

SUSTAINING ECONOMIC REFORM



NEW ZEALAND BUSINESS ROUNDTABLE

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**NEW ZEALAND BUSINESS ROUNDTABLE 1990
SEPTEMBER 1990**

FOREWORD

In September 1989, the New Zealand Business Roundtable published a series of speeches and articles in a volume entitled *Economic and Social Policy*.

This volume is a similar collection of papers produced since that time by the organisation, its members and executive staff. The material is organised in five sections: economic directions, the labour market, local government, education and submissions to select committees.

Included in the volume are three papers given at a labour relations media seminar on 29 May 1990 by John Foster, Richmond Limited, Ian Wearing, ACIL Australia Pty Ltd, and Ray Evans, Western Mining Corporation.

A full list of current NZBR publications is also included.

R L Kerr
EXECUTIVE DIRECTOR

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ECONOMIC DIRECTIONS

**ANNUAL CONFERENCE OF THE
NEW ZEALAND BUSINESS PLANNING SOCIETY**

**STRATEGIC PLANNING AND
INTERNATIONAL COMPETITIVENESS**

**SIR RONALD TROTTER
CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE**

**AUCKLAND
5 OCTOBER 1989**

STRATEGIC PLANNING AND INTERNATIONAL COMPETITIVENESS

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

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

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

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

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

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

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

The last few years have been a hard lesson in political risk. Many New Zealand farmers and businesses have lost a lot of money - and some have disappeared altogether - because they took huge political gambles. They gambled that governments would continue the artificial life support systems and indemnify imprudent business decisions. Any business that depends

on government policies in this way is a risky business. What governments give, governments can take away.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The government has done a poor job since 1984 on labour market policy in the private sector. There is virtually wall-to-wall agreement among outside commentators that its performance

in this area, along with rising tax burdens, is the Achilles heel of its economic programme. In some respects, in particular by reintroducing compulsory unionism and obstructing enterprise agreements by promoting large unions, it has made matters worse. And there is a real risk that it will compound the problem with proposals for pay equity legislation, forms of imposed arbitration and a return to centralism in the form of a Compact, all of which could set developments in this area back a decade or more.

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

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

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

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

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

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

As things stand, the government's performance in the area of its own expenditure has been flatly discouraging. Government expenditure is the real tax burden, and it has continued to rise inexorably since 1984. In Australia, federal spending has fallen dramatically from 30 percent of GDP at its peak to under 24 percent this year. In New Zealand it has risen over the past 5 years by a similar proportion - to over 42 percent. Much of this expenditure has been of poor quality. The number of New Zealanders dependent on handouts from the state is now enormous. The tax burden this creates is a substantial drag on internationally competing businesses. It will not be reduced to any marked extent until the government is willing to rethink the rationale and design of many of its programmes, as other OECD countries have

done during the 1980s. This can be done without compromising the objectives of the programmes, by reducing the disincentives they create, and by improving their targeting. New Zealand has been going against the international trend in the 1980s of smaller government and lower tax burdens.

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

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

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

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

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

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

I am hopeful, but by no means yet confident, that public attitudes will continue to force New Zealand politicians to deliver the policies necessary for success. The lessons of what needs to

be done have become more and more obvious, as experience from East Asia on the one hand to Eastern Europe on the other has demonstrated.

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

PACIFIC ECONOMIC COOPERATION CONFERENCE
SEVENTH GENERAL MEETING

REFLECTIONS AT THE TURN OF A
DECADE

SIR RONALD TROTTER
IMMEDIATE PAST INTERNATIONAL PRESIDENT
PACIFIC BASIN ECONOMIC COUNCIL

AUCKLAND
12 NOVEMBER 1989

REFLECTIONS AT THE TURN OF A DECADE

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

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

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

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

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

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

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

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

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

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

During the 1980s, views shifted about the role of exchange rates in achieving international competitiveness and balance of payments adjustment. Attention focused on the real exchange

rate which, as the *Financial Times* recently pointed out, is itself just a euphemism for the cost of labour, adjusted for its efficiency, relative to the prices of output that are set by world competition. What really matters for competitiveness is productivity, reliability, cost control and product quality.

