property. It is a manifest encroachment upon the just liberty both of the workman, and of those who might be disposed to employ him. As it hinders the one from working at what he thinks proper, so it hinders the others from employing whom they think proper."
>
> Adam Smith

Introduction

On 12 March of this year, the Australian government announced a programme for reducing most tariffs to a general rate of 5 per cent by 1996. As one commentator put it: "This was the day that protection died in Australia."

On 1 May next, the government in New Zealand appears set to implement the Employment Contracts Bill. This discards our century-old industrial conciliation and arbitration system and replaces it with a legal regime of free contracting. Property rights and freedom to trade in labour services are being restored.

As is well known, protectionism and labour market regulation have had a symbiotic relationship. Industry was protected from 'unfair competition' from imports in return for accepting that union members had to be protected against 'unfair competition' in the labour market through the award and arbitration system. This twin delusion has taken a fearful toll on the living standards of both our countries.

New Zealand has been dismantling its protection structures and average effective rates of assistance are now comparable to those in Australia. The current government is committed to further reductions, although decisions have yet to be taken. The signals from federal and state opposition parties suggest that labour market deregulation is not far away in Australia. Both countries may be laying the foundations for a turnaround in their relative long run decline.

Australian economic commentary on what has been going on in New Zealand in recent years has taken some curious forms. One school of thought has been blinded with admiration for the structural reforms achieved and has called for similar boldness by Australian Treasurers. Another sees the New Zealand economy as still struggling and puts this down to a misguided 'monetarist' and 'free market' experiment which Australia should avoid like the plague. Both views are wide of the mark. *The Economist* has generally had the story right, apart from a rather misplaced and passing preoccupation with the sequencing of reforms. As it put it recently, the problem has been that:

> "... the Labour government did only part of the job - the easiest part. Three huge areas were neglected: the rigid labour market and its centralised pay-award system, which prevents wages adjusting to market conditions; the lavish welfare state; and the budget deficit."

It is no great puzzle why the benefits to date have not been greater. The reform programme has been unbalanced for prolonged periods and political instability has eroded business confidence.

Nevertheless, much policy reform has been achieved and many gains are apparent. Labour productivity grew at an annual rate of about 5 percent in the manufacturing sector between the end of 1987 and the beginning of 1990, and by 3 percent for the whole economy. Productivity gains in state-owned enterprises and the waterfront have been spectacular. There has been a marked change in the pattern of investment away from protected activities to unprotected ones. The non-wage share of GDP has increased and aggregate business investment rates have remained high. Competitiveness has improved as rising labour productivity and falling real wages have reduced relative labour costs. Large reductions have occurred in inflation, inflation expectations, nominal interest rates and wage expectations.

One of the major downside factors has been a steep rise in unemployment. This is continuing and may top 10 percent of the labour force in the year ahead. However, as the recent OECD survey on New Zealand noted:

> "A large part of the increase in unemployment since 1986 reflected a transformation of hidden into open unemployment - and not the loss of profitable jobs. Many lost jobs had been viable only on account of government subsidies or border protection. These policies attracted resources into uncompetitive activities, in many cases reducing the incentives for the acquisition of the management and labour skills necessary for more competitive industries."

The OECD noted that the solutions to high unemployment would require difficult decisions involving industrial relations legislation, minimum wage laws, and the levels of and eligibility criteria for social welfare support.

The Labour Market Since 1984

As the figures for labour productivity show, there have been large changes in the New Zealand labour market since 1984. There has also been a transformation in attitudes and behaviour. Those who have been concerned about labour market developments have not argued that nothing has happened. Their point has been that not enough has been done to reform labour laws and institutions so as help firms adapt to intensified competition and enable workers displaced by restructuring to be reabsorbed in new activities.

In my view there have been two main reasons for the change in the employment relations climate. One is the impact of the general economic policies that have been pursued. A monetary policy aimed firmly at disinflation and policies such as trade liberalisation, deregulation of domestic industries, public sector reforms and privatisation have given firms strong incentives to contain costs, raise productivity and develop closer relations with their employees. This process has been enhanced by the second factor, the commendable refusal by ministers of labour to become embroiled in industrial disputes. The non-interventionist stance adopted by Mr Stan Rodger - 'sideline Stan' as he became known - has been followed by subsequent ministers and has forced parties to confront and resolve their own differences. Ten years ago, mostly at the behest of employers, the first item on the weekly cabinet agenda was the list of current industrial disputes. In recent years, even at times of tense industrial situations on the waterfront or the electricity industry, the imprecations from employers were for the government to keep out.

In contrast to these two powerful influences on the labour relations environment, the contribution of specific changes to labour law has been relatively modest.

Probably the single most important and least noticed change made by the previous government was the introduction of voluntary arbitration. This happened at the same time compulsory unionism was reintroduced, and this 'one step forward, one step back' approach was to characterise the government's term. The abolition of automatic access to third party arbitration by a decision of one party strongly reinforced the disciplines on wage bargainers to find their own solutions. The trade union movement agreed to the decision to scrap compulsory arbitration at the time, but later lamented it as an error and surreptitiously pressed for its restoration, with some success in the final months of the Labour government.

The major attempt by the Labour government to achieve labour market reform was made in 1985-87. The New Zealand equivalent of the Hancock review - as it unhappily turned out - was based on a Green Paper issued in late 1985. Most of the government's expressed intentions were commendable. It wished to encourage a more decentralised and dispersed wage fixing system, to promote new options for bargaining arrangements other than blanket coverage national awards (in particular by allowing unions to opt out of the award system), to allow workers the choice of union representation, to eliminate second tier bargaining by requiring all employees to be covered by a single document and to promote sanctity of contracts. On the other hand, it set its face against contemplating genuine voluntary unionism and sought to promote union amalgamation by increasing the minimum size of unions to 1,000 members, a move that flew in the face of efforts to develop enterprise-focused bargaining structures.

The reformist ministers in the previous government who had come, albeit rather slowly, to appreciate the significance of labour market reform, were thwarted by opposition in the party and the trade union movement. Despite claims to the contrary, the Labour Relations Act of 1987 largely amounted to tinkering with the existing system. Subsequent initiatives in the labour area saw a continuation of the 'one step forward, one step back' pattern. On the positive side, the government implemented a State Sector Act, in the face of fierce resistance from public sector unions, which went further towards dismantling the centralised system and introducing greater flexibility. It also abolished the special legislation governing waterfront employment relations, which has led to one of the major success stories in New Zealand microeconomic reform, and it deregulated shop trading hours. On the other hand we endured a futile inquiry into industrial democracy and a two year debate on proposals to legislate for so-called 'employment equity'. The bankruptcy of these was convincingly exposed in the debate, allowing the new government to repeal the employment equity legislation as one of its first moves. In March 1990, recognising that its attempts at bargaining reform in the Labour Relations Act were insufficient, the Labour government decided to give employers a right to opt out of awards, but this too was so circumscribed as to be totally ineffectual. At the same time, it reintroduced a form of compulsory arbitration. In a final twist, the government reverted to centralism in September 1990 with a so-called 'Growth Agreement' with the trade union movement, the central feature of which was an undertaking to confine wage adjustments to 2 percent.

Throughout this period, developments in industry were characterised by a mix of the encouraging moves towards workplace cooperation and more productive work arrangements that I referred to and 'business as usual' as far as the pattern of award rounds and the institutional machinery was concerned. A major event in the transition from centralised wage fixing to 'free' bargaining was the irresponsible wage push by unions in 1985/86, which led to an increase in average weekly earnings of 17.4 percent in 1986. This was the single most important setback in the economic reform programme, resulting in the disappearance of thousands of union members' jobs and a loss of competitiveness from which the economy is still struggling to recover. However, the lesson was quickly learned. Increases in average weekly earnings in the two succeeding years were around 7-8 per cent, in 1989 and 1990 about 4-5 percent, and are currently running at 2-3 percent. With inflation coming down to similar levels and continuing productivity improvements, a platform for achieving genuine competitive advantage is being created.

As far as policy is concerned, the overriding lesson of the period is that piecemeal reforms to labour law produce disappointing results. The architects of the Labour Relations Act, including the Department of Labour which has been a principal defender of the old system, argued that the removal of a few 'keystones' and the provision of opportunities to opt out of awards were all that was needed to allow desirable change. This has proven to be a recipe for reform at a snail's pace and for a growing gap between employment displacement and absorption. It is clear that wide freedoms need to be created to overcome inertia and the power of vested interests to resist change. The new government has recognised this in bringing down the Employment Contracts Bill.

The Employment Contracts Bill

From the mid-1980s, New Zealand employer organisations, government agencies other than the Department of Labour, the OECD and IMF, independent commentators and the National party in opposition pressed the case for much more comprehensive labour market reform. Public opinion surveys also showed large majorities - of the order of 70 - 80 percent, including among trade union members - in favour of voluntary unionism, worker choice of representation, and giving employers and employees the freedom to deal directly with one another. The present government made labour relations reform a central element of its election campaign and assumed office with a clear mandate for change.

The cornerstone of the Employment Contracts Bill is a rejection of the century old conflict-based model of employment relations which holds that employee and employer interests are fundamentally opposed, in favour of a model which recognises that they share a common interest and that employment contracts depend for their existence on making both better off. Myths about the 'special' nature of labour contracts and 'unequal' bargaining power have also been discarded. As its name suggests, the Bill recognises that the best way of promoting high employment and high incomes - the best way of protecting workers - is to base labour law on the principle of freedom of contract.

Some of the most significant provisions of the Bill are as follows:

- compulsory unionism is abolished and replaced with freedom of association;
- unions will become incorporated societies with no special rights (the term trade union does not appear in the Bill, which speaks of employer and employee organisations);
- unions lose the exclusive right to collectively bargain on behalf of workers - they may negotiate themselves or use the services of any bargaining agent;
- awards and agreements disappear and are replaced with employment contracts;
- subsequent party provisions - the mechanism by which awards were given blanket coverage, even to parties who had no role in their negotiation - disappear and employment contracts will only apply to those persons who actually contract to be bound by them;
- terms and conditions of employment will be governed by contractual principles, either under individual or collective employment contracts;
- the elimination of union registration provisions removes the basis for demarcation disputes;
- no specific provisions are made for redundancy and the Labour Court loses the power to determine redundancy compensation where the parties cannot agree;
- a strike or lockout will be lawful except where there is a collective employment contract in force that relates to the striking employees; and
- appeals from decisions of mediators or other appointed persons to the Labour Court can only be made on questions of law (not fact).

At this stage personal grievance procedures are retained in their present form with some modifications:

- there will no longer be any requirement that workers be covered by unions before they can use the procedures;
- the right to use the personal grievance procedures will be dependent upon whether the person is covered by a collective employment contract or has a personal grievance procedure in his/her individual employment contract;
- reinstatement will no longer be the primary remedy;

- 'procedural unfairness' in the manner of the dismissal will no longer render the dismissal unjustified if the employer had substantive justification ('good cause') for dismissal.

The Mediation Service and Labour Court are to be retained, but there will no longer be any requirement to use mediators from the Mediation Service to chair disputes. The parties may agree to have any other person (such as an arbitrator, solicitor or industrial advocate) mediate the dispute. The government has indicated that it has yet to take final decisions on these institutions and on personal grievances.

Evaluation of the Bill

In its original submission in response to the Green Paper in 1986, our organisation wrote:

> "Labour and industrial relations law in New Zealand has gradually isolated labour market contracting arrangements from common law and common sense. The current myriad pieces of labour law are not only a mystery to the outsider; even practitioners find it a maze. The arcane body of rules inhibits beneficial contracts, and what is required in its place is a minimum set of laws necessary to allow the negotiation of agreements subject to enforcement by the parties and their appointed arbitrators. Complex and often unenforceable labour laws mean uncertainty, which reduces incentives for investment, risk-taking and hiring of new labour.
>
> The common law rules allowing freedom of association and freedom to enter into mutually beneficial arrangements (contracts) for employment that should exist in principle have been replaced in practice by a set of obligations and constraints which preclude more productive employment. Incomes of both workers and enterprises are reduced by the incapacity to adapt awards to local and individual conditions. Employers' offers are less than they could be owing to the insecurity and non-enforceability of awards. The parties to awards have few incentives to design their own arrangements to enforce agreements they have freely entered into... What the government must do is create a stable, non-distortionary and intelligible legal environment in which employment and productivity-enhancing contracts can be written."

A serious question arises as to whether any statutory law - other than legislation on employment standards - is needed to reflect these principles. The common law has continued to regulate employment contracts in New Zealand; indeed more than half the workforce is outside the ambit of collective bargaining and the 'special' jurisdiction of labour law. The protections of the common law against fraud, coercion, incapacity and duress apply to employment contracting as to other contractual relationships. The civil courts have remained involved in employment matters. The main argument for some form of statutory law which we found compelling was that over time labour law had become a special province and judicial precedent had moved it away from its role of protecting and enforcing contracts. In New Zealand circumstances at least, there seemed a need for Parliament to give fresh guidance to the courts in order to bring employment contracting into line with general contract law. This would limit if not prevent inappropriate forms of judicial activism while a new understanding and legal culture developed in respect of employment relationships.

This analysis points to the case for a relatively brief and simple statute with the essential purpose of facilitating free trade in labour services. The Bill certainly goes a long way to doing away with the enormous complexity of past arrangements. Where it currently falls short is in its unwillingness to entertain a full range of contracting freedoms and the retention of some of the baggage of the former system. There are a number of significant inconsistencies in this regard which could undermine both efficiency and equity objectives in the labour market.

- The Bill is effectively a 'right to work' law in that it disallows the right to make union or non-union membership a condition of a contract. While there may be a transitional argument for outlawing contracts which require union membership because of past attitudes and behaviour associated with closed shops, there are no obvious grounds for concern about allowing non-membership of a union to be a condition of an employment contract and full contracting freedom should be allowable in the longer run.

- Compulsory grievance procedures are retained in respect of collective contracts and there is a risk that they will be extended to individual contracts. Legislated redundancy and dismissal rules raise the costs and risks of employment and have been an important factor in the poor unemployment record of several European countries. There are no grounds for disallowing 'at will' or 'on notice' contracts and any alternative terms should be a matter for voluntary negotiation in employment contracts.

- Compulsory disputes settlement procedures are similarly retained for collective contracts. Again these should be a matter for voluntary contracting or, as a second-best option, should be legislated only as a standard form model for parties to avail themselves of should they so choose.

- The specialist Labour Court is retained, which poses a serious risk of perpetuating attitudes and a legal culture which have no place in the new regime. Since 1987 the Goddard court has greatly extended its reach. Employers and politicians alike have looked askance at the intrusions it has made into redundancy and dismissal cases in total disregard of commercial realities. While it will no doubt have its wings clipped, there is a strong case, supported by some of New Zealand's leading industrial lawyers, for its total abolition. The civil courts have the expertise and capacity to handle contractual disputes, which should greatly reduce in number.

- The provisions on strikes and lockouts fall somewhat short of reducing these issues to a simple determination of whether action has been taken in breach of a contract or whether trade has been interfered with unlawfully.

These inconsistencies are not fatal flaws in the Bill but they would undermine its effectiveness. With its difficult economic and employment situation, New Zealand can ill afford politically expedient compromises. A significant number of more or less technical problems have also been identified and it is hoped that these will be remedied. Other criticisms that have been made by its supporters have less validity. Among some employers there is an apparent 'fear of freedom' and a belief that some of the props and crutches of the old system are needed to prevent 'instability' in bargaining. The basic response to these criticisms is that employers need to get close to their staff to sort out any such problems and that managers should do what they are employed to do, namely manage.

Reactions to the Bill

The Bill was introduced by the government as part of an economic package in December 1990 which also included reforms to social welfare benefits. Market reactions have been favourable, with a welcome slide in interest rates over the last few months.

The introduction of the Bill has already given an impetus to bargaining reform. Recent negotiations in the accommodation and hotel industries have seen an end to penal rates, the introduction of youth rates and more freedom to use casual staff. These concessions would have been considered sacrilege by the union movement even 12 months ago. Other developments of this sort look set to follow.

There has been overwhelming support among employers for the Bill. Two briefing sessions in Auckland were attended by a total of 2,000 employers. According to the Director General of the Employers Federation:

> "The response is outstanding. Never before have we had such numbers. Without exception the meetings are giving massive support to the new bargaining arrangements and the new cooperative era of labour relations."

The initial reaction of the unions was muted, if not stunned. In submissions to the Select Committee considering the Bill, some unions have accepted its inevitability and concentrated on issues of detail. The capacity of the union movement to oppose the Bill has been weakened by the extent to which the intellectual argument in favour of reform has been won in recent years, the majority support for key changes shown in public opinion surveys and the government's electoral mandate. Lacking other bases for opposition, the unions have more recently resorted to old-fashioned rhetoric and protests in an attempt to influence political opinion. The arguments have been incoherent, with marxist slogans about 'wage slavery' conflicting with claims that wages will 'blow out' without the discipline of union restraint. There have been the usual threats of industrial anarchy and a disregard for the interests of others, with Combined Trade Unions president, Ken Douglas, saying the union response was to hold on to what they had and "somebody else would have to go to the slaughter". Most commentators seem to think that such crude tactics are unlikely to impress the government, which has put forward the case for the Bill in an articulate and principled way.

The news media have concentrated on opposition to the Bill. They have given prominence to the views of unions and other critics and have seized on the natural variations of opinion among employers on technical aspects of the Bill to suggest major differences of opinion that do not exist. Criticism has also come from industrial relations reporters, academics and lawyers. As in Australia, all these are groups whose professional 'expertise' in the old system stands to become largely redundant.

MAJOR AND MULTIPLE STORES CONFERENCE

GETTING NEW ZEALAND OUT OF THE SURVIVAL FRAME OF MIND

ROGER KERR
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE

WELLINGTON
22 JULY 1991

GETTING NEW ZEALAND OUT OF THE SURVIVAL FRAME OF MIND

I may be wrong, but something tells me things are looking up. The title of this session is one indication. The Institute of Management is organising a Business Forum on 'Growth Through Optimism'. Similar conference themes are becoming more common.

On the other side of the ledger, a group of academics from Auckland University recently warned the government "in the strongest possible terms" that, "in the present state of the economy and in the midst of an international recession," the deficit cutting strategy was fatally flawed and would depress the economy further. We can perhaps take some comfort from the fact that 364 prominent economists in the United Kingdom put their names to a celebrated letter with similar advice to Margaret Thatcher in 1982. This was almost exactly the moment when, thanks to persistence with tough fiscal policies, the United Kingdom economy began its longest post-war expansion.

Other economic commentators have also staked their reputations on predictions of doom and gloom, and no doubt we have not heard the last of them. As a respected Australian policy adviser once noted, many aspects of the supply side of the market in economic commentary resemble those in, say, cabbages. For example, entry is rather easy and there is a sizeable fringe of subsistence growers. We also suffer from periodic gluts and, as distinct from the market for cabbages, we do not have intermediaries such as yourselves to cull out inferior products before they reach the general public. Another difference is that not many cabbages are produced in the public sector, whereas academic commentators in our public universities do not have to face normal competitive tests of survival.

Fortunately the public does have access to assessments which carry authority and credibility. Earlier this year the OECD urged the government to pursue price stability, reduce the fiscal deficit by cutting its expenditure and carry on the programme of microeconomic reforms, particularly in the labour market. It concluded:

> "To build on the reforms of recent years and to underpin the much-needed improvements in the country's medium term growth prospects, it is essential for New Zealand to consolidate and extend the policy orientation pursued since the mid-1980s."

The Porter study emphasised that countries can only become competitive by competing, not by cocooning themselves from world prices. As Porter told an Australian audience, competitiveness does not come from "one or two silver bullets like the exchange rate or some marvellous tax change." By comparison with other countries, he was clearly struck by the extent to which the New Zealand social welfare system had removed incentives to upgrade skills and to work and save.

More recently the rating agency Moody's confirmed New Zealand's current credit rating, citing the government's economic reform programme, and in particular its labour and social welfare reforms, as the basis for its decision. Moody's wrote that:

> "The present moment provides a key political opportunity for the National Party, after its clear mandate in the elections of October 1990, to regroup the political consensus that had been lost in the later stages of the Labour administration."

The agency saw "a large share of support across various sectors for the current policy framework," but warned that:

> "...the main benefits will only become evident after two or three years of slow growth and rising unemployment, so the strategy remains vulnerable to a loss of political support."

In other words, we are still living on borrowed time.

Of course, according to one school of demonology, the OECD, Porter and Moody's are just the latest recruits to the Treasury, Reserve Bank, Business Roundtable, Federated Farmers, Employers Federation, IMF, University of Chicago, New Right monetarist conspiracy. It must be demoralising to some that the demons are steadily multiplying and that the non-demon population is becoming something of an endangered species.

It was always idle to believe that years of fortress New Zealand policies, fiscal deficits, double digit inflation, accumulating debt burdens, rising unemployment and deteriorating credit ratings could be put right in a short space of time. Even a bold and coherent programme that is unwaveringly adhered to will take years to pay off, as the Eastern European countries will discover. In New Zealand's case, of course, a teabreak was called on an incomplete programme. As our organisation and many others warned, the costs of that decision in terms of increased unemployment and hardship have been immense. The incoming government inherited a set of problems which require extraordinarily difficult political decisions to resolve. A further loss of nerve and patience would be catastrophic.

Speaking in Australia earlier this year, the editor of *The Economist* suggested that transforming an uncompetitive economy like Australia (or New Zealand) would take much more than a decade, and might well take two decades or three. He mentioned that after the eleven year era of Margaret Thatcher, one of his colleagues had said to him: "Wouldn't it be nice now if we had a bit of a breather." His response was: "We need three Thatchers in a row before we get the economy right." Regrettably, Mrs Thatcher's government also lost its grip on policy, which contributed to her downfall, and Britain does not appear destined to have even two Thatchers in a row.

In the OECD area as a whole, however, and despite some aberrations, the consensus on economic policies that developed during the 1980s is holding firm, with the result that the world economy now appears poised for a solid recovery. The dangers of unsustainable growth achieved merely through whipping up demand have been well absorbed. A number of countries loosened policy excessively after the October 1987 sharemarket fall, leading to overheating and an acceleration of inflation. But governments and central banks clamped down fairly rapidly, with the result that inflation is falling again and growth in the OECD area is expected to pick up to around 3 percent in 1992.

Overall, the OECD's latest *Economic Outlook* suggests economic fundamentals are as sound now as they were during the 8-year expansion in the 1980s. In particular, monetary regimes are more credible and there is a renewed emphasis on medium term fiscal policies. Unemployment remains a problem; the OECD's forecast is for an average rate of 7 percent in the coming 18 months unless significant labour market reforms are implemented. It calls for a shift away from labour market programmes which induce long run dependency on benefits and from wage bargaining structures which push up real wages and retard job growth. But overall, as a leader in last week's issue of *The Economist* puts it,

> "The next ten years hold out the promise of extraordinary, perhaps unprecedented, economic progress for the world."

The improving international economy will help New Zealand's recovery, even though no short term pick-up in our terms of trade is likely and the Australian economy seems set to suffer from a continuing period of policy hiatus. There is no shortage of potential demand for what we can produce, despite market restrictions. World trade expanded in volume by 80 percent during the 1980s, and imports into many countries in the Asia-Pacific region continue to grow rapidly. The basic task for New Zealand must be to improve its competitiveness and gain a larger share of that growing market demand.

There is good news on the competitiveness front. Relative unit labour costs are estimated to have fallen by around 4 percent since late 1988, and seem likely to fall by a similar amount in the year ahead. This trend has been driven by major productivity gains in areas such as manufacturing, ports and state-owned enterprises. Productivity gains should be strengthened with a recovery in activity. Following the June quarter CPI result, inflation is at a 25-year low and seems likely to stay that way. With the fall in interest rates and rise in the sharemarket, the nominal cost of capital to New Zealand firms has declined sharply. A further fall in real terms is likely if strong fiscal policy action is taken. Even those who have seen salvation in a lower dollar have had their share of the action. As the National Business Review pointed out on 5 July:

> "Against the US dollar the kiwi...is down 22% over the last three years. On the TWI the kiwi has eased 2.8% this year and 7.2% in the last 18 months. Would someone please tell Dairy Board chairman Dryden Spring."

In the last fortnight, the currency has fallen further. But we need to remember the economic fundamentals: currency depreciation counts for nothing if domestic costs, particularly wages, are not held. Last year, despite high and rising unemployment, real wages as a cost to employers still grew by around 2 percent. It is no use wringing our hands about unemployment and unprofitable export industries if past wage-setting practices re-emerge.

There are other signs of an economic turnaround. We have almost had an overdose of surveys indicating a pick-up in business confidence, not necessarily the most concrete or reliable of economic indicators. But manufactured exports are doing well, investment intentions seem to be on the rise, the number of people on welfare benefits has dropped sharply and the Telecom float has seen an international vote of confidence in New Zealand. These are signs of improving economic fundamentals.

There is now a good deal of market confidence that the government will deliver a budget that will strengthen this improving outlook. The backing which the prime minister has given to the need for tough and responsible decisions has been crucial in this regard. Attention will focus on the government's success in reversing the upward trend of spending relative to GDP, and to establishing a path which will yield a financial surplus by the mid-1990s. The quality of individual decisions will also be closely scrutinised. The efficiency gains available from structural reforms in areas like health, education, accident compensation and housing could easily surpass those achieved in state-owned enterprises in recent years.

The macroeconomic test of the budget will be whether it further eases pressure on monetary policy and inflation and consolidates the prospects of a recovery led by the traded goods sector of the economy. It is unlikely to do much in the short term to boost the domestic economy. The domestic economy is quite depressed, and there is still considerable restructuring to be done in both the public and private sectors. Tight policies will constrain growth in disposable incomes and hence consumption.

However, beyond the short term, I would put it to you that this is good news even for the retailing sector. The last thing we need is a recovery led by domestic consumption or investment in sectors such as residential housing. That would be simply unsustainable. A move to longer run growth must be based on a shift in resources to export and import-replacing industries, driven by further improvements in competitiveness and higher profits in them. If manufactured exports are increasing at double digit rates of growth in volume terms in a year or two's time, that would be one of the surest indications that policy is on track. By then, the benefits for the domestic economy would be starting to show up.

If the government delivers a further instalment of policy reform in the budget, it has every chance of achieving at least 5 of the 6 economic goals that it committed itself to prior to the election, namely:

- 0-2 percent inflation
- single digit business and mortgage interest rates
- a balanced budget
- a fall in the government share in the economy
- a growth rate reaching 3 percent by the end of its term.

The more problematical goal is a halving of the level of unemployment, but it is to be hoped that the government does not throw in the towel on this too easily. Employment grew by 3.8 percent or 47,000 in 1984/85 as the benefits of the wage freeze came through, and unemployment dropped by around 2 percentage points a year in the 1980s in several OECD countries as they emerged from a period of structural adjustment.

Moreover, the government can rightly argue that, in contrast to inflation for which it has sole responsibility, it cannot directly influence what happens to unemployment. Much will depend on whether public and private sector employers and their employees adapt rapidly to determining pay on the basis of labour supply and demand factors or whether old habits of automatic increases and relativities persist. Pay should essentially be based on what is needed to get and keep staff. In a more productive and growing economy, the market will force up pay rates over time. However, the government also has a role to play. While it has greatly improved the framework for employment contracting, more needs to be done following the budget if it is to achieve its employment goal.

The key here is clearly not a raft of so-called job creation schemes, which do nothing of the sort. It would be futile to adopt a politically motivated strategy aimed at achieving the target in ways that were unsustainable. Instead there needs to be an all-out attack on all the impediments to training and employing labour. In the labour relations area these range from some of the extraordinary decisions of the Labour Court, which the Court of Appeal has recently moved to check, to the problem of a minimum wage pitched far above safety net levels. Some unions and people in secure jobs will claim that offering people work at initially low pay rates is exploitation; in reality callousness consists of leaving the unemployed to their fate. There is major work to be done in the area of non-wage costs such as accident compensation. The process of making the education and training systems more relevant and responsive to labour market needs will need sustained effort. The Vice-Chancellor of Victoria University is on public record lamenting the fact that too many students want to go to his institution. Any other business would be delighted with burgeoning demand. More resources would be applied to satisfying the customers. Yet almost alone among OECD countries, our universities have a complex about policies which involve tuition fees plus protection for students who would otherwise be excluded on financial grounds. By comparison New Zealand polytechnics are becoming much more entrepreneurial and market orientated.

More generally, there is an enormous agenda still to be tackled in areas of microeconomic reform. Many New Zealanders who have not lived and worked in successful countries overseas still do not appreciate the scale of the changes in policies and attitudes that are needed if we wish to aspire to their living standards.

For example, the head of a Japanese forestry company recently pointed out that our planning laws in Carterton are stricter even than those in Tokyo, and that construction of a mill here takes far longer than a similar project in Japan. Our largest mining company has recently stated that it takes on average about four years to get a mining licence in New Zealand, a process that is slower and more difficult than in even the most anti-development state in Australia. With few notable exceptions, local government remains an area of massive inefficiency. Electricity Supply Authorities have made only a fraction of the efficiency gains achieved by Electricorp, and they seem to be the latest group to be offering extraordinary salary packages - Warren Cooper please take note. Yet they were the first to criticise the Corporation's proposed price increase, and the resulting public clamour for government intervention and a return to politicised pricing was the stuff of a banana republic. Effective rates of protection to the motor vehicle industry are currently of the order of 150 - 200 percent; a rate of 100 percent means the industry receives a subsidy of a dollar for every dollar of value added. In your own sector we have restrictions barring supermarkets operating pharmacies and a marketing board monopoly on domestic apple and pear sales - restrictions which I venture to suggest are unheard of in other OECD countries. The list goes on and on.

We must keep sober about the economic outlook. The farming sector is having one of its worst years on record. There is a major shake-out ahead in the meat industry, and massive losses to farmers from the Meat Board's investments in recent years are going to have to be taken on the chin. Even if employment picks up, unemployment is likely to rise for a period as more people seek work. The next couple of years will be extremely difficult, but for the first time since 1987 they hold the prospect of moving forwards rather than sliding backwards. This was the conclusion of this month's review of New Zealand by the London *Financial Times*:

> "Thanks to the structural adjustment of the past seven years", it wrote, "the outlook for the economy looks more promising than for several decades, but more pain will have to be inflicted before the results of greater competitiveness start to flow through."

The period immediately ahead will certainly be difficult for retailing, although the industry's fortunes are not entirely outside your own control. You too have a job to do to innovate, cut costs and make the consumer's dollar go further, and to contribute to the competitiveness and attraction of industries such as tourism. There has been no shortage of such innovation on the part of many of the major operators, and no lack of response to the opportunities opened up by the deregulation of shop trading hours, another success story in the moves away from a controlled economy.

The retail sector has never been afraid of competition and change. It has not been one to seek government handouts. Its voice will need to be heard in the period ahead when sectors of the economy that have not faced competition and change will be arguing that they should not have to. Television and Radio New Zealand can be guaranteed to feature a procession of post-budget commentators telling the public why the government should have gone for softer options. Some of the Auckland University academics may well be among them. But if the government maintains its commitment to its economic goals over the next couple of years, I believe the good news will be that their bad news is wrong. In that event, in this era of accountability, I trust the university authorities will hold them accountable for their performance.

THE LABOUR MARKET

THE EXAMINER

THE ECONOMICS OF THE GROWTH AGREEMENT

ROGER KERR
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25 OCTOBER 1990

THE ECONOMICS OF THE GROWTH AGREEMENT

Last month the government announced an Agreement on Growth with the trade union movement. This involved a commitment to restrain wage increases to 2 percent in the current award round, with any additional amount being dependent on productivity gains.

How should we think about the agreement as a component of an economic strategy?

The wage accord can be seen as part of a family of initiatives over the years in New Zealand to regulate wages by central decree. These took forms such as general wage orders, remuneration tribunals, wage guidelines, wage/tax trade-offs and the wage freeze implemented at the end of the previous government's term of office.

Wage (and price) controls were employed by a number of OECD governments during the 1970s to try to combat inflation and the effects of oil price increases, but have largely fallen into disuse. Australia is the only OECD country currently operating an institutionalised wage accord.

The basic lesson from OECD experience with incomes policies is that while they can have some favourable short term effects they generate increasing pressures and distortions the longer they remain in place. For this reason they harm long term economic growth.

Governments have also tended to employ incomes policies when other economic policy settings have been inadequate. Typically such accords are unable to compensate for the effects of bad policies. They usually make it more difficult to effect the necessary changes and other policies tend to become compromised over time.

Australian and New Zealand experience bears out these observations.

There has been a significant reduction in real wages since the mid-1980s in Australia, and an impressive growth in employment, especially in part time and female employment. There is some dispute as to whether this has been due to the Accord or to underlying economic conditions and the lessons learned from the 1981 wage blow-out, which resulted in unemployment rising from 7 percent to 10 percent of the workforce in just over 3 months.

In any event there is now widespread agreement in Australia about the relationship between real wages and employment - both the negative effects of excessive real wages growth and the employment-creating effects of real wage reductions. The debate about this relationship which was fiercely contested in the 1970s has now been largely resolved.

However, the counterpart to central wage fixation has been the perpetuation of the micro-level rigidities in the Australian labour market, with the result that productivity growth since 1983 has been effectively zero. Labour deepening has occurred, as theory would predict, but the environment has not been conducive to innovation and industrial flexibility. New variations of the Accord have not prevented Australia from sliding into its current economic predicament, and unemployment, which is at similar levels to New Zealand, is on the rise again.

Moreover, economic policy initiatives which are widely recognised as necessary in Australia have become hostage to the Accord. The Australian Council of Trade Unions vetoed the introduction of a goods and service tax, and only recently has the Hawke government managed to take the first tentative steps towards privatisation.

Experience with the Muldoon government's wage freeze was not dissimilar. Initially employers welcomed the reduction of wage pressures. As the benefits of real wage reductions came through, employment grew by over 40,000 during 1984 and 1985, the only significant period of job growth in the 1980s.

The difficulties came further down the track, when the distortions that had built up during the 20 month freeze had to be unwound. The unions did not accept the further cut in living standards necessitated by the 1984 devaluation, and demanded a catch-up for losses in the 1985-86 wage round. The result was a significant increase in real wages through 1986-87, a steep rise in unemployment and a loss of competitiveness from which the economy has still not recovered.

It is certainly a positive feature of the growth agreement that the link between wages and employment and the economy's weak competitive position appears at last to be recognised. Only a couple of years ago the Council of Trade Unions was arguing for wage increases on the basis of old-fashioned Keynesian notions of 'maintaining purchasing power'.

There may be a growing understanding about the demand side of a small economy, namely that tapping the enormous potential of international demand is dependent on being competitive in all respects and that effective domestic demand is assured by a stable monetary policy that facilitates real output increases, not inflation.

The reality of our weak competitive position is that across both the tradeables and non-tradeables sectors of the economy, our wage structure is generally too high relative to productivity. The problem is particularly acute at the low-skilled end of the market.

The downturn in key export prices and the new round of oil price increases has heightened the need for wage and productivity adjustments. Some employers appear to view the 2 percent benchmark as a welcome response. Given the coming economic crunch, however, it is arguable that no such floor should be put under wages and that market conditions would dictate lower outcomes in many circumstances. Colin Clark of the PSA has stated that several unions supported the agreement because "they doubted whether even a 2 percent increase could be achieved in some awards in the coming round".

The productivity leg of the agreement is also troublesome. Productivity improvements by themselves are not a basis for higher wages. Wages should basically be determined by the prevailing conditions of labour supply and demand in the particular job, industry and location. Productivity improvements should not lead to wage increases if there is an ample supply of workers with relevant skills seeking jobs. To do otherwise merely lengthens the unemployment queue for such workers.

Instead higher productivity and profits should be a signal to existing firms to expand and for new firms to enter the industry. Such firms would hire the available labour at prevailing wage rates until supplies become scarce and it becomes necessary to bid up wages to attract additional workers. That is the only way unemployment can be reduced.

Current labour market conditions in many industries do not justify wage increases. A new meat plant in Dunedin recently received 5 times as many job applications as the number of positions it was seeking to fill.

Productivity bargaining is in any case greatly hampered by the present award system. As a general rule, sensible deals are only possible at the level of specific enterprises, not on an industry or occupational basis. For example, the agreement in the recent metal trades negotiations to allow working beyond standard hours at ordinary time rates and to permit two rest periods in the day instead of three will be meaningful for some firms but irrelevant for others. It is economically damaging to incorporate a general productivity element in wages in these situations.

More generally, a regrettable feature of the wage accord is that it sees the government intruding anew into wage fixing after a period of disengagement which brought new attitudes and realities into employment relations. It will reduce the impetus which the government has been encouraging towards a wider, more market-related dispersion in wage settlements and towards new bargaining arrangements. It also reintroduces a form of two-tier bargaining, contrary to the intentions of the Labour Relations Act. Because no parties are bound by the accord, and employers are not even involved, there is every possibility of breakdowns. In that event there will be pressure for greater coercion or for the government to retreat from other economic policies.

Assuming that it remains in place, past experience with incomes policies indicates that a full evaluation of the effects of the agreement will not be possible for some time, perhaps 2-3 years. Because of this uncertainty, long term interest rates are unlikely to be reduced in the near future.

One acid test of the agreement would be the response to an exchange rate depreciation which, to be effective, would necessitate a further reduction in real wages. Another will be the response to the commitment to substantially reduce the projected budget deficit, a key commitment which has not yet been backed up with detailed plans. Unless this is to be achieved through tax increases, it will necessitate spending cuts in areas that are sometimes regarded as the 'social wage'.

One thing that is certain from all past experience is that over the long run central planning, including in the labour market, does not work. Economic growth depends on allocating all our resources to their best uses and using them productively. The labour market is a crucial allocation mechanism; labour accounts for some two thirds of the value of productive resources used in the economy every year. In a market economy, wage rates, along with interest rates, exchange rates and prices in general, are the signaling devices on which efficient economic activity depends. Suppressing by central decree the role of wages in adjusting supply and demand in the labour market, and in providing incentives for skill and effort, can only impair economic performance.

It is for these reasons that even advocates of incomes policies such as Professor Bryan Philpott see them as short term measures which need to be backed up by basic micro reforms in the labour market. This has been a key missing ingredient in the government's economic strategy and there are no indications of plans to implement significant reforms.

Even before the intervention of the accord, Rob Campbell had observed that "Over the full range of issues, we now have a more regulated labour market than in 1984". The fundamental gains from deregulation arise from the ability of employers and workers to continuously strive for more productive working methods in ways that are blocked by a centralised system. Whatever else the 'growth agreement' may achieve, it will not achieve growth until comprehensive labour market reform is moved to the top of the policy agenda.

H R NICHOLLS SOCIETY MEETING

COMMON LAW AND COMMON SENSE: THE EMPLOYMENT CONTRACTS BILL

ROGER KERR
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NEW ZEALAND BUSINESS ROUNDTABLE

MELBOURNE
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COMMON LAW AND COMMON SENSE: THE EMPLOYMENT CONTRACTS BILL

> "The property which every man has in his own labour, as it is the original foundation of all other property, so it is the most sacred and inviolable. The patrimony of a poor man lies in the strength and dexterity of his hands; and to hinder him from employing this strength and dexterity in what manner he thinks proper without injury to his neighbour, is a plain violation of this most sacred property. It is a manifest encroachment upon the just liberty both of the workman, and of those who might be disposed to employ him. As it hinders the one from working at what he thinks proper, so it hinders the others from employing whom they think proper."
>
> Adam Smith

Introduction

On 12 March of this year, the Australian government announced a programme for reducing most tariffs to a general rate of 5 per cent by 1996. As one commentator put it: "This was the day that protection died in Australia."

On 1 May next, the government in New Zealand appears set to implement the Employment Contracts Bill. This discards our century-old industrial conciliation and arbitration system and replaces it with a legal regime of free contracting. Property rights and freedom to trade in labour services are being restored.

As is well known, protectionism and labour market regulation have had a symbiotic relationship. Industry was protected from 'unfair competition' from imports in return for accepting that union members had to be protected against 'unfair competition' in the labour market through the award and arbitration system. This twin delusion has taken a fearful toll on the living standards of both our countries.

New Zealand has been dismantling its protection structures and average effective rates of assistance are now comparable to those in Australia. The current government is committed to further reductions, although decisions have yet to be taken. The signals from federal and state opposition parties suggest that labour market deregulation is not far away in Australia. Both countries may be laying the foundations for a turnaround in their relative long run decline.

Australian economic commentary on what has been going on in New Zealand in recent years has taken some curious forms. One school of thought has been blinded with admiration for the structural reforms achieved and has called for similar boldness by Australian Treasurers. Another sees the New Zealand economy as still struggling and puts this down to a misguided 'monetarist' and 'free market' experiment which Australia should avoid like the plague. Both views are wide of the mark. *The Economist* has generally had the story right, apart from a rather misplaced and passing preoccupation with the sequencing of reforms. As it put it recently, the problem has been that:

> "... the Labour government did only part of the job - the easiest part. Three huge areas were neglected: the rigid labour market and its centralised pay-award system, which prevents wages adjusting to market conditions; the lavish welfare state; and the budget deficit."

It is no great puzzle why the benefits to date have not been greater. The reform programme has been unbalanced for prolonged periods and political instability has eroded business confidence.

Nevertheless, much policy reform has been achieved and many gains are apparent. Labour productivity grew at an annual rate of about 5 percent in the manufacturing sector between the end of 1987 and the beginning of 1990, and by 3 percent for the whole economy. Productivity gains in state-owned enterprises and the waterfront have been spectacular. There has been a marked change in the pattern of investment away from protected activities to unprotected ones. The non-wage share of GDP has increased and aggregate business investment rates have remained high. Competitiveness has improved as rising labour productivity and falling real wages have reduced relative labour costs. Large reductions have occurred in inflation, inflation expectations, nominal interest rates and wage expectations.

One of the major downside factors has been a steep rise in unemployment. This is continuing and may top 10 percent of the labour force in the year ahead. However, as the recent OECD survey on New Zealand noted:

> "A large part of the increase in unemployment since 1986 reflected a transformation of hidden into open unemployment - and not the loss of profitable jobs. Many lost jobs had been viable only on account of government subsidies or border protection. These policies attracted resources into uncompetitive activities, in many cases reducing the incentives for the acquisition of the management and labour skills necessary for more competitive industries."

The OECD noted that the solutions to high unemployment would require difficult decisions involving industrial relations legislation, minimum wage laws, and the levels of and eligibility criteria for social welfare support.

The Labour Market Since 1984

As the figures for labour productivity show, there have been large changes in the New Zealand labour market since 1984. There has also been a transformation in attitudes and behaviour. Those who have been concerned about labour market developments have not argued that nothing has happened. Their point has been that not enough has been done to reform labour laws and institutions so as help firms adapt to intensified competition and enable workers displaced by restructuring to be reabsorbed in new activities.

In my view there have been two main reasons for the change in the employment relations climate. One is the impact of the general economic policies that have been pursued. A monetary policy aimed firmly at disinflation and policies such as trade liberalisation, deregulation of domestic industries, public sector reforms and privatisation have given firms strong incentives to contain costs, raise productivity and develop closer relations with their employees. This process has been enhanced by the second factor, the commendable refusal by ministers of labour to become embroiled in industrial disputes. The non-interventionist stance adopted by Mr Stan Rodger - 'sideline Stan' as he became known - has been followed by subsequent ministers and has forced parties to confront and resolve their own differences. Ten years ago, mostly at the behest of employers, the first item on the weekly cabinet agenda was the list of current industrial disputes. In recent years, even at times of tense industrial situations on the waterfront or the electricity industry, the imprecations from employers were for the government to keep out.

In contrast to these two powerful influences on the labour relations environment, the contribution of specific changes to labour law has been relatively modest.

Probably the single most important and least noticed change made by the previous government was the introduction of voluntary arbitration. This happened at the same time compulsory unionism was reintroduced, and this 'one step forward, one step back' approach was to characterise the government's term. The abolition of automatic access to third party arbitration by a decision of one party strongly reinforced the disciplines on wage bargainers to find their own solutions. The trade union movement agreed to the decision to scrap compulsory arbitration at the time, but later lamented it as an error and surreptitiously pressed for its restoration, with some success in the final months of the Labour government.

The major attempt by the Labour government to achieve labour market reform was made in 1985-87. The New Zealand equivalent of the Hancock review - as it unhappily turned out - was based on a Green Paper issued in late 1985. Most of the government's expressed intentions were commendable. It wished to encourage a more decentralised and dispersed wage fixing system, to promote new options for bargaining arrangements other than blanket coverage national awards (in particular by allowing unions to opt out of the award system), to allow workers the choice of union representation, to eliminate second tier bargaining by requiring all employees to be covered by a single document and to promote sanctity of contracts. On the other hand, it set its face against contemplating genuine voluntary unionism and sought to promote union amalgamation by increasing the minimum size of unions to 1,000 members, a move that flew in the face of efforts to develop enterprise-focused bargaining structures.

The reformist ministers in the previous government who had come, albeit rather slowly, to appreciate the significance of labour market reform, were thwarted by opposition in the party and the trade union movement. Despite claims to the contrary, the Labour Relations Act of 1987 largely amounted to tinkering with the existing system. Subsequent initiatives in the labour area saw a continuation of the 'one step forward, one step back' pattern. On the positive side, the government implemented a State Sector Act, in the face of fierce resistance from public sector unions, which went further towards dismantling the centralised system and introducing greater flexibility. It also abolished the special legislation governing waterfront employment relations, which has led to one of the major success stories in New Zealand microeconomic reform, and it deregulated shop trading hours. On the other hand we endured a futile inquiry into industrial democracy and a two year debate on proposals to legislate for so-called 'employment equity'. The bankruptcy of these was convincingly exposed in the debate, allowing the new government to repeal the employment equity legislation as one of its first moves. In March 1990, recognising that its attempts at bargaining reform in the Labour Relations Act were insufficient, the Labour government decided to give employers a right to opt out of awards, but this too was so circumscribed as to be totally ineffectual. At the same time, it reintroduced a form of compulsory arbitration. In a final twist, the government reverted to centralism in September 1990 with a so-called 'Growth Agreement' with the trade union movement, the central feature of which was an undertaking to confine wage adjustments to 2 percent.

Throughout this period, developments in industry were characterised by a mix of the encouraging moves towards workplace cooperation and more productive work arrangements that I referred to and 'business as usual' as far as the pattern of award rounds and the institutional machinery was concerned. A major event in the transition from centralised wage fixing to 'free' bargaining was the irresponsible wage push by unions in 1985/86, which led to an increase in average weekly earnings of 17.4 percent in 1986. This was the single most important setback in the economic reform programme, resulting in the disappearance of thousands of union members' jobs and a loss of competitiveness from which the economy is still struggling to recover. However, the lesson was quickly learned. Increases in average weekly earnings in the two succeeding years were around 7-8 per cent, in 1989 and 1990 about 4-5 percent, and are currently running at 2-3 percent. With inflation coming down to similar levels and continuing productivity improvements, a platform for achieving genuine competitive advantage is being created.

As far as policy is concerned, the overriding lesson of the period is that piecemeal reforms to labour law produce disappointing results. The architects of the Labour Relations Act, including the Department of Labour which has been a principal defender of the old system, argued that the removal of a few 'keystones' and the provision of opportunities to opt out of awards were all that was needed to allow desirable change. This has proven to be a recipe for reform at a snail's pace and for a growing gap between employment displacement and absorption. It is clear that wide freedoms need to be created to overcome inertia and the power of vested interests to resist change. The new government has recognised this in bringing down the Employment Contracts Bill.

The Employment Contracts Bill

From the mid-1980s, New Zealand employer organisations, government agencies other than the Department of Labour, the OECD and IMF, independent commentators and the National party in opposition pressed the case for much more comprehensive labour market reform. Public opinion surveys also showed large majorities - of the order of 70 - 80 percent, including among trade union members - in favour of voluntary unionism, worker choice of representation, and giving employers and employees the freedom to deal directly with one another. The present government made labour relations reform a central element of its election campaign and assumed office with a clear mandate for change.

The cornerstone of the Employment Contracts Bill is a rejection of the century old conflict-based model of employment relations which holds that employee and employer interests are fundamentally opposed, in favour of a model which recognises that they share a common interest and that employment contracts depend for their existence on making both better off. Myths about the 'special' nature of labour contracts and 'unequal' bargaining power have also been discarded. As its name suggests, the Bill recognises that the best way of promoting high employment and high incomes - the best way of protecting workers - is to base labour law on the principle of freedom of contract.

Some of the most significant provisions of the Bill are as follows:

- compulsory unionism is abolished and replaced with freedom of association;
- unions will become incorporated societies with no special rights (the term trade union does not appear in the Bill, which speaks of employer and employee organisations);
- unions lose the exclusive right to collectively bargain on behalf of workers - they may negotiate themselves or use the services of any bargaining agent;
- awards and agreements disappear and are replaced with employment contracts;
- subsequent party provisions - the mechanism by which awards were given blanket coverage, even to parties who had no role in their negotiation - disappear and employment contracts will only apply to those persons who actually contract to be bound by them;
- terms and conditions of employment will be governed by contractual principles, either under individual or collective employment contracts;
- the elimination of union registration provisions removes the basis for demarcation disputes;
- no specific provisions are made for redundancy and the Labour Court loses the power to determine redundancy compensation where the parties cannot agree;
- a strike or lockout will be lawful except where there is a collective employment contract in force that relates to the striking employees; and
- appeals from decisions of mediators or other appointed persons to the Labour Court can only be made on questions of law (not fact).

At this stage personal grievance procedures are retained in their present form with some modifications:

- there will no longer be any requirement that workers be covered by unions before they can use the procedures;
- the right to use the personal grievance procedures will be dependent upon whether the person is covered by a collective employment contract or has a personal grievance procedure in his/her individual employment contract;
- reinstatement will no longer be the primary remedy;

- 'procedural unfairness' in the manner of the dismissal will no longer render the dismissal unjustified if the employer had substantive justification ('good cause') for dismissal.

The Mediation Service and Labour Court are to be retained, but there will no longer be any requirement to use mediators from the Mediation Service to chair disputes. The parties may agree to have any other person (such as an arbitrator, solicitor or industrial advocate) mediate the dispute. The government has indicated that it has yet to take final decisions on these institutions and on personal grievances.

Evaluation of the Bill

In its original submission in response to the Green Paper in 1986, our organisation wrote:

> "Labour and industrial relations law in New Zealand has gradually isolated labour market contracting arrangements from common law and common sense. The current myriad pieces of labour law are not only a mystery to the outsider; even practitioners find it a maze. The arcane body of rules inhibits beneficial contracts, and what is required in its place is a minimum set of laws necessary to allow the negotiation of agreements subject to enforcement by the parties and their appointed arbitrators. Complex and often unenforceable labour laws mean uncertainty, which reduces incentives for investment, risk-taking and hiring of new labour.
>
> The common law rules allowing freedom of association and freedom to enter into mutually beneficial arrangements (contracts) for employment that should exist in principle have been replaced in practice by a set of obligations and constraints which preclude more productive employment. Incomes of both workers and enterprises are reduced by the incapacity to adapt awards to local and individual conditions. Employers' offers are less than they could be owing to the insecurity and non-enforceability of awards. The parties to awards have few incentives to design their own arrangements to enforce agreements they have freely entered into... What the government must do is create a stable, non-distortionary and intelligible legal environment in which employment and productivity-enhancing contracts can be written."

A serious question arises as to whether any statutory law - other than legislation on employment standards - is needed to reflect these principles. The common law has continued to regulate employment contracts in New Zealand; indeed more than half the workforce is outside the ambit of collective bargaining and the 'special' jurisdiction of labour law. The protections of the common law against fraud, coercion, incapacity and duress apply to employment contracting as to other contractual relationships. The civil courts have remained involved in employment matters. The main argument for some form of statutory law which we found compelling was that over time labour law had become a special province and judicial precedent had moved it away from its role of protecting and enforcing contracts. In New Zealand circumstances at least, there seemed a need for Parliament to give fresh guidance to the courts in order to bring employment contracting into line with general contract law. This would limit if not prevent inappropriate forms of judicial activism while a new understanding and legal culture developed in respect of employment relationships.

This analysis points to the case for a relatively brief and simple statute with the essential purpose of facilitating free trade in labour services. The Bill certainly goes a long way to doing away with the enormous complexity of past arrangements. Where it currently falls short is in its unwillingness to entertain a full range of contracting freedoms and the retention of some of the baggage of the former system. There are a number of significant inconsistencies in this regard which could undermine both efficiency and equity objectives in the labour market.

- The Bill is effectively a 'right to work' law in that it disallows the right to make union or non-union membership a condition of a contract. While there may be a transitional argument for outlawing contracts which require union membership because of past attitudes and behaviour associated with closed shops, there are no obvious grounds for concern about allowing non-membership of a union to be a condition of an employment contract and full contracting freedom should be allowable in the longer run.

- Compulsory grievance procedures are retained in respect of collective contracts and there is a risk that they will be extended to individual contracts. Legislated redundancy and dismissal rules raise the costs and risks of employment and have been an important factor in the poor unemployment record of several European countries. There are no grounds for disallowing 'at will' or 'on notice' contracts and any alternative terms should be a matter for voluntary negotiation in employment contracts.

- Compulsory disputes settlement procedures are similarly retained for collective contracts. Again these should be a matter for voluntary contracting or, as a second-best option, should be legislated only as a standard form model for parties to avail themselves of should they so choose.

- The specialist Labour Court is retained, which poses a serious risk of perpetuating attitudes and a legal culture which have no place in the new regime. Since 1987 the Goddard court has greatly extended its reach. Employers and politicians alike have looked askance at the intrusions it has made into redundancy and dismissal cases in total disregard of commercial realities. While it will no doubt have its wings clipped, there is a strong case, supported by some of New Zealand's leading industrial lawyers, for its total abolition. The civil courts have the expertise and capacity to handle contractual disputes, which should greatly reduce in number.

- The provisions on strikes and lockouts fall somewhat short of reducing these issues to a simple determination of whether action has been taken in breach of a contract or whether trade has been interfered with unlawfully.

These inconsistencies are not fatal flaws in the Bill but they would undermine its effectiveness. With its difficult economic and employment situation, New Zealand can ill afford politically expedient compromises. A significant number of more or less technical problems have also been identified and it is hoped that these will be remedied. Other criticisms that have been made by its supporters have less validity. Among some employers there is an apparent 'fear of freedom' and a belief that some of the props and crutches of the old system are needed to prevent 'instability' in bargaining. The basic response to these criticisms is that employers need to get close to their staff to sort out any such problems and that managers should do what they are employed to do, namely manage.

Reactions to the Bill

The Bill was introduced by the government as part of an economic package in December 1990 which also included reforms to social welfare benefits. Market reactions have been favourable, with a welcome slide in interest rates over the last few months.

The introduction of the Bill has already given an impetus to bargaining reform. Recent negotiations in the accommodation and hotel industries have seen an end to penal rates, the introduction of youth rates and more freedom to use casual staff. These concessions would have been considered sacrilege by the union movement even 12 months ago. Other developments of this sort look set to follow.

There has been overwhelming support among employers for the Bill. Two briefing sessions in Auckland were attended by a total of 2,000 employers. According to the Director General of the Employers Federation:

> "The response is outstanding. Never before have we had such numbers. Without exception the meetings are giving massive support to the new bargaining arrangements and the new cooperative era of labour relations."

The initial reaction of the unions was muted, if not stunned. In submissions to the Select Committee considering the Bill, some unions have accepted its inevitability and concentrated on issues of detail. The capacity of the union movement to oppose the Bill has been weakened by the extent to which the intellectual argument in favour of reform has been won in recent years, the majority support for key changes shown in public opinion surveys and the government's electoral mandate. Lacking other bases for opposition, the unions have more recently resorted to old-fashioned rhetoric and protests in an attempt to influence political opinion. The arguments have been incoherent, with marxist slogans about 'wage slavery' conflicting with claims that wages will 'blow out' without the discipline of union restraint. There have been the usual threats of industrial anarchy and a disregard for the interests of others, with Combined Trade Unions president, Ken Douglas, saying the union response was to hold on to what they had and "somebody else would have to go to the slaughter". Most commentators seem to think that such crude tactics are unlikely to impress the government, which has put forward the case for the Bill in an articulate and principled way.

The news media have concentrated on opposition to the Bill. They have given prominence to the views of unions and other critics and have seized on the natural variations of opinion among employers on technical aspects of the Bill to suggest major differences of opinion that do not exist. Criticism has also come from industrial relations reporters, academics and lawyers. As in Australia, all these are groups whose professional 'expertise' in the old system stands to become largely redundant.

The Labour opposition initially declined to give a commitment to repeal the Bill. Under pressure, it has now said it will do so.

Implications for New Zealand - and Australia?

The Select Committee is currently deliberating on the Bill and it is expected to be reported back to the House within the next week or so. The government has indicated that it is unlikely to be significantly changed, but hopes are held that some of the inconsistencies identified in it will be improved and technical deficiencies remedied.

The enactment of the Bill on 1 May or shortly thereafter will not usher in radical overnight changes in labour practices. Rather than being a quantum leap into the unknown, the Bill will facilitate an extension and acceleration of a process of decentralisation of employment relations and adoption of productivity-improving working methods that goes back several years. It will also put pressure on uncompetitive wage structures that have been maintained by monopoly union power and allow 'outsiders' - particularly the low-skilled, women, part time workers and ethnic groups - who have been marginalised by the rigidities of the previous system to compete more effectively for jobs.

The Bill does not mark the end of necessary labour market reform in New Zealand. As the OECD has noted, statutory minimum wages in New Zealand have been increased to an exceptionally high level by international standards and are precluding low-skilled workers from gaining employment. Antiquated employment arrangements in the shipping industry need to be overhauled. Some special provisions governing retail employment need to be repealed. The trans-Tasman maritime Accord remains in place even though it has now been repudiated by governments (and opposition parties) on both sides of the Tasman. There is a need for the jurisdiction of the Commerce Act to be extended to cover anti-competitive practices in the labour market on the same basis as other goods and factor markets. More generally the new freedom to negotiate employment contracts tailored to the needs of firms and employees will open the way for policy reforms in areas such as training, accident insurance and occupational health and safety.

Advocates of labour market reform in Australia can perhaps take some heart and draw some lessons from New Zealand experience.

One is that sound intellectual arguments and evidence win hearts and minds in the long run, not least among workers. It is hard to sustain arguments about exploitation and anarchy when even partial deregulation on the waterfront has led to fewer disruptions than ever before, higher not lower wages, massive increases in productivity and lower costs. Labour relations policies are not a matter of political debate in successful countries. I would be surprised if they are a source of contention in New Zealand in a few years' time.

Secondly, I believe there is little prospect that deregulation will lead to the kind of wages 'blow-out' much feared in Australia. Most workers are realists. They understand the relationship between profits and jobs, and the new system will bring this relationship into sharper focus. A few years ago a former Employers Federation leader accused me of "wanting to let the gorillas out of the cage" for advocating a move from centralised wage controls to free bargaining. He under-estimated the intelligence of most workers - and, for that matter, unionists. Provided monetary policy is set against inflation and product markets are competitive, there is no reason why deregulated labour markets in Australia and New Zealand should exhibit more of an inflationary bias than those of, say, Switzerland and Japan. Talk in Australia of the need for a 'wages policy' as a separate arm of economic policy has always struck me as curious. Why should governments regulate the price of labour any more than the price of wool? It is government action in fooling around with markets that is more likely to produce explosions - or implosions - in the case of either labour or wool.

Thirdly, New Zealand experience gives some cause for confidence that the business community can be encouraged to give its full backing to labour market reform. Having worked through the issues at a fundamental level 5 years ago, there has never been any debate within the Business Roundtable about the need for comprehensive reform or the shape it should take. Other employer groups in New Zealand have moved to similar positions. In the short term, some businesses gain from controls and accords, and some fear the consequences of change. But all lose in the long run from the inefficiency of centrally planned labour markets.

Finally, I believe the achievement of the Employment Contracts Bill owes something to a willingness by its advocates to argue from first principles and to reject tactically expedient formulations and compromises. It is perhaps noteworthy that the argument for labour market reform in New Zealand has not been advanced under the banner of 'enterprise bargaining' that has been fairly widely adopted in Australia. Although in a freer environment the traffic will certainly flow from broad occupational and industry awards to a more decentralised level, there is no economic principle which states that the right locus of bargaining is the enterprise. In some cases it may be smaller units within the enterprise, including individuals; in others it may be larger ones. The only economic principle that stands up to scrutiny is the principle of freedom to contract.

New Zealand's economic difficulties will not end with the passage of the Employment Contracts Bill, but a giant obstacle to progress will have been removed. In relation to Australia, the Bureau of Industry Economics recently concluded that:

> "With returns to labour accounting for some two-thirds of GDP, it is not surprising that reforms in the labour market seem to offer the greatest potential benefits among the different microeconomic reforms currently under consideration. Across the whole economy labour reforms alone might produce gains approaching 1 percentage point a year of GDP."

Potential gains in New Zealand might well be of the same order.

The debate about protection reform in Australia began in the early 1970s, and in New Zealand about 10 years later. It will be near the turn of the century before the damage protectionist policies has done to our economies has been repaired. The debate about labour market reform began in earnest in the 1980s and is now in its final stages in New Zealand, and I suspect in Australia as well. They have been wasted years for both countries. New Zealand still has a long way to go to get its economy into working order. But on 1 May or shortly thereafter one more breakthrough seems likely to be made.

THE LISTENER

THE EMPLOYMENT CONTRACTS BILL

ROGER KERR
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE

15 APRIL 1991

THE EMPLOYMENTS CONTRACT BILL

What will the current arguments over the Employment Contracts Bill look like from the year 2000?

Remember the fuss about waterfront reform? A recipe for anarchy and cutting waterfront wages, it was said. And deregulation of shop trading hours? The end of family life in New Zealand as we knew it.

The outcome? On the waterfront, fewer disruptions than ever before, higher not lower wages, massive increases in productivity and lower costs. And how many people would want to turn the clock back on weekend shopping?

Change is often uncomfortable and a threat to vested interests. The Employment Contracts Bill will put pressure both on employers that have sheltered behind the protections of the old system and on union and worker groups that have benefited from monopoly privileges. As *Metro* columnist Bruce Jesson recently put it:

> "The union bureaucrats maintain that voluntary unionism will disadvantage low-paid sections of the workforce but, in fact, the main victims will be the union bureaucrats themselves. As their memberships shrink, their funds will dry up and many officials will lose their perks and cushy jobs."

But change we must, if we are to get the growth in jobs and incomes that the community wants. Last year the Trade Development Board revealed some staggering statistics: real wages in New Zealand were no higher in 1987 than in 1960, whereas they were around 150 percent higher in Japan and Europe and 70 percent higher even in Australia and the United Kingdom.

Our conflict-driven industrial relations system bears a fair share of the responsibility for this truly abysmal performance. We are still living beyond our means and face a simple choice: cut wages or dramatically improve productivity. Clearly the emphasis has got to be on productivity increases.

In its recent survey of New Zealand, the OECD has again affirmed the need for comprehensive labour reform. Opinion surveys have shown that New Zealanders want voluntary and contestable unionism and freedom for workers to deal directly with employers, either individually or collectively.

The Business Roundtable is strongly committed to a New Zealand where average incomes are high and unemployment is low. We believe this goal will best be achieved by granting employers and employees the freedom envisaged in the Bill.

The Bill moves New Zealand's substantially unique employment arrangements in the direction of other OECD countries, in particular towards the more successful models such as Switzerland and Japan which have the fewest restrictions. Unemployment in both countries is low and incomes per head are amongst the highest in the world.

In Japan and Switzerland, strikes are a rarity. Japanese rail union leaders apologise to the public for the inconvenience of disruptions. Contrast this with the famous declaration of a New Zealand rail union leader a few years ago: "The public can go to hell".

The cornerstone of the Bill is its rejection of the conflict model of employment relations in favour of a recognition of the mutual interests of firms and workers. In place of strife and the class struggle we can expect to see cooperation and the productivity struggle.

Unions can survive in a freer environment if they do a good job. We are likely to see the kind of turnover of the old guard in union leadership that has occurred in New Zealand business as new skills and attitudes come to dominate.

There may be a settling down period with the new Bill but it is already clear that it has massive upside for firms, workers and the unemployed. Labour law around the world is not a generally controversial topic; the merits of better regimes are recognised across the political spectrum. By the year 2000, we will be looking back on 1991 and wondering what all the fuss was about.

Who knows, children may be asking their parents: "What was a strike? What was unemployment?".

KENSINGTON SWAN SEMINAR ON
THE EMPLOYMENT CONTRACTS BILL

A BETTER WAY OF WORKING

ROGER KERR
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE

WELLINGTON
24 APRIL 1991

A BETTER WAY OF WORKING

John Hyde, a former Liberal party member of the Federal Parliament in Australia, recently told the following story which is relevant to the topic of today's seminar.

> "In West Australia", he wrote, "there has recently been a considerable hullabaloo about people feeding dolphins to attract them to beaches where tourists may view them. Rules are now in force to restrict the practice, lest the dolphins become dependent on the handouts and fail to learn how to fend for themselves. Should we not have a similar concern for the human species?
>
> "Yet, if we were to countenance laws that prevented people from working and we were not to provide the resultant unemployed with an alternative income, then we would commit an injustice equivalent to denying the dolphins access to the fish in the sea without providing the alternative dole of fish."

The Employment Contracts Bill goes a long way to making high levels of employment in New Zealand legal once again. Yesterday the Bill was reported back to the House. Employers and employees can now evaluate its likely final shape and will soon be able to take advantage of the new opportunities it provides to create more jobs and find better ways of working.

With impeccable timing, Dave Morgan and the seafarers did the country an invaluable service in recent days by reminding us what the debate has been all about. When railway workers go on strike in Japan, which is a rare occurrence, they apologise for their actions and try to minimise the inconvenience to the travelling public. Factory workers turn up before work to make their protest, put their placards away at the normal starting time and continue working without loss of wages or production. Japan has one of the OECD's least regulated labour markets. The ferry dispute was a reminder of the economic consequences of a regulated and monopolised system and the habits and attitudes it breeds.

For decades, New Zealand workers were indoctrinated with the belief that 'the union makes us strong' and that copious strike activity raised living standards, just as the Aztecs believed that the rise of the sun depended on copious offerings of living human hearts. The truth is that unionisation as we have known it helped make us poor. Real wages have stagnated since 1960 in New Zealand whereas they have more than doubled in successful economies. In the 1980s non-union wages have risen faster than union wages in the United Kingdom and the United States. The reality is that strong economies and rising living standards are built on continually acquiring and adapting skills, increasing productivity and working hard.

We need to evaluate the new legislation in the context of trends in the international economy and New Zealand's place in it. The old system was part of the institutions and regulations of the set of fortress New Zealand policies that has been swept away by the irresistable pressures of international competition. Globalisation - the mobility of capital, know-how and skills to those locations where the highest returns can be reaped, and the supply of the entire world market from those locations - has increasingly become a reality in world industry. International economic relations are now little different from inter-regional exchange, and notions like a national labour force, a national capital stock or a national money supply are becoming more and more meaningless.

Henceforth national governments will have to ensure good locational conditions for mobile resources in competition with governments in other countries to avoid a flight of capital, businesses and skilled people. Handouts such as tax incentives and subsidies which can be withdrawn as easily as they are introduced will not be material in this regard; at most they will distort investment patterns rather than influence overall flows. Of far more importance will be factors such as labour organisation (unions, labour laws, work practices) in attracting or repelling mobile capital, high skills and knowhow.

In the past, international forestry firms have looked at the labour relations environment they would face if they invested in New Zealand and walked away. Already one Australian firm to my knowledge is likely to relocate to New Zealand because the new framework is more attractive than the labour situation in Australia. Another may do so if the trans-Tasman shipping problem is also solved.

However, it is not enough for New Zealand simply to dismantle the worst features of our current system. We are a country on the periphery, far from world markets and sources of international capital. If we wish to make New Zealand an attractive place to live, work and do business, the quality of the business environment we need to create, including our labour laws, must be exceptionally high. The government has also set itself demanding economic targets against which policy decisions must be judged. It indicated to the electorate a goal of reducing unemployment by half in its first term. It is also committed to restoring New Zealand's credit rating to a Triple A status. These are the kinds of benchmarks against which the new employment legislation must be evaluated.

The cornerstone and central achievement of the new legislation is its rejection of the century-old conflict-based model of employment relations which holds that employer and employee interests are fundamentally opposed, in favour of a model which recognises that they share a common interest and that employment contracts depend for their existence on making both better off. As its name suggests, the legislation recognises that the best way of promoting high employment and high incomes - the best way of protecting workers - is to base labour law on the principle of freedom of contract. Like other standard economic relationships - for example those between producers and consumers or savers and borrowers - the relationships of employers and employees will be governed largely by the principles of normal contract law.

The legislation rejects the myths about the 'special' nature of labour contracts and alleged 'inequalities' in bargaining power. It rightly recognises that - in the absence of legal obstacles - it is competition for labour services that sets wages and forces them up over time. The fallacy about unequal bargaining power is apparent when it is recognised that major corporates have no more ability to hire workers on inferior terms than the smallest firm in the land. If they offer work at $9 an hour when the market rate is $10, other things equal they will get few workers. The essence of bargaining power is the existence of alternatives, which are greatly expanded in the new legislation. This is not to say that in the labour market, as in any other, there are not times of scarce or plentiful supplies which favour sellers or buyers, but the point about properly functioning markets is that they adjust under competition to remove such imbalances. For this reason currently unemployed workers will be major beneficiaries of the Bill.

Ken Douglas has described the legislation as a return to the 1830s and others have painted a picture of a return to the world of Charles Dickens, sweat shops and chimney sweeps. This vision is absurd; it bears no relationship to modern conditions. Moreover, what readers of Dickens would never appreciate is the unprecedented economic growth and improvement in working conditions that occurred in that period. During the 19th century, the population of Great Britain increased from 11 million to 37 million and per capita wages quadrupled. The establishment of private property, the rule of law, the rapid growth of contract and the decline of regulation - particularly of trade and the labour market - provided the foundation for that spectacular economic success.

A legal audience may be interested in knowing that the great change in Britain which signalled the rapid spread of contracting in the labour market was the repeal of the Statute of Artificers (usually called the Statute of Apprentices) in 1819. As one authority described it, the previous laws:

> "... controlled entry into the class of skilled workmen by providing a compulsory seven years' apprenticeship; they reserved the superior trades for the sons of the better off ... they required permission for a workman to transfer from one employer to another ... and they empowered justices to fix wage rates for virtually all classes of workmen."

Britain led the so-called industrial revolution by discovering that there are basically two ways of organising the daily work of the world. The first is to have courts or, more recently, central planning bodies, telling everybody else what to do and how to do it. Examples were pre-industrial revolution Europe and what are, or were, the centrally planned economies.

The other way of organising work is to let everybody make any agreements they desire with one another - that is, to trade freely. A contracting society, in contrast to a regulated society, can use all of the widely dispersed information throughout that society in order to bring about as efficiently as possible the provision of goods and services, the formation of new capital, and the investment of time and resources in new ventures. In order for this sort of market economy to work, we need to have a rule of law, based in our system on property, tort and contract, and an independent bench and bar to administer it.

As is well known, the foundations of Britain's economic prosperity were undermined by trade union laws and other departures from relatively non-interventionist policies implemented from around the turn of century. A major achievement of Mrs Thatcher's government, which is now acknowledged by the British Labour party, was to attack trade union monopoly privileges in a series of Employment Acts. Similar developments are now occurring in Australia. The recent Troubleshooters case which upheld the right of a team to work as independent short term contractors alongside unionised building employees was described by a union leader, in rhetoric with which New Zealanders have become familiar, as representing:

> "... the first major breakthrough for the New Right, in its efforts to take the Australian workforce out of the award and arbitration system and into the quagmire of contracting."

As one Australian observer commented:

> "Those marvellous words - 'the quagmire of contracting' - cry out for display in large neon lighting. They ... demonstrate the profound contempt of the trade union boss for the ordinary working man and woman."

The Liberal governments that are likely to come into office at both federal and state level in Australia over the next 2 years are likely to go down the same road that New Zealand is taking.

Those who have supported major labour market reform in New Zealand have essentially advocated the creation of a stable, intelligible legal environment in which productivity-enhancing contracts can be written. There is a serious question as to whether any statutory law, other than legislation on employment standards, is needed to create such an environment. The common law has continued to regulate employment contracts in New Zealand; indeed more than half the workforce is outside the ambit of collective bargaining and the 'special' jurisdiction of labour law. The protections of the common law against fraud, coercion, incapacity and duress apply to employment contracting as to other contractural relationships.

Arguably the strongest case for some form of statutory law is that over time labour law has become a special province and judicial precedent has moved it away from its role of protecting and enforcing contracts. On this argument, the task of Parliament is essentially to give fresh guidance to the courts in order to bring employment contracting into line with general contract law so as to limit inappropriate forms of judicial activism while a new understanding and legal culture develops in respect of employment relationships.

The Bill as introduced, and as modified by the Select Committee, goes a considerable distance to doing away with the enormous complexity of past arrangements and performing a basic role of facilitating free trade in labour services. Some of the detailed changes made by the Select Committee will take time to analyse and the implications of some of the Bill's provisions cannot be known with certainty until tested in practice. For these and other reasons it is unlikely that the Bill is the last word in labour relations reform.

The Select Committee is to be commended for making some useful changes to the initial Bill, such as the deletion of the 'new matters' provisions, the provisions affecting the shipping industry and some improvements to transitional arrangements which will facilitate a faster adjustment to the new environment. Where the legislation still falls short is in its unwillingness to entertain a full range of contracting freedoms and the retention of some of the baggage of the former system. The general thrust of the amendments is to reintroduce a degree of prescription and detail which, in general, appears unnecessary, and to eliminate options permitting wider freedoms. Examples of these changes are the removal of clauses 3 and 4 which would have allowed contracts to be made in forms other than those specified in the Bill, some restrictions on bargaining agents and prescriptions on procedures for appointing them, and new provisions on sick leave and parental leave.

Of more significance is the requirement for all contracts, individual and collective, to include provisions for personal grievances. This extends a new form of regulation to the large section of the labour market that has been outside the ambit of collective bargaining. A considerable industry has grown up around personal grievance cases which has arguably not benefited the economy or the workforce at large. As other countries have found, provisions which strengthen job security for some workers inevitably reduce job security for other, more marginal workers. Legal practitioners would not be doing their clients - employers or workers - a favour by encouraging them to provide in their contracts for complex rules or liabilities governing redundancy or termination of contracts. For the employer, these raise the risks and costs of employment, and for the employee they will have the effect of reducing wages or other conditions of the contract. Contracts which provide for termination at will, on notice or on the expiry of a fixed term will be more efficient in many cases. Unless contracts provide otherwise, employers should have the same ability to terminate employment as employees have to quit. The resources of courts are better employed in determining whether contracts are breached rather than in arbitrating on vague notions of fairness arising out of complex rules which invite litigation.

These concerns are heightened by the retention of specialist institutions in the form of the Employment Tribunal and the Employment Court. These pose the risk of maintaining a legal culture which treats employment contracts as different from other contractual relationships. The risk will be increased if existing personnel are simply transferred across to the new institutions. Some of the recent decisions of the Labour Court have shown an astonishing lack of appreciation of commercial and economic realities. Another insight into attitudes in these quarters was the report of the previous government's inquiry into industrial democracy under former Chief Judge Horn, the findings of which were totally at variance with the philosophy behind the new legislation.

Although the government has clearly sought to clip the wings of the court, there remains a danger that former case law will be regarded as having precedent and that new forms of judicial regulation will replace the statutory regulation that the government has been at pains to remove. This is an area which the government and interested parties will no doubt be watching closely and any such developments will need to be nipped in the bud.

The government will also need to address other issues in labour market reform if it wishes to achieve its growth and employment objectives. Some special provisions governing retail employment have not yet been repealed. The trans-Tasman maritime Accord remains in place even though it has now been repudiated by governments (and opposition parties) on both sides of the Tasman. There is a need for the jurisdiction of the Commerce Act to be extended to cover anti-competitive practices in the labour market on the same basis as other markets. Taxpayer funding of the Trade Union Education Authority has no justification in the new environment and the Act supporting it should be repealed.

In respect of employment, the OECD commented in its recent report on the New Zealand economy that:

"As unemployment is of particular concern, attention should be paid to institutional characteristics which impede job creation. Difficult decisions will have to be taken, involving industrial relations legislation, minimum wage laws, and the levels of and eligibility for social welfare support."

Of these three items, the government has not yet addressed the effects on employment of the present Minimum Wage Act. *The Economist* recently reported that the Trades Union Congress in Britain wants a national minimum wage set at half average earnings, and noted that this would price thousands of workers out of a job. The current minimum wage in New Zealand is set at that level. The government's aim of halving unemployment over the next 2 1/2 years implies a need to create perhaps 100,000 new jobs, allowing for the fact that some discouraged workers would re-enter the workforce if employment conditions improve. This is a rate of job creation far in excess of anything achieved in recent years. It is implausible that it can be attained without ensuring that low-skilled people can be absorbed into the workforce at pay rates that reflect their initial productivity.

However, the task ahead is not only, or even primarily, one for the government to undertake. Employers, unions and workers all face new opportunities and challenges.

Most employers will clearly welcome the new opportunities. In a recent poll, some 70 percent of chief executives of firms of all sizes said their business would benefit from the freedom to negotiate with their workers under the proposed Bill, including - contrary to the findings of the Graham Task Force - 61 percent from the manufacturing sector. The task of employers will be to comprehensively review the needs of their operations, consider the aspects of awards or agreements and work practices they want to change, examine improved forms of individual and collective bargaining and talk with their employees to gain their trust and cooperation in bringing them about. They will also need to recognise that, in a competitive market, notions of wage fixing on the basis of relativities, employers' 'ability to pay' and automatic linkages with productivity gains go out the window. The only relevant criterion for pay fixing is the need to meet the market to retain or recruit staff in the numbers, quality and locations desired.

It is to be hoped that employers are learning that economic factors prevail in the labour market as in any other. It was ironic that the Reserve Bank's questionable involvement with the Growth Agreement last year, ostensibly on the basis of its contribution to wage moderation, recently cost it a higher settlement, according to union comments, than it would otherwise have incurred. The trouble with central planning of this type in the labour market, as in any other market, is that it doesn't work. That lesson has again been demonstrated by recent Polish experience. As one leading economic authority has reported:

"The government boldly abolished regulations over practically all prices, including the exchange rate. Unfortunately, Warsaw made a major mistake by freezing wages. This wage policy had much to do with Poland's subsequent decline in industrial output and with the recent defeat of the government. The Polish reformers apparently forgot that wages, like prices, need to be freely set by market forces in order to allocate efficiently a country's most precious resource, human capital."

This lesson is as relevant to the public sector as to the private sector. Supply and demand factors and rewards for performance must be recognised in public sector employment contracts if we want an efficient public sector. Accountability should be exercised through budget allocations, not through controls on managerial decisions. There are dangers of forgetting these lessons and drifting back to a system of centralised wage controls.

For their part, unions will need to adapt to retain loyalty and membership. We are likely to see a decline in union membership in line with worldwide trends; even without deregulation, unionism in Australia is expected to fall to around 25 percent of the workforce by the year 2000. Union members will need to decide whether membership remains valuable to them or whether to increase their take home pay by ceasing to pay union fees. The performance of some unions as bargaining agents will be stimulated by competition from people such as private arbitrators, solicitors or industrial advocates. On the other hand, there are some skilled union officials and some very unskilled aspirant advisors and negotiators. As Rob Campbell has observed, "the market will sort these out".

Either the present generation of union leaders or its successors will also need to review its general economic and political thinking if it is to remain relevant. The entire thrust of the Council of Trade Unions' submission on the Bill was to reject the economic directions New Zealand has been belatedly following in recent years in favour of some alternative economic model or 'third way'. Referring to a recent meeting of Eastern European economic reformers, *The Economist* recently reported that:

> "Astonishingly, they all more or less agreed on broad policy. No one much disputes the idea that reform will have to involve deregulation, demonopolisation, a tight monetary policy and, above all, fast privatisation. Anyone who so much hints at a 'third way' between communism and capitalism is considered naive; there is simply no more time to try more experiments."

We are still some distance away from reaching such a consensus in New Zealand. As one submission on the Bill pointed out, several generations have been taught at schools and universities the socialist view of the 'class struggle'. It added that for many years Radio New Zealand has played an acknowledged role in union activity by its ready and selective use of FOL, CTU and Victoria University spokespeople heavily biased against employers. In a radio debate only two years ago, CTU member Bill Andersen professed that for him East Germany - a country subsequently revealed as bankrupt and corrupt, and which has now disappeared from the map - was the ideal society. So long as such ideas are still taken seriously we will have difficulty as a community in overcoming our economic problems.

Massey University researchers have recently reported that although New Zealanders desire comfort and prosperity, hard work and competition are not particularly popular. Disturbingly, they found that social engineering tendencies in the education system have devalued hard work, excellence and competition - so much so that many young people hide their abilities. Today in Singapore, which has overtaken New Zealand in the per capita income stakes, factories typically work a three-shift, five or six day week with maintenance carried out during the sixth or seventh day except in continuous processes which work a seven day week. The New Zealand problem was recently summed up by an expatriate manager of a major New Zealand construction group who contrasted New Zealand performance with his home state:

> "It costs twice as much, takes twice as long, and the people who build are paid half as much... There's a lot of tradition here : morning tea, afternoon tea - I've never heard of the likes. The practice is not prevalent in the United States. If workers take a break, it's usually taken where they are standing, not by returning to base."

Clearly a further ingredient in restoring our economic performance can be summed up in two four letter words: 'hard work'.

As a debt-ridden and uncompetitive economy, New Zealand is far away from regaining a triple A credit rating. Indeed with the present Moody's review we are at risk of a further downgrading to single A status. This would take many New Zealand corporate borrowers out of the investment grade bracket, reducing their credit lines and increasing their cost of capital. Economic management of the highest quality will be needed to avert a future downgrading, as will a major turnaround in attitudes and work practices.

New Zealand still has a long way to go to get its economy in working order, but the enactment of the Employment Contracts Bill will remove a giant obstacle to progress. The Bureau of Industry Economics in Australia recently estimated that across the whole economy labour reforms of the type contained in the Bill would produce gains each year approaching 1 percentage point of GDP. Applied to New Zealand, such gains would be worth around $700 million a year or the equivalent of adding a fishing industry or a kiwifruit industry to the economy. Over time they would compound. The stakes for all in capitalising on the new opportunities are clearly very high.

THE PUBLIC SECTOR

NEW ZEALAND SOCIETY OF LOCAL GOVERNMENT MANAGERS

LOCAL GOVERNMENT : A BUSINESS PERSPECTIVE

BARRY DINEEN
CHAIRMAN/MANAGING DIRECTOR
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BLENHEIM
1 FEBRUARY 1991

LOCAL GOVERNMENT : A BUSINESS PERSPECTIVE

My brief is to offer you some business perspectives on local government and your role as managers in it. I welcome the opportunity, since the business community is taking an increasing interest in the performance of this part of the public sector. The Business Roundtable will be putting out a study on local government later this year. The Wellington Chamber of Commerce has been active in monitoring the Wellington City Council's corporate plan and budget. Federated Farmers has set up a committee to look at local government issues. These various initiatives reflect the fact that, despite the recent reforms, much remains to be done to improve efficiency in local government and its contribution to helping New Zealand make its way in the world.

The setting for your deliberations is a very tense domestic and international climate. As the New Zealand Chamber of Commerce put it in its submission to the government's conference of sector leaders:

> "New Zealand's longstanding economic problems are worsening. The policy drift of the last 3 years, the irresponsible 1990 budget and an unfavourable external environment have condemned New Zealand to a period of intense discomfort. Very substantial economic adjustments are needed. There is little community recognition of the magnitude of the difficulties and the consequences of failing to deal with them."

For all sectors of the economy, it cannot be business as usual. Local government is no exception. The government's December package is only a start to the new round of efforts that are needed, in all organisations and the country as a whole, to become more productive and live within our means.

Consider some of the indicators of New Zealand's performance as assessed in the 1990 World Competitiveness Report produced by the highly respected Lausanne Business School IMEDE, in conjunction with the World Economic Forum. We were ranked 17th overall amongst the 22 OECD countries covered, only ahead of some Mediterranean countries. Many of the new industrial countries in Asia were ranked far ahead of New Zealand. Some of the individual results are sobering. For example:

- We had the lowest rate of real GDP growth and real per capita GDP growth over the 1982-88 period.

- We scored bottom for growth in employee productivity over the same period; output per employee is barely half that of the top-ranked countries.

- We are a low wage country; the only countries on the list with lower hourly wages are Turkey, Hungary, Portugal and Greece.

- We work less than most other countries. Hours per week actually worked in manufacturing activities were 36.6 compared with 40-42 for countries like Switzerland, Japan and Germany (and 45-55 for the successful Asian countries).

- Our labour force is rated as one of the least willing to accept new technology.

- We have relatively low rankings for product design and for on-time delivery of products.

- Contrary to the claims of New Zealand educationalists, the performance of the compulsory education system in meeting the needs of a competitive economy gets a low mark.

- We have almost identically low scores (17 out of 23) for managerial drive, responsibility and initiative and for worker motivation (18 out of 23).

- Of particular relevance to local government administration, we also score a low 18 out of 23 for the extent to which pressure groups limit new industrial developments.

- We have almost the worst rankings for industrial disputes, for the extent to which organised labour affects corporate operations and for the extent to which industrial relations are conducive to labour peace. (Trade union claims that the government is moving towards a more disputatious system have it exactly backwards.)

This is a sorry catalogue. Although comparisons of this sort are indicative rather than definitive in all respects, the results suggest we are failing badly in many dimensions of international competitiveness. All must be addressed if we are to do better. The tendency to focus on the value of the currency as an indicator of competitiveness is far too narrow.

We need to remember that New Zealand is a country on the periphery. The rest of the world does not need us. If we are to succeed in attracting and retaining skilled people, capital and businesses, we must allow the excellent to excel. We must not tolerate second best decision making by governments. We should aim to have the world's best labour laws, the best planning regulations and the best business codes. We need top quality and low cost central and local government services and a low tax burden.

Given that kind of business environment, there is no reason why New Zealand cannot thrive. The scales are not tilted against small-fry countries. In the period from 1960 to the mid-1980s, income per head grew by as much in small countries on average as it did in countries with larger populations or land areas. Open economies are not limited by the size of their domestic markets; they can increase their markets through international trade.

There is much international evidence that a significant factor in poor economic performance has been the growth in the size and inefficiency of the public sectors in many countries. The collapse of the bureaucratic regimes in the Soviet Union and East Europe is the extreme example. However, I do not wish to engage in an exercise in bashing the public sector, either central or local government. You would find that as tedious and unwarranted as I find the equally popular sport of bashing the oil industry. It is pleasant to record that, with some exceptions such as the Consumers Institute, New Zealand has handled the recent oil market developments with a new maturity, by allowing markets to do their job of adjusting to changes in supply and demand. We need to avoid cheap shots and misinformed comment in talking about local government as well.

For example, the popular preoccupation with councillors' fees and executive salaries misses the real issues. There may be genuine questions to ask in this area, but they are not unique to the local government sector. Consider this story from the Australian Financial Review about the actions of one of Australia's most respected chief executives:

> "BTR-Nylex ... [m]anaging director Alan Jackson won much notoriety in 1985 when BTR took over plastics manufacturer Nylex ... for the brutal way he put an end to the Nylex executives' little indulgences.
>
> After he ousted then Nylex chief Henry Bosch, Jackson immediately sold his limousine, dismissed the chauffeur and emptied and sold off the vast quantities of liquor in the executive bar fridges.
>
> Today the BTR-Nylex head office in Melbourne is a study in poverty - no oak desks or rich leather chairs here."

You may know that in the meantime Henry Bosch spent several years as head of the Australian equivalent of the New Zealand Securities Commission trying to regulate and restrict company takeovers, and our Securities Commission has pursued a similar crusade. Takeovers are one of the key mechanisms for disciplining poor management performance in the corporate sector. Nothing could be more detrimental to the interests of shareholders as a body than moves to weaken such disciplines. Similarly the real issue with local government is the ability to monitor management decisions and to discipline poor performance. Progress has been made in this regard in the state sector with a move to chief executive contracts and performance measurement. To date local authority management has not had to carry risks or bear the costs of poor decisions. Future contracts should not provide for any bonus element without specifying a downside for non-performance.

I have no problem with paying local authority managers well, provided the payment is no more than is necessary to attract and retain people of the necessary calibre. Nor does it bother me that the same people are now being paid more than before, provided the expectations of performance have also risen. I was amazed to hear a teachers' organisation complaining last year that the principals of some schools were having to work a 50-hour week. Most successful business executives of my acquaintance would be delighted to have their working week reduced to 50 hours and to have the annual holidays that principals enjoy. I would have little sympathy with similar complaints from local authority managers.

I believe the proper approach to this issue is not to revert to centralised controls over remuneration or to require disclosure of remuneration arrangements as some are advocating. Such approaches would only turn talented people away from local government employment. You should resist them strongly and press your councils to do likewise. Rather, the focus should be on a variety of measures to monitor the performance of managers, the introduction of competition into all operating units, and contracts which incorporate sound performance incentives.

For example, contracts with generous redundancy provisions, which raise the cost of firing unsatisfactory managers, are seldom likely to be sensible from the point of view of councils and their principals, the ratepayers.

I have every confidence that good managers in local government will welcome the greater managerial freedom combined with the pressure to perform which is inherent in the new structures. That has been the experience of managers in the private sector and in state-owned enterprises.