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

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

And it argued in a separate article that:

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

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

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

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

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

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

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

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

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

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

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

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

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

DOMINION SUNDAY TIMES

BACK TO THE ECONOMIC BRINK

**SIR RONALD TROTTER
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NEW ZEALAND BUSINESS ROUNDTABLE**

14 JANUARY 1990

1980 - 1990 : BACK TO THE ECONOMIC BRINK?

Remember the 1980 Budget? Its aim was to "lift the economy out of the low growth trap" in which it had been caught. Faced with the second oil shock and the international recession, New Zealand had to adjust. There were no soft options: "Growth is now dependent on restructuring". Contractionary policies were producing results and "we will not throw away this achievement". Unless we boosted productivity, efficiency and competitiveness, we would "find ourselves at the end of the decade with not much more than we started".

Others believed the rhetoric. *Euromoney* reported that things were changing so fast in New Zealand that "every month sees some new initiative designed to drag the country kicking and screaming into the 1980s". It reported the widespread shock at proposals to open shops on Saturdays.

What happened? The going got tough and we threw away the achievements. We returned to policies of artificial stimulus, subsidies and wall-of-death controls. By 1984 we were peering over the cliff at the economic rocks below.

The country accepted the need for decisive change at the election and the Economic Summit of that year. The landmark economic event of the decade was the decision to remove exchange controls, float the dollar and link New Zealand to the international economy. Policy became subject to the unsentimental disciplines of global markets.

An enormous amount of structural reform was accomplished in 1984-87. The achievements were admired around the world and were recognised by the electorate in 1987.

But the job was only half done, the costs of change were inevitably felt before the benefits, and instead of pressing on we once again opted for the policies of the 'tea break'.

The results have been predictable. We end the decade with an economy which is only half-reformed and in consequence is only half-performing. Our problems have been reshuffled rather than resolved. We have swapped a chronic problem of external imbalance (current account deficit) for a problem of internal imbalance (high unemployment). The number of welfare beneficiaries has mushroomed. We have exchanged a massive fiscal deficit for a massive rise in the tax burden. Debt levels remain far higher than in 1980. Inflation has only been reduced from an underlying rate of perhaps 10 percent in 1984 to an underlying rate of 5 percent now.

Meanwhile the successful economies have pressed on with the policies which New Zealand has half-adopted. For them the 1980s were a decade of deregulation, privatisation, budgetary discipline, lower tax rates, firm control of inflation and a freeing up of labour markets. For the OECD as a whole, the decade of the 1990s, as one bank review recently put it, "stands a very good chance of being the most prosperous of the century... The end of more than 40 years of cold war and the victory of capitalism and democracy over socialism and totalitarianism in the contest of ideas have set the stage for more efficient use of global resources".

More market-oriented policies have been pursued not because a particular government came to power, or because politicians read certain books or talked to certain advisers, but because of the failure of the older, more interventionist policies.

Unhappily, New Zealand has got stuck between the old ways of looking at things and the new. The government seems unable to accept that the arguments for widening the scope for competition and consumer choice which motivated the economic reforms apply with equal force to areas like health, education and the labour market where monopoly institutions predominate. The trend now is back towards timid gradualism and forms of re-regulation

such as 'pay equity', the Compact, industrial democracy, resource management and unwieldy securities law. The inevitable consequences are a return to politicised decision-making, intrusive bureaucracy, a sacrifice of potential living standards and loss of personal freedoms.

I fear that we may now be set on a path that could take New Zealand back to the economic brink. An incoming government in 1990 - whether Labour or National - will face serious economic problems and an enormous task in portfolios such as health, labour, social welfare and Maori affairs. In a recent review of the critical economic situation facing Australia, the *Financial Times* wrote that the harsh reality is that the "modernising of Australia has gone neither far enough nor fast enough". Regrettably that is the bottom-line lesson New Zealand must contemplate in looking back on the 1980s.