Only a few short years ago, much of the private sector laboured under heavy regulation and faced few competitive pressures. Productivity levels relative to our international competitors were a disgrace. The oil industry is an example of the way in which deregulation has stimulated better managerial and operating performance. Substantial cost savings have been made at the Marsden Point refinery, the threat of competition from imported cargoes has seen a reduction in coastal shipping costs and the removal of licensing has intensified competition at the distribution end. Life is tougher for managers in industry just as it has become tougher for many of New Zealand's large businesses, contrary to the popular view that they have been the main beneficiaries of the restructuring changes. But few private sector managers would wish to turn the clock back.

The scope for improvements in efficiency is even greater in the public sector, especially in local government which has lagged behind in the restructuring process. Despite the earlier denials of the Public Service Association and various academic economists, the existence of massive waste and inefficiency in the former trading departments has been exposed beyond any possible doubt. The programme of corporatisation and privatisation has been an outstanding success and reflects credit on the politicians, boards and managers involved with it. Much less has so far been achieved at the central government level in areas such as health, education and social welfare.

At the local government level, I believe the priority task following the recent reorganisation should be a fundamental reassessment of what local government should actually do. Over the past year, there has been a good deal of controversy about rate increases. In my opinion, some of these were an outrage, such as the attempts by some local authorities to impose massive rate increases on the commercial sector. As the High Court said in its decision on the case brought by the Electricity Corporation, no local authority could reasonably have taken the decision to levy the amount attempted by the McKenzie District Council. In some cases the picture is confused by central government shedding functions to the local level and by the costs of reorganisation. But to focus solely on rate demands is to put the cart before the horse. As Sir Brian Elwood has pointed out, if people want lower rates the solution is in their hands : "make councils cut spending".

Reflecting on the poll tax debate in the United Kingdom, the London *Financial Times* recently made a similar point:

> "A proper examination of local government", it wrote, "would involve answering the following questions: What are the proper functions of local government? How should local governments be elected? ... How many tiers of local government should there be and what should each of them do? How should local taxation/property charges/rates be arranged? What role should

central government play in determining local authority spending and taxation patterns?"

The *Financial Times* pointed out that no British government had addressed itself to this whole complex of related issues at once. The same can be said of New Zealand.

The study being undertaken by the Business Roundtable is an attempt to answer some of these questions. A starting point is to note that under our unitary system of government, the powers of local government are delegated from central government. The decision about what to delegate to local government involves two interacting questions:

- the relative merits of private and governmental solutions to particular problems; and

- the relative merits of central and local government in performing the governmental role.

These questions can be posed in relation to the main functions undertaken by local government, which can be grouped under the headings of trading activities, public goods and services, and regulatory activities. In the interests of provoking debate, let me sketch some of the lines of thinking that seem to emerge from such an analysis.

The category of trading activities is the most straightforward. There is now widespread agreement that governments are not good at running businesses. Ratepayers should not be asked to bear the typically low returns and risks of investment in commercial operations. Early steps towards corporatisation and privatisation were taken in respect of ports, airports and, more recently, electricity supply authorities.

In the case of ports, enormous improvements in efficiency have been documented, although it is now apparent that a mistake was made to vest the shareholding of port companies initially with territorial authorities. While some of them appreciate that they have little to contribute to the management of port companies and have better uses for their funds, and have decided to sell down their shareholding, others seem inclined to hang on to their windfall gains or, worse, use ports as cash cows to fund other activities. One regional council is even considering buying the shares of a partner council which has decided to relinquish its shareholding! It is therefore pleasing that the government is committed to pursuing private ownership of port companies.

It is disappointing that local government has been slow to move in the area of trading activities, and has started to act only under pressure from central government. Fortunately this seems likely to continue. While National has promised to repeal the legislation on LATEs in its present form, it appears firmly committed to private enterprise approaches through corporatisation, privatisation or contracting out. With corporatisation of public transport operations now proceeding, the main outstanding trading activities are water supply (the most obvious privatisation candidate) and sewerage (which should at least be worth a look).

In respect of public goods and services, there is a need for a zero-based review of the need for local government involvement. The local government system was originally created as a user pays arrangement for providing a limited range of local services. The number has grown astronomically. There now seems to be no limit to the number of activities which some councils see fit to undertake.

To take a small but scandalous example, the Wellington City Council recently agreed to fund a trade union to make submissions opposing the government's labour relations legislation. The present government spelt out clearly to the electorate its intentions in this area, and won an overwhelming mandate at the polls. Public opinion surveys have shown that the reforms are backed by a large majority of New Zealanders. A recent study by the Australian Bureau of Industry Economics estimated that labour market reforms of the type proposed here would boost GDP in that country by nearly 1 percentage point a year or $3 billion. This episode demonstrates the propensity of local government to be captured by special interest groups at the expense of the wider community.

While there are some genuine local public goods such as streetlighting, many activities in this category turn out on closer inspection to be private goods funded publicly. No-one can accuse my company of being prejudiced against the game of golf, but it is hard to understand why most local authorities own golf courses when only those involved in the game benefit from them and there is clearly a competitive market in golf links. In terms of odd functions, zoos and cinemas also take a lot of beating. Views have been changing around the world about whether access to libraries and museums should be 'free', or whether they should be paid for, at least in part, by those - often from higher income groups - who use them.

Where genuine public goods and services are involved, and local government funding of them is justified, it is now widely accepted that local government does not have to act as a supplier. There is a large body of evidence that major cost savings are available from the contracting out of services. A United States study indicated that 98 percent of local governments have achieved a cost saving in this way. The savings are not insignificant - 80 percent of councils saved more than 10 percent and 10 percent of councils saved more than 40 percent. There is enormous scope for more contracting out of services in New Zealand.

Best practice in supplying services does not necessarily differ between public and private sector organisations. Management writer Tom Peters argues that:

> "The best answer for introducing innovation ... is to turn the firm into a marketplace, with virtually every service up for bid. Insist that providers of staff services test their mettle by peddling to outsiders as well as insiders... And encourage line departments to bypass ineffective staff units and go to the market."

Transpower, the Electricity Corporation's business unit responsible for the national grid, was deliberately set up without a maintenance staff so that it was forced to contract out maintenance services. It has encouraged competitive tendering and gained substantial leverage over its costs. No particular problems have been encountered in controlling service standards.

My conclusions under this heading are threefold:

- Local governments should pare back their activities to a much narrower range of genuine public goods and services.

- The provision of services should be contracted out wherever possible. John Fernyhough has argued publicly that quite large councils such as Dunedin and Auckland cities could be run by 20 people if such a policy were adopted.

- Wherever the beneficiaries from such services can be readily identified they should be charged for them.

Local government decisions on services should not be biased by central government. I see no role for central government subsidies for local public projects for which the benefits accrue locally. Urban transport is a case in point.

The final broad category of local government functions is regulation. Local government regulation is far-reaching and not infrequently bizarre, ranging as it does from dog control to licensing of street vendors to the entire edifice of land use and construction regulation. It has pervasive effects on households and businesses.

Again, in my view, the new local authorities should be reviewing from a zero base the entire array of regulations and by-laws to see whether they are necessary, properly designed and cost-effective.

You should be questioning, for example, whether even major and longstanding regulatory functions - or at least large parts of them - such as town and country planning are necessary at all. Much of the built environment of New Zealand was developed without any form of statutory planning; the common law did the job of protecting property and third party rights. Even today, some cities such as Houston have no planning procedures.

The average town plan is not mainly about the environment but about mundane things like the size of a backyard, the siting of a hairdresser and how many carparks a suburban outlet should provide. Is all of this necessary? Local government managers have too often failed to recognise that regulation involves the prevention of activity that would otherwise occur and the distortion of resource use in their region or district. Their role as 'gatekeepers' of economic activity has the potential to inflict significant costs upon their ratepayers and the economic health of their community. As the trading arms of local government are moved into the private sector, the relative importance of regulatory functions will grow, and it should be expected that accountability for performance in discharging them should grow at an equal pace.

Recent experience in this area is not encouraging. The Resource Management Bill promoted by Geoffrey Palmer was a regulators' paradise. It was disturbing that it received considerable support from people in the planning profession and local government, who appeared to relish the thought of benefiting from an expanded bureaucratic process. The Bill requires a major overhaul if New Zealand is to have any chance of attracting investment and creating jobs. I am not sanguine that the government yet appreciates the extent of the overhaul that is needed and can achieve it within the timetable it has set itself. Neither commercial nor environmental interests would be well served by merely tinkering with the present structure of the Bill. If it proceeds, I hope local and regional governments will make good use of provisions allowing them not to plan and intervene, and perhaps even seek the option to declare themselves Resource Management Act - free zones.

One issue that intersects with resource management is the role of regional government. I have a good deal of sympathy with the government's view that this branch of government may be unnecessary, at least in most parts of the country. I am aware that regional councils are not regarded as an extra tier but as an integral part of the local government structure. However, two factors in particular seem to me to call into question their rationale. One is the expanded boundaries of local government, which reduces the problem of coordination. The second is the potential for full privatisation of services such as ports, public transport and water where these are supplied on a regional basis. Given such developments, regional councils would become primarily regulatory bodies dealing with resource management. But if this planning function is streamlined as it should be, it seems questionable whether a separate branch of government is needed to coordinate activities across local authority boundaries. Cheaper solutions may well be available. I should be interested to hear your views on this issue.

I have omitted from my list of functions for local government a social welfare role. All that local governments can achieve is redistribution within their boundaries. It is difficult to see the justification for such redistribution given the national welfare system, the likelihood of conflicts with national policies and the absence of a mandate from central government. New Zealand has a major problem with central government's social welfare system, with respect both to its direct costs and the disincentives it creates. The presence of another layer of redistribution policies at the local level compounds the problem. Housing and many so-called community development activities are questionable on these grounds. I note that the government's policy is that the provision of health, education and social welfare services should remain the responsibility of central government.

Similarly there is little merit in the employment schemes that have been run by local authorities. These can do nothing to increase overall levels of employment. They have to be funded from rates, which reduces the spending power of households on goods and services supplied by the private sector and hence the number of jobs in it. The result is merely to shuffle jobs from the private to the public sector and typically to employ people in less productive activities. The solution to unemployment is a labour market that works, a social welfare system that does not discourage people from taking employment and a productive, growing economy. Work schemes are not the answer.

I see your role as senior managers in local government as being to ask the hard questions I having been raising and giving tough-minded advice to councils. You also have a leadership role in implementing changes and rationalising local government operations. The success of the SOE programme owes much to the selection of talented chief executives who have turned around the culture and performance of bureaucratic organisations. Some of your own roles are changing rapidly, for example from being quasi-business managers to that of advisors to shareholders seeking a commercial return on assets. In turn that role will disappear as trading activities are privatised.

Perhaps your society has a role to play as a forum for exchanging ideas and discussing common problems. In the business sector we are finding there is a convergence of interests and needs between public and private sector business organisations. For example, with the move to private sector modes of operation, three SOEs and the largest port company are now represented on the Business Roundtable. It is in the longer term interests of local government managers themselves to adopt other management practices and standards, and to welcome a much more critical monitoring of performance. Moves in these directions can only improve the current relatively low status of local government management as a career.

The issues with which you are concerned are far from academic. To return to my opening theme, the urgency and gravity of our country's economic problems cannot be overstated. Farm incomes will be down by unprecedented amounts in the current season. We still have a massive amount of public debt - around $36,000 for every household. This must be reduced quickly. Our credit rating has been downgraded, adding to the costs of capital to the corporate sector. The risk element in our interest rates is the price we pay for having shot ourselves in the foot so many times in the past that people are reluctant to give us a fresh supply of bullets. Despite prevailing negative sentiment, I believe there are grounds for optimism about New Zealand's future. There is no reason to suppose that an ongoing economic decline is inevitable - absolutely none. But a better future will only happen if governments face up to the hard decisions and the community recognises it can only be based on hard work.

Local government operations are a major part of the economy. They employ around 50,000 people - as many as Telecom, the Railways Corporation, Electricorp, New Zealand Post and the other remaining SOEs combined. They ought to be able to achieve at least the same efficiency gains as these SOEs. The previous Minister of Transport described Auckland's bus problems as an "appalling indictment" of the Auckland Regional Council's management, but this is not a unique example. Local authorities simply must find new ways to cut costs and increase productivity.

In the past local authority reform has not come from within. It should do so in future. Your society is well placed to debate issues and show the way. The business community will be looking for actual rate reductions this year, not just a standstill. Resources must be released to the private sector, particularly the export industries, to enable them to grow and create jobs. As managers of the new local government structures, I leave that challenge with you.

INSTITUTE FOR INTERNATIONAL RESEARCH

EFFICIENCY AND ACCOUNTABILITY IN THE PRIVATE SECTOR

WHAT CAN WE LEARN?

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WELLINGTON
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EFFICIENCY AND ACCOUNTABILITY IN THE PRIVATE SECTOR

WHAT CAN WE LEARN?

Introduction

Over the years, larger and larger shares of New Zealand's resources have come to be absorbed or directed by the state. Few people seem to associate this with any corresponding increase in social well-being or in the sense of satisfaction of the average citizen.

Government expenditure was 28.4 percent of GDP in 1974-75. By 1989-90, that figure had risen to over 40 percent. This sharp upward trend was unplanned. Throughout that period, most governments would have claimed that they were trying to hold each year's expenditure at roughly the same levels in relation to GDP. In other words, the single most important structural change in the economy in the past 15 years was largely unintended. The ever-rising tax burden, especially in the last five years, has undermined the growth potential of the market sector and sapped business confidence.

Transfer payments accounted for a large part of the spending growth, as did assistance to industry in the early part of the period. In recent years spending has mushroomed in areas such as education, health and government administration. The overall trend reveals the power of interest groups in obtaining political support for spending programmes which often benefit them rather than the wider community. It also exposes the weak disciplines on government employees to manage and control resources efficiently.

Incentives for Efficiency in the Private Sector

In the private sector, success and survival is firmly anchored to the disciplines of making a profit by meeting consumers' needs. The disciplines apply to sole traders, partnerships, and private and public companies alike.

Those forms of organisation have evolved over a prolonged period of time through competition with other forms of organisation. The listed company, for example, is a successful method of organising many kinds of economic activity because it allows for management by specialists and risk-sharing by a diverse group of shareholders who take no part in the detail of the organisation's business affairs.

The separation of company control from ownership makes it imperative to align the interests of managers with the interests of the shareholders. This is best achieved by allowing unrestricted transferability of ownership.

At a higher level, the interest of private firms is aligned with the interests of society as a whole by requiring them to operate without protection or privileges in a competitive environment. Within that framework, their objectives will not be achieved unless they put the customer first and, in doing so, organise themselves to use resources efficiently.

When those are the ground rules, private firms may make bad investment decisions or perform poorly, but the market checks on sustained poor performance are the strongest available. Since sustained poor performance is precisely the problem that public sector organisations are most prone to, it is important to understand how, on average and over the long haul, the private sector achieves superior results.

In all cases the answer comes down to effective incentives and disciplines. For example, the ability to transfer ownership in a company by means of the sharemarket has a powerful influence on the attitudes and behaviour of management. Poor quality management and inefficient resource use opens an opportunity for new owners to take over the company, replace the management, achieve more efficient resource use, and realise a gain on their investment. This motivates continuous monitoring for cases of poor performance. Even if a poorly performing company is not taken over, investors may dump their shares and the end result may be much the same. Debt holders also take a close interest in the performance of businesses to which they lend.

The market for corporate control and the market for managers are two of the most important markets in the economy. For both directors and management, reputation and future prospects are linked with the performance of the company and directly affected by the information generated by the sharemarket. There is little point in trying to withhold information from the market. Investment analysts nowadays are professional and vigilant. They mark up companies that openly disclose the bad news as well as the good and mark down those that appear to have something to hide.

None of these mechanisms is perfect, and poor performance can sometimes go hidden or uncorrected for a long time. But it cannot go on forever. The ultimate check on poor performance in the private sector is bankruptcy. This check is virtually non-existent in the public sector. No New Zealand government in recent history has let a public sector organisation fail. In the past 12 months, two more have been bailed out.

It is this set of mechanisms - competitive markets, the discipline of profits and losses, and the incentives for monitoring - that underwrite the efficiency of the private sector and the accountability of its decision makers. This point is poorly understood. It is often assumed that the public sector would work better if only it were run by more capable managers. But the private sector is not efficient because by chance it has been endowed with superior managers. It has better managers *because* competitive markets provide the filter mechanisms required to make sure that only managers making the correct decisions survive and prosper. Appointing top flight managers to run factories in the Soviet Union or hospitals in New Zealand would have a minimal pay-off in the longer run unless the systems in which they have to operate are changed.

The relative efficiency of the private sector in relation to the public sector does not mean that there are no cases of poor performance in the private sector nor cases of good performance in the public sector. Of course mistakes are made in the private sector; indeed successful entrepreneurship involves taking risks, accepting a number of mistakes and learning from them. The difference is that the discipline of having to make a profit ensures that bad decisions are not enshrined in open-ended, ongoing investments. Successful managers have to make more good decisions than bad ones. In the public sector, by contrast, bad decisions may not be transparent, politicians have incentives to conceal them, and good money is often thrown after bad when things turn sour.

Nor can private sector efficiency be guaranteed when markets are not open to entry and firms are not subject to competition or the threat of it. There is no reason to expect that in a sheltered environment private firms will behave much differently from public sector organisations. We have seen much evidence of that in protected industries in New Zealand in the past.

The changes in Eastern Europe and the Soviet Union have now convinced most people that, at the level of whole economies, political and bureaucratic systems work less well than competitive market systems, if indeed they work at all. But this lesson has not yet been fully absorbed in relation to major parts of OECD-type economies. For example, Americans are puzzled and frustrated that their superior performance in industry relative to the Soviet Union is not matched by the superior performance of their schools. Commentators have pointed out that this should be no real surprise: in both countries schools are largely run by the public sector. Although the notion is still fiercely resisted, it is unlikely that education performance will increase markedly until competition, pressures from owners and consumers, and private initiative are introduced into the education system.

The State-Owned Enterprise Reforms

The reforms adopted for state-owned business enterprises in recent years have deliberately aimed to replicate as far as possible a set of private sector incentives and sanctions to improve business performance. Enormous advances have been achieved in SOE efficiency. The Electricity Corporation has reduced the average wholesale price of electricity by 16 per cent in real terms over the past four years while total real unit costs are down by 29 percent. At the same time profits have gone up from $140 million to around $400 million and returns are now approaching commercial norms. Current Airways charges for a Boeing 737 from Auckland to Wellington are only a little over a third of their 1987 level. The combined costs of Telecom toll calls and local services for a range of businesses have gone down between 32 percent and 48 percent in real terms in the past 4 years, and people no longer spend months waiting for new telephones. New Zealand Post has held postage rates for ordinary mail constant for over three years.

The evidence of waste and mismanagement has conclusively disposed of the arguments of those in the State Services Commission and Public Service Association who saw no need for the reforms. It was pleasing to hear the new minister for state-owned enterprises, Mr Kidd, say recently:

> "We are by no means at the end of the corporatisation process. There are more government departments, and even more activities within departments, which could be turned into State-Owned Enterprises. The Housing Corporation has already been flagged by this government as a potential SOE. The answer isn't for government to build or buy more, but to make sure that people who need housing assistance get it."

Even in the business areas of government activity, however, corporatisation is not enough. The limitations of the SOE model were succinctly summarised in a Treasury paper written as long ago as September 1987. Corporatisation, the paper said, had undoubted advantages over previous organisation forms for government trading activity. But it went on to point out that:

> "In the absence of contestable ownership and control, however, the incentives for SOE directors' interests to coincide with those of a wealth maximising owner are blunted... There are difficulties in monitoring the performance of SOE boards and in applying sanctions...
>
> "For SOE directors to be held responsible for performance, they must have the freedom to make commercial decisions. But there is also evidence from history that the more independence they are given, the more likely it will be that over time they will substitute non-commercial objectives because of the lack of commercial incentives that would normally occur with contestable control...
>
> "The fundamental conflict between avoiding political interference in SOEs and ensuring that SOEs are operated in the commercial interests of shareholding Ministers remains."

In other words, privatisation is a fundamentally better option than corporatisation for the economy and society in the longer run. Mr Kidd acknowledged that in his 8 February speech, when he said that he intended to recommend a resumption of asset sales, subject to the state of the market and the condition of the business - and after all regulatory, monopoly, social and Treaty of Waitangi issues have been properly resolved. The lengthy list of reservations may be sound in principle, but it can also prove very costly if it is applied with excessive caution. Recent experience with the Bank of New Zealand and the Government Property Services Corporation has demonstrated that the sooner exposure to business risks is reduced the better.

The prime motives for sale, as stated by the new National government, will be efficiency and risk avoidance. No business venture is risk free - not even the biggest trading bank in the country. Moreover, without privatisation, the growth of many state-owned businesses would remain hostage to other priorities for government funds. Their development might well be stunted for lack of capital. This could hinder the growth of the economy as a whole.

Structural Solutions to Public Sector Management Problems

There is ultimately no satisfactory solution to the problem of monitoring public sector performance. That is why it is important to shrink the public sector as far as possible while seeking to achieve further improvements in accountability.

The principles underlying corporatisation and privatisation must be extended as widely as possible through the public sector. Allowing unreformed departments to levy user-pays charges on a full cost-recovery basis without any real competitive pressure on them is a licence for waste. Many commercial and net-funded activities undertaken by departments should be set up as state-owned companies. Wherever possible, privatisation should follow to complete the process.

Where privatisation is not feasible - perhaps because of the requirements of foreign governments as may be the case with MAF meat inspection services - the organisation could be split into two or more competing units or the function could be contracted out. Greater contestability is feasible and desirable in departments as diverse as Social Welfare, Labour and Justice, as well as universities and hospitals.

Funding should be split wherever possible from decisions about who produces goods and services. This separation is what frees the government to buy on a basis of best value for money, instead of buying as a matter of principle only from some other government organisation. The proposal of the minister of broadcasting to put the publicly-funded programmes of Radio New Zealand out to tender is a sound application of this approach.

Comparable problems continue to occur where a single organisation is responsible for both policy advice and major departmental operations. Housing Corporation advice on housing has consistently favoured spending more money through the Housing Corporation. MAF has advised Federated Farmers on how to make a case for disaster relief; it has then advised the government on the proposals made by Federated Farmers; and finally it has received a percentage of the funding granted for the administration of the subsequent relief programme! While I agree with those who say that the principle of splitting functions should not be pushed beyond reasonable limits, it has a lot going for it.

It is not enough to exhort civil servants to be objective, and to put the public interest first. Nobody can be objective under those conditions. That is why client capture has been such a frequent occurrence in the past. The Ministry of Transport typically argued Air New Zealand's case to the government; it did not put the interests of consumers in lower fares first. Trade and Industry aligned itself with the Manufacturers Federation in promoting protection and subsidies for industry. The Department of Social Welfare came to think of beneficiaries as clients to whom it should deliver the highest possible level of benefits. Fairness to clients dominated considerations of fairness to the taxpaying public. The only satisfactory answer to such problems is structural change.

The Core State Sector

The State Services Act and the Public Finance Act laid a foundation for a much more efficient public service. Departmental chief executives are now on contract. An annual contract between the CEO and the minister spells out the government's goals and priorities for the year, and agrees the resources which will be provided in order to achieve them. The CEO's performance is to be judged in terms of departmental outputs against that contract.

CEOs can be appointed from anywhere. They have power to hire and fire, choosing staff from inside or outside sources. For the fixing of pay and conditions, each department is regarded as an enterprise. Negotiations can be based on departmental circumstances rather than on nationwide occupational classes. CEOs are no longer bound to give preference to other departments in buying their inputs.

Those are large changes of fundamental importance. Yet in the core public service departments, as both the prime minister and the minister of state services have publicly stated, surprisingly little has changed. Their comments indicate that the papers coming forward to the government are still, in many cases, woefully inadequate and that Crown assets continue to be poorly managed. In many areas, expenditure creep remains the norm. The fact of the matter is that, by the best private sector standards, management in the core state sector remains seriously deficient.

Currently there is a danger of drawing the wrong conclusions from this experience and going back to a system of centralised controls. There have already been indications of such thinking in respect of wages, accommodation and computing. This would fly in the face of ongoing trends in private sector management practice towards decentralised decision making with accountability being exercised through budgets and results. Past problems of control agencies and ministers running departments and confused accountability for performance are too easily forgotten. In my view the new structures provide a much better basis for achieving government objectives, but they must be made to work. The focus should now be on matching greater managerial freedom with greater accountability for performance and on remedial action where performance falls short.

People in the private sector find it difficult to understand, for example, why those responsible for the botched implementation of the Picot reforms were not brought to account, or why there have been no apparent sanctions on those responsible for this year's blow-out in the education budget. What is the accountability of managers in the Department of Justice for the mess that has been made of commercial law reform in recent years, or in the Department of Labour for their steadfast opposition to necessary labour market reform? Who in the Ministry for the Environment was responsible for the incompetent handling of the resource management review which has had to be revisited by the present government, or in the Law Commission for the low quality exercise on accident compensation which is also having to be reworked? Ministers may have had some responsibility in some of these cases, but they appear to raise large questions about public sector management performance.

Three years down the track from the State Sector Act, a number of potential improvements have yet to be realised. The evidence is clear that many ministers have a limited understanding of their role in the new system, and how to play that role effectively. Of the first 23 CEOs appointed as heads of departments under the new contract system, only 4 came from outside the public service. Although management talent is in short supply in the country at large, the State Services Commission has not yet been successful in significantly widening the pool it draws on.

The new system, however, needs a new mix of skills to make it work properly. Some top jobs in the public sector have large responsibilities compared with many in the private sector. There is no point in quibbling over remuneration for such positions. Management skill is an internationally traded commodity. The cost to the country of paying cut rates for inadequate talent is far higher than meeting the market. Individuals can make a difference, as experience in Telecom and the Electricity Corporation has shown.

The State Services Commission is responsible, subject to government policy directions, for setting the framework within which performance agreements are made and ministerial assessment occurs. It plays a key role in finding the right people, advising on appointments, helping ministers to monitor performance, and advising on what to do in cases of inadequate performance. A power of dismissal exists now. Despite some visibly inadequate performances, it has not been used. While that continues to remain the case, many will doubt the seriousness of the SSC and the government in seeking to use all the tools at their disposal to achieve maximum departmental efficiency.

It is, of course, impossible to know precisely why top departmental positions continue to fail to attract top applicants from the private sector. The intrusion into individual privacy of forced disclosure of salaries is one negative factor. Very probably, private sector CEOs continue to lack confidence that politicians would be content to set clear objectives and let the department get on with the business of achieving them efficiently. It is also important to ensure that CEO positions are properly specified. DSIR, for example, recently managed to bias the choice of CEO for that department by placing virtually an exclusive emphasis in the job specification on the need for scientific standing and ability to relate to the scientific community. There is no excuse for allowing such manoeuvring to go unchallenged and become the basis on which an appointment is finally made.

The SOE programme was successful precisely because exceptionally capable chairmen and directors were appointed to run the various businesses largely free from ministerial interference. There are signs that this is changing, and that the life of the SOE model may have run its course. There has already been one directive under the SOE Act to prevent a corporation from taking decisions it regarded as commercially sound, and there are reports of a much higher level of interest in the day-to-day running of SOEs. The inevitability of a re-emergence of political control constitutes one of the strongest arguments for privatisation.

In the case of core government departments, ministers in the past have tried to become the chief executive themselves or allowed themselves to be captured by departments which had already been captured by their clients. In one or two cases, distrusting the department, they tried to run policy out of their own offices by way of decree.

The fact is that this new system cannot work properly unless ministers understand that their role is that of the board of directors, not the chief executive. Who helps ministers to come to terms with these problems? So far, we do not have any answer which is good enough. Ministers need to recognise collectively the requirement for skills and training in running a large organisation, setting its objectives, and determining which priorities ought to have precedence over others.

A variety of options exist which might fill the gap. It is clearly possible to appoint an advisor or two with real professional clout to the offices of ministers to provide assistance of this kind. Another option may be to appoint appropriate outside people as boards of directors for core public sector agencies - either like the SOE Steering Committee on an advisory basis or as a more direct counterpart to the boards of directors of SOEs. In the case of onerous tasks such as Social Welfare or Health, particularly where major organisational change is involved, there may be a case for appointing an establishment board or commission to supervise an effective reconstruction and find or support a chief executive with skills that fit the new requirements of the job. A third option could be modelled on the advisory board used by the Debt Management Office of the Treasury, which uses experienced outsiders as a sounding board to help monitor market conditions and plan debt management strategy.

Whatever the options adopted, they should of course preserve and reinforce the improved accountability which the new system has established for CEOs.

Health and Education

Health and Education are among the largest businesses in the country. In most respects, the job of improving the way they run has not yet seriously begun. The previous government's attempted decentralisation of education was, in the event, compromised profoundly by education bureaucrats at every level. This was one of the more notable cases in recent years of sound proposals being captured by the providers, and turned to their advantage.

The education reform process needs to go back to the original Picot concept and involve a real decentralisation of control to local school boards. Indeed it needs to go further, as a flaw in the Picot thinking was the belief that satisfying consumer interests in education meant that parents had to become involved in running schools. This is analogous to the proposition that to improve the quality of beer, consumers need to get involved in running a brewery. Parental involvement in schools has merits, especially where educational choices are limited, but a far more potent force for raising educational standards is competition. Means need to be found to fund students, whether on a per pupil basis or by direct vouchers, instead of funding the providers. Without this, there can be no satisfactory parent/pupil discipline on the quality of education. Public and private schools should compete in the education market. Like their private sector school counterparts, the boards of public schools should be able to set the pay and conditions of teachers, and hire and fire, in line with the terms of the new Employment Contracts Bill. Until we have a system of this kind, educationalists will continue to defend the inadequacies of a system which has turned far too many children out into the world without the skills they need to cope in today's job market.

The new government appears to be heading in the right direction in the case of schools, and in tertiary education. Corporatisation of tertiary institutions will be a dramatic improvement on the present situation. It will be necessary to appoint boards with the right skills to assess performance, not just in commercial and asset management, but also academic excellence, teaching and research in order to achieve international standards. An element of private tertiary provision should be welcomed, not feared. Competition is important to force the pace in providing higher quality education.

As with the SOEs, fresh appointments should be made to chief executive positions. Present CEOs should obviously be able to apply, but they should have to compete to hold their positions. New terms of appointment are required, not just for them but for all tertiary education staff. The international market for academic skills should determine terms and conditions. In some areas that may cost more than at present. In others, it will undoubtedly cost less. There is no shortage of skilled people in some disciplines, and where this is the case terms of employment should reflect it.

In the health area, the Hospitals Task Force headed by Alan Gibbs set out some initial steps that should have been taken three years ago. The crucial first step is to separate funding from provision. Both public and private providers should be placed on an equal footing to compete. What matters is not whether provision comes from a public or privately owned facility, but whether it offers the public the best value for money.

The Wellington Area Health Board's Wellbank proposal moves in the right direction. Unfortunately, our present system provides no incentives to area health boards other than a politicised process where outcomes are largely determined by interest group pressures. Health care will continue to be grossly wasteful and grossly unfair to disadvantaged people as long as that system persists.

The following steps should focus on how to fund health care. Traditionally we have funded health care out of taxation revenue. People have paid on the same basis, regardless of how well or how badly they chose to look after their own personal health and the health of their families. Nothing in the system of funding health insurance gave them any particular incentive to adopt a healthy lifestyle or placed any penalty on those who failed to do so, thereby imposing higher costs on others.

The evidence of the Hospitals Task Force was that the present system has been wasteful in the extreme. Large numbers of people, most often the disadvantaged, have been deprived of timely health care as a result. We need an improved set of incentives and sanctions at every level: for the funders, the providers, and the people whose health the system is supposed to look after. The present approach to state funding has been disintegrating under the weight of its own inefficiencies for many years. A better structured mix of public and private funding has become a necessity for the future.

Conclusion

I began by referring to the growth in the public sector share in the economy in the last two decades. One way of measuring it is by looking at what has happened to Tax Freedom Day. This is the day on which New Zealanders effectively start working for themselves. Until that point in the year, all of their earnings go to the government in tax.

Government expenditure is the best measure of the true tax burden. When the government share in the economy was around 30 percent, Tax Freedom Day fell around now. Today it takes about 150 days or another 5 weeks of the year - close to the end of May - before New Zealanders earn income for themselves.

I applaud the aim of the minister of finance to bring Tax Freedom Day back to around mid-April. Reducing the tax burden in this way would give a real impetus to the economy. To achieve this aim will require the utmost discipline on the part of governments. In respect of transfer payments, many more hard decisions on rates and eligibility criteria for state assistance will need to be made. In respect of government provision of goods and services, a rigorous application of the principles I have been discussing is called for.

To summarise, I have argued:

* First, that while it is not immune from making poor decisions, the private sector - provided it operates in a competitive environment - is subject to strong checks on poor decision making which encourage efficient performance;

* Second, that these checks are almost impossible to replicate in the public sector. Hence the most important requirement is a structural one: to shrink the public sector as far as possible, so that ministers and other elected representatives can concentrate their energies on those functions that cannot be handled satisfactorily in the market sector;

* Third, that this implies a need for privatisation of all government activities that can be run as businesses;

* Fourth, that where the government is properly engaged in funding services such as health and education, it does not automatically follow that it should be the provider. It should explore the scope for funding the recipients of such services where appropriate, allowing competition between the public and private sectors and scaling back its role as a provider over time;

* Finally, that there is a real problem of monitoring, rewarding and disciplining management performance in the core state sector which has not been overcome. The temptation to revert to centralised controls should be firmly resisted but ways of strengthening current standards of accountability need to be found. Control agencies and ministers should be much more rigorous in correcting problems, including dismissal of non-performing managers.

I might add that much the same analysis applies to the local government sector.

If we take these principles to heart, I believe that there is a real possibility that if this conference is held on the same date in the year 2000, we could be celebrating the occasion of Tax Freedom Day.

REGULATION

FEDERATED FARMERS OF NEW ZEALAND
DAIRY SECTION CONFERENCE TARIFF DEBATE

DOES TARIFF PROTECTION COST JOBS?

ALAN GIBBS
CHAIRMAN
FREIGHTWAYS HOLDINGS LIMITED

WELLINGTON
25 JUNE 1990

DOES TARIFF PROTECTION COST JOBS?

I have great sympathy for our opposition in this debate.

For many years I thought tariffs created jobs and economic growth, and like losing faith in most attractive, simple, warm and cuddly propositions, I hated learning the truth in this case.

So perhaps a brief saga on my learning curve may be appropriate.

At university, at the height of Keynesian economics in the 1950s, I learnt about market failure and how governments could, by regulation and intervention, solve all our worldly woes.

Not only did I get taught it, I believed it.

Thus, shortly after I left university, and being in a hurry, my brother and I decided that the best way to crash into the New Zealand economy of protected monopolies was to give the country what it seemed to want - a New Zealand motor vehicle.

This proposition conformed perfectly with the 'protection all round' ethos of the day.

Well, to cut a long story short, New Zealand was not inflicted with its own motor vehicle, but to this day we still do something nearly as stupid and assemble other people's.

Since then I have been involved in manufacturing almost everything - stapling machines, forklift trucks, washing machines, refrigerators, crockery, TV sets, bricks and bras.

I have to tell you that many of these businesses never made a contribution to the New Zealand economy.

In fact, worse than that, many were a deadweight cost.

Naturally, I and other manufacturers didn't rush out and tell you that. No fear.

We told you how indispensable we were to the New Zealand economy. In addition to enlisting the Manufacturers' Federation in our service, one of my businesses had a whole floor of people in a building on The Terrace who did nothing but tell politicians, bureaucrats and anyone else who would listen how valuable we were.

I am afraid, however, that the truth is that most of those businesses relied on heavy protection, they were a disaster for the economy, and ultimately when we had to shut them down, they were a disaster for us also.

A typical example was the television assembly industry.

We would go to Japan and explain to wide-eyed Japanese that our government wanted us to assemble their TV sets in New Zealand.

They could hardly believe their ears.

They said no one assembles Japanese TV sets. "Do you have cheaper labour?" they asked. "Make your own tubes? Transistors? Anything?"

"No," we said, "we just have to make them in New Zealand, and because there are only a few of us permitted to do this, we make good money doing it."

After much time and explanation and shaking of heads, the Japanese finally agreed to sell us the bits to assemble their sets in New Zealand.

However, they explained this was very costly.

They were making tens of thousands of sets a day and we only wanted parts for a few thousand each year.

At great cost they contracted outside people to come in, sort out all the pieces we needed and put them in boxes.

They got engineers to write out all the instructions in English for reassembly, and shipped them on their way.

Naturally, someone had to pay for this, and on average they charged us, as a special favour, 110 percent of the price of the finished goods - all boxed ready to go to the retailer - for the parts.

We then opened a factory, imported much machinery, paid the highest wages in the neighbourhood, employed the most intelligent engineers to decipher the instructions, used a great deal of electricity, and finally produced a TV set with negative New Zealand content at twice the imported price.

Thanks to Roger Douglas and David Caygill, that nonsense has gone in the TV industry and many others.

As a result, TV sets and many other goods have halved in price.

I think the saddest party in this story is not really the consumer who got ripped off but the people in that industry who worked their guts out but, due to no fault of their own, made no contribution to the society in which they worked in exchange for the goods and services they consumed.

They may as well have been digging holes and filling them in.

They were, in fact, on welfare and the welfare cost was much higher to society than the dole.

New Zealand is not a rich enough society to waste our talents this way. We must do what we are good at and buy what others are better at.

An even sadder story than TV assembly is that of Crown Lynn crockery.

Based on the infant industry theory and very talented lobbying, Crown Lynn was able to obtain protection for 70 percent of the New Zealand crockery market.

You would think that with this base of business we could build an industry that would be internationally competitive.

Unfortunately, the more protection we obtained, the more we needed.

The problem was that rather than concentrate on a few products and develop real skill and talent in depth, we tried to make the whole spectrum of crockery to supply 70 percent of the New Zealand market.

We concentrated on the home market because it was easier and guaranteed.

We made everything, but were master of none.

By the time we had to stand on our own feet (having been an official infant industry for 45 years) we found we had dispersed our talents.

In addition, under this protection regime, our management let their guard down and our unions were able to entrench totally uneconomic work practices.

When we told the unions these practices would have to stop if we were to survive, their answer was no way, they would rather take redundancy.

You farmers know from the bitter experience of the freezing industry that once protection (based in that case on licensing) destroys the work culture it is easier to start from scratch, like Fortex, than rebuild.

Protection destroyed Crown Lynn, and all those jobs.

I believe New Zealand could have an internationally successful crockery industry. We certainly have the skills and the raw materials.

Such a successful industry will only develop, however, when someone is prepared to stand up to the world and build a team with the talent and desire to be winners in this huge, open, competitive market.

You might say to me, surely these two examples are exceptions. Surely most of the industries still receiving protection are more efficient than that.

I am sorry to say that due to successful lobbying by Manfed and others, the worst example of protected waste still carries on regardless. This is the motor vehicle assembly industry.

This industry is much worse than the TV assembly industry.

Nowhere in the world do they assemble dozens of models of car for three million people.

This so-called industry is a value destruction machine.

We pay a subsidy of $10 for every dollar the industry cuts off real GDP.

Motor vehicles are one of the largest items of capital expenditure for most businesses.

They are also one of the largest items of household expenditure.

The huge 35 percent tariff which the government has given the industry imposes a massive burden on the rest of the economy.

Part of this burden is that, due to higher costs, many truly productive jobs that would otherwise exist are never created.

If tariffs cost jobs we should expect to find high rates of unemployment in the most open economies and low unemployment in the most protected ones.

But what we find is that Argentina and other third world countries that have followed inward-looking policies have endemic unemployment, while some of the world's most open economies - like Hongkong, Singapore, Switzerland and Sweden, have the best employment records.

Contrary to much myth-making in the West, Japan is another country with few external trade barriers for industrial goods, and as it has become more open in recent years its high employment performance has not suffered.

But, our opponents will say, hasn't unemployment increased in New Zealand as trade barriers have come down?

The fact is that unemployment was rising through the 1970s, long before serious trade liberalisation got underway.

Economic studies have invariably found that trade liberalisation programmes have, at most, a small and temporary effect on unemployment.

The dismantling of trade barriers by the industrial countries in the 1950s and 1960s was associated with high levels of growth in output and employment.

Few people would argue that CER has been responsible for unemployment in New Zealand and Australia.

The reasons for New Zealand's unemployment are largely to be found elsewhere.

The fundamental one is a labour market that does not work - that does not allow labour in declining industries to be absorbed smoothly in new and expanding industries.

The problem is aggravated by a welfare system which reduces the incentives for many to take employment, and a failing education system.

Current unemployment is also due to poor decisions on wage fixing during the period of disinflation, in particular the disastrous 1985/86 wage round.

This pushed up the real exchange rate and priced thousands of New Zealanders out of work.

I wish Manfed would concentrate on these fundamentals and drop its obsession with protection and the Reserve Bank.

We still have economic illiterates arguing that New Zealand should not be reducing its trade barriers while others maintain theirs.

This is pure Sutchism. Sutch deplored a policy of "making New Zealand an island in a sea of controls". But protection, as we have seen, helps one domestic industry at the expense of others.

Trade wars are not wars with foreigners; they are essentially civil wars.

New Zealand is a small country and has to take the rest of the world as it finds it.

We would be better off if other countries dropped their trade restrictions. But we shoot ourselves in the other foot if our response is to add trade barriers of our own.

All we do is tax our exporters and make it even harder for them to compete in protected markets overseas.

Let me finally say that there is nothing special about tariffs or import protection.

The same arguments apply to any industries with protected or monopoly positions.

Farmers have got over arguing for controls on imports of margarine and synthetic carpet, but they still regard their monopoly producer boards as sacred cows.

But why should farmers have large amounts of capital locked up in processing and marketing activities and receive price signals which bear little direct relationship to the value of their product?

And, when we look beyond the narrow interests of producers, why should New Zealand consumers not be able to buy apples and pears from anyone who wants to supply them?

And why should the Apple and Pear Marketing Board not have to compete with Dole, or the Dairy Board with Nestles?

These questions deserve more than a knee-jerk response.

It would be sad to see farmers cling to these vestiges of protectionism in New Zealand, and sad for the economy to continue to forgo competition and innovation in agricultural marketing.

Mr Chairman, tariffs do not create or protect jobs.

In fact, they cost jobs, by reducing competition, and making the economy less innovative, flexible and dynamic.

There is no trade-off between locking people up in sheltered industries and the numbers on the dole; in all likelihood we end up with higher dole payments.

Protection is about lifting one industry relative to another, and you can't artificially lift them all.

Protection to all industries is equivalent to protection to none.

This is an absolute truism in economics, understood by all reputable economists for over 200 years.

In many ways I am astounded that this debate is taking place today.

The protection debate in New Zealand and Australia was over several years ago.

A recent official Australian report has proposed the scrapping of all Australian tariffs by the year 2000.

The Manufacturers' Federation seems to have been taken over by the economic troglodytes. Some years ago its former Director-General, David Walker - by no means a rampant free-trader - accepted that Manfed could not argue that protection adds to the number of jobs available.

The "most they could claim", he said, "was that if protection were removed very rapidly, there would be some unemployment in the affected industries."

I cannot understand why the current Manfed hierarchy are so determined to put their heads firmly back in the sand.

They are certainly not serving the interests of manufacturing exporters, manufacturers who are lightly protected on the domestic market, or manufacturers who have faced up to the restructuring task in recent years.

There are many good manufacturers in New Zealand, and they are ill-served by concepts equating them to welfare beneficiaries.

Mr Chairman, I rest the case of a reformed protectionist.

AUSTRALIA - NEW ZEALAND BUSINESS COUNCIL

A COMMON EXTERNAL TARIFF, EXTERNAL TRADE AND INDUSTRIAL DEVELOPMENT POLICIES

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CHRISTCHURCH
14 NOVEMBER 1990

A COMMON EXTERNAL TARIFF, EXTERNAL TRADE AND INDUSTRIAL DEVELOPMENT POLICIES

I think it is important to put this topic into context by recalling some of the basics about CER and the gains from trade.

First, CER has been of great value to New Zealand, and to a lesser extent to Australia, primarily as a catalyst in the process of opening up the economy in the last 10 years. Neither country was a particularly bright star for the other to hitch its wagon to. The gains have come in part from competition in the wider market but more particularly from giving both countries the confidence to open their economies to the world.

It follows, secondly, that the main gains have not arisen from the reduction in barriers to the partner country's market. Protection harms mainly those who practise it. Making a 'concession' in trade negotiations is really doing oneself a favour. The benefits of a reduction in protection take the form of bringing domestic and world prices closer together so that we put our resources into activities we are good at, encourage investment in optimal scale plants that can sell on world markets, and provide a competitive spur to domestic producers.

Thirdly, the smaller partner in a trade agreement is always the biggest winner. Again this is not primarily because of export gains. People are mistaken in thinking they are ahead of the game by swapping a small 'home' market for a larger 'single' market. The mistake is that markets in a competitive environment do not belong to anyone but have to be won every day. Rather, the small country gains most from the greater stimulus of competition. It is not just the height of the tariff that matters but its length. Germany would be harmed by a high tariff wall but Luxembourg would suffer far greater damage.

Fourthly, the argument that New Zealand or Australia should not reduce protection because other countries still protect some of their industries is based on a fallacy. 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 to keep the Japanese cure for cancer out of the American market? The answer is obvious. Small countries like New Zealand and Australia have to take the rest of the world as we find it. Our exporters have a hard enough job as it is in world markets without being doubly penalised by the self-inflicted cost burden of protection.

Fifthly, the gains from trade are of course measured in terms of greater efficiency in the use of economic resources and hence higher living standards. They are not measured in terms of changes in the balance of trade. Whether New Zealand has a trade deficit with Australia or vice versa is no more relevant than whether I have a deficit or surplus in my transactions with my drycleaner, butcher or local service station.

Finally, adjustment to lower protection is not a problem in an economy that is working properly. All sorts of dire predictions were made about CER. Our Manufacturers Federation believed many New Zealand industries could not cope with Australian competition and argued strenuously to retain import licensing after 1995. Now we are facing world competition without import licensing. Those who are worried about adjustment should focus instead on the effects on industry competitiveness of things like inflexible work practices and wage bargaining arrangements, poor fiscal policies and inadequate education and training systems.

Coming to the topic of this session and the background paper which you have, I think its analysis is generally sound and in line with these points. I will comment, however, on one general matter not so much because of its importance in the present context as because it is a pervasive and misleading feature of the wider protection debate.

The matter I refer to is the use of statistics based on tariff revenues as a proportion of either total imports or dutiable imports as a measure of an economy's level of protection. For example, the paper indicates tariff revenues for Australia in 1987 were 9.2 percent of total imports and for New Zealand were 2.6 percent. This could be taken to imply that New Zealand's average level of protection was lower than Australia's. That may or may not be the case, but making such an inference from this comparison would be totally misleading.

The easiest way to see this is to imagine the two cases of a free trade economy and one with absolute protection that shuts out all imports. In both cases tariff revenues are zero. Clearly a statistic based on tariff revenues is useless as a measure of protection.

Alternatively, consider a hypothetical economy with, say, a 10 percent tariff on all imports and a 10 percent subsidy on all exports. The tariff revenue ratio would be 10 percent - higher than the figures quoted for either Australia or New Zealand - yet the economy would have an allocation of resources approximating the pattern under free trade.

A better measure of the incidence of trade restrictions is the average effective rate of assistance or protection to industry. The paper gives figures of 19 percent and 17 percent currently for New Zealand and Australia respectively, with the New Zealand average coming down more rapidly in recent years. But the paper goes on to acknowledge that average measures of effective assistance are themselves of limited value in assessing distortions and the losses of economic efficiency resulting from protection. As it says, the crucial factor for any country is the internal disparities in assistance. Quite low average figures can mask very high levels of assistance to selected industries, involving a major misallocation of resources. This has been the pattern in Australia and New Zealand.

The CER agreement has contributed to a reduction of these distortions in both countries. Because each started out with high and variable levels of tariffs, and of industry assistance more generally, there was concern that freeing trade between them would not always work to bring about a more efficient industry structure in both countries. For example, a producer of a consumer good in Australia might be more efficient - in the sense of using fewer resources per dollar of value added at world prices - then the counterpart New Zealand producer. However, because the Australian producer used tariff-protected inputs from the more broad-based Australian manufacturing sector whereas the New Zealand producer used duty-free imported inputs, the latter might be more competitive and expand relative to the Australian producer. From the point of view of efficient resource use in the two countries, this would be an undesirable situation.

This particular distortion, the so-called intermediate goods problem, was catered for in the CER agreement. It was a major issue at the time, especially on the Australian side. One possible measure foreseen to deal with it was the establishment of a common external tariff. As the paper notes, this measure has never been invoked and the intermediate goods problem has not turned out to be a real difficulty. As tariff rates come down further in both countries, it is receding further in importance as a distorting factor and source of contention.

More generally, distorting factors in trade between the two countries have on the whole diminished over time. The paper notes that, for Australian industry generally, non-tariff assistance by way of bounties, export incentives and quotas has substantially declined. The same is true of New Zealand. There are still irritants such as the export facilitation arrangements for Australian motor vehicles. While these can be regarded as a subsidy from the Australian taxpayer which New Zealand consumers should accept with gratitude, such a policy is not part of a desirable assistance environment. Australia and New Zealand should be steadily reducing all forms of assistance to their motor vehicle industries, along with others industries, including export facilitation schemes. The Australian Industry Commission has recommended the phase-out of export credits to New Zealand but only by 1996, which seems unduly long.

The background paper rehearses the standard arguments for and against a common external tariff and I do not have a lot to add to them. It leans towards the conclusion that the arguments in favour are not strong, and points out that a de facto harmonisation is occurring anyway. I do not believe that the possible advantages cited, namely greater negotiating power, the ability to dispense with rules of origin and tariff simplification carry much weight.

The paper notes that a CET would not necessarily improve resource allocation decisions, though it is wrong in suggesting that this will hinge only on whether the higher or lower of the two tariff rates is chosen. The outcome would actually depend on a whole host of factors, including the levels of other tariffs, export subsidies and other assistance measures, as well as issues of industry structure such as the pattern of production of intermediate and final goods.

Probably the most basic point to make is that with ongoing tariff reduction programmes in both countries, the issue of a CET is becoming academic. A move in that direction would also carry the risk that one country would be handicapped by the other if it faltered in its efforts at trade liberalisation. Both countries' interests are best served by continued efforts to reduce their overall levels of protection, particularly in the case of the most highly protected industries.

In Australia, tariffs are heading down to levels of 15 or 10 percent by 1992, with the exception of textiles, clothing, footwear and motor vehicles. Further reductions are expected. The Liberal party has committed itself to a virtual elimination of tariffs, by the year 2000.

In New Zealand, general tariff levels are scheduled to reduce to a maximum of 10 percent by 1996, and rates on the few industries exempted from this programme are also reducing. This programme is challenging but I believe that most manufacturers are quite capable of coping with it provided other policies are in good shape. The National government is committed to ongoing reductions in tariffs to encourage further improvements in efficiency. However, it has also said that it will review the post-1992 programme, essentially in the light of progress in other policy areas. The logic of this position is somewhat back to front. The government is correct in asserting that the benefits of trade liberalisation have been undermined by unbalanced policies. However, the remedy is to fix the unbalanced policies, not to fix what ain't broke. For example, there is ample time to address the budgetary problems and to free up the labour market before the post-1992 tariff cuts occur. It should also be noted that there are important interactions between these policies. Labour market reform, for example, will not yield the full benefits it is capable of yielding unless firms face strong domestic and international competition and are forced to develop better employment relationships.

With both countries heading south, as it were, in their tariff policies, to the point where duties seem likely to be eliminated or reduced to low levels in the period ahead, there seems little point in artificial harmonisation exercises. Indeed there are serious dangers in many of the proposals for harmonisation that are made in the CER context. I want to round out this discussion with a word on these.

The proper lessons about harmonisation can be learned from the experience of the European Community. For the first 20 or so years of its existence it embarked on a policy of harmonisation of laws, regulations, standards and sometimes even prices (especially agricultural prices) based on a belief that these things had to be achieved before goods, services, people and capital could be allowed to move freely from one country to another. This was the period of the interminable Euro-sausage debates. Even if more agreement had been possible, the end result would not have been market integration. This can only take place as a result of trade - and trade only occurs as a result of differences. Harmonisation kills trade. If labour costs, energy costs, regulatory costs and so forth were identical across countries there would be little basis for trade.

This simple point was belatedly recognised in 1985 when the Community decided to move swiftly to a single market in 1992, relying not on the principle of harmonisation but on that of mutual recognition. This holds out the prospect of competition based on differences. It is a much more market-friendly approach - implying the withdrawal of heavy government direction and assigning the task of integration to markets.

Australia has recently, if belatedly, acknowledged the merits of mutual recognition in inter-state trade. The Brisbane Special Premiers' conference was called by the prime minister to explore the realities of cooperative federalism. A major outcome has been an agreement between the Commonwealth and states to adopt mutual recognition principles in their regulatory practices. For the present the focus is on traded goods and government-controlled occupations. However, the power of competition is pervasive and it might be expected that the implications of this decision will ripple across all regulation, and across the Tasman.

This approach has powerful consequences. Free trade in goods and services, free movement of people, capital and information, based on different institutional structures and in an increasingly mobile society, mean that all institutions are subjected to intense competition. The choice between a high tax/low risk or low tax/high risk environment, or a high regulation/low growth versus a low regulation/high growth environment, will start having a noticeable effect on the mobile factors in the economy.

We shall be forced to think far more carefully than was necessary in the past about the various trade-offs.

It has been suggested that two institutions are particularly at risk in this new competitive environment: the discretionary power of governments and the monopoly power of organised labour. An over-expansion of government will make people vote with their feet for a warmer fiscal climate. The taxman will not want to see the tax base disappear. Trade unions will come under pressure : if a car manufacturer suffers strikes or excessive wage demands in the United Kingdom, it will locate its next plant in Germany or Spain. Trade union members will not want their jobs to walk away.

These lessons are very relevant in the CER context. The last thing we want, for example, is harmonisation of New Zealand's and Australia's labour laws, at least on any existing basis. Both are disasters. New Zealand now stands a good prospect of achieving fundamental reforms. The consequences could be dramatic. As one Australian businessman has put it:

> "If New Zealand moves quickly and accepts the efficiency of the law of contract in the labour market, it will gain an advantage over Australia. I do not believe Australia could watch New Zealand growth rates of 7 or 8 percent per annum (the minimum result of labour market deregulation in my view) and not quickly follow suit. It would be impossible for Australia to persist with its present labour market institutions and do nothing as capital, and brains, flowed easterly across the Tasman."

My feeling is that this estimate of the effect of labour market deregulation on growth is on the high side, but experience with even the partial reforms on the waterfront shows that staggering productivity gains are possible.

What holds for labour law also holds for other areas of policy. We need competition to create the warmest fiscal climate - not through artificial inducements to invest in one country or the other but by cutting government spending and lowering tax burdens. In the area of business law Geoffrey Palmer had things precisely the wrong way round. He seemed to believe that economic welfare can be made compulsory by law and that harmonisation should be pursued for its own sake. But the last thing New Zealand needs, for example, is Australia's cumbersome companies and securities codes. Both countries should be competing to find the lowest cost forms of regulation so that companies are attracted to locate and do business in them. Efficient tax and regulatory regimes are one form of comparative advantage that a country can create.

None of this is to say that there is anything wrong with both countries striving to achieve best-practice policies in any area and, if successful, discovering that they have a lot in common. This is effectively what has been happening with trade liberalisation. No-one would deny that there are some additional gains in the lower transactions costs associated with common regimes. My argument is simply that there is little merit in uniformity for its own sake, and that there can be major benefits from having an environment which allows for experimentation and competition between institutions and jurisdictions.

If this argument is valid, then ideas such as a common external tariff are backward-looking rather than the way of the future. Both countries would do better to press on with the task of opening up their economies and, in respect of external trade policies, look at the possibilities of free trade agreements with North American or Asian countries in the post-Uruguay Round period. Such moves could reduce further the distortions that motivate proposals such as a CET. They would also do well to remove other distorting forms of assistance such as bounties and tax preferences where these have no economic justification. In doing so each country would help itself in the first instance, and its CER partner as a by-product.

There are still some important if unspectacular issues on the CER agenda to be worked through. However, the main determinants of the economic performance of both countries, and hence their value to each other as a trading partner, now lie elsewhere, in the domestic policy arena. Both countries have made haste too slowly in the 1980s while the rest of the world has continued to change. Both are now again on the edge of an economic precipice.

If either is to reverse its relative long run decline, its priorities must be things such as achieving and sustaining low inflation, deregulating labour markets, shrinking the size of the public sector and making it more efficient, radically improving education standards and rethinking the role of the welfare state. As we consider the CER relationship in this forum, we should perhaps keep in mind these priorities and consider whether anything can be done jointly to encourage our governments to give them the attention they deserve.

MINISTRY OF CONSUMER AFFAIRS SEMINAR ON CONSUMER POLICY

DEREGULATION AND CONSUMER POLICY

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DEREGULATION AND CONSUMER POLICY[1]

> Consumption is the sole end and purpose of all production, and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer... But in the mercantile system, the interest of the consumer is almost constantly sacrificed to that of the producer; and it seems to consider production, and not consumption, as the ultimate end and object of all industry and commerce.
>
> *Adam Smith*
> *The Wealth of Nations, 1776*

The Primacy of Consumer Interests

Adam Smith had it right. Consumption is the end purpose of economic activity. Economics is about using scarce resources to best meet consumers' needs. The interests of producers are only relevant insofar as they create benefits for consumers. Consumers are the ultimate employers of the suppliers of both capital and labour. Economic policy should be directed to creating an environment in which firms are forced by competition to be efficient and to give consumers wider choice, higher quality and lower prices.

For the long period of fortress New Zealand, economic policies in this country conformed with what Smith labeled the mercantile system. Producer interests were paramount. Over the last decade, New Zealand has belatedly joined the worldwide trend towards trade liberalisation, deregulation, privatisation and greater reliance on the private sector and competitive markets to better serve consumer interests. However, we are still much further away from being a genuinely open and competitive economy than is popularly imagined, and the unbalanced and partial nature of the liberalisation programme is the source of many of the persisting economic difficulties.

Consumer Benefits from Deregulation and Public Sector Reform

Looking back over the moves towards more consumer-oriented policies in the last 10-15 years, one is struck by the fact that few of the major reforms owed much to the advocacy of those nominally responsible for advancing consumer interests. As a first example, it is plain that consumers have benefited enormously from the dismantling of import licensing through access to a greater variety of better and cheaper products, including from domestic firms responding to the stimulus of

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1 Views expressed in this paper are my own and do not necessarily reflect those of the New Zealand Business Roundtable.

competition. Yet the Department of Trade and Industry, the official agency with responsibility for consumer affairs in that period, fought tooth and nail for many years against efforts to relax licensing. Similarly I recall from first hand experience that efforts to interest the Consumers Institute in import licensing issues or the programme of industry studies were largely unsuccessful.[2]

Much the same could be said about the area of competition policy. The same department was responsible for the arsenal of price controls which stifled competition and led to pervasive cost-plus pricing behaviour. As recently as the early 1980s it resisted the abolition of national pricing. For many years it was hostile towards the franchising arrangements for whitegoods operated by Fisher and Paykel. Not until last year's decision of the High Court overturned the majority decision of the Commerce Commission was an arrangement with clear-cut consumer benefits recognised and sanctioned. The costs to the company of this fiasco were enormous.

Nor were consumer interests instrumental in the moves to corporatise and more recently privatise government trading departments. There were few more obvious examples of organisations, often with legislated monopoly positions, that exploited consumers through inflated prices and poor quality services. Yet consumer interests such as the Major Energy Users Group criticised corporatisation, arguing that electricity prices would jump by around 40 percent. In fact the Electricity Corporation has reduced its total real unit costs by 29 percent over the last 4 years and average wholesale prices are down by 16 percent in real terms. Service standards in organisations like Telecom and New Zealand Post have improved out of sight. The extent of waste and inefficiency that has been revealed in state-owned enterprises is mind-boggling. Yet many of those who denied the scope for gains from corporatisation are now arguing against the subsequent moves to privatisation which have the potential to offer further gains to consumers.

Consumer voices were barely heard in the debate over financial market deregulation. I do not recall consumer pressure for airline deregulation, perhaps the most striking example of the benefits of competition in the eyes of the New Zealand public. The two stages of liberalisation of shop trading hours over the past ten years were promoted much more strongly by producer interests (such as the retail industry) than by consumers. To my knowledge the current moves to deregulate the labour market have received no support from consumer representatives, even though their contribution to productivity and hence consumer welfare is likely to be massive.

Indeed, far from being reliable allies of advocates of market competition, consumer organisations have on occasions been quick to invoke the use of controls and regulations. A recent case in point was the threat to oil supplies posed by the Gulf crisis which prompted calls from the Consumers Institute and the Automobile Association for government intervention despite New Zealand's costly experiences

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2 The Porter study on New Zealand's international competitiveness has drawn attention to the role of domestic demand conditions in forcing firms to upgrade their performance. It finds that decades of protectionism reduced consumer choice. Consumer demand is relatively unsophisticated and has provided little stimulus to New Zealand industry to achieve competitive advantages.

with such policies in the past. Thankfully both ministers of energy in office over the period resisted such pressure and markets efficiently handled the adjustment: prices rose as supply risks grew and are now falling as they recede.

There are exceptions to the pattern that I have been describing. One such is port reform, which has been driven in substantial measure by pressure from user interests. Farming and business groups will continue to press for privatisation of port companies and further improvements in employment arrangements which will yield benefits over and above those already realised. But whereas consumer lobbies in Europe are active campaigners against agricultural protectionism, New Zealand consumer representatives, in contrast to groups such as the Importers Institute and the Merchants Association, have had no significant role in moves to reduce high tariffs or indeed in trade issues generally.

So there is a paradox to explain: public and private sector organisations ostensibly dedicated to consumer interests have seldom been effective supporters of freedom fighters attacking the mercantilist system. Economics has long provided part of the explanation for this paradox, which is that consumer interests are typically dispersed, difficult to organise and benefit only in small measure from successful lobbying (and as a result consumer movements are easily captured by crusaders), whereas producer interests are concentrated and organised and have much at stake. There are other institutional explanations. Consumer interests were formerly stuck with a department 'charged' (in its mind) with 'helping' industry. In the laudable interests of not duplicating the responsibilities of other departments, the present Ministry of Consumer Affairs has deliberately limited its focus to the narrow (and less economically significant) range of issues that fall within the rubric of 'consumer policy'. But a puzzle remains: Why is it that consumer spokespersons often seem to end up missing the larger picture and hissing the wrong guys?

The Ideology of Consumer Protectionism

A clue to this puzzle is given in an analysis of what Parish has called the 'ideology of consumer protectionists'. As he puts it:

> "Hostility to the market economy is a strong element in consumer protectionism - as it is of protectionist thought in general. This is directed not merely against monopoly and other market imperfections long-recognised and analyzed by economists, but at the central proposition of the economic theory of markets, namely, that voluntary exchange is mutually beneficial. Scepticism about the performance of markets contrasts with an unquestioning faith in the ability of governments to intervene in the consumer interest." (p. 233)[3]

3 Parish, Ross, 'Consumer Protection and the Ideology of Consumer Protectionists,' in *Consumer Protection Law and Theory*, Duggan A.J. and Darvall, L.W. (eds) Sydney, The Law Book Company Ltd, 1980.

This stance can be detected in the thinking of both the Ministry of Consumer Affairs and the International Organisation of Consumer Unions (IOCU). In its briefing for the new government, the Ministry wrote:

> "The orientation of the Ministry of Commerce, in line with its business perspectives, is very much away from direct intervention in markets unless demonstrated market breakdown is occurring. The activities of the Ministry of Consumer Affairs are more interventionist by nature. This is required to correct bargaining and legal imbalances between traders and consumers... Interventionist consumer policy would no longer be necessary if conditions of equity in markets and perfect competition were achieved." (p. 6)[4]

Similarly, IOCU has stated:

> "The concept of a 'free' market is often touted as the magic solution to solve huge economic problems, presumably because in a free market perfect competition exists and therefore protects consumers from market domination and control. This trend towards freeing the market is very strong and might become a main issue of the nineties. But does a free market really exist? Many do not think so, at least not in the true sense of the word. If a free market cannot exist, then there is a need to protect consumers in the market-place." (p. 1)[5]

The IOCU's discussion of 'free' markets and its equation with the textbook model of perfect competition is primitive and has no counterpart in the economic analysis that has driven regulatory reform in New Zealand in recent years. This has paid a good deal of attention to issues such as transactions costs (defined broadly as the costs of information, negotiation and enforcement), asset specificity, limitations on rationality and opportunism, all of which have no part in the naive perfect competition model. It is ironic that those employing this more sophisticated analysis of market competition are often accused of using and ignoring the limitations of the simple model whereas their critics, for example those who are hostile towards arrangements of the Fisher and Paykel type, in fact base their judgments on the standards of perfect competition. By those standards, an exclusive dealership contract appears to be anti-competitive.

There are other problems with the foundations of consumer policy as outlined by the Ministry. Considerable weight is placed on the assumed lack of equity in markets which is defined as the imbalance of bargaining power between traders and consumers. This is analogous to the notion of the alleged imbalance of bargaining power between employers and workers which has underpinned 100 years of industrial law in New Zealand and which the government has rightly rejected in framing the Employment Contracts Bill. The fallacy is apparent in the employment context when it is recognised that Fletcher Challenge has no more ability to hire workers on inferior terms than the smallest firm in the land: if it

4 Ministry of Consumer Affairs, Briefing for Incoming Government, October 1990. The Ministry nevertheless affirms that the end result it desires is market efficiency.

5 IOCU, Congress Prospectus, 13th World Congress, Hongkong, July 1991.

offers work at $9 an hour when the market rate is $10, other things equal it will get few takers. The essence of bargaining power is the existence of alternatives.[6] This is not to say that in both factor and product markets there are not times of scarce or plentiful supplies which favour sellers or buyers, but the point about properly functioning markets is that they adjust under competition to remove such imbalances.

Parish discusses this issue in the consumer protection context as follows:

> "Most consumer protectionists seem to see economic life as a series of great struggles between different groups, especially between employers and employees, and between producers and consumers. Producers are said to 'exploit' consumers – and landlords tenants – because of their superior 'bargaining power'...
>
> "I and many other economists share a quite different view. We see producers and consumers, or landlords and tenants, as being in a complementary relationship: each needs the other and each gains from a transaction with the other... The great competitive struggle is not between producers and consumers, but between consumers and consumers, on the one hand, and between producers and producers on the other. That is, consumers compete with one another for the supplies provided by producers, with producers competing with one another for the custom of consumers." (p. 5)[7]

The vision of the economic process which underlies theories of bargaining power bears little relation to current realities. Consumer bargaining power was constrained to a much greater degree in the era of import licensing and widespread controls over domestic markets. Deregulation has greatly enhanced consumer choice and hence bargaining power.

For this reason, a further theme of the Ministry of Consumer Affairs, and of the Ministry of Commerce in relation to competition policy, has it exactly backwards. This is that in a less regulated economy there is a need to strengthen consumer policy and antitrust enforcement to prevent "private regulation", whatever that means, and the abuse of market power. The reality is that the scope for abuses of market power is now vastly reduced compared with the fortress New Zealand era.

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6 The issue of bargaining power is often confused with the problem of monopoly. As Posner notes:

> "Under monopoly, by definition, the buyer has no good alternatives to dealing with the seller, who is therefore in a position, within limits, to compel the buyer to agree to terms that in a competitive market would be bettered by another seller. But there is no reason to expect the terms (such as sellers' warranties or the consequences of the buyer's default) to be different under monopoly from what they would be under competition; the only difference that is likely is that the monopolist's price will be higher. The problem is monopoly, not bargaining power - unless, unhelpfully, these are treated as synonyms."

(Posner, R.A. *Economic Analysis of Law*, Boston, Little, Brown and Company, 1986.)

7 Parish, Ross, 'Economic Effects of Residential Tenancies Legislation', mimeo.

The number of situations in which monopoly may be a concern has shrunk essentially to those supported by legislation and to some parts of the non-traded goods sector. Yet in the same period the bureaucracies responsible for competition policy and for the newer forms of consumer policy have expanded considerably.

Consumer Incompetence, Imperative Values and Distributional Issues

Some further arguments of doubtful validity in the consumer protection debate are worth a brief comment.

One of these is based on a view of consumer incompetence. Thus the minister of consumer affairs, justifying plans to introduce pre- and post-sale legislation, has argued that:

> "As the marketplace is becoming increasingly sophisticated... consumers are less able to assess a (sic) product characteristics and quality without specialist knowledge."[8]

One response to this claim is to ask: "Have you ever bought a horse?" But even if it were true, it is hard to see how consumers are disadvantaged by an increasing variety of things among which to choose. This increase in choice has also been accompanied by a vast range of industries and institutions supplying information to consumers. Thus, as Sieper notes:

> "...specialist organisations and publications test and review products of all kinds, brand names signal commitment to performance, large retail stores search out products and certify their suitability by money back guarantee, franchises reduce search costs through product standardisation etc. while dealers in information such as general practitioner doctors, travel agents, insurance brokers, architects etc. evaluate consumer requirements and recommend consumption plans. Even consumer organisations sometimes play an informational role." (footnote 8)[9]

Similar tendencies to use official policy or the law not to protect every member of society from the injustice or oppression of every other member of it but to protect individuals from themselves arise in the field of product safety. In the United States, courts have imposed strict producer liability to the extent of finding in favour of complainants who have come to grief cutting a hedge with a power mower. The Ministry of Consumer Affairs has noted that New Zealand's no-fault Accident Compensation Scheme has had the effect of reducing the incentives for traders to meet strict standards of safety.[10] In turn this leads to pressures to restrict or ban activities deemed dangerous or unhealthy. As one writer has put it:

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8 Hon Katherine O'Regan, minister of consumer affairs, addressing Major and Multiple Stores Conference, 21 February 1991.

9 Sieper, E. 'Consumer Protection - Boon or Bane?', Centre for Independent Studies, Sydney, 1978, mimeo.

10 Op. cit. p. 11.

> "We are heading towards a society where dangerous sports will not be permitted, pedestrians will be required to have a licence, obesity will be illegal and what we are allowed to eat will be determined by the National Dieting Board!" (p. 6)[11]

Martino went on to say that if you think that this is ridiculous or exaggerated, consider the European Community toy regulations. As pointed out by Digby Anderson:

> "The contemporary obsession with safety, especially safety for children, has found its true bureaucratic home in the EEC... Committees have now recommended the statutory minimum dimensions of marbles based on the average width of toddlers' throats so that the Community shall protect its young from swallowing them. Or perhaps it is so that they *will* be able to swallow them rather than get them stuck: it's not clear... The pea in a whistle may be governed by regulations as to its toxicity lest someone tread on a whistle, the pea escape, be picked up and chewed by a child desperately looking for a pre-EEC-ban-style marble."
>
> "I'm unsure," Anderson concludes, "about whether such peas will have to be the size of tennis balls (for marble-ish reasons) and how huge post-1990 whistles will have to be to incorporate them."[12]

Safety is a valid social objective, but not an imperative value that can normally be allowed to take precedence over all others. The costs and benefits, and the frequently perverse side effects, of safety regulations, in particular the undermining of incentives for personal responsibility and care, need to be carefully weighed. To date, New Zealand has not travelled far down this particular regulatory road, though there are pressures to go further.

An argument for consumer policy invoked by the Ministry of Consumer Affairs is to "empower groups of consumers who have been identified as particularly vulnerable and disadvantaged in the marketplace, for example Maori, Pacific Island people, women, the elderly, low income and rural consumers.[13] (The non-disadvantaged are presumably non-retired, wealthy European men living in cities.) There may be a case for targeting the consumer education function in this way, if targeting is accepted for public education in general. However, it is far from clear that we are making the least well off better off with the sorts of regulatory interventions under discussion. A recurring finding in regulatory studies is that regulations tend to operate in the interests of better-off groups and against the interests of the less privileged. In the consumer field, as the Ministry notes, the organised consumer groups comprise "people who are principally educated,

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11 Martino, A. 'Liberalism in the Coming Decade,' The Mont Pelerin Society General Meeting, Munich 1990, mimeo.

12 Anderson, Digby, 'Games that Eurocrats Play...' Sunday Telegraph, 2 October 1988.

13 Ministry of Consumer Affairs, op. cit. p. 4.

articulate and have the resources and time necessary to pursue vigorously the interests of their members."[14]

Consumer protection, like all forms of protection, typically involves higher prices in return for reductions in risk. The trade-off between risk and price involved in such protection may be more in line with middle class tastes than those of the poor, who are likely to value low prices more. For those who are relatively poor, which includes most of us at some stage of our lives, the preferences about these trade-offs are different from when we are better off or have greater responsibilities to others. One illustration of this effect was experience with the Safety of Children's Nightclothes Act 1977, which aimed to protect children from burns. According to a former minister of consumer affairs, this resulted in the near-disappearance of children's nightclothes from the market as a result of vastly reduced demand due to high costs. Instead, parents made their own children's nightwear out of highly flammable but cheap material, and children were put at even more risk. There are many other similar examples.

In the consumer protection field there is frequently too little recognition of the links between the price and other conditions of the contract. Many consumer protection advocates appear to believe in a 'free lunch', i.e. the absence of a risk-price trade-off. The reality is that if the risk in the terms of sale is altered in favour of the consumer, the price is likely to adjust to compensate the seller for the cost of bearing extra risk. Thus the additions to tenants' rights in the Residential Tenancies Act 1986 have in all probability come at the cost of higher rents. Better-off people may well find such altered risk-price trade-offs desirable. But because most protection involves higher prices, and because the poorest members of society will tend to put the most value on low prices relative to risks, we may actually be especially penalising the poorest people.

Conclusion

It is not difficult to identify further initiatives for consumer protection legislation which seem ill-conceived. The current proposals to introduce mandatory labelling requirements for country of origin, care and fibre content seem to fit into that category. The government is proceeding with country of origin labelling despite a consultant's report to the Ministry which found against it, and would have done so more strongly if some important issues had not been overlooked. (To its credit, the Ministry of Consumer Affairs has advised against country of origin labelling regulations.) The Auckland Chamber of Commerce has called for the regulation of education services for foreign students on the basis of a couple of unfortunate experiences. There have been calls for curbs on imports of used cars from Japan on grounds that have little to do with consumer interests. Last year a visiting consumer affairs expert, Jeremy Mitchell, recommended that New Zealand should establish a deposit insurance scheme to protect bank customers against the risk of collapses, despite the widespread recognition that the incentives for unwise lending created by deposit insurance have been at the root of the savings and loans

14 Ministry of Consumer Affairs, op. cit. p. 11-12.

fiasco in the United States.[15] Those who think New Zealand is immune from such folly would do well to note the creeping re-regulation of financial markets being promoted by the Reserve Bank.

I have argued that consumers in New Zealand have benefited immeasurably from policies to open markets to competition, even though these are, as yet, far from complete. We still maintain, for example, an extraordinary form of commercial regulation of pharmacies which restricts supermarket pharmacy and the ownership of multiple outlets. Many other occupational regulations impose restrictions which are in the interests of producers rather than consumers, and the Ministry of Consumer Affairs has rightly identified these as a reform target. There is no effective competition in the market for accident insurance. The electricity industry remains partially regulated at the distribution level and is still publicly-owned. Producer board monopoly controls remain largely intact. We still have significant tariff barriers. Education, particularly at the tertiary level, is largely a state monopoly. In the education sector in general, consumer interests are now asserting themselves more forcefully and are demanding greater choice and competition. The same can be said of health. The potential of market reform in serving consumer interests better is still enormous.

Consumers have not captured all the benefits of regulatory reform, nor should they necessarily do so in the short run. In cases such as the SOEs and port companies, taxpayer and ratepayer shareholders have also benefited from higher returns on their investments. But as returns rise to normal competitive levels and are constrained by competition and other influences, consumer benefits will dominate. Similarly efficiency gains in our export industries arising from deregulation have benefited owners and workers in export firms - as well as consumers abroad.

I noted that, with some honourable exceptions, organised consumer interests in the past have not played a large role in many of the changes which have benefited consumers. Often they seem to have missed the bigger picture and concentrated their efforts on finding the rotten apple in the bottom of the barrel. Economic theory provides an explanation as to why the political influence of consumers is often weak, and the ideology of consumer protectionism also sheds light on why some initiatives promoted by the consumer movement have not been in the interests of consumers overall.

Given the shaky foundations on which parts of official consumer policy have been seen to rest - particularly erroneous notions of imbalance in bargaining power and the effects of deregulation - together with the risks of perverse distributional outcomes from consumer protection, there seems a good case for a general review of consumer policy. I suggest this is likely to find that a number of current policies meet the tests of sound economic analysis. For example, the maintenance of a system which guarantees the value of ordinary weights and measures in the interests of facilitating contracts would be widely accepted as a core government function. (As an anti-inflation discipline, the same standard might appropriately be applied to maintaining the value of the monetary unit of account.) Laws to prohibit knowingly misleading or deceptive conduct, false representations, fraud

15 Federal expenditure flowing from this episode is estimated to exceed the total amount of aid provided to Western Europe after World War II under the Marshall Plan.

and duress and to protect against incapacity are reasonably non-controversial. There is a place for consumer education, at least as part of the public education role. Legislation such as the old Sale of Goods Act is among the best on the statute books, and proposals to modify it should be approached with particular care. On the other hand, it seems likely that some of the principles underlying statutes such as the Hire Purchase Act (e.g. the ban on add-on security clauses), the Residential Tenancies Act and the Fair Trading Act will not stand up well to scrutiny. Reform efforts in this direction could well prove fruitful.

AUSTRALIA NEW ZEALAND FOUNDATION
CER AWARENESS PROGRAMME

CONFRONTING ECONOMIC REALITIES: THE NEW CER AGENDA

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AUCKLAND
11 APRIL 1991

CONFRONTING ECONOMIC REALITIES: THE NEW CER AGENDA

I have entitled my remarks 'Confronting Economic Reality' because that is where I believe New Zealand and Australia are now at. Both are between a rock and a hard place. If we are to make our way as countries in the 1990s, this must be the new CER agenda.

I thought you might be interested in some possible variants of CER which I understand were being considered at the time the agreement was negotiated.

The first was TACT, the Tasman Agreement on Closer Trade. Perhaps that symbolised our collective habits of pussyfooting around. We still sometimes seem to behave like an old boys' club rather than real competitors, for example in agricultural trade between the two countries.

The second was TATTERS, the Tasman Agreement on Trade, Transport and Economic Relations. That seemed to reflect the steady slide of both countries into genteel mediocrity. This hasn't stopped yet.

A third suggestion was TEAT, the Tasman Economic Agreement on Trade. No doubt its promoter had in mind the prevailing beliefs of industries on both sides of the Tasman that taxpayers and consumers were there to be milked.

Finally there was a proposed name for a joint secretariat: OCER, the Organisation for Closer Economic Relations.

We have come a long way since CER began in 1983, but not far enough. Taken as a whole, the 1980s were another decade of lost opportunities for both countries. The world did not stand still while we continued our debates about protectionism, welfarism and trade union reform. The Asian countries in particular continued to pass us by.

On the positive side, governments in both countries started to accept that we had to open up our economies to the world. Starting with Australia, both countries largely deregulated their financial markets, removed exchange controls and floated their currencies. They made some progress in reducing budget deficits and reforming their tax systems. Belatedly they started to corporatise and then privatise state-owned industries.

But these and other steps towards the sort of policies that the successful countries of the world have adopted have not added up to a coherent economic programme. Once again, both countries are in deep economic trouble. Our economies are in recession, our unemployment rates are climbing towards 10 percent of the labour force and we have large current account deficits, dangerous levels of external debt and shattered business confidence.

Some in New Zealand have drawn the conclusion that our structural reform programme was an experiment that failed. As *The Economist* said recently:

> "In truth it didn't. New Zealand's industry had been isolated for so long that competition was bound to be painful. The moral for reformers in

> Eastern Europe is not that New Zealand tried to do too much too fast but that it did not go far enough. The former Labour government did only part of the job - the easiest part. It left the least responsive market to last: the labour market remains riddled with restrictive practices and a wage fixing system which suppresses pay differentials and prevents wages from adjusting to market conditions. Here lies the real blame for job losses."

New Zealand started from a worse position. Australians have talked about becoming a banana republic; by 1984 we were just about there. As a recent *National Business Review* editorial put it, there was a belief that:

> "In many ways Australia can afford to go slower than New Zealand, throw money around to ease the burden of change and hold off things like the introduction of a broad-based consumption tax. It has a lower cost welfare state, a more efficient public health service and a better education system. It has achieved these by avoiding the mistakes we have made on a wide number of fronts, from immigration to no-fault accident insurance."

But slow adjustment has its cost, as Australia has been discovering. Sooner or later, realities have to be confronted.

A genuine economic crisis does concentrate the mind, but unfortunately for New Zealand we lost concentration. After three years of working hard to put in place sound reforms, our government decided to take a teabreak and forgot to come back. The cost has been enormous. The economy has been more or less flat for the last three years, a major fiscal problem has reappeared and the markets have delivered their verdict by marking down our credit rating once again.

During the six years of the last government's term, the world economy was growing and our terms of trade were high. Organisations like the Business Roundtable were arguing that if we did not restructure when times were good, we would be forced to do so when they were bad. That is exactly what has happened. The new government has the unenviable task of having to pick up an aborted programme and telling the community that there must be further adjustment before we can expect better things, assuming that - this time - we have the resolve to see it through.

Both New Zealand and Australia have found it hard to come to terms with the idea that successful economic management requires getting all or most things right. This is the painful lesson that the East European countries are learning as they try to dismantle command economies. Some politicians like Vaclav Klaus, the Czech finance minister who is visiting Australia and New Zealand later this year, have understood the importance of moving to a "market economy without adjectives". Others are clinging to versions of reformed socialism or piecemeal perestroika-style reforms. All experience from the Soviet Union to Australia and New Zealand tells us that such strategies will only make matters worse.

The Australian government has recently delivered another instalment of perestroika. By some past standards it is a courageous package. As one commentator put it:

> "Yesterday will go down as the day protection died in Australia".

The *Australian Financial Review* elaborated as follows:

> "For almost a century... the nation built high tariff walls to shield local industry from the rigours of international competition. While most developing countries were opening up economies and developing an export tradition, Australia fostered an indolent and insular industrial culture based on political expediency. The country lost its way in the world, becoming a Third World primary producer with a taste for the industrial world's standard of living."

Mr Hawke deserves credit for acknowledging that:

> "However much our competitors might bend or break the principles of fair trade, our own self-interest is served by a steadfast refusal to return to the days of protectionism."

But achieving a personal best standard is no longer enough. The *Australian Financial Review* rightly asked why the government did not go all the way to a zero tariff rate as the Garnaut review had recommended. It criticised the government for failing to tackle industrial relations reform - "perhaps the nation's most pressing obstacle to international competitiveness".

None of the Australian business organisations was satisfied with the overall thrust of the package. They pointed to the lack of action in whole areas where New Zealand has tackled structural change: labour market reform, waterfront costs, the public sector, telecommunications, inflation and taxation reform. Governments are no longer judged on the basis of their personal best. The only relevant standards now are international standards of excellence.

I am encouraged by these reactions and by a growing sense of economic maturity in both countries. New Zealanders are dissatisfied with our abysmal economic performance primarily because of the social stresses that it has generated. A continuation of past trends would see more of the best and brightest leaving and the old and unskilled left behind. Australians are dissatisfied with their track record because it has diminished their status in the world. The producing community - business and farmers - in both countries accept the reality of facing up to world competition without protection or subsidies. Electorates have been rewarding governments prepared to tackle difficult issues and jettisoning those that lose the stomach for them.

The business community in New Zealand has been very encouraged by the performance of the new government to date, and has shown little time for those peddling soft options. A recent poll of 40 chief executives of companies of all sizes showed 80 percent support for more measures to cut public spending. Most respondents were against monetary policy being eased to hasten falls in interest rates. Despite past claims that labour market reforms were not rated highly by manufacturers, a large majority of the sector said they would benefit from them. A mere 2.5 percent of respondents favoured national awards. Those are encouraging statistics. Other polling has shown that most New Zealanders support the government's benefit reforms.

More and more businesses are accepting the view that they must stand on their own feet. As a fellow Business Roundtable member, the chief executive of a highly successful Australasian company, put it recently:

> "Far too many of them developed a business base dependent on government support - licences, tariff protection, tax advantages, and so on. It is absolute folly to base long term investment decisions on the whim of a government. [We are] unshakeable in our belief that a company must never need government support."

Firms that are dependent on preferential access under CER to survive should heed this warning. Such artificial trade diversion is not in the interests of either country. As tariffs continue to fall, shareholders' funds will be at risk.

The Porter project has underlined the relatively modest role that governments can play in promoting international competitiveness. The most important one is to create a stable macroeconomic environment. We should stop arguing about whether low inflation is a priority; that should be taken as given, as should the conclusion that devaluation is no answer by itself to a competitiveness problem. Porter believes that governments can help by doing things like upgrading educational performance, investing in basic research and infrastructure and promoting immigration. Beyond that they should open markets to competition and get out of the way. It is the responsibility of firms to define their business strategies, find ways of meeting consumer needs, innovate, develop their human resources, and foot it with the best competition in world markets.

As young business people and professionals, you are the first generation to have to think globally. CER was never about swapping a hothouse domestic market for a hothouse trans-Tasman market. Much can still be done to round out our economic relationship. We should move quickly to free up trans-Tasman shipping and aviation and establish a free investment zone. As a frequent trans-Tasman traveller I wish we could scrap passports and streamline other immigration and customs procedures. But we have no need to copy each others' tax regimes or business laws unless they are world class. And we have to look beyond each others' market to the dynamic economies of Asia and the Pacific Basin, and further afield.

Most of our handicaps are still self-inflicted. A successful Uruguay Round would help us both, but only in a marginal way. Real success depends on confronting our domestic economic realities. Current problems are difficult but they are not insuperable. I hope your generation can help show the way forward.

SUBMISSION BY THE
NEW ZEALAND BUSINESS ROUNDTABLE

"DEVELOPING A STRATEGY TO REDUCE CO_2 EMISSIONS: A SCOPING PAPER"

10 MAY 1991

SUBMISSION ON "DEVELOPING A STRATEGY TO REDUCE CO_2 EMISSIONS: A SCOPING PAPER"

- Scientific findings on the 'greenhouse' hypothesis are much less certain than implied in the paper prepared by officials. There is no agreement among scientists as to the existence or potential severity of the hypothesized effect. These uncertainties, outlined below, are an important factor in deciding the appropriate actions for New Zealand.

  - The earth's climate has a large natural variability due to factors such as the inherent variability of the earth's orbit and changes in solar energy input. Superimposed on this is the variability of a system composed of the atmosphere, oceans, large continental masses and natural ecosystems.

  - Only a small fraction of the annual quantities of CO_2 emitted into the atmosphere are man-made. The rest comes from plant decay, volcanic seepage and other natural processes that are by no means constant.

  - If the greenhouse hypothesis is correct, the changes to temperatures, rainfall patterns and sea levels will bring both positive and negative effects that would impact unevenly within and between countries. It is not certain that the costs of global warming would necessarily outweigh the benefits for the world as a whole. Some individual countries would very likely be net winners.

  - Even if net economic costs are imposed because producers do not face the full economic costs of emissions, action to contain emissions to given target levels may not be feasible or economically justifiable.

  - Regardless of the net global effect, there is, as yet, insufficient evidence to determine whether New Zealand would on average gain or lose from the greenhouse effect. A complex range of factors including changes in production, demand and trade in world markets would have a bearing on the outcome. If we are likely to gain, this raises the question of whether, or the extent to which, New Zealand should take costly actions to reduce global warming.

  - Any warming will take place gradually so that adaptation can occur over time. If future research indicates that the impacts are serious, time lost by delaying action now can be regained by accelerating the future response even though this might be achieved at higher cost in the future (but at a lower expected cost viewed from the current position of uncertainty).

- There is a risk of an international over-reaction to fears of global warming of the kind that accompanied fears of oil shortages in the 1970s.

• In overall terms, New Zealand's contribution to any build-up in greenhouse gases is minute. Gross emissions are substantially offset by the absorptive capacity of our extensive forests. Moreover, there are no easy options for reducing current levels of emissions. For example, reducing thermal generation emissions by 20 percent by 2005 could require a doubling of electricity prices. Achieving that target by 2000 would be virtually impossible without draconian measures. Most available options would have other negative environmental effects as well as economic costs.

• The paper does not emphasise sufficiently the fact that unilateral action to reduce greenhouse gases by New Zealand would be pointless. The major impact of unilateral measures would be a reduction in New Zealand's comparative advantage in competitive world markets, and a reduction in national income. Our action would not reduce total greenhouse gas emissions because other countries would adjust their production to satisfy unchanged world demand.

• New Zealand does not have to take costly unilateral actions to be taken seriously at international forums.

  - The futility of New Zealand adopting unilateral measures should be apparent to all in the international community.

  - Many other countries, most notably the United States, are not prepared to commit themselves to significant initiatives on the basis of present knowledge.

  - New Zealand is recognised as a middle income country confronting major economic problems and is in a poor position to sustain further falls in income from growth-denying measures. Other middle income countries such as Ireland, Spain and Portugal have made no commitments to reduce emissions.

  - New Zealand can already point to significant policy actions which are compatible with the mitigation of greenhouse effects. Examples are the elimination of subsidisation and underpricing of energy products, the improved efficiency in the energy sector following deregulation and SOE reforms, and the imposition of a 12 1/2 percent GST on all sales of energy.

  - If deemed desirable, New Zealand can work for international agreement on reducing greenhouse gas emissions and can agree to join in a programme of internationally coordinated measures. New Zealand can, in the interim, research the least cost methods of reducing CO_2 emissions should an international agreement be reached.

- The potential contribution New Zealand can make to the international debate and any negotiated agreement on action should not be overstated. There is no basis for aspiring to a leadership role in the process.

• If the case for reducing CO_2 emissions is accepted, the paper is correct in suggesting that lowest cost options should be considered first, and that, where possible, market based solutions should be adopted in preference to heavy regulation.

• The potential achievements of energy management are overstated in the paper. There is little, if anything, that makes investment in energy saving technology any different from investments in other cost saving technologies or techniques. The 'barriers' identified in the paper are generally real costs faced by individuals in their decision making - in particular, the cost of obtaining and assimilating information.

  - The pressure of competitive markets provides strong incentives for firms to adopt methods (including energy management or other approaches) that reduce costs.

  - Sellers of energy management methods and technology (and other cost reducing methods) have strong incentives to market their products to potential customers.

  - If government officials can identify very high rates of return from energy conservation measures, this raises two questions: first, why are people in the private sector so much less skilled than public officials at identifying such opportunities; and second, why do those officials not leave the public sector and set up their own businesses and realise the large profits that they claim are available?

  Little merit is seen in direct interventions (subsidies, building regulations, favoured technologies etc.) on energy management grounds.

• The paper provides no basis for evaluating the economic (and environmental) costs to New Zealand of meeting a percentage target reduction in greenhouse gas emissions. Indeed there can be no assurance that reductions of the order of 20 percent are remotely feasible, having regard to their practical implications. There is far too flimsy a base of evidence and analysis for any responsible commitment to such a target.

- It is submitted that New Zealand's approach to the issues raised by global warming should involve:

  - a suspension of the commitment to a 20 percent reduction in CO_2 emissions by 2000 pending clearer scientific evidence and concerted international agreement on concrete action to give effect to such a target;

  - a quantitative analysis of the likely economic costs, and an assessment of the environmental effects, of achieving percentage target reductions in emissions so as to provide an informed basis for government decision making;

  - the avoidance of action which would narrow future options, such as a diminution of water rights available for the generation of hydro electricity;

  - the adoption of a conservative approach towards any commitment to reduce emissions, and the avoidance of unilateral action. New Zealand is justified in moving at a slower pace than other major countries, particularly the United States, which are proceeding cautiously. Given current government expenditure priorities, resources devoted to this area, both domestically and in respect of New Zealand's participation in international forums, could be scaled down.

NEW ZEALAND PLANNING INSTITUTE CONFERENCE

GREAT EXPECTATIONS

BARNEY SUNDSTRUM
MANAGING DIRECTOR
MAIR ASTLEY HOLDINGS LTD

DUNEDIN
25 MAY 1991

GREAT EXPECTATIONS

Expectations, great or otherwise, are always easier to hold than to fulfil. New Zealand has found this out the hard way over the last six years as we have struggled to make the reforms necessary to fulfil our expectations. That reform is far from complete and the process of reform remains perilously fragile.

This morning I wish to point to some of the expectations which the business community has of you in your roles in local government and resource management. It goes almost without saying that we have to do better in this area - a good deal better, just as business has had to become internationally competitive and efficient.

The process has yet to be completed in the business world, but in local government and resource management it has only just begun. How well expectations are fulfilled depends in no small measure on how successful you are in driving a positive and fundamental reform process.

Far From Out of the Woods

First a few brief remarks about the economic setting in which you will be operating. This is critical because local government and the many planners working in it cannot be removed from the wider commercial world and its pressures. After a long lag, these are being felt in local government and they provide opportunities to be grasped as well as threats.

The restructuring programme has been nowhere near as thorough or continuous as many people think. Labour market reform was significantly delayed. Tariff protection remains high. Significant businesses remain in government hands, and are therefore not subject to full commercial disciplines. Fiscal management has been weak, and has provided little support for monetary policy.

Other countries' experience shows that it takes many years to rebuild a poorly structured and uncompetitive economy and achieve the benefits of sustained economic growth. In our case volatility and inconsistency in policy making has undermined credibility and delayed action on the part of business. The quality of the government's decisions in the forthcoming budget will determine whether the prospects of better policy balance and improving business confidence will be given a boost or whether, as happened so frequently in the past three years, they are dashed once again.

To date it has been the business world which has born the brunt of the changes - farmers and the primary sector, manufacturers and, to a lesser extent, the service industries.

Now it is the turn of the government sector, in particular the ailing structures charged with delivering health, housing and education services and the non-commercial activities in the core state sector, including regulatory functions such as environmental policy.

Markets have pegged back interest rates and driven up share prices on the basis of promised reforms in fiscal policy, a reduction in borrowing demands and the hopes of a more balanced economic programme.

These are positive signs. But they are only signs. If New Zealand is to build sustainable growth from these building blocks, a comprehensive strategy must also include vigorous pursuit of the opportunities provided by the new resource management legislation and the local government reforms.

Resource Management and the Environment

The debate over this legislation has generated far more heat than light. Most fundamentally there has been a refusal to recognise that wealthy societies can afford higher environmental standards, greater conservation amenity and a better quality of life than poor societies. Stagnant economic growth harms the environment in the long run.

Recently I saw a list of ten green fallacies in an overseas journal. They are not widely known in New Zealand. The list reads as follows:

"• The world is underpopulated - human settlements occupy no more than 3.6 percent of the earth's land area. A few billion extra people will make the world happier, healthier, and richer.

- Global starvation is off the agenda: the world's food supply has been growing faster than population ever since World War II.

- Air and water in Britain and the West generally are becoming cleaner not dirtier.

- The Third World is a greater threat to the environment than the West.

- Pollution is not caused by capitalism; the world's worst polluters are the countries of the Communist bloc.

- Nature destroys more species than man.

- Human living conditions are steadily improving, a fact reflected in rising life expectancy worldwide.

- We shall never run out of raw materials (unless we embrace socialism). For instance, there are enough metals in the top mile of the earth's crust to last a hundred million years.

- Overall there is no evidence of deforestation. Even in the Brazilian jungle the rate of shrinkage is low and represents no serious danger to the global environment.

- The ecological damage from acid rain is limited, and is not a menace either to agriculture or human life. The best way to reduce it is to

> scrap coal-burning plants for electricity generation and switch to nuclear power."

The good news on the environmental front is that much of the bad news is wrong. There is no basis for panic even in respect of such issues as global warming and ozone depletion, which are far from well established as scientific phenomena. The influence of green parties in places like Germany and California has waned as electorates came to realise that green concerns were over-sold and that some green movements were following other agendas.

Much of the debate between advocates of development and the environment is contrived. I have yet to meet someone who is not concerned about the environment. Similarly I know few people who are uninterested in higher living standards. The trick is to find better mechanisms for achieving both sets of goals.

As the doors to Eastern Europe and the Soviet Union have opened we have become aware of the devastation which centrally planned economies have visited on the environment and the failure of regulation as a tool for producing either material or environmental benefits. There is now a worldwide move to harnessing market mechanisms to achieve better environmental results.

This task of building a sound framework for resource management in New Zealand is not yet complete. The revised Resource Management Bill still does not confront squarely the need to develop the economic property rights essential to superior outcomes and it continues to rely excessively on political and bureaucratically designed 'plans'. We still have the tiers of national statements, regional plans and district schemes. I hope the government's current efforts to see whether the regional government layer can be substantially eliminated will bear fruit.

Nor does the answer lie in a new series of taxes masquerading as economic instruments. To be sure there are great opportunities to move away from regulation but the primary issue here is the creation of rights in the resources in question, and of markets to trade those rights.

The emphasis needs to be on developing markets for resources such as water, on building efficient legal rules in the area of environmental liability (which does not mean slapping new duties willy-nilly on members of companies), and on the basic government role of preserving and maintaining property rights.

The legislation does provide some new opportunities, however. It allows local government to use market mechanisms such as covenants and bonds to control development. It requires them to test the costs and benefits of regulation. It requires them to consider the 'do nothing' option. Most importantly, it demands that they ask why they are regulating at all.

This approach was once regarded as heresy. It is now critical to progress. Growth in investment, employment and the protection of the environment demands that regulation be seen as a last resort device, not a scheme based on the proposition that everything should be prohibited unless it is allowed.

The challenge is to exploit the opportunities the new legislation offers, to minimise the costs of the parts which are flawed, and to work for future improvements.

Local Government Reform

The business community is now focusing strongly on local and regional government, and its perceptions are that there is not yet a general will and determination to change decades of inefficient practices. The uncertain stumblings toward reform would tend to bear this out - at least so far. Recent reports on councils in Auckland and Wellington have documented mismanagement and confused accountability on a large scale, but it remains to be seen whether they are capable of internal reform.

Many of the rate increases last year were regarded as irresponsible by the business community. The efforts of some councils to place exorbitant demands on major businesses drew a strong reaction. This year it is pleasing to see many councils aiming for a zero rate increase, although I would prefer to see an actual reduction in costs in line with what many businesses have had to achieve in order to survive.

Ratepayers also need to scrutinise carefully how budgetary savings are being made. For example, I understand some councils are planning to defer maintenance, which means running down the net worth of the assets they control in a way that may not be readily apparent in their financial reports. A zero rate increase achieved on this basis may be a poor housekeeping performance.

There are many sounder ways of achieving economies. The sale of under-utilised local government assets and the privatisation of commercial operations should be a priority task. Most local economies depend for their infrastructural support on ports, airports, electricity supply, gas supply and waste disposal. The evidence is overwhelming that these services are most efficiently provided when ownership is in private hands. The framework to achieve this is now in place. Local governments concerned with the economic growth of their communities must take advantage of it.

I understand some authorities are contemplating setting up commercial operations as business units rather than Local Authority Trading Enterprises because of a difference in tax treatment. I believe the government should remove this distortion as a matter of urgency so that organisational decisions are not artificially biased and the terms of competition with private suppliers are fair and neutral.

Contracting out is another area where enormous improvements in efficiency are possible. A recent survey showed that, on average, savings of 16 percent have been made where services for which local government is responsible are contracted out. Savings in some authorities are up to 60 per cent. Recent decisions on bus services in many of the main centres graphically illustrate the value of competition and private contracting.

Regulatory services of the type covered by the resource management legislation can also be contracted out. In one instance the survey I referred to found savings of 50 percent were achieved through contracting out noise control responsibilities.

Conclusion

The shock which hit business over the last six years is now reaching regulatory activities and the government sector, in particular local government. The onus is squarely on this sector to respond at least as well as the private sector has.

By definition governments, whether local or central, have tended to be in the business of stopping things happening. Investors, producers, managers and employees in the private sector, if they are successful, are in the business of making things happen. It is this mentality which holds the key to prosperity for New Zealand in the future.

My expectation for New Zealand's future requires several things of the delegates to this conference. It demands the broadest view of development, investment and growth, along with the imagination and vigour to make changes and find better ways of doing things.

It demands completion of the task of social and economic reform which now involves all those problems we have traditionally shied away from or hidden in the government's too hard basket.

In particular it demands a fresh approach to environmental issues, development issues and the role of local government. That approach needs to recognise the failings of our past command and control mentality and the strengths of market processes and the property rights which support them.

Building a strong economy and generating wealth using these principles will not be simple. It is, however, essential as the failures of the past keep demonstrating both at home and abroad.

As you prepare to meet these new challenges and expectations, I would urge you to bear in mind a point made by the former British chancellor of the exchequer, Nigel Lawson. "The business of government, he said, "is *not* the government of business".

AGRIBUSINESS ASSOCIATION OF AUSTRALIA AND NEW ZEALAND

AGRICULTURAL MARKETING: WHY RESTRICT CHOICE?

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12 JUNE 1991

AGRICULTURAL MARKETING : WHY RESTRICT CHOICE?

As an inactive environmentalist I am pleased to be able to talk to a group including many endangered species.

The endangered species are, of course, the agricultural socialists amongst you who still believe that government-imposed monopolies and cooperative business structures are good for you and your customers.

The rest of the world has learned that collectivism generally leads to stultification and mediocrity. Free markets are not only good for customers but also producers. Actually, they can be a lot of fun and are certainly better than being the only game in the country, which some of the producer boards want to be.

I will be arguing that New Zealand farmers in their own interests should disown the monopoly powers currently granted producer boards. In doing so I acknowledge that all producer boards are not the same. The Meat and Wool Boards both have regulatory functions, while the Meat Board also has major investments in the industry. The problem here is being both player and referee at the same time. The boards for kiwifruit, apples and pears and dairy products all have absolute control over exports, although the Dairy Board may grant licences to other exporters.

But before discussing agriculture I want to comment on New Zealand's experience in the past 20 years as we dismantled regulatory controls over two major industries, transport and manufacturing, and joined the real world. The regulations were largely put in place in the 1920s and 30s, the same period in which we embarked on extensive controls over primary product marketing. The gains we have made and lessons learned from the changes in other sectors are directly relevant to agricultural marketing.

Ten years ago Railways employed more than 21,000 people. They were protected against most road competition and most road transport operators were also protected against new entrants. Railways and truckies had a symbiotic relationship but neither made much money. In fact Railways accumulated substantial losses and debt. Costs were very high and service was often lousy but we all fought tooth and nail against deregulation. Railways argued that they were highly efficient and that if protection was lost its few captive customers would pay much more. Protection was needed in the interests of an "orderly market". For its part the road transport industry opposed delicensing in order to prevent "weak selling" and "cut-throat competition" by "fly-by-night" operators. Both the Road Transport Association and Railways claimed that everyone would be the loser from deregulation. Despite their best endeavours at a political level, deregulation happened. What has been the result?

The answer, as we all know, is that there has been a revolution in transport with major benefits going to users. Since 1983 rail freight rates have dropped by nearly 50 percent in real terms. Railways now has around 7,300 staff and is heading towards 6,500. Similar changes have occurred in road transport. While there were several bad years, good operators are now making more money than ever and Railways is making an operating profit for the first time.

The manufacturing sector has also undergone a revolution in the past decade. In 1981 our manufacturers tried to produce just about everything this side of jumbo jets. I am told that even Sir Robert Muldoon was startled to discover that jumbo jets were subject to import licensing. In most cases manufacturers produced mediocre goods at excessive prices. However, they too argued that they were efficient, and that the "special" characteristics of the New Zealand market made continued protection through import licensing the only way manufacturing could survive. The manufacturers' lobby certainly had a record for consistency. Way back in 1965 they argued that the NAFTA deal with Australia posed a death threat to manufacturing.

Emotive arguments of this sort paralysed rational decision making. The import licensing system was a sacred cow that no government could attack. Although some politicians understood that the protection arguments were humbug, a bit of heavy breathing from Manfed soon brought them into line.

Amazingly, despite decades of such indoctrination, we finally got governments in the 1980s which were prepared to act. Federated Farmers, of course, was the strongest advocate of change. We now have free trade with Australia, virtually no import licensing and significantly lower tariffs.

The net result of these changes has been dramatic. We have lost many of our hopelessly uncompetitive manufacturers who should never have been there in the first place. But most companies have survived. Manufactured exports are growing, particularly to Australia where our companies are showing they can often out-perform the local competition. I believe manufacturing will be one of the growth sectors in the 1990s. Not even Manfed would now want to turn the clock back.

The lesson we should take from the experience with transport and manufacturing is that arguments for restricting competition are rarely valid and usually involve the protection of special interests at the expense of others. Furthermore, those that argue for protection usually find that after it is removed they raise their game and survive.

All the commercial experience of the last few hundred years tells us that open competition works best in the long run. Monopolies by their very nature tend to become fat, dumb and lazy. Monopolies created by legislation continuously lobby to protect their positions. They spend far too much time in the political marketplace (speaking at seminars such as this) and too little on working out how to improve their efficiency and do a better job in the real marketplace.

There are some who will argue that agriculture is somehow different and requires a special approach - that it is possible, through controls, for producers of agricultural products to obtain higher net returns than would otherwise be the case. It is argued that restrictions on access to overseas markets and the necessity to have large scale operations make monopoly producer boards the best way of selling agricultural products.

These arguments merit close examination. There are some special factors about agricultural markets, but not a lot. The similarities with other trade are much greater than the differences. Situations like the United Kingdom quota for butter are special cases. Sure, this might justify a mechanism which ensures that the quota rents come back to New Zealand and are fairly distributed to producers. But there are ways of doing this which do not require a giant monopoly with absolute powers over the export of all dairy products, including differentiated and branded items. The world market for cars is also riddled with political interference and import controls. Japanese exporters face quotas in many European countries and import restraints in the United States. When was the last time you heard a Japanese arguing for a 'single seller' organisation for Japanese cars?

The joke is that in nearly all cases New Zealand agricultural exporters are operating in highly competitive markets. They are not a De Beers with exclusive control of the world diamond market. They are subject to competition from all over the world both from other suppliers and from substitute food products.

The second argument for marketing boards is that the outside world is tough and size is needed to foot it with other international sellers. This may well be true, particularly for commodity lines, in which case the industry will naturally tend to large units. But such industry realities do not give rise to a case for state-created marketing monopolies controlling the full product range for all markets. The forestry industry also needs large operators and we have firms that compete very successfully internationally. But would anyone care to argue the case for a state monopoly to sell logs or pulp and paper?

It is competition and the opportunity to test new ideas that drives commercial performance. Firms that innovate and do a better job for consumers gain market share and improve their net worth. If we have a high market share in our business we create our own genuine competition to ensure we stay there. For example, Freightways has about 80 percent of the New Zealand courier market. We couldn't do that with one company. It can only be achieved by having several competing ones which offer different solutions for the customer. Thus we have New Zealand Couriers, Courier Systems, Castle Parcels, Sub 60, Roadrunner Cycle Couriers and so forth, all competing in the same market. Their competition strengthens demand for couriers and ensures that by having multiple teams doing things differently we are constantly filling niches and finding the best solution. That is the sort of dynamism the New Zealand dairy industry needs.

The wealth-creating power of the competitive system depends on choice. If, for instance, 80 percent of apple growers want to export through one giant apple cooperative they should be free to do so, just as the other 20 percent should be free to choose other options and compete with them. Have you ever heard a Japanese saying they are disadvantaged by Toyota competing with Nissan, or Sony with National?

In this area the most absurd situation of all is the monopoly position of the Apple and Pear Marketing Board in the domestic market. I understand that government reviews have regularly concluded that it has no justification but agricultural politics and the marginal seat syndrome have so far preserved it.

I do not argue that the producer boards are incompetently managed. We simply don't know. In the absence of detailed information it is not possible to come to a definitive view about any of them, particularly the boards for dairy products, kiwifruit and apples and pears, because objective information is non-existent. Until their economies fell over, the authorities in Russia and Eastern Europe also told everyone they were doing a great job and a lot of people in the West believed them.

In normal commercial operations ultimate control is exercised by shareholders who can vote directors off the board or even sell the company if it does not perform to their satisfaction. Investors are able to make such decisions because they can compare the performance of their company with others. Analysts and competing management teams are constantly on the lookout for poor performance and ways of doing a better job.

This situation does not apply to producer boards. They cannot be sold and an individual producer cannot sell his or her shares to another producer. It is virtually impossible to assess the performance of a marketing board. There are no comparisons with competing organisations, as they have been outlawed. The producers have to take the claims of efficiency on good faith.

Producer boards are commercial organisations that operate politically. They survive by convincing producers that they are doing a great job, and that without them farmers and growers would earn much less.

The boards have well-honed public relations teams which perform very effectively. Control over information is vital to this process. Thus it is no coincidence that the Dairy and Apple and Pear Marketing Boards enjoy stronger support from their producers than the Meat and Wool Boards where there are alternative sources of information.

One of the very interesting features of the main producer boards is their location. With the exception of kiwifruit, all are within one kilometre of Parliament. The Dairy and Apple and Pear Marketing Boards are the closest. Treasury is even closer than the Dairy Board and for a while, under the previous Minister of Agriculture, it looked as though the Board was in trouble. But the new home for politicians has been moved closer to the Board. They are now so close that you could throw a cow cover over them. My guess is that Treasury is now on the back foot.

You may be wondering what this choice of location has to do with running a commercial business. So do I. I am not a Wellingtonian, but to the best of my knowledge there are not many cows or orchards on Lambton Quay or The Terrace. Something tells me the choice has more to do with politics than business.

The extraordinary socialist nature of the producer boards is highlighted by the ownership of the Dairy Board. The Dairy Board has a net worth of $1.5 billion. This is effectively owned by no one. It represents $107,000 of capital for every dairy farmer. There is a fiction among dairy farmers that this asset is capitalised into their farm values. This is not the case. I have a sheep farm next to a dairy farm. I could convert to dairy farming and theoretically get my share of this equity. If you gave me shares worth $107,000 I would jump at it but I can assure you I would not increase the value of my farm by $107,000 by switching.

Dairy farmers own the Dairy Board in the same way workers in Russia own their own factories - they don't. To be real, ownership requires transferability of shares. Don't our socialist farmers know the meaning of ownership? I wouldn't think most dairy farmers could afford to have $107,000 tied up in another business, particularly if they could never get it back.

There is plenty of evidence that people only make above average returns when they invest where they have superior knowledge of manufacturing or marketing. Farmers would do much better to put their money into farms and let other money be attracted into specialised activities.

Why do farmers want to own manufacturing and distribution businesses? Manufacturers rarely own retailers. Tree farmers don't need to own paper mills. It is a total myth that unless farmers own processing and marketing operations they will get exploited. As in the rest of the economy their protection is that if there are competing manufacturers and marketers buying their produce, farmers will get the best price available. By only selling to an ownerless monopoly they are far more likely to get a bad deal.

At the Prime Minister's recent enterprise conference there was a strong view among business sector representatives that the powers of all producer boards should be reviewed and trimmed to the bare essentials. I subscribe to that view. There needs to be a clear separation of commercial operations from the exercise of any control powers that are necessary for restricted markets. It is vital that the private sector companies that are involved with agricultural products operate with freedom and with confidence that the rules are not likely to be changed by a combined player and referee producer board. This is not the case today.

There is no need to abolish producer boards. I do not share the Porter view that fragmentation is necessarily best. A much better approach is to remove barriers to competition wherever possible and let others have a go. Before this is done the existing institutions would need to be corporatised and their shares made tradeable.

Deregulation of agricultural marketing would revitalise the agricultural sector. There would be new investment, new ideas and stronger links with commercial interests overseas. Companies that want to experiment with new apple or dairy products, for example, would know they could do so without the fear of being overruled by a statutory player and referee. The continued existence of these powers is a major deterrent to investment in agricultural processing. Our statutory monopolies are still biasing the product range towards basic commodity lines. Competitors would have both the freedom and the incentive to develop brands and specialised products.

Once the existing operators got over the initial shock they would find life much more interesting and challenging. If they are as good as they tell us they are, then competition will make them stay that way and new entrants may not even get off the ground. Instead of constantly looking over their shoulders at the critics and worrying about the direction of the government, they could concentrate full time on their commercial business.

Anyone who believes that the Wool Board has done a decent job in recent times is not in touch with reality. I think the boards are now the single most important factor holding the agricultural sector back. In my view, a careful approach to deregulation would give us the same kind of gains that we have seen in manufacturing and transport. New Zealand agriculture should have a great future. So, I say unto the agricultural socialists, rise up and overturn your monopolies - you have nothing to lose but your chains. Ten years down the track not even the most conservative farmer would want to turn the clock back.

AGRIBUSINESS ASSOCIATION OF AUSTRALIA AND NEW ZEALAND

THE POLITICS OF AGRIBUSINESS: MARKETING STRUCTURES AND SYSTEMS IN AUSTRALASIA

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ACIL AUSTRALIA PTY LTD

AUCKLAND
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THE POLITICS OF AGRIBUSINESS: MARKETING STRUCTURES AND SYSTEMS IN AUSTRALIA

1. INTRODUCTION

When invited to participate in this conference I asked myself whether it was possible to say anything new or different about developments and opportunities in Europe post-1992. Having considered the array of research and commentary on the issue to date, and the range of expertise assembled at this conference, I decided to approach the subject from a slightly different angle.

What I want to concentrate on is not the politics of Europe but the politics of agribusiness marketing structures and systems down-under, and how they influence our approaches to capitalising on Europe post-1992.

In Europe the interaction of politics and commerce has been, and will continue to be, important in shaping the region's future. Similarly, the interaction of politics and commerce will be a key influence on agribusiness marketing structures and performance in Australasia. It is this subject I intend to consider today.

What I want to explore is the extent to which politics has become entwined into the commerce of agricultural marketing in Australia and New Zealand and the consequences of this phenomenon. I will be arguing that the future success of our agribusiness sector depends critically on getting politics out of marketing. If we fail to do this, then our politicised marketing structures and systems will, as we have recently seen with wool, bring themselves down.

I believe it is very important that we do not fall into the trap of spending too much time agonising over what may or may not occur in the European Community where we have only limited influence, while avoiding major beneficial reforms in our own backyard where we do have the ability to make changes.

However, before turning to this subject, a few comments and a conclusion about Europe post-1992.

2. THE EUROPEAN COMMUNITY POLITICAL MACHINE

At last count the European Commission's headquarters in Brussels housed over 11,000 Eurocrats. A proportion of these European public servants make the rules and their remaining colleagues administer and police those rules.

The two species - that is, the rule-makers and the rule-policers - enjoy a very successful symbiotic relationship. Complicated rules require intensive administration and policing. Intensive administration and policing, among other things, identifies where the rules need strengthening or extending.

The relationship is symbiotic because each species provides a powerful growth promotant for the other. Furthermore, both species receive additional husbanding from an array of vested interests wanting the rules and the policing to favour them.

However, these bureaucratic arrangements are only part of Europe's political machine. The Community also has a Council of Ministers - which comprises the representatives of the governments of the member states - and the European Parliament. These two institutions house European politicians - the people elected supposedly to ensure that what happens in the European Community is in the best interests of the people of the region as a whole - some 320 million of them.

The European Parliament has over 500 members drawn on a proportional basis from the member states. In all, about 70 national political parties are represented in the Parliament, although they have arranged themselves into 8 transnational political groups. For example, the 'Rainbow Group' comprises around 40 members of the Parliament and is drawn from national parties concerned with environmental issues, and Spanish and Italian regional parties.

Forecasting Western Europe's future and, in particular, market opportunities and how to exploit them, must take into account and assess the impact of this political machine on the rate and direction of change.

Many expert prognoses of where Europe is heading post-1992 have highlighted an 'either/or' conclusion. Either outward looking and competitive, or a protected economic fortress. This was well encapsulated by the Australian minister for trade negotiations in 1989 when he said:

> "The effects on Australia of Europe 1992 will largely depend on whether integration turns out to be genuine elimination of barriers and discriminatory regulations, resulting in a self-confident, internationally competitive Europe, or whether it will simply be the pushing out of the internal walls of protection to the Community's external frontiers".

The minister's latter alternative would not be particularly good economic news for Australasian agribusiness. However, because developments will be dominated by the European political machine, political accountability and self-interested behaviour, this alternative is the more likely in my opinion.

It is my observation that whenever politics is a dominant influence on economic and commercial behaviour, it is common for vested interest outcomes to prevail until such time as economic pressures are sufficient to bring existing structures tumbling down. I think Eastern Europe and the Soviet Union are the biggest and best case studies of this phenomenon around at the moment. The wool industry is a good example closer to home.

To finish my brief remarks on prospects in Europe post-1992, let me offer the following single, subjective, and very generalised conclusion.

I believe that over the next decade the most exciting prospects in the European section of the Northern Hemisphere will be emerging in parts of Eastern Europe. That region has started to dismantle its political machine and breathe air back into the role of the market as the dominant influence on economic and commercial decisions. Western Europe, on the other hand, has not yet got on top of the processes of economic sclerosis which accompany extensive political involvement in the marketplace. In twenty years from now, Western Europe will probably be commencing a process of institutional demolition and regulatory reform, a process which Eastern Europe already has underway.

Let me now turn to the subject I intend to address: the influence of politics on agribusiness marketing structures and systems in Australasia and the implications for exploiting European opportunities - or, for that matter, any market opportunities.

3. APPROPRIATE MARKETING STRUCTURES AND SYSTEMS - WHY ARE THEY AN ISSUE?

One would have to live as a recluse in Australia or New Zealand not to be aware that the types of agricultural marketing structures and systems best suited to our needs is a hotly and continuously debated topic. The debate is complex, detailed and, at times, heated and doctrinaire. What is in dispute is the role of statutory legislation as a requirement, and an influence, on agricultural marketing structures and systems and their performance. Essentially, it is an unresolved debate about the pros and cons of restricting choice in agribusiness marketing activity.

It is not necessary to spell out to a conference of agribusiness practitioners and analysts the importance of successful marketing to the agricultural industries and economies of Australia and New Zealand. Investors in agribusiness marketing, from the farmer to the retailer, have one prime objective and that is to make money. Put more technically, the objective is to maximise net returns from the resources being used.

The general principles of successful marketing are also widely understood and agreed. The importance of meeting consumer needs, supply reliability, unambiguous and 'true-to-label' price/quality relationships, innovation, branding, promotion, and the efficient provision of marketing services generally, are recognised by all successful marketers.

Differences of opinion emerge when marketers relate these general principles to the characteristics of the market to devise the best type and mix of marketing strategies and activities. Individuals differ in their judgments about what to sell, to whom, and how. These differences derive from differences in opinions and ideas about what particular commercial and marketing strategies are best, as well as the fact that each participant is seeking to do as well as, and preferably better than, everyone else.

At this point I think it is important to distinguish between marketing systems and structures, on the one hand, and the actual marketing functions and activities on the other. In essence, marketing systems and structures determine the particular strategies and approaches taken to marketing, how well they perform, and how effectively this performance can be assessed. Conversely, a marketer's judgment about the best marketing approach has an important influence on the characteristics of the marketing structure and system which will be necessary to put it into practice and sustain it.

Consequently, the variety of ideas and judgments about how to market would be expected to result in an array of marketing structures, systems and participants. In essence, the agricultural marketing debate gets underway the moment any individual or group asserts that a particular approach to marketing is best and, as a consequence, that the structures and systems necessary to implement that approach must exist by right, and alternatives be restricted or prohibited.

Clearly, advocates of restricting choice must hold the view that, in some way, they would be relative winners in the marketplace if choice were restricted and certain types of marketing arrangements favoured over alternatives. From the perspective of commercial self-interest, it is a reasonable and understandable position to take and one that you would expect to see pursued with some vigour.

Those who believe choice should be restricted, and certain marketing arrangements preferred over others, put forward the following three major propositions:

- politicised export markets involving subsidies and entry controls need to be managed and this can only be done in a manner which ensures benefits are maximised by large, government-backed marketing organisations either doing the marketing or controlling it extensively;

- private or corporate marketing organisations do not have producers' interests at heart and will compete with each other to drive down prices received by Australia and New Zealand in export markets ('weak sellers') and/or grow to dominate the industry and commercially exploit small, vulnerable farm businesses; and

- fluctuations and differences in short term market circumstances, between markets and over time, commercially disadvantage farmers, depending on what they produce, where, and when, and farmers want to 'pool' these variations because of the importance they are said to attach to 'equity'.

Those who take a contrary position usually put forward three counter-arguments:

- the management and control of access to politicised or distorted markets, including any market premiums, can be achieved at least as well with competitive and commercially-oriented policy instruments that may require some degree of statutory intervention but considerably less than at present, or can result from natural incentives to collude;

- statutory monopolies and other forms of control over entry and commercial freedom lead to organisational cost-padding and the suppression of risk taking, diversity and innovation associated with competitive marketing structures; and

- pooling distorts price signals and leads to resource misallocation and, therefore, economic efficiency losses.

Associated issues include the extent to which statutory arrangements combine the roles of market participant and regulator, and the merit or otherwise of a 'Country Incorporated' approach to marketing as a form of countervailing power to size and concentration internationally.

It is not my intention in this paper to enter into the detail of the debate over the propositions I have just summarised. What I intend to do is look behind them and examine why the debate occurs, is so vigorous, and seems unable to be resolved. In particular, I will examine the consequences of introducing politics into marketing?

4. HOW POLITICS BECOME INVOLVED IN MARKETING, AND THE CONSEQUENCES

A market is nothing more than a collection of human beings with opportunistic tendencies, trading with each other. They prefer to be better off than worse off. They respond to the incentives they face.

In market economies, competition exploits this behavioural trait by stimulating enterprise, effort and ideas. The consequence of individual advantage being pursued is collective economic gain. However, not everyone necessarily wins. The unregulated market is a transparent and impersonal adjudicator in the competitive contest.

In the pursuit of individual gain, people choose to adopt, or participate in, a wide variety of different organisational structures. In the main, their decisions on how, and with whom, they will pursue their commercial objectives is determined by where they think the rewards to them will be greatest.

If an individual or group is dissatisfied with market outcomes, for whatever reason, one option is to modify behaviour and improve performance. Their alternative is to call for government intervention. They ask politicians to make rules designed to favour them. However, they frequently argue that such intervention is also in the interests of the overall industry and the nation.

When governments agree to intervene - and in agricultural marketing in Australia and New Zealand they have agreed very readily in the past - there are three important consequences:

- the statutes become rallying points around which those who benefit from the legislation, and those who believe they are disadvantaged, gather to lobby governments and politicians for rules which are believed to favour them;

- significant changes occur in the types of performance indicators available and their value in providing accurate and useful assessments of performance of the bodies created by the legislation; and

- the organisational structures which are created by legislation, and the resultant changes in performance indicators, lead to political forms of accountability; 'political accountability' figures prominently in the debate over the pros and cons of restricting choice.

The nature of the marketing debate, and the approach taken by the various participants, is influenced very much by these three major consequences of intervention. To understand the debate it is necessary, therefore, to consider them in more detail.

5. WHY ARE POLITICIANS LOBBIED?

Governments, and the politicians they comprise, have the ability to influence market outcomes and confer favours because they have the power to make laws which all must follow. Legislative power attracts all market participants to lobby for laws that will advantage them. This leads to 'rent seeking' - the use of resources to make profits without creating any useful output. The extent of rent seeking will be influenced by the willingness politicians show in catering for sectional interests when they enact laws.

Generally, politicians have a poor track record in resisting the lobbying activities of rent seekers. There are two main reasons why this is the case and they epitomise what I have labelled 'political accountability'.

First, a political system contains inherent incentives to bestow favours. Political success - being re-elected - depends on the politician's ability to keep the electorate satisfied. In particular, it is important that those on whom a politician's success depends are kept happy.

Second, once legislation is in place its removal or significant modification will commonly disadvantage some people or be perceived to do so. Often it will remove or reduce the advantages which it was providing to a particular group. As a general rule, these circumstances result in lobbying which is considerably more intensive than occurs when intervention is initially being introduced.

For politicians there is only one thing potentially more dangerous than refusing to confer a benefit, and that is proposing to take one away. Consequently, when politicians agree to intervene they set the scene for very intense lobbying over whether the intervention should continue.

The current debate over agricultural marketing arrangements is essentially about the pros and cons of less intervention and control and more choice. Politicians are being asked to remove rules - many of them longstanding - which have created extensive economic rents and well-entrenched perceptions of what is good and bad for those who are affected. Vested interests can be expected to resist vigorously such changes because they believe, often very genuinely, that they will be losers.

In summary, politicians have legislated forms of intervention in agricultural marketing which encourage and facilitate political rather than commercial decision making. An environment has been created where market pressures for change most commonly elicit political rather than commercial responses and decisions. It is this very important difference in how market participants respond to pressures for change when the environment is politicised, and its consequences for our marketing systems, to which I now turn.

6. STATUTORY INTERVENTION, PERFORMANCE INDICATORS AND ACCOUNTABILITY

When statutes are used to intervene extensively in the operation of markets, the basis on which change occurs in response to market pressures is altered fundamentally. In particular, the extent to which the impersonal market, and so-called 'market forces', determine the rate and direction of change is diminished and the influence of political considerations is increased.

This relative balance of power between commercial and political influences on change is fundamental to understanding the ongoing debate about the best approaches to agricultural marketing and the consequences of intervention. Most importantly, it requires an understanding and appreciation of the differences between 'commercial accountability' and 'political accountability' - differences which only take on significance when statutes are used to restrict commercial choice extensively.

The joint stock company is a common form of organisational structure to emerge as a result of people with opportunistic tendencies pursuing individual gain. I want to use that form of commercial structure, and the performance indicators and systems of accountability associated with it, as my benchmark in what follows. This is the so-called 'corporate model'. I will be comparing and contrasting it with the 'political model' which characterises markets where there is extensive statutory intervention.

The fundamental characteristics of the corporate model are straightforward and well known. Investors monitor performance through profits, dividends, bonus issues and share prices. There are markets for capital and management. Investors 'vote' with their mobile capital exercising choice based on monitored performance, and their influence on the organisation is in proportion to their commercial stake as shareholders. Those who have to trade with such organisations 'vote' with their custom.

Provided there are no restrictions on contestability and choice, the net result is a collection of incentives faced by those responsible for the organisation's performance to get it right, and keep getting it right, or suffer the consequences. Directors and managers will employ rhetoric and all manner of persuasion to convince shareholders and customers that their performance is up to the mark. In the final event, however, it is the results they deliver, clear for all to see, monitor, and react to, which determine their fate and that of their organisation. This is 'corporate accountability'.

Much of agribusiness - such as the supply of inputs and services, including marketing services in some instances - conforms to this corporate model. However, it is in the provision of some marketing services where we depart most commonly from this approach.

It is axiomatic that legislation which restricts choice and directs commercial behaviour will change the nature and mix of performance indicators and methods of accountability. The institutions created by statute, either to administer the rules or participate directly, are subject to different types of assessment and sanction when their performance is being reviewed. As a consequence, they behave differently when subjected to market pressures for change.

Statutory organisations do not produce conventional commercial performance indicators. Their assets, including their management, are not traded and priced in an open market. They do not have to compete with others for capital. They cannot go broke or be taken over like public companies. The measurement of their performance and the means by which they survive are very different from the corporate model.

It is my observation that those arguing in favour of extensive statutory intervention do not dispute the existence of these important differences in the means of performance measurement and accountability.

In fact, they argue that statutory marketing bodies compare more than favourably with accountability in most parts of the corporate sector. It is argued that producers have representatives throughout the system and very democratic processes are used in their selection. On this basis it is argued that statutory bodies and their performance are transparent and readily able to be influenced by 'shareholders'.

I contend that these assertions overlook the fundamental differences between commercial and political accountability.

Organisations created by statute are, by definition, political organisations. Consequently, the people responsible for these organisations are politicians. They act and behave like politicians and they employ the full array of political accountability techniques.

Political accountability involves the use of emotion and rhetoric, particularly calls for loyalty, unity and even patriotism, as well as the management of facts and information. The presence of any form of real or imagined 'enemy' is an aid to this type of accountability.

Political accountability involves one person one vote rather than influence through a commercial stake. Producer 'democracy' does not allow producer influence to reflect the individual's commercial stake in the industry.

Markets are dynamic - change is continuous and often unpredictable. Commercial success depends on market participants adapting to these changes. The participants themselves are important contributors to change, each trying to perform better than competitors through ideas, innovation and market differentiation.

With the commercial model, failure to adapt and keep up with the pace is quickly reflected in performance indicators. Tardy responses lead to loss of custom and dissatisfied shareholders seeking higher returns for their mobile capital. If poor performance persists, capital and management markets provide the means for changes in ownership and control.

The political model handles these market dynamics differently. While such organisations do change the way they conduct their business, the incentives and consequences of being tardy are considerably blunted compared with the corporate entity. Furthermore, their recourse to political accountability means it is common for slow changes to be defended, behind barriers which restrict competition and new entrants, and for this defence to succeed because calls for loyalty and indicators of activity can be substituted for conventional indicators of performance. Even where performance is demonstrably poor, the response is to debate the issues in the absence of market sanctions being able to deliver a solution.

The success of this political accountability process is aided and abetted by a 'shareholder' electorate which can be convinced that all is well and in their best interests. More often than not, this electorate comprises those who know that they could lose, or at least find commercial life tougher, if they were exposed fully and immediately to changes in the marketplace. They are naturally attracted to the apparently more 'comfortable' options they are offered.

The Australian wool industry and the New Zealand meat industry provide two examples of political accountability at work.

The Australian minimum reserve price scheme for wool eventually collapsed when industry politicians failed totally in their efforts to dictate to the market.

In the late 1980s the Australian government handed woolgrowers and the Australian Wool Commission the responsibility for setting the minimum reserve price. Between 1986/87 and 1988/89 this minimum was increased by over 70 percent. With the benefit of hindsight the increase was too much.

However, this was not the fundamental reason why the scheme collapsed - at the time the market price was well above the reserve. The reason it collapsed was that woolgrower politicians, having convinced their electorate that price had become less important in determining sales, found it politically untenable to correct the mistake quickly when its consequences became clear.

Part of the political problem was that over the years of the scheme's existence it had become accepted as an article of faith that under no circumstances would the reserve price level ever be reduced. No industry leader was going voluntarily to be responsible for breaking the faith - regardless of the evidence. Those responsible to woolgrowers for the scheme's operation sat and watched as demand contracted, stocks rose and farmers maintained record sheep numbers because they were getting the wrong price signals and did not appreciate what was happening in the market.

It is quite likely that participants in an unregulated market could make similar mistakes about future demand and prices. However, responses to the emerging situation would have been faster and it is very unlikely that all participants would have behaved the same and brought the industry to its knees as a result.

The processing sector of the New Zealand meat industry has been plagued by overcapacity, poor productivity and lack of profitability for years. The commercial circumstances of the industry continue to deteriorate.

During this as yet unfinished saga of commercial decline, the Meat Board has had a firm and unyielding hand on the tiller, guiding and influencing developments supposedly in the interests of New Zealand livestock producers. The Board has proclaimed as a success the fact that producers now own and control over 70 percent of the meat processing industry - an industry which is currently unprofitable and highly geared. Wherever possible, producers continue to send their livestock to the processor who pays the most. They have little trouble in separating the commercial from the political.

It seems very likely that the end result of this commercial husbanding of the processing industry by the producer board will be an industry either owned by the banks or having to accept extensive foreign investment. Surely producers will eventually conclude they have paid enough and lost too much?

Why do satisfactory commercial solutions still elude the meat processing industry? I believe the reason is simple - politicians do not like taking unpopular decisions. Capital write-offs are inevitable in the meat processing industry and attempts to avoid solutions the market has been demanding for some time mean they will be particularly painful when they eventuate. Instead of letting the market decide who succeeds and who fails, industry politicians have attempted to manage the industry to a 'soft-landing'. At the same time they further distorted investment and adjustment decisions by, for example, systems of freight and transport charging which advantaged some processors at the expense of others.

The problems of the New Zealand meat processing industry seem destined to be solved in a manner similar to that experienced by the Australian wool industry.

The producer politicians eventually have to let go, some dramatic consequences and a bout of severe commercial pain ensues, and then a market driven process of reconstruction occurs.

Both of these examples of intervention which eventually ends in a big 'bang' lead me to a final, and perhaps the most important, conclusion on the consequences of restricting choice and limiting competition in the marketplace.

7. INTERVENTION CONTAINS THE SEEDS OF ITS OWN DESTRUCTION

The main issue which all agribusiness practitioners, and farmers in particular, need to come to grips with is that the types of intervention and statutory structures which we tend to adopt will always become politicised.

As I have explained, this is axiomatic because they are creatures of statute - of laws which only politicians can put in place, amend, or remove. An inevitable consequence of this politicisation is that the arrangements will eventually seriously break down or lurch from crisis to crisis at considerable and unnecessary cost.

This inevitable consequence is a fundamental characteristic of their design. It derives from the constraints that are placed on the exercise of choice.

The constraints on choice and alternative forms of commercial enterprise lead to commercial pressures building both inside the system and from outside. This occurs without the commensurate and steady adjustments to structures and practices which occur in less controlled markets. The industry politicians use political tools, and make marginal changes to the arrangements, as they attempt to manage and reduce these inevitable commercial pressures. The stronger the 'pressure vessel' (the extent of controls and constraints on choice), the bigger the bang (disruption and economic damage) when the vessel finally bursts.

It is my casual observation that throughout the world every attempt to comprehensively constrain the normal opportunistic behaviour of people and the exercise of commercial choice eventually meets the same fate. It collapses under pressure for change. I see no reasons, in principle or in practice, which would lead to the conclusion that the type of intervention in agricultural marketing in Australasia is an exception to this general conclusion.

For those who want to believe that the arrangements they hold dear have stood the test of time, consider the ability of the Soviet Union to constrain an entire economy for nigh on 70 years. Consider also the economic mess that country now has to set about cleaning up.

8. CONCLUDING COMMENTS

I would like to draw together the arguments and propositions I have advanced, and the logic that underlies them, into the following general observations:

- as we go about deciding how to benefit commercially, and minimise the pain, from Europe post-1992, let's remember that the politics and their consequences we observe in Europe have their parallels here in the approaches we take to agricultural marketing;
- it is a certainty that the current debate about the pros and cons of restricting choice in agricultural marketing will continue with its intensity being fairly directly related to the extent of controls and constraints that are imposed;
- it is equally certain that marketing structures and systems which exist by virtue of protective and restrictive statutes will eventually collapse, and the greater the controls the bigger the ultimate bang;
- why not, therefore, look to an approach which might avoid the need to suffer consequences that are inevitable? Achieving that would be relatively straightforward. We simply need to remove politics from the agribusiness marketing arena.

WATERFRONT, PORTS AND SHIPPING CONFERENCE

TRANS-TASMAN SHIPPING: AN AUSTRALIAN PERSPECTIVE

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TRANS-TASMAN SHIPPING: AN AUSTRALIAN PERSPECTIVE*

Speaking fifth, in a panel of five, on the same subject, has its risks. Will everything have already been said, leaving tail-end Charlie with nothing to do except to be repetitious and put everyone to sleep? Or, will the fifth speaker - given that his views on the subject under discussion are fairly well known - have been a convenient whipping post for some of the earlier speakers?

Which ever way it goes, how does one prepare a written paper in advance of the conference? The only option, it seems to me, is to cover the subject, and the questions posed in the conference brochure, as if one were the only speaker and then adjust the presentation as appropriate. In attempting to do this, I will provide an Australian perspective, albeit one which is reasonably conversant with recent developments in New Zealand.

Let me at the outset acknowledge the commendable progress which has been made by New Zealand on shipping and waterfront matters in recent years. By comparison, Australia's progress is virtually non-existent. Sure, we have been talking about the subject for a long time and at great length, but in terms of tangible improvement we have little to report.

On the waterfront, it took an all night session of prime ministerial cajoling and duchessing recently to endeavour to reach a so-called enterprise agreement between the Waterside Workers' Federation and one of Australia's largest stevedoring companies, Conaust - a subsidiary of the P and O group. No 'Sideline Stan' there. That deal was necessitated by the ACTU's earlier rejection of a national wage case decision of the Industrial Relations Commission, with characteristic churlishness and lack of respect for the umpire's verdict. The ACTU threatened that if its national wage case position - the so-called Accord Mark VI - did not form the basis of a Conaust agreement, then all bets were off as far as waterfront reform was concerned. The deal had more to do with reinforcing the prime minister's tenuous grip on the leadership of the Labour party than with improved waterfront productivity and efficiency. In an ironic twist, the IRC is threatening to refuse to ratify the agreement reached - which would leave Mr Hawke's much vaunted negotiating credentials somewhat up in the air. And, of course, those affected by the outcome - ports and shipping users - were not party to it, nor was any consideration given by the participants to lowering barriers to entry within the stevedoring industry so that a genuinely contestable outcome could be ensured.

As far as trans-Tasman shipping is concerned, we have at least had one form of progress in recent months. In the aftermath of the government's March economic statement, the prime minister has conceded that the maritime 'accord' costs Australia $A70 million per annum. Mr Hawke's admission came in the context of defending the statement against the almost unanimous business and media charge of 'opportunities missed'. He argued that pursuing gains of this magnitude was trivial compared with the gains of $A1 billion a year on offer from waterfront reform. Perhaps they are. But an improvement in national welfare of $A70

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* Address to 'Waterfront, Ports and Shipping Conference', organised by AIC Conferences, Sheraton Hotel, Auckland, 28 June 1991.

million annually is surely not to be sneezed at, especially as it is relatively easy to secure.[1] Moreover, as I have said, the waterfront gains are, to put it mildly, not yet in the bag.

Let me state my position on trans-Tasman shipping quite unequivocally. The trade should be free. The so-called maritime 'accord' should be openly repudiated, by governments, shipping companies and, if necessary, the courts. The nature and extent of shipping services across the Tasman should be solely determined by the market. There is no justification whatever for the respective maritime or waterfront unions to be involved and the fact that they have called the shots for so long does no credit to any of the parties which have allowed this to happen. There is no need for repeated surveys by well-intentioned officials of user attitudes or service trends. There should be no involvement by ministers in encouraging minor reform in response to this representation or that. All of these activities merely add to the transactions costs of doing business and allow those involved to believe that the issues are complex, when they are really quite simple.

This, of course, is not merely my view. It is the view of business on both sides of the Tasman. It is the stated view of both the previous and present New Zealand governments. It is the stated view of the Australian opposition parties and it is the private view of many Australian ministers.

Indeed, it is an issue where, by any sensible assessment, the arguments for sweeping away restrictions are overwhelming, where the benefits of change are tangible and substantial, and where consistency with the objectives of microeconomic reform and desirable industry policy could hardly be clearer.

It is perhaps not surprising then that, prior to the March economic statement - a statement about microeconomic reform - media analysts in Australia argued that its two litmus tests were decisions regarding a third runway for Sydney airport and the trans-Tasman shipping accord.

The fact that restrictions remain despite the weight of argument to the contrary is a perverse compliment to the doggedness of their defenders. In the remainder of this paper I will consider why this is so, what should be done to redress the situation, how, when and by whom, and what the likely effects might be.

Before doing so, however, I would note that following a similar presentation to an equivalent conference in Sydney last February, I was the recipient of some stern correspondence. A branch of the Seamen's Union of Australia conveyed to me a resolution it had carried, advising me to "get my facts straight". And a well known shipping company representative wrote in somewhat similar terms. I responded to both groups with an invitation to provide a specific written critique or rebuttal of my paper. Regrettably, neither replied.

Another shipping company representative wrote with some helpful comments, particularly in respect of the motor vehicle industry and I have taken a number of these on board in this paper. But none of the comments alter the overall policy conclusion - that the maritime 'accord' must be done away with, and the sooner the better.

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1 Incidently, the basis of the $A70 million figure has yet to be revealed publicly.

Background

Union-imposed restrictions on trans-Tasman shipping arrangements enjoy a considerable history. As early as 1931 the New Zealand Seamen's Union, supported by watersiders in Wellington and Auckland, thwarted an attempt by the Japanese carrier Osaka Shosen Kaisha to operate its Japanese crewed vessel, Brisbane Maru, in the trade. The success of the union strategy was credited with immediately persuading other foreign lines not to lift trans-Tasman cargo which they had already contracted to carry.

Sporadic and unstructured arrangements reserving the trans-Tasman trade to Australasian crewed vessels remained until 1974. In February 1974 these arrangements were formalised in a document entitled, 'Trans-Tasman Union Agreement'. Parties to this document were the Waterside Workers' Federation of Australia, Seamen's Union of Australia, New Zealand Waterside Workers' Union and New Zealand Seamen's Union. In March 1988 at a meeting in Auckland between New Zealand and Australian seagoing and waterfront unions, the 1974 document was updated and a new agreement entered into.

The critical clauses in these documents are Clause 8 of the 1974 agreement and Clause 6 of the 1988 agreement. It is these clauses which have reserved the trans-Tasman trade for Australian and New Zealand crewed vessels. Clause 6 of the 1988 agreement reads:

> "The Unions agree that trans-Tasman trade be retained for New Zealand and Australian manned vessels. Where specialised shipping of New Zealand or Australian ships are *unavailable*, the Unions are *prepared to consider* acceptable alternative arrangements" (emphasis added).

Thus the only exception made for the exclusive carriage of trans-Tasman trade by New Zealand and Australian crewed vessels is on grounds of vessel unavailability. No price competition by non-Australian or non-New Zealand crewed vessels is sanctioned by this clause. Moreover, the only commitment given to provide exemptions on unavailability grounds is to 'consider acceptable alternative arrangements'. Since vessel unavailability is only determined in the short term and since the giving of 'consideration' involves multiple unions on both sides of the Tasman, exemptions are difficult to secure. Although some exemptions have been given to timber and petroleum shipments from New Zealand to Australia, other traders have not been successful in obtaining exemptions even where suitable vessels have not been available.

In Clause 3 of the 1988 agreement (and Clause 5 of the 1974 agreement) the unions "agree with the principle of the New Zealand and Australian seafarer and waterfront unions sharing growth of trade across the Tasman". Apparently, competition is not even to be given free rein between Australian and New Zealand crewed vessels, but there is to be some 'equitable' dividing of the cake by the unions involved.

Neither the 1974 or 1988 agreements specify the mechanism the unions would use to reserve the trans-Tasman trade for Australian and New Zealand crewed vessels. The only practical mechanism, however, would be for the waterfront and towage maritime unions to impose bans in Australia and/or New Zealand on the loading and/or docking of vessels manned by other nationals which engage in trans-Tasman trade.

Civil Remedies

The imposition of bans in Australia would certainly contravene domestic law. If a foreign crewed vessel wished to enter a port in Australia to take a load of cargo for trans-Tasman shipment and Australian unions placed bans on handling the ship, they would be in breach of the secondary boycott provisions of Section 45D of the Trade Practices Act. A person suffering damage as a result would be entitled to seek injunctive relief and damages. The most obvious persons suffering loss would be the consignee or shipping company.

Such bans are prohibited by Section 45D (1A), since they constitute conduct for the purpose of hindering a person from engaging in trade or commerce between Australia and places outside Australia. They could also be in breach of Section 45D (1) if seamen refused to man tugs or stevedores refused to load cargo with the purpose of preventing the shipping company acquiring berthing or stevedoring services.

In addition, common law proceedings could be taken in Australia against those involved in the imposition of bans. Further, Section 30K of the Crimes Act could be relied upon to bring criminal proceedings against those seeking to damage international trade.

In New Zealand, the situation is not as clearcut. Section 27 of the Commerce Act prohibits contracts, arrangements or understandings that have the purpose, or have, or are likely to have, the effect of substantially lessening competition in the market. However, there is some doubt as to the applicability of the Commerce Act to shipping. The Employment Contracts Act will facilitate the introduction of competition in trans-Tasman shipping by removing exclusive bargaining rights and blanket coverage awards. But there is, as yet, no case law behind the Act. Possible extensions or clarifications of legal remedies are currently under review following statements by successive ministers to this effect.

There would also appear to a wider obligation for the governments of Australia and New Zealand to provide port facilities to the vessels of other nations engaging in trans-Tasman trade. Both governments are signatories to an international treaty entitled 'International Regime of Maritime Ports'. This treaty provides reciprocal equality of treatment to all vessels of signatory nations. In the words of Article 2:

> "Every contracting State undertakes to grant the vessels of every other contracting State equality of treatment with its own vessels in the Maritime ports situated under its sovereignty... as regards freedom of access to the port, the use of the port and full enjoyment of the benefits of the port regarding navigation and commercial operations which it affords to vessels, their cargoes and passengers."

Finally, the agreement itself may be prosecutable under trade practices law in Australia. Section 45 of the Trade Practices Act, amongst other things, provides that a contract, arrangement or understanding shall not be arrived at which has the purpose or effect of substantially lessening competition. The trans-Tasman union agreement may be captured by this provision.

The apparent illegality of the agreement begs the question of why importers, exporters and shipping companies have been so subservient to its terms and conditions for so long. There are two major reasons. The first concerns the expense and complication of possibly having to mount legal cases in two jurisdictions, and the fear by shipowners that involvement in a trans-Tasman dispute may well result in retaliatory union action elsewhere. The second is that, until recent times, the 'accord' enjoyed implicit endorsement by governments on both sides of the Tasman. In this environment, few were prepared even to consider a challenge to its legality.

Impact of the Featherbed

Making meaningful freight rate comparisons is a task fraught with difficulties. Especially in liner trades, freight rates are influenced by many factors unrelated to blue-water operations, such as the extent of port coverage, container storage times, land transport arrangements and stevedoring costs.

Nevertheless, in 1987 the Bureau of Transport Economics and the Ministry of Transport surveyed a number of selected large importers and exporters on freight rates they were being charged to ship product to various destinations.[2] This survey suggested that trans-Tasman rates (about $A2,000 per 20 foot container) were higher than rates from Australia to Asia ($A1,200-$A1,400), roughly the same as the voyage to Europe (approximately $A1,600-$A2,200) and lower than to North America ($A2,000-$A3,000). From this and other data, BTE/MOT concluded that cross-traders could offer trans-Tasman container freight rates roughly 25 percent below prevailing rates.

The potential for securing lower rates from cross-traders, however, must be traded off against a lower level of service from these vessels. It is because quality of service is valued that there will always be a place for dedicated trans-Tasman vessels. Moreover, operators of dedicated vessels will be able to charge a price premium. It would, therefore, be quite erroneous to believe that liberalisation of trans-Tasman shipping would lead to the decimation of Australian and New Zealand operators on the route. Rather, cross-traders would fill niche activities, a number of which can be identified.

Freight rate comparisons for bulk shipments can be made with relative ease. Quotes can be readily obtained for foreign flag bulk carriers. Data are available showing the movement of dry bulk freight rates for Australian/New Zealand crewed and foreign flag vessels between January 1987 and June 1990 (the data relate to 15,000 tonne shipments ex-east coast Australia to New Zealand). It is apparent from this information that freight rates pertaining to Australia/New Zealand crewed vessels have never been below those available from comparable foreign flags. At the beginning of 1987 and in 1990, Australian/New Zealand crewed vessels were about twice as expensive as comparable foreign flag vessels. At the point of closest convergence, Australian/New Zealand crewed vessels were about 20 percent more expensive than foreign flag vessels.

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2 Australian Bureau of Transport Economics, New Zealand Ministry of Transport (1987), *Review of Trans-Tasman Shipping*.

Second, there have been substantial fluctuations over time in freight rates on foreign flag vessels. In contrast, freight rates on Australian/New Zealand crewed vessels have been relatively stable and gradually increasing. The foreign flag freight rate fluctuations are part of longer term cyclical variations in international dry bulk freight rates. These freight rates are low for extended periods of time, separated by short, sharp peaks. This pattern reflects the fact that rising freight rates stimulate new shipbuilding activity. The introduction of new vessels, in turn, forces freight rates down to more normal levels. Price stability is compelling evidence that a shipping operation is not fully exposed to the forces of supply and demand.

Bulk commodities, by their very nature, do not enjoy the benefits of product differentiation. Bulk products, such as grains, minerals and salt, sourced from Australia are much the same as these products sourced from any other nation. The predominant factor influencing a buyer's decision on where to source these products is frequently price. In this context freight rates are of critical importance.

There are numerous instances of potential bulk exports being lost to other countries largely because of high trans-Tasman shipping charges. Among the commodities that have suffered are wheat, gypsum, sugar and salt from Australia and urea from New Zealand.

The Case of Cars

The case of motor vehicle exports from Australia to New Zealand is both a topical and an extremely clear illustration of what is wrong with trans-Tasman shipping arrangements.

The Australian automotive industry is facing progressively lower assistance levels up to the year 2000. It has a daunting task to become internationally competitive. At present New Zealand is an attractive export market for CBU motor vehicles. New Zealand's own assembly industry is being wound back and industry estimates last year put the likely number of cars to be shipped from Australia to New Zealand in 1991 at about 14,000 - a value of around $A150m. The impact of recession has since cut these estimates in half.

Past shipping arrangements have been inadequate in several respects:

- total capacity scheduled to be offered by existing operators for 1991 was initially just over 5,000 cars, with no proposals for this to be increased;
- the Managing Director of Nissan Australia stated that the cost of shipping a car from Australia to New Zealand was about $A200 more than from Japan to New Zealand;[3]
- there are no direct shipping services from Adelaide to New Zealand - and none were projected by existing operators - yet around half the cars to be exported would originate in South Australia; the cost of

3 Ivan Deveson (1990), *Business Review Weekly*, 31 August 1990.

positioning these cars by road to Melbourne adds a further $A110 to the total transport cost;

- in an industry where quality is paramount and where Australian producers are being constantly exhorted to lift their quality standards to the best international levels, widespread damage has been reported in the form of footprints over car bonnets and roofs, major salt spray damage, cars knocked together because of poor stowage and vehicles being loaded from general freight areas.

At the time these problems were being experienced, there was ample capacity on specialist car carriers across the Tasman, unloading cars in New Zealand after first calling at Australia.

For example, Toyota told the recent Industry Commission inquiry that it:

> "has dedicated car carrier ships which deliver imported vehicles and CKD packs from Japan to Australian ports. The ships then sail to New Zealand, mostly empty, then return to Japan... Freight rates [on Australian exports to New Zealand] could be reduced substantially if the trans-Tasman shipping were deregulated and our own ships could be utilised for vehicle exports."[4]

The situation became so bad towards the end of last year that some car companies were considering resorting to air freight, taking advantage of the presence in Australia of, of all things, a large Soviet air freighter. One could hardly envisage a more telling indictment of the situation.

For several months the industry has been pressing both the government and shipping companies to improve various aspects of shipping services. A number of improvements have indeed been made, especially the introduction of new RO/RO capacity by the Union Shipping company, ANL's use of specialist car carriers and "some services out of Adelaide". I understand that freight rates are now also more competitive.

As a result, the minister for shipping, Senator Collins, concluded that "there are now better prospects for improved services to be available for trans-Tasman vehicle exports in 1991" and that he would "continue to monitor developments".

While Senator Collins is no doubt pleased with his efforts, they represent a failure to appreciate the true nature of the problem - normal commercial arrangements and competition being inhibited by the existence of an illegal trade union agreement - and hence the appropriate solution: the repudiation of the agreement in unambiguous terms.

It is **not** Senator Collins' responsibility to encourage or ensure that ANL, Union Shipping or anyone else should provide particular vessels, capacities, levels of service etc. to suit the motor vehicle industry or any other industry. This is the appropriate role for commercial negotiations. What *is* Senator Collins' responsibility - and what he has failed so far to achieve - is to ensure that the policy framework is in place so that maximum commercial pressure can be brought to bear to produce the optimum commercial outcome.

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4 Industry Commission (1990), *The Automotive Industry*, December 1990, p. 51.

Before indicating what might now happen, let me briefly summarise the sorry record of more general attempts to address the trans-Tasman shipping issue by successive ministers and their officials on both sides of the Tasman.

Consultation and Recent Policy Developments

Since the 1987 review of trans-Tasman shipping the issue has gradually moved higher on the policy agenda. A brief chronology of recent developments includes the following:

- November 1987: New Zealand and Australian ministers of transport met and confirmed their commitment to achieving greater efficiency and lower shipping costs on the Tasman and to consulting with industry interests in the trade;

- December 1987: Officers from the Australian Department of Transport informed industry interests that the government's immediate objective was to obtain agreement from the unions to free some trans-Tasman trade from restrictions as a prelude to a complete freeing-up of the Tasman;

- February 1988: Two meetings took place between Australian officials, exporters and maritime unionists; exporters tabled examples of trades being lost or in jeopardy as a result of the 'accord';

- March 1988: Australian and New Zealand ministers of transport agreed to consider measures which could lead to the introduction of lower cost, more efficient Australian and New Zealand crewed vessels;

- March 1988: Australian and New Zealand seagoing and waterfront unions entered into a new 'accord' excluding foreign vessels from trans-Tasman trade;

- June 1988: A formal CER communique included an agreement between ministers "that it was vital to pursue measures to reduce the costs of shipping across the Tasman, in the interests of both economies and particularly to complement the accelerated elimination of barriers to trade resulting from the CER review"; the leader of the New Zealand side of the ministerial review of CER was quoted as saying that trans-Tasman transport was a disgrace;

- November 1988: Australian importers and exporters were advised that trans-Tasman shipping lay outside the charter of the Australian Shipping Reform Task Force;

- March 1989: The New Zealand minister of transport stated that:

  > "While I have proposed to the New Zealand maritime unions that they consider relaxing their restriction, shippers

can be assured that the law places no restriction on their freedom to contract with the carriers of their choice";[5]

- June 1989: An Australian ministerial statement on shipping and the waterfront foreshadowed discussions with the New Zealand government "to determine the scope for further reductions in trans-Tasman shipping and waterfront costs prior to the achievement of free trade between the two countries on 1 July 1990";

- September 1989: Australian importers and exporters were advised that the Australian and New Zealand ministers of transport had agreed to determine the scope for further reductions in trans-Tasman shipping costs;

- October 1989: Australian importers and exporters were advised by the Department of Transport of consultations planned for later that month between relevant Australian shipowners, importers/ exporters and maritime unionists (these consultations were never held);

- March 1990: As part of a wider economic statement, the New Zealand finance minister stated:

  > "The government is serving notice that the union accord is on the agenda. The government is not happy that shippers are restricted in their choice of carrier, and that the union accord is effectively denying lawful trade in shipping services";

- May 1990: The New Zealand and Australian ministers of transport discussed trans-Tasman shipping but no agreement was reached;

- May 1990: The New Zealand minister of fisheries strongly condemned the 'accord';[6]

- July 1990: Following the prime ministerial review of CER, the joint communique stated:

  > "We noted the positive trends in recent years arising from waterfront and shipping reforms. At the same time, most CER commerce continues to be reserved, under a Maritime Union Accord, to Australian and New Zealand crewed ships."
  >
  > "Our governments regard competitive shipping services as vital to the trade between Australia and New Zealand. We expect that the benefits of shipping and waterfront reform programs and initiatives in both countries should produce further significant reductions in costs in the trans-Tasman

5 Hon W P Jeffries, (1989), Address to the International Cargo Co-ordination Association, Annual General Meeting, Wellington, 15 March 1989.

6 Hon K Shirley, (1990), Address to the Third National Conference, Agribusiness Association of Australia and New Zealand, Canberra, 30 May 1990.

trade and consider it is important that the benefits flow through to exporters and consumers. Reducing shipping costs on the Tasman - to at least OECD levels by mid-1992 - is a common objective of our respective reform programs. Meanwhile, if necessary, New Zealand will take steps to provide shippers and carriers with legal remedies complementary to those already provided under the Australian Trade Practices Act."

"There will be consultations at Ministerial level with Australian and New Zealand trade union leaders as we address the development of trans-Tasman shipping."

"Governments will continue to assess costs, freight rates and levels of service of trans-Tasman shipping to determine what further measures may be necessary to improve efficiency and competition in the trade. Trans-Tasman shipping policy will be reviewed in parallel with the full review of CER in 1992;"

- December 1990: The Australian minister for shipping, Senator Collins, warned the Seamen's Union that "the government's position on the trans-Tasman trade was quite separate from its position on cabotage policy";

- February 1991: Following the first official meeting between the prime minister of Australia and the new prime minister of New Zealand, a joint statement was issued. Trans-Tasman shipping barely rated a mention. The statement said, in part:

  "The process of microeconomic reform was opening up opportunities for services providers to the other country's market. [The prime ministers] looked forward to benefits, specifically reduced costs to exporters, emerging from further processes of reform in the waterfront and shipping industries";[7]

- February 1991: The New Zealand prime minister was slightly more specific. At a press conference on 4 February, when asked how fast trans-Tasman shipping progress might be, Mr Bolger said: "the sooner the better as far as New Zealand is concerned, let's be quite clear about that. There is significant work to be done to inject much greater competition across the Tasman";

- March 1991: The Australian prime minister publicly acknowledged that the trans-Tasman 'accord' costs Australia $A70 million per year, although he said that the government's priority was to attempt to secure the $A1 billion per year waterfront reform benefits; he did say the government did not approve of the 'accord';

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7 Hon R J L Hawke and Rt Hon J B Bolger (1991), Joint Prime Ministerial Statement, 4 February 1991.

- March 1991: The New Zealand minister for trade negotiations, Mr Burdon, agreed to establish a joint government-industry working party to "crunch through" the issue of trans-Tasman shipping in the context of the 1992 CER review;

- March 1991: Australian government officials announced that they were working on a new survey of shipping users and service providers to establish current attitudes and emerging trends in line with the prime ministerial communique of July 1990; "an interim report will be published by the end of June";

- April 1991: The New Zealand minister of transport, Mr Storey, and the Australian minister for shipping, Senator Collins, discussed trans-Tasman shipping, with the New Zealand minister again foreshadowing amendments to the Commerce Act to enable the 'accord' to be challenged legally. The joint communique talked about continuing to monitor performance through the normal processes of reviewing CER; however, it did state that "both ministers reiterated that their governments did not support the current accord"; and

- April 1991: Mr Storey foreshadowed greater competition on both the New Zealand coast and trans-Tasman as a result of the Employment Contracts Act; on trans-Tasman, he said that "general labour market reforms in the (Act), involving voluntary unionism and the removal of blanket award coverage, may make it difficult for the unions to sustain such an arrangement (the 'accord')".[8]

This list may be lengthy but it can hardly be described as impressive. It indicates clearly that the Australian government's actions are timid and subject to continual consultations with a trade union movement which is opposed to the policy change required. It also suggests that the Australian government believes that merely talking about achieving lower shipping costs often enough (as in 1987-88) will make them a reality (given that the July 1990 prime ministerial communique was expressed in terms of *further* reductions). While the New Zealand government's position is less ambiguous, it has not been prepared to confront the Australian government directly by going to it alone, or by blowing the whistle on the Australian government's lack of political will.

What Has to Happen, When and by Whom?

So long as shipping costs and charges between Australia and New Zealand remain at unnecessarily high levels, the benefits possible from CER will not be fully realised. The effective exclusion of international competitors from the Tasman, and the excessive freight rates or restricted sailing schedules which result, discourage bilateral trade between Australia and New Zealand - an undesirable outcome for both countries.

The New Zealand government has displayed a greater willingness than the Australian government to confront inefficiencies directly and has already chalked up some impressive achievements, especially in terms of port reform. It has also consistently and publicly expressed its opposition to the 'accord' over the past

8 Hon R. Storey (1991), Press Release, 23 April 1991.

couple of years. Exporters in both countries have done so for a longer period. Even ANL is reported to have said recently that its performance has improved to the point where it is quite prepared for an end to the 'accord'.[9]

The Australian government, and successive ministers, duck and weave around the issue in a way which invites suspicion that somewhere in the background a secret deal has been done with relevant unions that the 'accord' will not be touched. We have recently had experience elsewhere of secret deals involving senior politicians and trade union leaders! The explanation that waterfront reform takes higher priority is certainly not compelling.

The responses of shipping companies and union representatives typically fall into one or both of two categories. They allege that:

- either particular freight rate comparisons are wrong, out of date, unrepresentative, anecdotal or do not fully account for the complexities involved - in other words, that existing arrangements are not greatly removed, if at all, from the commercial optimum which would exist in a free market; or

- opening up the trade to international competition would destroy dedicated services as fly-by-night operators, perhaps using unsafe vessels, picked the eyes out of the market.

Apart from noting that simultaneously advocating both viewpoints - as I have seen attempted - stretches credulity, neither response constitutes a case for leaving the 'accord' intact. If the potential for service or freight rate improvement is small, then encumbents have little to fear from greater competition. If there is enormous potential for cross-over or tramp services, then shippers are being heavily penalised now for their unavailability.

Resolving the issue - and removing it once and for all from the policy agenda - requires prompt action in three areas:

- first, the Australian government needs to be made to answer 'yes' or 'no' to two questions:

  - does it endorse the 'accord'?; and

  - will it in any way, implicitly or explicitly, seek to frustrate commercial attempts to use cross-over vessels on the trans-Tasman trade, including if civil remedies need to be sought as part of such attempts?;

- second, the New Zealand government needs to decide what, if any, legislative strengthening is required to ensure that a legal challenge to the 'accord' would be successful and enact such changes; and

- third, cross-over vessels need to be engaged as and when appropriate.

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9 Quoted in *Inside Canberra*, 25 January 1991.

As to the latter point, it is not a matter of seeking the elimination of, or substantial reduction in, services offered by existing shipping operators. Rather, it is to give shippers wider choice to make commercial arrangements which suit them, and to ensure that existing operators are more effectively motivated than hitherto to provide customer-orientated services. As noted earlier, there is much more to a shipping service than simply price. Service frequency, port coverage, ship board and waterfront equipment and so on, all contribute to the overall service quality. But there are many other shipper lines - bulk and liner - which ply between Australia and New Zealand as part of services to third countries. Some would offer attractive services to trans-Tasman shippers. It is long overdue that they be allowed to do so.

As to who might take the lead, there are several candidates - grain, sugar, alumina and motor vehicles from Australia, and forest products, urea and petroleum from New Zealand. Possibly the one closest to the starting gate is wheat. The Australian Wheat Board stated in April that, "having now exhausted all avenues for negotiating a reform of the accord", it was ready to defy it.[10] It has taken more than two years for the Board to reach this view and even then its government member is reported to be cautioning against hasty action.[11] The task of a pioneer is always difficult and at times lonely. When the first attempts are being made, the active support of shippers generally on both sides of the Tasman must be forthcoming. Once the precedents have been set, others will follow, including shipping company-initiated innovations and further service improvements provided by existing carriers.

It would be pleasing to be able to report to an equivalent conference in twelve months time that the 'accord' had, to use the American terminology, at last been rendered inoperative.

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10 AWB Deputy General Manager quoted in *The Land*, 25 April 1991.

11 Ibid.

LARGE HERDS CONFERENCE

MARKETING NEW ZEALAND'S DAIRY OUTPUT:

WHAT CHANGES ARE NEEDED AND WHY?

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MASTERTON
1 JULY 1991

MARKETING NEW ZEALAND'S DAIRY OUTPUT: WHAT CHANGES ARE NEEDED AND WHY?

1. INTRODUCTION

The 1990s promises to be a decade of exciting and beneficial change in the New Zealand economy. The continuing implementation of a programme of structural reform is laying the foundations for a significant and sustained reversal of our inferior economic performance.

Undoubtedly the dairy industry will want to participate fully in this revitalisation process. In fact, the significance of the industry to the New Zealand economy means it must be involved. Dairy farmers are already experiencing some of the benefits. Lower costs through a more competitive ports industry, reduced protection and more efficient state-owned enterprises are examples.

Enhancing competition, reducing real tax burdens, removing price distortions and restoring the roles of incentives and choice in business and private decision making are key factors in getting New Zealand back on a path of economic growth and rising living standards. This is very much the setting for my remarks today. Competition, clear price signals and choice are just as important and potentially beneficial to dairy farmers and their industry as they are to the economy as a whole.

I have been asked to present a personal viewpoint on the marketing structure that would best suit the dairy industry in the future. Although I grew up on a dairy farm and helped promote the industry's interests in Europe for several years, I would claim no particular dairy industry expertise. The task is therefore an ambitious one. Alternatively, this could be an advantage if you are interested in the questioning and ideas of an outsider, who has a constructive purpose in mind.

My participation undoubtedly also reflects the fact that the New Zealand Business Roundtable has commissioned a major study into the agricultural marketing systems and structures best suited to New Zealand's circumstances and aspirations. I will be drawing on the research and preliminary conclusions of that study which is in the process of being finalised.

The Business Roundtable is an organisation of chief executives of major New Zealand business firms. Its purpose is to contribute to the development of policies which reflect overall national interests.

The importance of agriculture, including the dairy industry, in the New Zealand economy is a major reason why we have an interest in how well our marketing systems perform. Also, a number of Business Roundtable members head companies which are involved in agribusiness. Other considerations underlying our interest include the fact that many of New Zealand's existing agricultural marketing structures and systems have been in place for a long time, and that they involve varying degrees of statutory control and restriction on participation and competition. Part of our research programme has involved reviewing regulatory controls on major industries in the economy.

The substantial overhaul of longstanding regulatory arrangements, and the removal of restrictions on choice and competition, are proving very beneficial elsewhere in the economy. It is in the interests of us all to examine and discuss whether this might not also be the case in agricultural marketing.

Today, I want to question and challenge some features of the existing marketing systems and structures in the New Zealand dairy industry, and suggest some changes which I consider would benefit dairy farmers, the industry and the economy as a whole. Perhaps even more important, I want to encourage you, as dairy farmers, to do the same.

I will not be advocating the wholesale dismantling of existing marketing structures in the dairy industry. The Dairy Board, in particular, could well be one of the industry's most valuable marketing assets. The difficulty which analysts, and I suspect many dairy farmers, have is that under the current marketing regime an unequivocal judgment on the Board's performance is impossible to make.

I agree with the Porter study's conclusions regarding the importance of competition to innovation and improved commercial performance, but do not agree with the contention that this necessarily requires large numbers of industry participants within New Zealand. The key consideration is to make sure there are no unnecessary impediments to entrepreneurs being able to test ideas, pursue opportunities and take risks. This may or may not result in a large number of players in New Zealand.

I will return later to these important considerations. What I intend to do next is to outline briefly the history and role of the dairy industry's existing marketing arrangements.

2. THE EVOLUTION AND ROLE OF MARKETING STRUCTURES IN THE DAIRY INDUSTRY

The distinction between marketing systems and structures on the one hand, and the actual marketing functions and activities on the other, is very important. In essence, the marketing systems and structures - the concern of this address - are critically important in determining:

- how well the marketing functions and activities are performed;
- how effectively this performance can be assessed; and
- how dairy farmers receive and respond to returns from their various investments in the industry on and off the farm.

Dairy farmers have expertise in the efficient production of milk and generally do not have expertise, or want to be involved, in detailed oversight of the processing, packaging and marketing of the products made from their milk. However, they do want to be satisfied that these manufacturing and marketing functions are carried out in their best commercial interests.

Dairy farmers therefore require two things from the marketing system. Those requirements are that it:

- maximises the returns received for milk; and

- provides a basis for dairy farmers being sure that this is occurring.

To use the traditional jargon of the industry, maximum producer returns with adequate accountability. The desire of dairy farmers to be sure these two requirements are met underlies, in large part, the origins and apparent continuing support for the industry's existing marketing arrangements.

These marketing arrangements involve milk processing being undertaken exclusively by producer cooperative manufacturing companies, and a producer board being the sole exporter of New Zealand's dairy products. The Dairy Board and the manufacturing cooperatives work very closely together although individual cooperatives are generally not in direct contact with their markets or customers.

Dairy farmers 'own' the marketing system because 'their' cooperatives effectively 'own' the New Zealand Dairy Board. However, dairy farmers do not have an explicitly tradeable asset reflecting their equity in cooperatives or the Board.

The existing marketing arrangements and structures are also partly a product of the industry's history. In particular, they evolved in part from the involvement of the government in marketing associated with historical links between Britain and New Zealand, and 'special' arrangements put in place during the two World Wars. In preparing this paper I recalled - with a slight shudder - that in my days on a dairy farm the predecessor of the Dairy Board was a government bureaucracy.

Dairy farmers have lived with, and some would say prospered under, this marketing system and structure for some time. There appears to be a cooperative culture in the dairy industry which holds that dairy farmers must own and control the processing and marketing sectors of the industry. This culture has supported, and in turn derives from, the history of government involvement, intervention and control which, in a self-fulfilling way, has led to the perception that dairy farmers must 'cooperate or perish'.

Dairy farmer judgments about what marketing systems and structures are needed have also been influenced, particularly more recently, by the characteristics of the international market for dairy products. While New Zealand is a major player in world dairy trade, both international trade and New Zealand are relatively minor elements of the world dairy industry.

These characteristics, together with the widespread use of production subsidies and market entry restrictions, make the world dairy market volatile, and particularly hard work for an efficient and unassisted producer and exporter. The dairy industry appears to have the view that only the current export marketing arrangements will maximise producer returns in such a politicised and distorted international market place. Interestingly, the dairy industry really has had no entrepreneurial experience with alternative systems and structures for processing and marketing its output.

At the very least, existing perceptions and views need to be regularly examined to assess their relationship to reality, and their contemporary relevance. This is all the more necessary when it is considered how different the industry's cooperative and statutory structures are from the conventional corporate model in respect of openness to competition, performance indicators, accountability systems, and ownership and control.

I hasten to add that being different does not necessarily mean a change needs to be made. Assessment of performance compared with the likely performance of alternatives, or of a system which provided greater choice, should be the basis for such a conclusion.

In my view the dairy industry's marketing systems and structures can be changed in a way which would improve their performance, and hence returns received by dairy farmers. Furthermore, I believe this can be achieved without needing to expose dairy farmers to unnecessary commercial risks or threaten existing marketing organisations if they perform satisfactorily.

As the means of explaining my views, and the main reasons why I consider changes to existing marketing systems and structures are needed, I intend to discuss the following three broad topics:

- the reasons why the current organisational structures in manufacturing and marketing make it very difficult for dairy farmers to assess commercial performance and know whether their returns are being maximised;
- the basis on which dairy farmers make investment and production decisions and the implications for the structure and growth of the dairy industry; and
- the extent to which market characteristics require that the industry's marketing structures exercise 'control' over export marketing and restrict participation.

While market circumstances are a major reason advanced in support of current arrangements, what I consider to be much more important are issues relating to how dairy farmer returns from processing and marketing are determined and delivered, and how these affect the monitoring of the system's performance and farmer investment and production decisions. I believe that all the issues relating to overseas market circumstances either have their consequences exaggerated significantly or can be managed or accommodated by means which are much less restrictive on commercial opportunities and choice than the current arrangements.

3. HOW CAN DAIRY FARMERS TELL IF THE CURRENT ARRANGEMENTS MAXIMISE THEIR RETURNS?

Dairy farmers receive a net return per kilogram of milk supplied to their manufacturing cooperative. Diverse factors influence the net return, including:

- market returns obtained by the Dairy Board for the products manufactured from the milk and pooled across certain markets and products;
- returns from the Board's non-New Zealand dairy product trade and from non-dairy commercial activities;
- all marketing costs, including freight, insurance, finance, administration and promotion, which are also subject to pooling;
- returns to individual manufacturing cooperatives from sales on the domestic market;

- all processing and manufacturing costs past the farm gate; and
- cooperative and Board investment funding through either retention of earnings or borrowing costs.

The payout received for milk fat and protein is the major commercial indicator dairy farmers have for determining whether their entire production, processing and marketing system is maximising their income, and the returns they are receiving on their investment in the dairy industry on and off the farm. The manner in which this return is determined and delivered to dairy farmers reflects the particular organisational features of the industry's marketing structure, namely a statutory 'single seller' on the export market and cooperative manufacturing companies owned by their milk suppliers. Along this chain between milk delivery and consumer, people who are eventually accountable to dairy farmers endeavour to maximise market receipts and minimise associated manufacturing and marketing costs. In doing both, their objective is to maximise the milkfat payout to the dairy farmer.

The diversity of commercial information embodied in this single dairy farmer return severely reduces its usefulness as an indicator of the efficiency and profitability of the industry's manufacturing and marketing activities. For example, the average dairy farmer has around $150,000 invested off-farm in processing and marketing. The dairy farmer has no way of knowing how well each item of off-farm investment is performing, absolutely and relative to the farm investment.

There are simply no comparative commercial performance indicators. Neither the Board nor the cooperatives report profits or remit separately identifiable dividends. The off-farm equity held by a dairy farmer is only negotiable if the farm is transacted - i.e. it becomes capitalised into the land value and probably discounted because of the restricted and indirect way in which it can be commercially negotiated. If you wish to be a dairy farmer you have no choice but to make this off-farm investment. There is no explicit share price because there is no direct market for the off-farm equity.

There are really only three bases on which dairy farmers can reach any conclusions about the economic performance of 'their' manufacturing and marketing system and each of them has major deficiencies.

First, they can compare their incomes with those of farmers in other rural industries. This is of limited value unless scale of farming operations and extent of off-farm investment in other industries can be taken into account.

Generally, dairy farmers appear to be 'satisfied' when their incomes compare favourably with those of farmers in other industries. Rising dairy farmer anxiety levels, and discussion about performance and accountability, are usually associated with periods when incomes fall absolutely or relative to other industries. This behaviour means that those responsible for the industry's performance past the farm gate have a strong incentive to keep incomes at 'comparable' levels, but this may not mean at their highest levels.

Dairy farmer incomes do not appear to have differed significantly from those of beef/sheep farmers. The dairy industry has not been growing vigorously. The production base has been static and growth in physical output has been due entirely to a rise in output per cow, which happens to be the factor dairy farmers have most direct control over.

This evidence does not suggest that the existing marketing system has been an engine room for growth or above average farm incomes. However, it could be that without this system the dairy industry would be considerably smaller and incomes lower. That hypothesis is very difficult to prove or refute.

The second basis on which a dairy farmer can assess commercial performance is by comparing returns received from the cooperative being supplied with returns from other cooperatives. This comparison throws some light on the relative efficiency of manufacturing between cooperatives but indicates nothing about marketing efficiency or returns to off-farm investments. Differing levels of retentions for investment between cooperatives would also confound this indicator.

Finally, the dairy farmer can rely on what is said by elected representatives and senior management in the Board and cooperatives. However, the commercially useful information provided to dairy farmers appears to be very limited and not of a comparative nature, and so has to be taken very much 'on trust'.

Furthermore, most of the information provided to dairy farmers relates to variables such as gross returns, changes in turnover and developments in market share. These are really indicators of activity rather than performance.

The clear conclusion from this analysis is that a 'cost' to dairy farmers of the current marketing structures is a lack of satisfactory performance indicators. This is a major deficiency given the size and diversity of the investment each dairy farmer has in the industry. No amount of accountability in the form of consultation and questioning by dairy farmers will satisfactorily substitute for performance indicators such as profitability, dividends (returns on capital), share prices and ultimately survival. This is all the more so when there is an absence of markets for the capital and management involved in the marketing system and structures.

Various forms of review and audit are proposed to overcome this lack of performance information and market-based disciplines and sanctions. The fact that they are proposed, and seen to be necessary by dairy farmers, indicates that the deficiency is recognised.

However, reviews and audits of the types proposed are unlikely to assist dairy farmers greatly in their assessments of performance. This has been evidenced in the case of state-owned enterprises where it is now being appreciated that markets in capital and management, and associated performance indicators such as share prices and dividends, are essential to performance monitoring and ensuring efficient use of the resources involved.

There are structural options available to the dairy industry which would provide dairy farmers with conventional performance indicators and improved markets for their various investments in the industry without necessarily sacrificing the desire to hold equity in manufacturing and marketing activities. I will return to these options later.

4. WHAT INFLUENCES DAIRY FARMER INVESTMENT AND PRODUCTION DECISIONS?

As in all business endeavours, investment and production decisions made by dairy farmers are influenced by returns. The dairy farmer's net return will be the basis for deciding whether to stay in dairying and what level of output, or output growth, to aim for. In aggregate, these individual responses will determine the size and growth of the New Zealand dairy industry.

Dairy farmers currently base these important decisions on a composite and residual net return for milk that contains a diversity of information on returns and costs. The nature of this return is such that its appropriateness as a guide to on-farm investment and production decisions would have to be questioned.

The reasons why the current return on milk may be an inappropriate basis for deciding what to do on the farm are fairly clear-cut. The return which a dairy farmer receives, and which determines whether to run an extra cow, is not the net return that will be received for the extra production from that cow. It is an average return, pooled across various markets, reduced by off-farm costs which have also been pooled, and including revenue obtained from activities which have nothing to do with what markets are paying for New Zealand dairy products.

Furthermore, the dairy farmer's return includes a return to off-farm investments in the manufacturing cooperative, the Dairy Board, and the Board's off-shore portfolio of businesses. Overall, it is a very confusing and misleading commercial signal on which to base milk production decisions.

The following two examples illustrate the point.

New Zealand retains favoured access to the United Kingdom butter market. This has been estimated to be worth some $200 million per year to dairy farmers compared with returns if the same butter had to be sold on the international market. In fact, the benefits could be greater if, as a result of placing this additional quantity of butter on the international market, prices in this market were driven down.

This United Kingdom premium is combined with returns from other markets when paying the dairy farmer an averaged net return. As a consequence it raises milkfat returns, and hence production, by more than is economically justified given returns in markets where this extra production will have to be sold.

What this means is that after having successfully secured this premium the industry dissipates at least part of the benefit by increasing production when this is not what the market is indicating should happen. This problem, and the loss of income it entails for dairy farmers, can only be avoided if the premium from the United Kingdom market is returned to the 'shareholder' in a manner not likely to induce a production increase.

The second example illustrating how the return to the dairy farmer is likely to result in the wrong milk production decisions concerns the increasingly diverse range of commercial activities performed by the Dairy Board.

In 1989/90, 32 per cent of Dairy Board revenue was derived from either non-New Zealand dairy products (23 per cent) or non-dairy products (9 per cent). The Board publishes only limited information on exactly how this revenue is generated although the wholly-owned Sovenz Group would appear to be a significant contributor to non-dairy revenue. It is involved in a variety of activities including trading in motor vehicles and tractors, meat, peat moss, potash, vodka, and the construction of processing facilities for dairy, meat and fish.

Simply put, the profits from these diverse, non-New Zealand and non-dairy product activities should not be returned to farmers as a return on the milk they produce. To do so is to invite and encourage significant commercial and economic distortions in the production and manufacturing sectors of the industry.

If such distortions are not occurring there are two possible explanations, and both should encourage critical scrutiny by dairy farmers.

The first is that these non-core activities are not profitable and therefore not contributing any distortion to the milk price. The second is that they are profitable but for some reason the profits are not reaching dairy farmers in the return on milk.

These potential investment distortions caused by the method used to deliver returns to dairy farmers represent another 'cost' associated with the existing marketing systems and structures. The obvious question is what changes can be made to marketing structures to remove these costs. However, before moving to that question I want to consider whether there are benefits from the current arrangements which might exceed these costs. In particular, are these 'costs' worth accepting because of the improved returns dairy farmers might receive from an 'orderly and disciplined' approach to international marketing?

5. MARKET CHARACTERISTICS AND THEIR IMPLICATIONS FOR CONTROLS OVER EXPORT MARKETING

New Zealand produces 1.5 per cent of the world's milk but accounts for around one quarter of world trade in dairy products. Because very little of world production enters trade, the market is volatile and unpredictable. This is to be expected since small changes in production can have significant effects on quantities which enter trade.

Production subsidies and restrictions on market entry are also widespread in the international dairy market. In particular, the international market for dairy products is very much influenced by developments in the European Community, the United States and the Soviet Union. Between them, these three groups participate in more than three quarters of world trade in dairy products. Japan is also an important market with a protected domestic industry.

There is no doubt that participating in such a politicised and subsidised world market is hard work. But New Zealand has no option but to persevere and do the best we can. This, of course, is complemented by political activities and negotiations aimed at reducing surplus international production, intervention and subsidies.

The important question for the New Zealand dairy industry concerns whether the current marketing arrangements, particularly the 'single seller' on the export market, are required to maximise returns because of these market circumstances. It is also necessary to consider whether, in fact, there would be greater innovation, market development and penetration, and improved returns, if others were allowed to participate in exporting.

These questions focus on the ability of the New Zealand dairy industry to act effectively as a monopolist on the export market. It is possible that the New Zealand dairy industry could be a successful monopolist in situations where institutional arrangements in the importing country favour New Zealand if it presents itself as if it were a single entity, or where New Zealand has some natural supply advantages it can exploit.

A clear instance where the New Zealand dairy industry has a readily available monopoly is the United Kingdom market quota. As noted earlier, this may be worth an additional $200 million per year to New Zealand. Whether the dairy industry alone or the community generally should be the recipient of this 'economic rent' is an issue but one which I do not intend to debate here.

The point I want to highlight is that obtaining this additional revenue does require that the New Zealand dairy industry operates in the United Kingdom market in a coordinated way. If multiple New Zealand exporters competed in this market then the premium would be lost to United Kingdom importers.

Such a situation in international trade is not unique, however. For example, the Japanese motor vehicle industry has faced quantitative export restrictions (so-called 'Voluntary Restraint Arrangements') in the United States market but appears to have captured the associated economic rents without forming an industry 'board' or operating as a single seller. Moreover, I know of no other significant market for New Zealand dairy products with the same characteristics and hence the same uncomplicated opportunity for successful monopoly behaviour.

Similarly, I see no evidence to suggest New Zealand has a product which is unique in a way that might enable us to extract monopoly advantages or premiums. On the contrary, the world seems to be awash with the same or similar dairy industry products to those New Zealand is exporting.

Professor Wayne Cartwright has estimated that price premiums of up to 5 per cent over spot and tender prices are available for dairy commodity suppliers that can guarantee delivery, volumes and quality. This is not a particularly big margin, nor is it free for the taking. It could only be achieved at some cost with a monopoly exporter marketing structure. Moreover, there are other ways of organising reliable supply.

It is clearly not possible in a paper such as this to explore all the arguments and considerations relevant to the pros and cons of the dairy industry's current 'single seller' export marketing structure. However, even if a detailed analysis were undertaken, I have some difficulty in seeing how an unequivocal empirically-based conclusion one way or the other could be sustained. If only one marketing system and structure were used, and all the alternatives were precluded absolutely, from where does one derive unequivocal counterfactual evidence?

The report of the Porter Project appears to have popularised the All Black analogy to illustrate the advantages to New Zealand of commercial choice and competition. The All Blacks are successful, it is argued, because they are the product of an intensely competitive system. I consider the analogy very apt.

However, I have heard dairy industry representatives argue that the All Blacks illustrate perfectly the merit of the industry's current 'single seller' marketing arrangements. They agree that domestic competition is what makes the All Blacks great, but point out that New Zealand does not send numerous teams overseas and require them to compete with each other on New Zealand's behalf.

To me, the use of the analogy in this way really misses the point. The dairy industry is not facing a single overseas market for its output. The market for dairy products is extremely diverse and changing all the time. In these circumstances, leaving all the marketing to just one organisation makes as much sense as expecting the All Blacks to represent New Zealand in every sport we choose to compete in overseas. Would the Japanese motor vehicle industry see things that way?

6. SOME SUGGESTED CHANGES TO CURRENT MARKETING STRUCTURES

It is my view as a policy analyst that dairy farmers would benefit from more competition in the export marketing of their output and organisational structures which embodied more conventional commercial performance indicators. This is likely to enhance the diversity of skills and ideas brought to bear on the export marketing task. It would also provide dairy farmers with a better basis for monitoring the performance of the marketing system and greater individual choice over the extent to which they wished to participate in commercial activities past the farm gate.

I consider it most unlikely that removing the Board's export monopoly would threaten the organisation's survival or success. The Board is a large, experienced international marketer. Its attributes and market experience provide it with distinctive advantages in competing with any new entrants. If, for some reason, this was not the outcome when it faced competition, then the industry is better off discovering that now rather than at some time in the future.

The fact that many dairy farmers are anxious about changing existing arrangements and introducing more competition is understandable. Current marketing structures have been in place for a long time. However, what I find puzzling is why the industry does not avail itself of readily available options which would allow dairy farmers effectively to test views such as mine without immediately putting at risk the major features and claimed benefits of the existing marketing arrangements.

Because differing views about what marketing systems and structures are best suited to the New Zealand dairy industry seem unlikely to be resolved by debate, it is very important that some of the alternatives being advocated are tested in the market place. My concluding remarks outline the way in which I believe this can be done.

Currently, there are two policy issues under debate in New Zealand which provide the opportunity for important changes to the dairy industry's marketing structure to be introduced and their consequences assessed.

One is the Dairy Board Amendment Bill which was introduced into the Parliament before the last election and is currently being considered by a Select Committee. The other is the Companies Bill, which is also under consideration by a Select Committee and is of particular relevance to the dairy industry because of the implications it carries for the cooperative form of business structure.

The Dairy Board Amendment Bill proposes relatively minor but potentially very important changes to the industry's marketing arrangements. In particular, it would relax, but not remove totally, the control exercised by the Dairy Board over exports.

The Bill proposes the introduction of very modest (and Board-controlled) competition on the export market. The Explanatory Note tells us that the Bill:

> "...allows exporters to apply to the Board for permission to export dairy produce, and requires the Board to give its permission if satisfied that the produce is intended for markets in States that do not impose quantitative restrictions on imports, and that the export of the produce will not harm overall returns to the New Zealand dairy industry.
>
> "The Board will not be able to use its powers of compulsory acquisition in respect of dairy produce for which an exporter has applied for permission to export, unless permission has been refused".

The changes proposed in the Bill would provide opportunities for existing manufacturing cooperatives, or possible new entrants, to undertake export marketing outside the Board's control and direct influence. If the Board refused an applicant permission to export, it would have to explain, in terms of industry benefits, why permission was refused.

It is my understanding that the Dairy Board is not fully supportive of these changes being introduced. I find it difficult to understand why the Board would wish to adopt this position – unless it viewed the Bill as a Trojan horse. Dairy farmers should be particularly suspicious of any attempts to base the approval process on internal, non-transparent criteria.

While the changes might fall considerably short of what I think is necessary in terms of introducing more choice and competition, at least they are likely to demonstrate the ability of commercial participants to seek out and develop new markets, products and methods of marketing. If such attempts fail, dairy farmers would be no worse off; if they succeed, then this must result in greater demand for milk output.

Perhaps of most importance, the commercial activities likely to emerge would provide dairy farmers with valuable experience and evidence of marketing alternatives and their consequences. And this would be achieved without putting at risk the major features of the existing marketing arrangements.

If I were an innovative dairy farmer with an interest in testing alternative marketing systems I would be advocating strongly the passage of the Dairy Board Amendment Bill.

The second current policy issue is the Companies Bill and the commercial structure and forms of accountability of relevance to the dairy industry which it raises. The Dairy Board, on behalf of the manufacturing cooperatives, has made a submission to the Select Committee advocating provisions in the final legislation which will ensure cooperatives can continue to be structured and operate as they have in the past.

In my view, if a group of individuals wish to form themselves into a business which operates on traditional cooperative lines then corporate law should allow this to happen. However, what I find of interest is the very strong advocacy from the industry for the exclusive use of this form of business structure in the dairy manufacturing sector. As I discussed earlier, it is the cooperative business structure, with its particular and unique method of delivering returns to member shareholders, which makes it very difficult for dairy farmers to monitor commercial performance and which contributes to investment and production decisions which may sometimes be inappropriate.

As is the case with marketing structures, there are organisational alternatives available which would allow dairy farmers to retain control of their manufacturing cooperative if that were considered beneficial, while allowing returns from differing investments to be separated, conventional asset markets to function, and normal performance indicators to exist.

There are various corporate models which allow equity to be raised, shares to be traded and dividends paid without putting the organisation at risk of takeover by 'outsiders'. Essentially these models involve the issue of different categories of shares with restrictions on trading and ownership sufficient to ensure that any particular group or class of shareholder can maintain effective control and ownership. Such restrictions may have an efficiency cost, and should not be applied without good reason, but they are a straightforward way of maintaining a closely-held ownership stake in a firm.

This is a model which allows individuals who want to pursue a cooperative business philosophy to enjoy the best of both worlds. I am surprised to find this corporate model not being used widely in the dairy industry.

Removing the Dairy Board's total control over export marketing would encourage the adoption of alternative commercial structures in the manufacturing sector. While dairy farmers might want, initially at least, to consider structures which allow them to maintain control and be 'takeover-proof', I would commend consideration of the potential benefits from non-producer shareholding. 'Outside' investors can be valuable sources of capital. There is no reason to believe their objectives would not be the same as farmer shareholders - the maximisation of long term returns from their investment. They might even bring new ideas and suggestions for improving profitability.

7 CONCLUSION

Let me finish by summarising my key points and conclusions.

The New Zealand dairy industry has a set of marketing arrangements and structures which have been in place for a long time. They involve significant restrictions on choice, entry and competition. This appears to reflect a strong cooperative culture in the industry and a belief that a 'New Zealand Incorporated' approach to export marketing and exclusively cooperative manufacturing companies are in the best interests of dairy farmers.

Two very significant deficiencies in these arrangements derive from the manner in which the 'single seller' Dairy Board and manufacturing cooperatives deliver returns to the dairy farmer. The dairy farmer's return for milk is a composite of returns and costs from a variety of activities and investments. This places severe limitations on the ability of dairy farmers to monitor effectively commercial performance and returns on investment and to be able to negotiate their equity. This return is also potentially a very misleading indicator for on-farm investment and milk production decisions.

Apart from the United Kingdom market, which is likely to continue to diminish in importance, the traditional reasons put forward in support of a 'single seller' exporter do not stand up well to close scrutiny. This essentially reflects the fact that the New Zealand dairy industry is very limited in its ability to be an effective monopolist in the international dairy market. It is in competition with many other suppliers and many other substitute food products.

However, rather than continue to pursue a barren debate about whether or not the existing systems and structures should be changed, the dairy industry should take advantage of available opportunities to test the consequences of greater choice, more competition and corporate structures which allow commercial activities to be subject to conventional performance measures and market sanctions, side by side with existing arrangements. The suggestions I have made fall short of the extent of choice and competition I consider the industry needs. However, they represent some very low-risk steps in the right direction.

SUBMISSION BY THE
NEW ZEALAND BUSINESS ROUNDTABLE

THE GOVERNMENT'S ROLE AND RESPONSIBILITIES IN DISASTER INSURANCE

AUGUST 1991

THE GOVERNMENT'S ROLE AND RESPONSIBILITIES IN DISASTER INSURANCE

1.0 Introduction

1.1 This submission is made on behalf of the New Zealand Business Roundtable (NZBR), an organisation of chief executives of major New Zealand business firms. The purpose of the organisation is to contribute to the development of sound public policies which reflect overall New Zealand interests.

1.2 The NZBR has participated in recent reviews of New Zealand's disaster insurance arrangements because of the importance which it attaches to the establishment of an adequate set of policies to mitigate the economic consequences of a major disaster. Risk management techniques such as disaster insurance form part of this set of policies. Because the resources committed to disaster insurance are substantial, and are currently channelled in large part through a state insurer, the efficiency of the insurance market and the performance of insurance organisations in it are significant public policy issues.

1.3 Previous submissions were made to the former associate minister of finance on the White Paper, *Disaster Insurance Policy*, and to the Commerce and Marketing Select Committee of the House of Representatives on the Disaster Insurance Bill.

1.4 The thrust of the present submission is that the government's proposals to allow a competitive and voluntary market for disaster insurance in respect of property other than residential property is desirable. The move to relax the requirement for homeowners to buy disaster insurance if they insure their homes against the risk of loss from fire is also a step in the right direction. In contrast, we believe that further consideration should be given to the following aspects of the proposal:

(i) The appropriate role for the government in respect of disasters;

(ii) The desirability of competition in the supply of disaster insurance to homeowners; and, most particularly,

(iii) The role and organisational form of the Earthquake and War Damage Commission (or its successor).

The remainder of this submission focuses on the above areas where we believe improvements should be made.

2.0 IS COMPULSORY INSURANCE OF RESIDENTIAL BUILDINGS JUSTIFIED?

2.1 Under the proposals, homeowners who buy fire insurance in New Zealand would also be required to insure their properties with the Earthquake and War Damage Commission (EQC) against loss from a natural disaster. The sum to be insured would be the lesser of the property's indemnity value or $72,000. The latter represents around two-thirds of the average value of houses (Annex two of the paper refers). The EQC would be the sole provider of such insurance and it is to charge a flat premium, regardless of the risk characteristics of the particular property (e.g. its location on a fault line or in a low risk locality).

2.2 As far as residential buildings are concerned, this proposal represents a minor relaxation of the present compulsory scheme. Currently, homeowners are required to insure their properties for their indemnity value (without limit) if they buy fire insurance in New Zealand. Thus, where homes have an indemnity value greater than $72,000 (excluding land and certain improvements, such as garages), the owners would be able to choose whether to insure their additional investment and from whom that insurance would be purchased. However, we suspect that most homeowners will be unaffected by the proposal as the indemnity value of many properties is unlikely to exceed $72,000. Because houses in high risk areas such as Wellington tend to have a higher value than the average New Zealand house, the proposal will result in a lower ratio of insurance cover to indemnity value in high risk areas than in other areas. This would be a perverse outcome.

2.3 In our submission to the former Associate Minister, we examined the question of whether compulsory insurance was justified (see pages 8 to 14 of that submission). In paragraph 4.26 we expressed a sceptical conclusion and suggested that the government had not shown that the benefits of compulsory insurance outweighed the costs involved.

2.4 The key arguments advanced in the paper for compulsory disaster insurance in respect of residential property are, first, that the state has some responsibility for homeowners who could not look after themselves in the event of a disaster and, secondly, that the commercial insurance market may not be able to provide disaster insurance for all residential property (paragraphs 16 and 17 of the paper refer).

2.5 These arguments are not compelling. The paper does not provide an analysis which shows that the cost benefit test has been met. While there is a free-rider problem associated with disaster insurance (as with many other activities), this problem can be contained by a clear policy statement on the extent of government assistance in the event of a disaster; by limiting that assistance to civil defence services, initial emergency accommodation assistance (e.g. in halls, schools and tents); and, beyond that, by the availability of the government's existing means tested welfare assistance. If such a policy were adopted, communicated and implemented as situations arise, (such as storms and floods), we believe that the residual free-rider problem would not be of sufficient magnitude to justify the level of compulsory insurance envisaged in the current proposal. The paper itself downplays the free-rider argument and points out that uninsured property owners would not rank high in claims for government assistance.

2.6 We are sceptical that private insurance markets would not respond to the community's demand for disaster insurance cover. Furthermore, should the insurance market be unable to absorb the risk, in the absence of price controls, the government should be particularly careful about stepping in because there may be valid economic reasons for such an outcome. We suspect that some of the concerns expressed by existing insurers on this point are essentially designed to limit competition, not just in the provision of disaster insurance but more particularly in the provision of general insurance to homeowners.

2.7 It should also be noted that the current proposal will bear more heavily on people who are less well off. They will tend to own lower-valued houses which will be insured compulsorily, while those with more valuable houses will have some choice and they may be better placed to insure their property offshore, thereby avoiding entirely the compulsory levy. As is the case now, some less well-off people may be forced to forgo fire insurance, which they would prefer to buy, in order to avoid the unaffordable cost of disaster insurance on the indemnity value of their house.

2.8 The foregoing arguments have even greater force in relation to the compulsory insurance of household contents. Any suggestion that the government has a social responsibility in respect of items such as floor coverings, light fittings and appliances would not stand up to close scrutiny. Similarly, we do not accept that the private market does not have the capacity to insure the first $10,000 of household contents.

2.9 While we are unconvinced of the arguments for compulsory insurance of residential properties, if the government wishes to adopt this course we would suggest a lower ratio of insurance to the value of the house, say 50 percent, differentiated on a regional basis, with no compulsory insurance for household contents.

3.0 COMPETITION IN THE SUPPLY OF DISASTER INSURANCE

3.1 If the government were to decide that some minimum level of compulsory disaster insurance should be imposed on homeowners, it could achieve that objective by regulation without also needing a state agency to provide such insurance. Thus the continued provision of compulsory disaster insurance cover by the EQC, without competition up to a regulated level of coverage, requires separate justification. We submit that adequate justification is not provided in the paper.

3.2 There is a wealth of information which shows that monopolies provide low quality services to consumers, that their product range is limited, that they are unresponsive to genuine complaints from consumers, that their costs are excessive and that they do not innovate as much as firms subject to competition. Furthermore, state-owned monopolies are subject to the additional disadvantage of weak monitoring by their owners which accentuates these problems. For these reasons, we are opposed to the proposition that the provision of compulsory disaster insurance should remain a state monopoly. We also believe that this would result in greater risks than necessary being assumed by taxpayers, thereby defeating one of the original objectives for reviewing the EQC scheme.

3.3 A flat rate of premium is also undesirable. It could only be sustained by a monopolist. The chief disadvantages of a flat rate are that it impairs the incentive for households to undertake optimal amounts of damage prevention (such as steps designed to minimise the risk of damage in the event of a disaster) and distorts location decisions. It will tax homeowners in low risk areas and subsidise those that face the largest risk of loss from a disaster.

3.4 There are no valid equity or social grounds for a flat rate levy nor would the cost of implementing an appropriate system of risk rating be excessive. If the government wished to assist some homeowners on social grounds, it should direct such assistance to people in need. A needs-based approach would be unlikely to include many homeowners.

4.0 THE ROLE OF THE EARTHQUAKE AND WAR DAMAGE COMMISSION

4.1 The paper argues that the proposed changes in the provision of disaster insurance mean that the EQC would not be a commercial participant in the insurance market and that it would not be constrained by the disciplines of meeting rate-of-return objectives. Its structure would be changed to what is claimed to be a more suitable one for the delivery of "social services". As a consequence, its risks are to be managed as part of the Crown's general reserves.

4.2 This aspect of the proposal, which is discussed on pages 11 to 15 of the paper, appears to be based on the seriously flawed analysis presented in the Marsh and McLennan report. At a most basic level it is abundantly clear that disaster risks have no place in a national reserves portfolio. The risk to be managed is stochastic (random) and of relatively long duration. Such risks require long duration assets to be matched against them to hedge the risks. Few long-lived assets which would be unaffected by a disaster are available in New Zealand. On prima facie grounds a diversified asset mix is required to hedge the risk undertaken.

4.3 The shortcomings of the Marsh and McLennan report are as follows:

- While noting that the EQC's monopoly had distorted the market for disaster insurance, the report failed to consider the implications of its conclusions for the efficient functioning of the disaster insurance market.

- The report failed to analyse the nature of the EQC's liabilities and the risks inherent in them and thereby deduce the nature of the assets required to appropriately manage those risks. As a consequence it suggests that the risk be covered by Crown borrowings when a disaster occurs and by a loose consideration of the level of foreign reserves held. In this regard, the report is simply out-of-date with contemporary private sector risk management practice.

- The report places undue emphasis on the need for liquid reserves in the event of a disaster, thereby under-stating the importance of other characteristics of the portfolio required to hedge disaster risks (e.g. the duration of assets), and the impact on the risk/return trade-off involved with diversification of the portfolio.

- The report gave undue attention to accounting issues, such as the debt to GDP ratio, and implicitly assumed that financial markets are inefficient. For example, it implies that financial market participants and credit rating agencies do not take account of the contingent liability on the Crown as a result of its ownership of the EQC. Given the public debate on disaster insurance arrangements which has taken place since 1988, this is an unsustainable presumption.

- The report correctly identified greater private sector provision of disaster insurance as being desirable and noted that privatisation of the EQC would also be an option, but then dismissed the latter option without serious analysis. We question the validity of the argument advanced for this conclusion. There are many possible ways in which EQC risk could be transferred to private risk takers.

- The report fails to analyse the implications of its approach for the incentives facing the management of the EQC and their accountability, thereby ignoring the lessons from the past poor performance of state agencies and the substantial literature which underlies the worldwide move to the corporatisation and privatisation of state businesses.

4.4 In short, the proposals advanced by Marsh and McLennan represent a return to pre-1970s thinking. They ignore industry practice in approaches to risk management and in the organisation and management of state businesses. The report did note some better options but, for reasons which are not fully explained in the report, it dismissed them.

4.5 In our view the preferred approach would be to adopt the following course of action:

- Implement all steps necessary to ensure that the market for disaster insurance operates as efficiently as possible. This would require low barriers to entry and exit and reform of the EQC so that it operates on a competitively neutral basis.

- Re-examine the case for requiring compulsory insurance of residential properties and household contents. We are sceptical that a compulsory minimum level of cover is justified but if it is imposed we believe a lower limit established on a regional basis (so as not to discriminate against lower housing cost regions) should be applied, and set at a level which would cover an estimated half rather than two thirds of all houses.

- The EQC should be first established on SOE principles and subsequently privatised. Because of special difficulties involved in monitoring entities engaged in disaster insurance activities, there is a case for restricting the business of the EQC to the provision of compulsory insurance (in competition with private insurers in this segment of the market).

- The review of the taxation of insurance activities should be concluded. It should involve the implementation of a regime which, as far as practicable, taxes domestic and foreign insurance activities on a neutral basis.

- Any attempt to raise barriers to entry through the guise of prudential supervision ought to be resisted. We do not think that there are valid grounds for industry-specific prudential regulation, but if the government were to move in this direction the best approach would be to require insurers to be rated as to their claims paying ability by a recognised insurance rating agency.

The grounds for these views are set out fully in our previous submissions.

5.0 CONCLUSION

5.1 The NZBR believes that the proposals set out in the paper relating to the insurance of non-residential property are desirable and should be implemented. It is of the view, however, that further steps should be taken to enhance competition in the provision of disaster insurance to homeowners. The government's role in the event of a disaster should also be more tightly defined and spelt out clearly as part of a move to a more credible and transparent policy.

5.2 In addition, we believe that the section of the paper relating to the organisation of the EQC and the management of its risks is unsound. It draws heavily on the Marsh and McLennan report which is flawed. We believe that standard SOE principles should initially apply and that the EQC should then be privatised. Standard industry approaches to risk and asset management should be used, the EQC's risk should be sold down to private risk takers, as far as possible, and private investment managers with proven performance should be engaged.

SOCIAL POLICY

QUEEN MARGARET'S COLLEGE

THE BUSINESS OF EDUCATION

BOB MATTHEW
VICE-CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE

WELLINGTON
19 MARCH 1991

THE BUSINESS OF EDUCATION

There has probably never been a more appropriate time for New Zealanders at large to undertake a critical review of where education is at and identify what its objectives and priorities must be for the future.

I commend Queen Margaret's for initiating this forum for a debate which is now urgent if we are to ensure that New Zealand has a future, and a satisfying one, for all its citizens. I especially commend the participation tonight of the education industry's customers - the students.

My comments and views tonight largely reflect the perspectives which the New Zealand Business Roundtable has developed over recent years on the direction of education in this country.

Before tackling the subject, I should first explain briefly what the Business Roundtable is and why it tries to encourage and participate in public debate on a range of issues.

The Business Roundtable is an organisation of some 40 Chief Executives of major New Zealand business firms. The sole purpose of the organisation is to contribute to the development of sound public policies which reflect New Zealand's overall interests. It enlists the help of a wide range of highly qualified and experienced consultants of international standing to develop its policy perspectives and to initiate debate on them.

Contrary to the theory promoted mostly by the popular press, a few threatened politicians and some minority pressure groups who find the facts unpalatable, our policy proposals are not the fiendish work of some group of rich, power-crazed, selfish 'business barons' with a hidden agenda. But we make no apology for exposing the facts or the reality of any situation as they are essential for effective debate.

We accept that we have no monopoly on good ideas or the right solutions. We are happy to be a catalyst for debate and to compete with others for good ideas. Our organisation's only motive in all this is a better New Zealand, one in which all New Zealanders will enjoy higher prosperity and other valued goals.

I have deliberately entitled this address 'The Business of Education' because that is what education is about, however much that term might be an anathema to some in the profession. But first I will set out some key facts about our economic situation because many people still don't seem to grasp the dimensions of the harsh reality facing us all.

The Lausanne Business School IMEDE, in conjunction with the World Economic Forum, assessed New Zealand's performance in the 1990 World Competitiveness Report. Over the range of indicators we ranked 17th amongst the 22 OECD countries surveyed.

Some of the individual results are sobering.

* We had the lowest rate of real GDP growth and real per capita growth over the 1982-88 period.

* We scored bottom for growth in employee productivity over the same period; output per employee is barely half that of the top ranked countries.

* Our labour force is rated as one of the least willing to accept new technology.

* We have almost identically low scores (17 out of 23) for managerial drive, responsibility and initiative, and for worker motivation (18 out of 23).

* We have relatively low rankings for product design and on time delivery of products.

* Finally, this study found that the performance of the compulsory education system in meeting the needs of a competitive economy deserved a low mark.

It was clear more than 20 years ago that post-war economic policies had to be abandoned. Farming for the British consumer was good while it lasted but it didn't. At the same time the New Zealand consumer got a rotten deal as protection and over-regulation ensured the prices of goods remained high, while quality was often mediocre or worse.

Despite closer economic relations with Australia (CER), land transport and other deregulation, and the structural reforms of the last government, we have not adapted anywhere near fast enough. It is true there have been dramatic improvements in productivity on the waterfront, in manufacturing and in the service and public sectors. However, the two main areas where we have failed are in controlling public expenditure and labour market reform. This is basically why interest rates have been so high and why companies have not employed more of those available for work.

The situation would have got much worse if the new government had not taken steps to reduce the deficit between its own income and expenditure. Last December we were looking at a deficit in the 1993/94 year of around $5 billion (i.e. more than $1,500 per New Zealander) and with revised predictions being made almost daily that could well have been a 'best case' scenario unless drastic action was taken. To its credit the government has already taken some very difficult decisions. Lower interest rates have followed and more benefits will flow from the successful implementation of the Employment Contracts Bill and other initiatives.

Notwithstanding the urgent attention the new government has given to some areas of public expenditure, there is still much to do in respect of both the quantity and quality of this expenditure - which at the end of the day can only be paid for by the community itself in the form of taxes and other government levies.

The last six years have revealed major weaknesses in the business sector. Many companies failed to handle the new environment with the skill it required. Hundreds of manufacturers disappeared because they couldn't deal with the competition from overseas.

Where was the well educated and flexible Kiwi when we needed her, and him?

The evidence suggests that for decades we have deluded ourselves about skills and attributes we didn't have, certainly not in the quantity required. We wallowed in mediocrity while pretending that we were in the top stream. While we have always had innovative entrepreneurs, so many of us were really timid unenterprising creatures hiding behind protective devices such as import licensing, public sector job security or trade unions. We had a cosy but suffocating environment which stifled initiative and created enormous pressures to conform.

Conforming was profitable in a regimented economy, but none of this can work any more. The country's rural sector is struggling to survive, let alone subsidise anyone else. We have joined the international economy - we had to and there is no going back.

The real challenge which we cannot avoid is the internationalisation of business and the use of increasingly sophisticated technologies and methods of operation. Exporters have to match or better the competition in terms of price, quality and service. There is no other choice. If we try to protect some industry we impose costs on others and thereby undermine them. This is a real change which affects all countries in the same way. It basically explains why the centrally planned countries found they could not survive on their earlier course.

Given our relatively prosperous past, we don't want to compete on the basis of low wages with the developing countries. Yet without real change we will continue to head in this direction. As the Porter team argues, the traditional agricultural products will not produce the returns needed to support, let alone improve, our current living standards, although they will remain very important.

Our economic and social salvation depends on producing more sophisticated goods and services that will find ready markets overseas. We have instances of companies that are succeeding in this area. We need thousands more.

This is where the education system comes into the picture.

I would like to comment on why the Business Roundtable has chosen to devote resources to studying the education system. We have published two reports - Professor Richard Blandy from Australia looked at tertiary education in 1988 and more recently Stuart Sexton, director of the Education Unit of the London-based Institute of Economic Affairs, reported on the Tomorrow's Schools reforms. We shall be taking a continuing interest in the development of education policy.

In commenting on the Sexton report, the primary teachers' union president Carol Parker had this to say:

> "The report makes public the Roundtable's real agenda for education - having wrecked the New Zealand economy and destroyed most of the private sector, big business is now looking around for new investment areas and has targeted the public sector, including education, to 'privatise and plunder.' "

This statement says a lot more about the minds of some people active in teacher unions than its does about the views of the Business Roundtable. It demonstrates the difficulty of having a rational debate about the fundamentals of education - let alone the detail. It also shows how determined the providers are to remain in control of the whole process. Finally, it reveals an anti-business bias which is unhealthy.

What the Business Roundtable seeks is an education system that is efficient and meets the country's economic and social goals. We want to see the system producing well rounded, better qualified and highly motivated future members of the workforce. The skills we are looking for include literacy and numeracy; a knowledge of history, foreign languages, economics and science; the ability to communicate; and flexibility to work and lead in a team environment.

Ten days ago Professor Elley of Canterbury University was quoted as saying that children's reading levels in classes from Standard 2 to Form 4 were on a par with those of 1968. You may find this very reassuring. I don't. Would you be impressed if I were to tell you that my business's products were no worse than those produced 22 years ago?

While the data on comparative performance at specific ages is less than adequate, it is clear that the secondary system is not producing students with a high enough level of educational attainment. The Planning Council's publication 'Tomorrow's Skills' produced two months ago set the facts out very clearly.

The rate of participation in the education system at age 18 is 36 percent, which gives New Zealand a ranking of 16th out of the 18 OECD countries surveyed. Only the United Kingdom and Turkey are below us. As the Planning Council concluded:

> "The results of these low participation rates over time mean that currently 46 percent of New Zealand's workforce has no formal school qualification, and 60 percent has no tertiary qualification. We conclude that our current workforce is ill equipped for the challenges of the new economy".

Our participation rates in the 20 to 24 age groups in full time or part time education showed we are well below par amongst OECD countries with an overall ranking of 10th out of 13.

The data show that there is a apositive correlation between GDP per head and participation rates in education. Of the 19 countries surveyed for participation rates of 17 year olds, only Ireland and Greece had higher participation rates and lower GDP per head than New Zealand.

All this strongly suggests our education system is doing rather poorly, although I would not lay the responsibility solely on the schools. For much of the post-war period there was a ready market for unskilled workers who were relatively well paid. When the job market failed to absorb these people the state stepped in with an assortment of artificially-created work schemes, and there was of course the dole.

This approach, combined with a rigid labour market, created an environment where young unskilled people were given inadequate incentive to obtain the necessary education or work qualifications, and where they were not allowed to price themselves into the job market. The recent removal of the dole for those under the age of 18 and other changes in welfare benefits are altering the marketplace in a fundamental way. I have no doubt that in due course the net result will be different attitudes in the home, much better educated young people and, quite quickly, more of the unemployed pursuing and finding productive work.

In his report, Stuart Sexton argued that responsibility for the education of children lies first with parents not the state - just as parents are obligated to feed, clothe and house their children. He acknowledges that many parents will choose to delegate the educational role to other parties. However, he also argues that parents, as agents for their children, should have the major say in how education is to be provided.

There should be close parent - school links. Active involvement in the school's policy making process reinforces the value of good education to the whole family and gives parents the opportunity to have an influence on the nature of the service. It is important that, as is the case in private schools, the boards of trustees in the state sector are able to operate with minimal interference from officials in the Ministry of Education and other central agencies.

Parental involvement is also bound to lead to greater diversity. This is good. Maori children are under-achieving in the present system and many believe that their best interests would be better served by different approaches. A system that is flexible and that allows for more parental choice will be better able to cater for the needs of different communities and individuals.

The key questions are who should fund and who should provide education services.

In the primary and secondary areas we believe it is appropriate that the state be the principal funder. However, this does not mean to say it has to be the major provider. The private sector has a role to play in giving real choice to the consumer. As the principal funder the state should set standards and be neutral as between state and private schools.

In the tertiary sector we believe that as the main benefits fall on individuals, it is appropriate they pay a significant share of the cost of their education. If student contributions were combined with loans and government loan guarantees for students, there should be a role for private universities and existing state institutions could be corporatised.

To summarise, the winners in tomorrow's world will be those countries which invest wisely in their human capital. It is not just a question of money. We need an education system that is both efficient and effective. I see it as imperative that the education industry accepts that it exists for a market - not just for itself. The market, that is the customers, are students and parents choosing on their behalf. With the right to choose they will demand value for money - an essential performance requirement for educationalists along with all other producers/ providers of goods and services.

SUBMISSION BY THE
NEW ZEALAND BUSINESS ROUNDTABLE

BULK FUNDING OF TEACHER SALARIES

MAY 1991

BULK FUNDING OF TEACHER SALARIES

Introduction

Recent reviews of New Zealand[1] education have made a strong case for greater decentralisation of education administration and self-management of individual public schools. The changes recommended include the establishment of local boards of trustees, agreed charters for each school and the delegation of decision making over school operations. Underlying these changes is the view that parents and local communities have stronger incentives and better information to determine education needs and ensure performance than education providers and central government agencies. They are also an integral part of a process of moving to a system which allows greater competition between schools and greater parental choice over education offerings.

The Picot concepts of self-management were considerably watered down in their implementation in the face of resistance from established education interests. Moreover, they relied too heavily on elected parental and interest group representation on boards rather than the exercise of choice by parents within a more competitive education system.

Considerable frustration has been expressed by trustees over their restricted ability to make important decisions about school management. Over time capable people may be discouraged from serving as trustees and the present system may become unviable. Remedying these weaknesses involves providing schools with greater autonomy over resource decisions, linking funding directly to enrolments and ultimately allowing public and private education suppliers to compete on even terms for students. Bulk funding of teacher salaries is an essential part of such a programme.

The Case for Bulk Funding

At present school boards of trustees have effective control only over the smaller component of school expenditure represented by the operational grant. Staff are the crucial resource both in financial terms and in terms of their impact on the quality of education. The advantages of allowing boards to control staffing resources on the basis of bulk funding of teacher salaries are as follows:

(i) Boards have better information about individual school needs and should have full freedom to make decisions over such matters as:

- teacher to student ratios
- the mix of senior and junior staff
- the mix of teaching and other support staff (e.g. library, remedial reading)
- the relative numbers of full time and part time staff.

Schools are not free to make all such decisions at present.

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1 In particular, *Administering for Excellence: Report of the Taskforce to Review Education Administration,* (Picot Report), 1988 and Stuart Sexton, *New Zealand Schools: An Evaluation of Recent Reforms and Future Directions,* New Zealand Business Roundtable, 1990.

(ii) Decisions on staffing could be made by boards in relation to operational expenditure (e.g. whether priority should be given to a library assistant or computer equipment). At present flexibility exists only in the direction of operational to staffing expenditure, and on a very restrictive basis. To allow these trade-offs to be made, the salary and operational grants should be combined.

(iii) Additional funding raised by schools could be applied to either staffing or operational needs.

(iv) Vesting staffing decisions with boards would strengthen school-staff relationships and incentives for teacher performance, even without more far-reaching changes to employment arrangements.

(v) Financial controls over education spending would be more effective. The weakness of present arrangements has been demonstrated by the recent over-expenditure on teacher salaries.

(vi) Financial allocations to schools would be more fairly based. At present effective per pupil funding varies because of factors such as differences in teacher seniority.

(vii) Bulk funding would provide a basis for a subsequent review of teacher employment arrangements. There is a good case for moving away from inflexible, centrally determined awards, in line with the general employment changes being promoted by the government with the Employment Contracts Bill.

In order to maximise flexibility, the preferable bulk funding option is to relate funding directly to student rolls. There may be a case for a small number of bands of per pupil funding according to the costs of education for different age groups. Any special grants (e.g. for handicapped children) could be paid as a supplement to the standard per pupil allocation. There may also be a need to modify the formula for very small schools e.g. by way of a minimum grant. However, to achieve a system which is efficiency-driven rather than cost-based, such variations should be kept to a minimum. Considerations of administrative efficiency also point to the cash-based and direct funding options wherever possible.

Objections to Bulk Funding

Most of the objections raised against bulk funding are considered spurious. They appear to have little to do with educational goals. Rather, they reflect the self-interest of teacher unions and central bureaucracies in maintaining their power and resisting moves to transfer control to the local level.

(i) It is claimed that bulk funding would place an undue administrative burden on schools. This is not credible. It is noteworthy that private school administration is considerably more complex since it involves the collection of individual fees rather than a bulk payment on, say, a monthly basis. School personnel administration is not a complex function. Automatic payment systems operated by banks and other payroll services would be used by most schools in the same way as other organisations. The savings made by cutting down on centralised salary administration could be reallocated to schools to enable them to hire or train administrative personnel, or to contract for services.

(ii) Teacher unions have argued that moves towards making schools responsible for employment would encourage individualistic and non-cooperative behaviour and 'pit teacher against teacher'. Again the example of private schools demonstrates the absurdity of this claim. Schools are no different from many other autonomous organisations, including commercial firms, whose performance is dependent on cooperative team effort. Such attributes would be an important aspect of teacher performance assessment in any successful school. This claim can be seen as a transparent attempt to resist stronger forms of performance assessment and accountability.

(iii) It has been suggested that bulk funding would lead schools to substitute junior teachers for more expensive experienced staff. This would be irrational. Consumers place emphasis on *value*, not low costs or prices per se. A more consumer-driven system would rightly focus on gaining greatest value from the education dollar. It would appropriately value experience, apply appropriate differentials for teaching quality and create incentives for quality to be upgraded.

(iv) Claims have been made that school boards are not competent to handle staff employment matters. This overlooks the point that boards are now responsible for appointing principals, and that most other staff appointments would be handled by principals under delegations from the board. Again the fact that private schools handle all employment matters independently as a matter of course exposes the emptiness of these claims.

(v) It has been argued that the government would be at risk of individual boards negotiating 'irresponsible' pay deals, exceeding their budgets and becoming insolvent. Recent experience suggests the current centralised system is not immune from budgetary blowouts. Strict financial controls would minimise any such risks and existing legislation allows the government to take remedial action in the event of school mismanagement. Such arguments may be motivated by a desire by central agencies to maintain a centralised wage fixing role, which is not conducive to encouraging sound and responsible management on the part of schools.

Implementation of Bulk Funding

In contrast to these largely spurious objections to bulk funding, there are some legitimate concerns about any transition from current arrangements. It is clearly desirable to allow boards time to set up effective arrangements for staff administration. On the basis that overall funding levels are maintained, there will be a mix of 'winners' and 'losers' amongst schools from a change to student-based funding, depending on their present staffing profile. Some issues such as the implications of a general bulk funding formula for small rural schools or special education may need specific solutions.

These problems are clearly not insuperable and it is submitted that they should not be allowed to obstruct a reasonably rapid move to bulk funding. The ability of boards to make more efficient decisions over staffing and operational expenditure will mitigate the problems of those schools which face reduced allocations. These efficiency gains (as well as greater fairness in allocations) are the objectives of a switch to bulk funding, and efforts to move in this direction should not be thwarted by the fact that there will inevitably be one-off winners and losers.

There may be a case for phasing in bulk funding over a period of perhaps 1-2 years, starting with schools that are best placed to handle it. While larger schools, particularly in the secondary sector, may fall into this category, other schools should not be excluded. Small schools which face no staffing adjustments should have little difficulty picking up the administrative responsibilities. It would be undesirable to introduce bulk funding on a 'trialling' basis as opponents of the policy would be likely to go to considerable lengths to undermine its prospects of success.

Conclusion

Current reforms aimed at improving education performance by transferring responsibility for school administration from the central level to parents and local communities are currently at an unsatisfactory and unstable stage. A move to bulk funding of teacher salaries on a 'funding first', cash and direct basis wherever possible, and to combine the staffing and operational grants, is crucial to the success of a strategy based on self-management of schools. The benefits of a move to bulk funding would be enhanced by other changes to the environment in which schools operate. In particular, there is a case for reviewing:

- governance arrangements for schools, in particular problems of continuity and expertise on boards of trustees, and the conflict of interest which could arise if staff representatives or parents engaged as teachers at the school are engaged in employment decisions;

- monitoring of school performance, through mechanisms such as external examinations, more information on school achievements and the reintroduction of a form of inspectorate;

- ways of increasing competition between schools, such as the current moves on zoning and moves to per pupil or voucher-based funding which would allow direct competition between public and private schools.

However, these are separate issues which would not be prejudged by a move to bulk funding.

The objections that have been raised to bulk funding are not convincing and appear to be motivated by interests other than the educational interests of children. It is submitted that the government should confirm its policy of adopting bulk funding and introduce it on a basis consistent with achieving a smooth but relatively rapid transition.

THE UNITED STATES HEALTH CARE SYSTEM

SYMPTOMS VERSUS REAL PROBLEMS

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SYMPTOMS VERSUS REAL PROBLEMS

INTRODUCTION

Several countries around the world, including the United Kingdom and now New Zealand, are trying to introduce elements of competition into their publicly-financed health care systems. These initiatives are constrained by the fear that moving from a predominantly public monopoly towards competitive private insurance will necessarily unleash all the evils of the United States health care system - relentless cost inflation, vast disparities in access to care and deprivation of the poor.

The United States health care system has been aptly described by Alain Enthoven as "poverty in the midst of excess." The United States is unique in relying largely on private health insurance, except for the public programmes Medicare and Medicaid, which serve the elderly and some of the poor, respectively. The United States also spends a larger fraction of GNP on health care than any other country - 12 percent, in contrast to under 10 percent in most other OECD countries and 7 percent in New Zealand - and more per capita in absolute dollars. The United States is also unique among developed countries in having roughly 15 percent of the population (33 million people) without health insurance. This is deplorable and is deplored by most American citizens - hence the raging debate over national health insurance. But while one cannot condone the status quo, it is a mistake to jump to the conclusion that correlation implies causation, and that excessive cost inflation and lack of access are the inevitable consequences of private health insurance.

How Meaningful are the Statistics?

Some of these much-abused 'statistic' should be put in perspective.

First, advocates of a Canadian-style national health insurance scheme often point to the fact that health care spending as a percent of GNP has risen less rapidly in Canada since it adopted its national health insurance plan. A more careful look at these trends reveals that the divergence is driven largely by the relatively slow rate of growth of GNP in the United States, while health care spending per capita has risen at very similar rates in both countries.

Second, the United States is a richer country than Canada. Richer countries tend to spend more per capita on health care, just as they tend to spend more on consumer appliances, automobiles and other goods and services that make life easier or save time. Health care has both these characteristics.

Third, there is an implicit assumption that Americans spend more but get the same level of health care; alternatively, some concede that Americans get more health services but argue that the additional care has no effect on health. This is based on the fact that the United States performs poorly on international comparisons of mortality and morbidity. But such comparisons do not control for the host of other factors that affect health - including education, nutrition, stress and genetic factors.

More fundamentally, the available mortality and morbidity data cannot measure the multidimensional value to consumers of many of the health services that are routinely more available in the United States. These benefits include the information that comes from more frequent use of MRI scans and other diagnostic techniques; greater access to elective procedures such as hip replacements that reduce pain and improve well-being, particularly for the elderly; greater freedom of choice of physician, location and timing of treatment.

I would certainly not argue that there is no waste in the United States system. Use of many services is certainly abused, and many cost more than they are worth, because of distortions in insurance markets that are discussed below. But much of the additional care that Americans consume does have some benefits that are omitted from simple comparisons of cost differences that ignore real but unquantifiable benefit differences. The extreme view, that Americans just pay more for the same level of health benefits, is clearly wrong.

Fourth, lower is not necessarily better. Surely no one would argue that zero is ideal. The growing demand for supplementary private insurance in countries with budget-constrained public systems, such as the United Kingdom and New Zealand, is evidence of consumers' desire for greater convenience, ease of access or simply more medical services. One virtue of a *well-designed* (which the United States is not) system of competing health insurance plans is that people can choose the quantities and qualities of health care that they want. Monopolistic national health insurance schemes cannot cater to diverse preferences. And because it is very hard for individual consumers to express their preferences through the political process, public health plans are prone to capture by provider interest groups.

Fifth, some of the benefits of United States spending, particularly on drugs, new technologies and information systems, accrue to other countries. Pharmaceutical prices, for example, are much higher in the United States than in most other countries, including Canada. As more and more countries adopt pricing strategies that attempt to pay only the marginal cost of manufacturing and distributing drugs to their residents, United States consumers are paying an increasing share of the costs of the R&D that conveys benefits to consumers world-wide. The same is true of other medical technologies. Not all R&D spending on drugs or other medical technologies is worthwhile. But on balance, United States spending in these areas surely provides spill-over health benefits to other countries that are omitted from the simple comparisons of percent of GNP spent on health.

THE REAL PROBLEM: MISGUIDED PUBLIC POLICY

Regardless of how much benefit Americans or others really get from United States health care spending, it is critical to understand that, to the extent that there is waste and gross inequity in the United States system, this is driven largely by misguided public policy rather than fundamental flaws in competitive markets and private financing of health care. Neither the United States nor any other country has tried a well-designed, undistorted system of private health care financing. The United States system is heavily influenced by government tax policy and other cost-increasing regulations, and by a lack of appropriate subsidies and other interventions to assure universal access. Indeed the worst evils of the United States system are not the inevitable result of private insurance; rather, they flow from badly designed government policies.

Tax Subsidy to Employer Health Insurance

Chief among the distorting government policies is the tax rule that employer contributions to health insurance are tax-exempt income to employees. This exemption applies to federal and state income and payroll tax, from zero for workers who pay no tax up to 50 percent or more for higher income employees, with an overall average of 33 percent. For example, for an employee in a 40 percent marginal tax bracket, $100 of employer-provided health insurance effectively costs only $60 in terms of after-tax income. This subsidy is sufficient to more than offset the administrative load on health insurance. Consequently most workers are better off having insurance for virtually all the health care they expect to use, even though the insurance overhead adds 10-20 percent to the cost of the services, because this is more than offset by the tax subsidy.

This tax subsidy plays a critical role in the inflation and the inequities of the United States health care system. It leads employees to choose very comprehensive plans with relatively low levels of co-payment and, until recently, few other mechanisms for controlling costs. Although nominal co-payment levels have increased in recent years, in reality even these co-payments are tax-subsidised under flexible spending accounts which are common in most large firms and permit employees to shelter from taxes a certain level of out-of-pocket spending on health or other insurance benefits. High tax-induced levels of health insurance in turn have contributed to price, quantity and technology dimensions of health care cost inflation, making consumers insensitive to prices, fuelling the demand for costly technologies and undermining demand for cost-reducing technologies.

The structure of the tax-subsidy is also fundamental to the inequities and coverage gaps of the United States system. Because the value of the subsidy rises with the employee's marginal tax rate, it is highly regressive and is of little or no value to low income families. Moreover, because the subsidy applies only to employer contributions, those who do not obtain insurance through employment face much higher costs for health insurance. (Individual insurance premiums are tax-deductible only if total health expenditures exceed 7.5 percent of adjusted gross income, which is rare.) Further, the employment-focus of the subsidy has probably stunted the formation of other insurance-purchasing groups, such as banks, which could offer some of the scale economies of group purchasing but have little incentive to develop such plans when most of the population is better off getting insurance through the workplace.

Insurance Regulation

The regulation of insurance has also operated to increase the cost of insurance for individuals and small firms. Commercial insurers in the United States are regulated at the state level, but self-insured employer plans are exempt from this state regulation under federal regulation of employer benefit plans (ERISA). As state regulation has become more onerous, an increasing number of medium and large firms have self-insured, but small firms and individuals do not have this option and have been left facing the higher costs of commercial insurance.

The most costly form of state regulation is mandated minimum benefit laws, which require that commercial insurers cover specified services such as alcoholism treatment, chiropractors, psychologists, in vitro fertilisation, acupuncture, etc. There are over 800 state mandates in 1991. In a well-designed system of competing health insurance plans, all plans should be required to cover a minimum set of basic services that are known to be cost-justified. But such a cost-benefit test has only recently been applied to new mandates in a few states, and old mandates have usually been grandfathered.

These mandated benefits (which are often instigated by and inure to the benefit of the providers of the services) increase insurance costs disproportionately for small firms and reduce their willingness to offer plans.

Small firms are also disproportionately burdened by state financing of high risk health insurance pools via levies on commercial insurers. Since such levies must ultimately be passed on as a cost of providing insurance, the burden falls only on those firms that are too small to self-insure.

Power of Professionals

It is sometimes argued that competition cannot work in medical markets because of monopoly power enjoyed by providers. It is said that many individual patients are poorly informed and are not cost-conscious price shoppers when it comes to health care, particularly if they are heavily insured. But competitive health insurance markets can respond to this problem. Insurers and employers can and do act as cost-conscious buyers on behalf of consumers. The array of innovations in health plan design - some of which have been copied in other countries - offer consumers a menu of choices that trade off lower cost, on the one hand, with freedom of choice and comprehensive financial cover on the other. There is no free lunch in health insurance, public or private: consumers cannot have unrestricted choice, total financial protection and low cost. Plans compete by developing innovative ways to control providers without imposing high co-payments on consumers. With insurers acting as surrogates for consumers, individual providers have very little market power. Competition could work well to provide consumers with whatever trade-off between cost and free choice they prefer.

But such competition is being emasculated in some states by provider-initiated legislation that restricts competition, increases provider incomes and raises costs for consumers. Mandated benefits are just one example. Laws against the corporate practice of medicine stunted the growth of HMOs for many years. Freedom-of-choice laws in some states limit the ability of employers and insurers to contract selectively with lower cost providers to form preferred provider organisations (PPOs) that have demonstrated an ability to reduce costs. Limits on consumer co-payments for using out-of-plan providers obstruct the formation of point-of-service plans, which are a popular hybrid type of plan that permits consumers to use out-of-plan providers if they are willing to pay more but not the full cost out-of-pocket. In other states, providers are hamstringing managed care plans through laws that impose restrictions on utilisation review procedures.

The Public Safety Net

Although some 15 percent of the United States population do not formally have either private or public insurance, in fact they have quasi-insurance through an informal, and haphazard, publicly-subsidised safety net with several components. Public hospitals are required to operate as providers of last resort and public clinics provide outpatient services. Private not-for-profit hospitals are under pressure to provide some free care in order to retain their tax-favoured status (exemption from corporate profit tax and entitlement to issue tax-exempt bonds). The 'near poor' whose income is normally above the level that would entitle them to Medicaid can 'spend down' to become eligible for Medicaid if they incur large medical expenses.

Given this safety net, the decision not to buy insurance may be a rational decision for many without employment-based coverage. Granted this safety net quasi-insurance may entail lower quality care, long waits in public hospitals, and the embarrassment of relying on charity or being a bad debt. But the alternative for those without employment-based coverage is to pay a high price for an individual policy, with no tax subsidy, mandated benefits that may be of relatively low value, and a high administrative load.

The Uneasy Co-Existence of Public and Private Programs

Medicare and Medicaid were established in 1966 and now account for over 40 percent of personal health spending. As the most rapidly growing component of the federal budget, Medicare has contributed to health care spending directly and indirectly, by driving up costs for the private sector. Before the introduction of DRG (Diagnosis Related Group) payments for hospitals in 1983, Medicare paid hospitals based on the share of accounting costs attributable to Medicare patients. Retroactive cost-based reimbursement is like a blank cheque. It eliminates hospitals' incentives to control costs. It also creates powerful incentives to adopt new technologies that enable hospitals to compete for patients and physicians on the basis of quality and technological sophistication, rather than price and cost-effective care.

Although Medicare payments to hospitals have slowed since the adoption of DRGs, to the extent that Medicare now pays less than its fair share of joint overhead costs, Medicare has simply shifted costs to private payers. Medicaid is even more blatant in cost-shifting. Medicaid rates in some states are below the marginal cost of serving Medicaid patients, leading to problems of access for these patients.

For physicians' services Medicare has traditionally paid fee-for-service, subject to a limit that depends on the doctor's usual charge to private patients. Not surprisingly, this creates incentives for doctors to raise fees to private patients in order to increase their reimbursement from private patients. Since the early 1980s, Medicare has regulated the rate of increase of physicians' fees. But Medicare has not introduced successful managed care plans. The volume of physician services has exploded.

Public programmes are intrinsically ill-equipped to design and implement provider-targeted strategies for controlling costs, such as selective contracting and managed care. But the patient-targeted strategy of co-payments is ill-suited for many Medicare and Medicaid beneficiaries who are the elderly and the poor. This is why both Medicare and Medicaid are increasingly adopting strategies to permit patients to 'voucher out' by enroling with HMOs and other private plans.

Malpractice liability

No one knows exactly how much the consumer-oriented malpractice system adds to United States health care costs but it is certainly a factor. Physicians in the United States are five times as likely to be sued as their Canadian counterparts. Malpractice insurance premiums are only roughly two percent of United States health care spending. But there are no good estimates of the cost of 'defensive medicine' - the additional tests, time spent and procedures performed to reduce the risk of being sued.

Defensive medicine is hard to measure because much of the low-benefit care would be provided even without liability because patients want it, given the distorted costs that they face for health insurance. Even if one could tease out changes in medical practice that are induced by insurance from those that are liability-induced, it is even more difficult to separate the purely wasteful defensive medicine from cost-justified precautions that reduce the risk of injury to patients. It is these cost-justified safety measures that the tort system is intended to encourage.

The United States system of tort liability is certainly poorly designed, excessively costly to administer and adds unnecessarily to health care costs. But it is a mistake to conclude from the United States experience that a system of no liability is clearly superior, and that any system that retains any element of provider liability for fault, however defined, is fatally flawed. An attractive third alternative is an 'administrative fault-based' system. The essential features of this proposal are: an administrative agency rather than courts and juries to decide cases; scheduled damage awards and limits on payments for pain and suffering; but the retention of liability on the part of providers for fault or failure to take reasonable or cost-justified care, defined as precisely as possible. Such a system would have its problems, as do all the alternative systems proposed for handling the issue of medical negligence. But it is probably the best of the imperfect alternatives, because it retains the best components of fault-based, tort systems and administrative no-fault systems, but avoids the excesses of both.

CONCLUSION

It is naive and mistaken to conclude that the United States experience clearly demonstrates the inability of competitive insurance to provide appropriately comprehensive health care coverage at reasonable cost.

The United States experience is heavily distorted by the open-ended, employment-targeted tax subsidy to insurance that creates powerful incentives for the rich to buy cost-increasing forms of insurance, but offers no financial assistance to the poor or those who lack employer-provided coverage. Combine this with cost-increasing regulations that raise costs for commercial insurers and raise incomes for providers, a publicly-subsidised safety net of free care and poorly designed public programmes, and you have a blueprint for poverty in the midst of excess.

However, the responsibility lies with misguided government policy, not private insurance markets. Public policy in the United States has many features that are counterproductive to the efficient functioning of competitive private insurance markets. But it has not taken the steps necessary to ensure that a competitive private insurance system achieves the goals of universal coverage at a minimum level of basic care. These necessary steps include mandating that everyone has coverage and providing appropriately-designed assistance to make that coverage affordable to the poor.

Any country that is in the process of rethinking its health policy should clearly understand the extent to which counterproductive policies, on the one hand, and the lack of other essential interventions, on the other hand, contribute to the problems of the United States health care system.

Much of this is already well-understood by health analysts and policy makers in the United States. So why does it persist? The fundamental problem is that expanding health insurance coverage for the uninsured will add to the federal deficit unless the additional care for the uninsured is financed by reducing the tax subsidies to those of middle and upper income. The tax subsidy alone is estimated at over $40 billion. This, together with the potential savings that could be realised from reducing existing programmes for the uninsured (public hospitals and clinics, uncompensated care payments) would be more than enough to pay for insurance for the uninsured poor, and partial subsidies for the near poor.

But the beneficiaries of the tax-subsidy include many powerful interest groups: large employers, labour unions, middle and upper income workers, and the medical profession. That is a powerful alliance that no politician has yet had the courage to take on. Similarly, tort reform is opposed by the plaintiff's bar, although significant progress has been made in some states.

But as the debate continues there are some promising signs that a reasonable compromise may be reached - one that retains the competitive private market system, but makes coverage universal, limits subsidies for better-off people and provides appropriate subsidies for those on low incomes.

MISCELLANEOUS

LIST OF NEW ZEALAND BUSINESS ROUNDTABLE

PUBLICATIONS

	PRICE (incl. GST)
NEW ZEALAND LABOUR MARKET REFORM April 1986	22.50
THE NEW ZEALAND PORTS INDUSTRY August 1986	11.25
INDIRECT TAXATION POLICY December 1986	11.25
SUBMISSION TO THE LABOUR SELECT COMMITTEE - THE LABOUR RELATIONS BILL March 1987	9.00
BETTER VALUE FOR PUBLIC MONEY - THE GOVERNMENT'S 1987 BUDGET AND MEDIUM TERM FISCAL POLICY May 1987	9.00
FREEDOM IN EMPLOYMENT - WHY NEW ZEALAND NEEDS A FLEXIBLE DECENTRALISED LABOUR MARKET June 1987	No Charge
REVIEW OF ACCIDENT COMPENSATION - A SUBMISSION TO THE LAW COMMISSION July 1987	33.75
CORPORATISATION OF HARBOUR BOARDS August 1987	11.25
TELECOMMUNICATIONS IN NEW ZEALAND - THE CASE FOR REFORM November 1987	33.75
PUBLIC OPINION SURVEY OF INDUSTRIAL RELATIONS ISSUES November 1987	11.25
TOWN AND COUNTRY PLANNING - TOWARD A FRAMEWORK FOR PUBLIC POLICY November 1987	33.75

REVIEW OF ACCIDENT COMPENSATION - SUPPLEMENTARY SUBMISSION TO THE LAW COMMISSION December 1987	5.60
COMMENT ON THE REVIEW OF THE TOWN AND COUNTRY PLANNING ACT 1977 BY A HEARN QC December 1987	5.60
THE REGULATION OF SHOP TRADING HOURS - SUBMISSION TO THE SHOP TRADING HOURS ADVISORY COMMITTEE March 1988	5.60
SUBMISSION TO THE COMMITTEE INQUIRING INTO "DEPENDENT" CONTRACTING March 1988	5.60
SUBMISSION TO THE LAW COMMISSION ON COMPANY LAW March 1988	22.50
LABOUR MARKETS AND EMPLOYMENT - NEW ZEALAND BUSINESS ROUNDTABLE STATEMENTS ON LABOUR RELATIONS April 1988	33.75
STATE OWNED ENTERPRISE POLICY - ISSUES IN OWNERSHIP AND REGULATION April 1988	33.75
REFORMING TERTIARY EDUCATION IN NEW ZEALAND June 1988	33.75
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SHAREBROKING AND EQUITY MARKET REGULATION - A SUBMISSION TO THE MINISTERIAL COMMITTEE OF INQUIRY INTO THE SHAREMARKET December 1988	33.75

INDUSTRIAL RELATIONS ISSUES IN NEW ZEALAND - A SURVEY OF PUBLIC ATTITUDES December 1988	22.50
FISCAL POLICY 1989/90 March 1989	22.50
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REVIEW OF THE OPERATION OF THE LABOUR RELATIONS ACT IN THE 1988/89 WAGE ROUND April 1989	5.60
INDUSTRIAL DEMOCRACY - A CASE FOR REGULATION OR DEREGULATION? May 1989	33.75
SUBMISSION TO THE WORKING PARTY ON EMPLOYER FUNDING CONTRIBUTION TO TRAINING June 1989	11.25
RESERVE BANK OF NEW ZEALAND BILL - SUBMISSION TO THE FINANCE AND EXPENDITURE SELECT COMMITTEE July 1989	11.25
DISASTER INSURANCE POLICY July 1989	22.50
THE ANTITRUST DEBATE IN NEW ZEALAND - COMMENTARY : PROFESSOR W A BROCK August 1989	7.00
PORTS AND SHIPPING REFORM IN NEW ZEALAND - CURRENT DEVELOPMENTS AND FUTURE REQUIREMENTS September 1989	33.75
ECONOMIC AND SOCIAL POLICY - NEW ZEALAND BUSINESS ROUNDTABLE SPEECHES AND PAPERS September 1989	33.75
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AUCKLAND ROTARY CLUB

THE NEW ZEALAND BUSINESS ROUNDTABLE:

ROLES AND GOALS

ROGER KERR
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE

AUCKLAND
12 NOVEMBER 1990

THE NEW ZEALAND BUSINESS ROUNDTABLE: ROLES AND GOALS

I am grateful for the invitation to speak to you about the New Zealand Business Roundtable. Apart from anything else, it forced me to sit down and think about how the organisation has evolved since its informal beginnings and over the $4^1/_2$ years that I have been involved with it.

I will start with the origins of the organisation and its basic structure. Next I plan to say something about our mission and goals, and go on to talk about the issues we address and how we go about addressing them. Finally it might be of interest if I say something about our relations with other organisations, governments and the political process.

The basic format of the organisation is a fairly standard international model. It is an organisation of chief executives of major New Zealand businesses. The model appears to have its origins in the United States Business Roundtable which was established in 1972. The United States counterpart comprises about 200 chief executives from the major corporate sector. Closer to home, a Business Roundtable was established in Australia in the early 1980s. In 1982 it merged with the Australian Industries Development Association, which was extending its role beyond manufacturing, to form the Business Council of Australia. The BCA has around 80 members. Similar organisations are to be found in Canada and other countries.

The shape of such organisations is largely determined by the need to devise an efficient vehicle to allow busy chief executives the opportunity to meet and discuss national issues. In New Zealand and elsewhere, top managers and larger companies have often not been actively involved in business organisations. The commitments of time and the more cumbersome methods of consultation and decision making in large representative organisations discourage involvement. To my mind at least, the lack of involvement of many of New Zealand's most talented business leaders diminished the quality of the business community's contribution to public life. It meant that business organisations tended to adopt a narrower vision and to attract people who stood to gain from using a lobby group to extract privileges from governments.

The history of the organisation in New Zealand is that it started out as a loose coalition of chief executives meeting informally and on an irregular basis. Around 1980 the name Roundtable was adopted. The organisation debated policy topics of common interest and in its early years its advocacy was often little different from traditional pressure groups. After the Economic Summit there was a change in thinking. Many senior businessmen came to accept for the first time that it was no longer advantageous to lobby governments for their own interests. They recognised that the scramble for political favours had been bad for business and worse for the economy. Under Sir Ronald Trotter's chairmanship they set about creating an organisation that explicitly rejected sectoral lobbying, adopted a national perspective and focused on medium term policy improvement.

In 1986 a permanent office was established to give the organisation a little more structure and a policy research capacity. It now comprises four people - myself, a policy analyst and two administrative staff. It is thus much smaller than organisations like Federated Farmers and the Council of Trade Unions.

Membership has grown to around 40, which is about the maximum that can be accommodated 'around a table' and still make for a manageable discussion. We meet for half a day five times a year. Members' other commitments during the course of a year consist of reading and commenting on draft reports, possibly attending an ad hoc committee on a special topic, taking part in occasional meetings with ministers and opposition members, and perhaps undertaking a speaking engagement or two. These tasks are shared around and the overall workload is not burdensome.

Most member firms are listed companies. They represent about 80 percent of the market capitalisation of the New Zealand Stock Exchange. However, membership also includes private companies, financial mutuals such as the major life insurance companies, multinationals such as the oil companies, cooperatives, and state-owned enterprises which are increasingly becoming part of the private sector business community.

The range of business interests represented extends from meat and dairy processing companies in the rural sector to forestry, manufacturing, construction and a range of service sector activities. The idea that we ever moved away from industry towards so-called 'paper-shuffling' interests is a myth. Almost all New Zealand's major manufacturers are members; if anything the sector is over-represented. There were few links with the investment and property companies that collapsed after the October 1987 sharemarket fall.

The approach and influence of big business organisations is a interesting topic of study. The United States Business Roundtable is regarded as a powerful voice in Washington. President Jimmy Carter, who entered office with few supporters in business, is quoted as saying he came to rely on the counsel of the Roundtable:

> "I was very reluctant to proceed with a decision without consulting the leaders of the Business Roundtable. I didn't always feel constrained to take their advice, but I considered it very carefully."

However, although the United States Business Roundtable is regarded as having fought on the right side of some important policy battles, it is also regarded as prone to unprincipled behaviour and compromise. As one critic has put it:

> "... the Roundtable's underlying philosophy is profoundly defeatist, emphasising accommodation rather than opposition to government intervention. In this way the Roundtable only too well represents the interests of its big business members, many of whom look to government to protect them from competition and guarantee their profits."

Others have argued that if United States enterprise is to be kept reasonably free, the Roundtable and its member executives must learn to defend the market, not just the interests of some businesses. What's good for General Motors is not necessarily good for America.

The approach of the Business Council of Australia has been somewhat different. It has been concerned to be strictly non-party political, objective and research-based, and focused on longer term objectives. The rationale has been that only by taking such a stance could the Council maximise its influence with both political parties and win really important change in Australian economic directions. On the other hand, the Council has experienced tensions because of the Hawke government's corporatist approach to economic management, involving pressures on business to engage in tripartite deal-making.

Recently Treasurer Paul Keating has accused it of being 'impotent' on major economic issues such as telecommunications deregulation (because Telecom is a Council member), lacking the courage for an effective anti-inflation policy and deserting the field on labour market reform.

I think it is fair to claim in our case that we have been consistent in our policy approach. When I was appointed to my present position, Peter Neilson sent me a telegram of congratulation : "Good luck. I hope you can convert them to capitalism." I am happy to report that that has not been a problem. An important early exercise was to formulate a basic mission statement which committed the organisation to pursuing overall national interests, a pro-competition philosophy, neutral treatment of sectors of the economy, a role for the government in modifying market outcomes on appropriate social grounds and a high standard of professional analysis. I think we would be confident that our record stands up to scrutiny in terms of these criteria.

Our statement of purpose goes on to talk about our priorities and methods of operation. Our priorities are major national issues - essentially the overall quality and consistency of policy and the 'big ticket' policy issues which basically determine the success or failure of an economic programme. With limited resources and membership time, we do not attempt to take positions on a whole variety of issues. If we pick up an issue we try to do our homework well and adopt a view on it only after thorough internal analysis and discussion. If we have not gone through this process on an issue we have nothing to say about it.

The essence of our methods of operation is that we are concerned to be open in our analysis and advocacy, but not to be a noisy lobby group. One reason for openness is the anti-business mentality that has prevailed in New Zealand and is only slowly fading as New Zealand struggles to adjust to global competition. We have taken the view that only integrity of analysis and an open approach are capable, over the long run, of breaking down established attitudes and views. This has meant rejecting a traditional lobby role, looking for short term advantages or engaging in influence-peddling behind closed doors. A former Australian politician once suggested that the best way to help small business was to keep representatives of big business out of Ministers' offices. We have been very happy to go along with that idea.

Over the last four years we have worked our way through a portfolio of policy issues covering the public sector and fiscal policy, the labour market, regulatory reform and the welfare state. This has resulted in some 50 published reports or studies, including a full length book on labour law by Dr Penelope Brook, an outstanding researcher who worked on the subject for two years as our former policy analyst. Typically the major research projects have been undertaken by academics or other experts of international standing; we have used many leading figures from the United States, Canada, the United Kingdom and Australia. In doing so we have tried to match the resource pool and competence of the government's own advisers and break down its intellectual monopoly in policy formation. This approach has helped demonstrate a commitment to analytical integrity, since researchers of the standing we have sought would not be associated with partisan advocacy. It has also meant a preparedness to go where the analysis leads us. In a number of cases - perhaps a recent report on immigration is a good example - we had little idea when we set out on the project what conclusions we would reach.

One of the slightly tedious things that go with the job is having to put up with some of the labelling and misrepresentation from critics and commentators. Our experience has been that news media treatment generally is competent and fair, but a minority of lazy or ideologically-committed journalists seem unable to refer to the Business Roundtable without a liberal sprinkling of adjectives like 'powerful and influential', 'New Right' or 'extremist'. Bruce Jesson, for example, who writes much the same article in every edition of *Metro*, manages to use most of them most of the time.

If 'powerful' is supposed to refer to economic power, the reality is that businesses large and small have far less economic power in the present economic environment than in the former era of privilege and bureaucratic controls. Certainly many of New Zealand's larger businesses have had no power to withstand the competition resulting from deregulation and wider consumer choice: they have had to adapt or go out of business. We have consistently backed such policies even though they have involved massive restructuring and losses for many member companies.

I find it impossible to assess how influential we have been. We are just one player in the marketplace for ideas, and many others have promoted similar approaches. The relative influence of each cannot be disentangled. By no means all of our ideas have been accepted. Basically I believe that over time good ideas tend to drive out bad, and that electorates vote out governments which persist with failed policies. I don't think that business has any more right to influence than the most humble citizen. If what we advocate is well-researched and well-argued, we hope some notice is taken of it. If we fail to meet our own standards of professionalism and integrity, we deserve to be ignored. Nor is our thinking likely to be infallible. But it is interesting to note that while we have been called 'idealistic', 'politically naive' and 'insufficiently pragmatic', few, if any, criticisms of shoddy analysis have been levelled at us.

I spoke to the Auckland Rotary Club two years ago on the theme of why labels of 'left' and 'right' in politics and economics have become largely meaningless over the last two decades. An Australian academic observed some years back that:

> "One of the refreshing differences from Australia ... is that deregulatory reform in New Zealand has not been accompanied by hysteria over the so-called New Right."

It is a matter of regret that amongst some journalists who are content to substitute labels for serious thought, that has not remained the case. However, the acceptance of market-oriented policies around the world and the developments in the Soviet Union and Eastern Europe are blowing away such mindsets. Given the lags operating in New Zealand, it may take a little longer to happen here.

Journalistic cells like the former 'Frontline' team have been the most notable inhabitants of an ideological time warp. In communications relating to our complaint on the notorious 'For the Public Good' programme, Television New

Zealand produced twelve examples of what they regarded as 'extremist' policies advocated by the Business Roundtable.

In each case we were able to demonstrate that they had either got them wrong or that they were endorsed by one or both major political parties in New Zealand, by many OECD governments and by a raft of policy analysts. Almost everything we have come up with is boringly mainstream by international standards. As Dan McCaffrey, the unsuccessful Labour candidate for Te Atatu, said earlier this year : "If Karl Marx were around today, he'd probably join the Business Roundtable."

It is, of course, sometimes the case that critics have not bothered to read or understand what we have said on a particular issue. I had the bizarre experience of being told in court recently by a representative of unemployed workers that we advocate workfare - schemes involving working for the dole - when in fact we have been sceptical about make-work employment programmes. People in that category have earned themselves the right to be ignored.

Sometimes we are accused of having no 'heart' or concern for people. We would yield to no one in respect of concern for groups like the unemployed or people on low incomes. But compassion is not enough. What is needed are effective solutions. The unemployed workers organisation has a fortress New Zealand policy agenda which would take us further down the road to third world status. Others have to be prepared to stand up and be counted in opposition to such views.

We believe that most of what we have advocated is in line not just with best practice policy analysis but with a broad spectrum of New Zealand opinion. Commenting on economic and business matters in the run-up to the election, Tony Garnier wrote in the National Business Review:

> "In recent weeks key business organisations have emerged with remarkably similar views and concerns about the reasons for the lack of business confidence in 1990. Federated Farmers, the Chambers of Commerce, the Manufacturers Federation and the Business Roundtable : all have put out position papers saying virtually the same thing."

Opinion among the general public appears to be little different on many key issues. Surveys that we have commissioned have found around 75 percent or more New Zealanders support voluntary unionism, choice of union representation and alternatives to national awards. In a recent poll some 61 percent preferred reduced government spending to increases in taxes or more borrowing. A pre-election Herald - National Research Bureau poll showed a clear majority of voters support the low inflation target of zero to two percent. Quite often public opinion is more in line with sensible policy than the views of so-called experts. Recently a survey of 1000 British economists showed the majority were locked into the conventional economic wisdom of two or three decades ago. They favoured policies such as increased government spending and wage and price controls and opposed privatisation. An editorial headline on this survey posed the question: "Why are economists so stupid?"

One of the major sources of irritation for those afflicted by what might be called the 'Frontline syndrome' is that both main political parties shifted in the 1980s to market-oriented economic policies. The popular interpretation is that they have been captured by the Treasury, the Reserve Bank or business and farming interests.

The alternative explanation is that they have been influenced by worldwide intellectual trends and the indications of public opinion that I mentioned. Political views are not static; as one British commentator has put it:

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

If ideas matter, it follows that more mileage is to be gained by promoting them patiently to all political parties and others that influence the policy making process rather than by taking a partisan stance. We have been concerned to have good relationships with both political parties. For a time this was more difficult with the National party in opposition, since some National members found it hard to come to terms with the fact that many business leaders supported the policies of the 1984-87 Labour government and were prepared to assist in roles such as serving as directors on SOE boards. We have worked hard in recent years to establish that our interests are issues and policies, not party politics, and believe we have developed an excellent basis for constructive relationships with the new government. We shall be equally concerned to do the same with the Labour opposition. No organisation that wishes to maximise its community standing and have an ongoing influence can afford to do otherwise. The highly partisan position adopted by the Council of Trade Unions in respect of the Growth Agreement and other pre-election moves by the previous government was arguably damaging to the longer run interests of both.

What of the future? Personally I believe it has been important for New Zealand that in recent years business leaders have been prepared to seriously examine why we have performed so poorly as a country for so long, and to support the difficult changes that have to be made. I have the utmost respect for the many members of the Business Roundtable who have got to grips with difficult topics, committed themselves to positions that are in the wider community interest rather than the narrow interests of their firms, and stuck with them despite a disappointingly partial reform programme which has compounded many of our economic problems.

For a group of 40 independently-minded people, there has been a remarkable consensus about what needs to be done. If anything, this has become stronger over time. Some time ago one member withdrew from the organisation saying it had a 'death wish' for advocating a deregulated, enterprise-oriented labour market. Today we are far from dead, and the government has won an overwhelming mandate for genuine labour market reform.

To me, the interesting thing is not that some business voices can be found in support of soft inflation policies, growth agreements, business tax concessions and the like, but rather that within a disciplined setting where views can be examined and debated, these have found no support. While the secretariat does much of the work, members control the policy process and it is axiomatic that they collectively decide on positions taken. For my part it is equally axiomatic that the day the organisation departs from its principles of pursuing genuine national interests is the day I look for another job. I am happy to say that has not happened, nor is it likely to occur.

For the foreseeable future, I believe there is worthwhile work to be done. As a result of the drift and inconsistency in policy since 1987, New Zealand has tragically got itself back into a deeper hole than at any time in recent history. Any credible effort to get out must now involve a sharp fall in living standards and further major structural changes. At best we are in for a long period of discomfort before we see improvements; at worst, if we screw up or lose patience, we are over the cliff and on to the rocks. The government has a strong mandate to deal with the government spending, social welfare and labour market problems that our organisation has regarded as the crucial policy weaknesses, and we shall be supportive of bold action in these areas.

Beyond that, I hope we can be pro-active and make contributions to other items that must be on the national agenda in the 1990s. I can see us giving high priority to education; business is increasingly conscious of the need for a skilled and adaptive workforce in meeting global competition. It would be challenging to try to make a contribution on Maori issues and on electoral and constitutional reform in due course.

If New Zealand is to survive in a fast-changing and unsentimental world, we shall have to meet international rather than domestic benchmarks of success. I believe business will be demanding of governments world class standards of decision making, not just their 'personal best'. I hope that with any policy topic that we pick up we continue to try to put a 'beacon on the hill', regardless of the immediate popularity of the idea. As one writer has said:

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

I believe the best role an organisation such as the Business Roundtable can play in an open, market-oriented democracy is to urge good public policy on governments, whose job alone it is to reconcile competing views and make decisions on behalf of electors.

ROTARY CLUB OF ELLERSLIE SUNRISE

LABELS

ROGER KERR
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE

AUCKLAND
31 MAY 1991

LABELS

Discussing the role of business organisations, the recent report of the Porter Project opened by saying:

> "Historically, most New Zealand industry organisations have seen their prime role as lobbying government. It is time to change this conception."

The Business Roundtable is entirely comfortable with this proposition, and has been from the outset. Its submission to today's government conference on enterprise policies, which is a follow-up to the Porter study, contains the following statement:

> "The Porter team believes that the private sector must undertake the task of wealth creation and commercial decision making within a stable macroeconomic framework and a competitive environment. This is in accord with the approach of the Business Roundtable. It has not been a supplicant for government help. It endorses the view that the government should play a more limited economic role than has historically been the case in New Zealand and that businesses must take responsibility for determining competitive and innovative global strategies and for their own commercial success or failure."

The Business Roundtable started to acquire its present form after the Economic Summit of 1984. Its leaders at the time were concerned to help support the constituency for a radical change in New Zealand's economic directions and sustain it through an inevitably difficult adjustment period. A permanent office was established in 1986 to service the organisation and provide a research capacity. Our statement of purpose commits us to take an economy-wide perspective and promote overall New Zealand interests based on the principles of an open, competitive economy. Other key features of the organisation have included:

- the personal involvement of chief executives of major firms in a New Zealand business organisation;
- a focus on long term rather than short term economic goals;
- an orientation of work towards the overall shape and balance of an economic programme;
- a concentration on major policy topics, often selected on a forward-looking, pro-active basis;
- a commitment to integrity of analysis and argumentation;
- an avoidance of publicity-seeking but a willingness to be open and speak out on major preoccupations.

There are similar organisations around the world. Our nearest counterpart is the Business Council of Australia. Its Executive Director, Peter McLaughlin, recently described its outlook in terms which would fit equally well with our own:

> "While recognising the importance of working constructively with the elected government of the day, the Council has consistently eschewed opportunities to negotiate for short term advantage. Instead, it has sought to focus on medium term policy improvement, believing that in the longer term this will maximise its community standing and its influence with both major political parties. It also reflects a belief that the proper role for an organisation such as the Business Council in an open market-oriented democracy is to inform the government of its views, with decisions ultimately the responsibility of the government of the day."

This is a far cry from the accusations of some of our critics that the organisation is some group of rich, power-crazed, self-serving 'business barons' with a hidden agenda. An example of this sort of hysteria was the comment of a teacher union president earlier this year on a report which we commissioned on New Zealand schools:

> "The report makes public the Roundtable's real agenda for education - having wrecked the New Zealand economy and destroyed most of the private sector, big business is now looking around for new investment areas and has targeted the public sector, including education, to 'privatise and plunder.' "

This statement says a lot more about the minds of some people in teacher unions than it does about the Business Roundtable. In my experience such outbursts cut no ice with seasoned politicians. Successful advocacy these days is about proper research, doing your homework and getting your facts and arguments straight. It is not about labels and abuse, or defending indefensible positions based on self-interest. I was not surprised to hear a speaker at a recent teacher union conference lament that "no-one out there is listening to us".

Our approach has been to strive for depth, quality, fearlessness and a rejection of self-serving advocacy. We know that if we fall short of those standards we will rightly be attacked. We really have little alternative. We do not have the resources of many of our critics. Marching in the streets is hardly an option for us. Our total staff of 4 compares with 46 in the office of the Post-Primary Teachers' Association. The Council of Trade Unions is reported to have spent $130,000 on its campaign against the Employment Contracts Bill. This far exceeds our total annual public relations budget.

The approach to economic management that we have advocated is boringly mainstream. It is probably best characterised by the type of policy framework which OECD Ministers have collectively endorsed since the late 1970s following the inflationary and stagnation experiences of that decade. The essence of it is stable macro policies - non-inflationary monetary policy and sound public finances - and micro-level policies aimed at improving market flexibility, economic incentives and competition so as to promote necessary structural changes.

The OECD is hardly a radical or avant-garde organisation. Indeed, as an organisation of governments, it tends to lag behind developments in economic thinking. For example, it was slow to abandon its attachment in the 1970s to fine-tuning demand management and incomes policies. But its recent report on the New Zealand economy, which incidentally is one of the most informative New

Zealand reviews that it has produced for some time, is fully consistent with the views which we have put forward. Among the points it makes are the following:

- The macroeconomic policy mix of recent years has put an excessive burden of adjustment on the traded goods sector.

- This should be corrected by greater fiscal consolidation achieved through expenditure restraint.

- Price stability is desirable for both efficiency and equity reasons. Furthermore, achieving it is the only positive contribution that monetary policy can make in the long run.

- A severe problem exists with high income replacement ratios and work disincentives, especially for married people and those with children.

- The labour market is characterised by an unusual industrial relations framework for wage bargaining between employers and employees. Difficult decisions also need to be taken on minimum wage laws.

- New Zealand tariff rates remain well above the OECD average, and are largely concentrated on industries (textiles, footwear and passenger motor vehicles) where New Zealand has limited comparative advantage.

The OECD report concluded as follows:

> "Looking ahead, continued progress needs to be made on achieving price stability. Fiscal consolidation should be pursued vigorously, concentrating on expenditure reduction. The process of microeconomic reform should be continued, particularly in the labour market. There could be a temptation to revert to large fiscal deficits and government intervention to boost economic growth and job creation... Such an approach should be firmly resisted. New Zealand is now a considerable way through the adjustment process. Policies geared to stabilisation and structural adjustment are yielding dividends in terms of lower inflation, enhanced productivity performance, stronger international competitiveness and higher and better quality investment. To build on the reforms of recent years and to underpin the much-needed improvements in the country's medium-term growth prospects, it is essential for New Zealand to consolidate and extend the policy orientation pursued since the mid-1980s."

Such a programme is in line with a widespread international consensus on economic policy that developed in the 1980s. As P.P. McGuinness, the former editor of the Australian Financial Review, has put it, this consensus cannot in any remote way be analysed in left-right terms. Rather, it:

> "... agrees on the need for a more liberal regime in which government ownership and regulation are not oppressive, in which individual economic activity is not discouraged by excessive taxation or direction, in which the reality of the market is incorporated into the policy objectives of

governments, and in which welfare and social policy measures are judged by their efficacy, not by their ideological purity."

The description contrasts with the simplistic labels that are often attached to this policy consensus by some New Zealand commentators. Most of these serve to confuse rather than enlighten.

One common label is *free-market* policies. However, there is no such thing in a modern economy as an unconstrained free market. Perhaps the nearest contemporary equivalent to such a free market is the state of anarchy prevailing in Lebanon. Markets need rules within which to work properly. The labour market debate was in large part about restoring the standard law of contract to employment relationships. The real issue here is the legal framework which should govern private transactions in different parts of the economy.

Similarly the use of the term *non-interventionist* does not take us very far. The last Labour government was often described as non-interventionist. One simple measure of the extent of intervention in any economy is the size of the government sector. In the dynamic Asian economies, the public sector share is typically around 30 percent of GDP or less, whereas it exceeds 40 percent in New Zealand. Contrary to the use of this label, the steep increase in government spending and taxation in New Zealand under the previous government was hardly a non-interventionist policy. Decision making through the political process is by definition intervention. The issue for debate is the scope of such decision making - the proper role of the state - compared with the role for private initiative.

Monetarism is another label that gets used in bewildering ways. To an economist, its technical meaning is an approach to monetary control based on aiming for a stable rate of growth in the money supply. Ironically, the only New Zealand minister of finance to adopt such a rule was Sir Robert Muldoon. Narrow monetary targeting has generally been abandoned, but the main teachings of monetarism have been incorporated into pragmatic, 1990s monetary management. However, it is bizarre to hear a monetarist label being applied to policies such as education to which it has no relevance. At that point the label is simply being used as a term of abuse.

As McGuinness pointed out, the contemporary economic policy consensus has remarkably little *ideological* content, in any political sense. It extends from Chile to Czechoslovakia. At the same time, there is no need to shun the use of the term ideology. The roots of the word are the twin concepts of 'idea' and 'logic'. The debate should focus on the logic of the ideas being advanced. There is as much ideology in this sense in taking a protectionist position, for example, as in favouring free trade. Too often the implicit suggestion is: "I have well-founded principles, you are the slave of an ideology."

Perhaps the most empty label in this catalogue is *New Right*. One dictionary describes it as the anti-collectivist revival of the 1970s and 1980s. But the term has been used to describe almost anything and everything that displeases people like Frontline journalists. Those of a market liberal persuasion reject authoritarianism of both the right and the left. The ground has shifted in the 1980s to the point where debating topics pose the question: "Is the New Right all that's left?" The term is best avoided by people more interested in information than emotion.

Finally, it is popular in some circles to characterise the kind of economic policies that New Zealand has been adopting as *extremist*. Labelling a person or a view as extremist is to put them outside the range of discussion. In our complaint on the notorious 'For the Public Good' programme, we challenged the Frontline producers to substantiate their claims of extremism about policies we had advocated. They came up with twelve alleged examples. In two cases their facts were wrong and the other ten turned out to be policies which had been endorsed by one or both political parties in New Zealand and/or by many OECD governments. There is a strong aversion to theory and logic in New Zealand and a belief that the right answer must lie in some pragmatic middle ground. But it is no less arbitrary and dogmatic to maintain that "the truth lies somewhere in between". It may, or it may not. Truth is not necessarily a half-way place. There is no way of avoiding the difficult task of considering the facts and logic that lie behind an argument. As a Chinese proverb has it, the man who stands in the middle of the road is run over by chariots going both ways.

In summary, the labelling game is a substitute for serious thinking and a tell-tale sign of lazy or partisan commentary.

It must be apparent to any open-minded observer that the economic policy debate has shifted significantly in the last 10 years. The Pope has recently come out strongly in favour of the 'new capitalism' and against planned economies and expansive welfare states. He affirmed "the fundamental and positive role of business, the market [and] private property". Church doctrines to the contrary have helped create poverty around the world. It will be interesting to see the influence of this change of thinking on church teaching in New Zealand. As the National Business Review put it, the Pope would approve much of the thinking behind the Employment Contracts Act, whereas local church spokespersons branded it as sinful.

However, elements in the church have not been alone in living in a time warp. One capital market analyst recently wrote of experiencing:

> "... that strange mixture of rage and despair that only Morning Report can induce ... another overdose of incoherent pre-news financial analysis, the revelations of vicars who have reached the staggering conclusion that life on a benefit is difficult and even unpleasant, an assortment of commentators talking their book, economic consultants drumming up business, educationalists and health workers agonising over the horrifying possibility that the people who pay their wages may eventually have some influence over what they do ... and the forces of caring and sharing ... ever vigilant in search of employers rash enough to attempt to exploit people by giving them a job."

Morning Report carries some excellent business reporting, but it is regrettably true that it and some other Radio New Zealand programmes serve up much economically illiterate commentary. There is an over-exposure of fringe opinion and economists with little professional standing. Perhaps analysts may be comforted by the thought that markets seem to be trying to tell public broadcasters something at the moment about the quality of their product.

Critics of the sort of economic programme put forward by the OECD and endorsed by organisations such as ours often claim that it 'overlooks people' or 'lacks compassion'. These too are empty slogans. The argument is not about noble objectives; the proverbial road to hell is paved with good intentions. The argument is about practical policies which will do something effective to create jobs, reduce dependence on welfare and reverse New Zealand's longstanding relative decline in living standards. There was nothing compassionate about previous policies which served us so badly.

As we see it, the government has faced up to some harsh economic realities and has taken some essential steps to correct an unbalanced economic programme. The forthcoming budget will be the next crucial economic event. Delivery by the government on its commitments to cut spending and the deficit in a substantial, sustainable way would boost the slowly emerging prospects of a sound, export-led recovery. Failure to do so, or to resort to tax increases, would be a massive setback to investor confidence and would reverse recent interest rate falls. Simple fiscal arithmetic indicates that a positive outcome is dependent on far-reaching changes in superannuation, health, housing and tertiary education policies in particular, as well as severe pruning or elimination of all low-value government programmes.

Our organisation will continue to advocate policies for sustainable, non-inflationary growth at high levels of employment that satisfy New Zealanders' aspirations for a turnaround in living standards. As we said in our submission to today's enterprise conference:

> "The starting point for achieving this goal is an acceptance of the Porter study's conclusion that our economic weaknesses have accumulated over a long period; that we have only just begun the process of rebuilding an internationally competitive economy; that major government policy and business strategy adjustments still have to be faced up to; and that the adjustment process is unavoidably a lengthy one which will be prolonged rather than expedited by recourse to soft options, 'kick start' initiatives and efforts to shelter interest groups from necessary change."