Over the decade 1980-1990, national income in the OECD economies increased by an average of around 30 percent. In Japan it went up by around 50 percent. The New Zealand economy grew by a meagre 18 percent - or less if one adjusts for the unsustainable accumulation of debt.

These figures tell the difference between the waste and the wealth of nations. To those who have agonised over the costs of restructuring they should bring home the costs of not restructuring. We have not yet sprung the low growth trap. And we live in a world that is not about to stop changing.

The opportunity to take part in the dynamic Asia-Pacific economy of the 1990s is open to us, but our politicians have yet to show that they want to grasp it. In my view they seriously under-estimate the electorate's understanding of the reasons for New Zealand's poor performance and its willingness to support change. As the income gap continues to widen, I believe there is a good chance that New Zealanders will vote decisively for those who can show the way.

**WELLINGTON CHAMBER OF COMMERCE
1990 ECONOMIC BUSINESS FORECAST MEETING**

THE OUTLOOK FOR BUSINESS IN 1990

**BOB MATTHEW
CHIEF EXECUTIVE FOR NEW ZEALAND
BRIERLEY INVESTMEMNTS LIMITED**

**WELLINGTON
20 FEBRUARY 1990**

THE OUTLOOK FOR BUSINESS IN 1990

INTRODUCTION

Thank you for the opportunity to express at least some of my views on what 1990 might hold for New Zealand in business terms.

From the outset I should make it plain that whilst I am an executive with Brierley Investments and a fairly active participant in one or two business groups, including the New Zealand Business Roundtable, the views I express today are my own, developed primarily from my fairly active role in a rather wide range of New Zealand business interests.

I should also make the point that I have a great deal of respect for many of the economic restructuring initiatives undertaken in recent years by the current Labour government, which has demonstrated great courage in seeking to give this country improved prospects in competing with the rest of the world. I remain convinced that many of the economic policy changes of recent times have been necessary and only hope that whoever succeeds at the next polls continues much of the good work already underway.

My main concern now is that we continue to shrug off the 'fortress New Zealand' mentality of earlier times with consistent fiscal - and related - policies and that the rejuvenation of the economy when it comes, is nurtured by the intelligent management of those key areas which deserve specific attention. It is imperative, having been through what inevitably proved difficult times for most New Zealanders, that we maximise rather than squander the benefits which will follow.

Having said that all is not well yet, I am afraid 1990 shows every sign of being another disappointing year for business. Mid-way through last year some - particularly politicians and economists - were much more optimistic than they are today. The 1988 income tax cuts had stimulated domestic demand and strong commodity prices were lifting exporter incomes. The financial market response to the Budget was positive and we were all encouraged to think interest rates would fall steadily for the rest of the year. The themes played by the hopeful commentators of that time made it seem like the economic recovery was seriously underway.

However, many would not have anticipated the extent of the negative impact of the 1989 about-turn on tax, the government's internal squabbles and the effects that the GST and company tax increases had on consumer spending, investment confidence and inflationary expectations. Regrettably, the reality is that what little growth in incomes we have had has been channelled into debt reduction and tax to pay for expansive government spending - rather than into improved personal living standards as must be everyone's clear preference.

Nor would we have anticipated the DFC collapse, the government's quite extraordinary response to it and the subsequent fallout in financial market confidence - or the ratcheting up of interest rates as the world began to worry a lot more about New Zealand's creditworthiness and the reliability of its fiscal policies.

To make matters worse, we now have a major balance of payments blow-out. The trends in oil and wool prices and the level of car imports all have to make us rather anxious about the longer term balance of payments outlook. These factors are likely to combine to hold up interest rates and continue to depress demand. Accordingly, this year looks like being another tough one for business and for many New Zealand businesses this means the domestic economic recession is entering its third year - an almost unprecedented downturn.

In the past, businesses used to be able to rely on election cycle spending gyrations and the inflation that followed to validate pricing and investment decisions. But five years of tight money have meant a dramatic end to the old automatic capital appreciation syndrome - where we could invest in an asset today and be confident that, given a little time, it would automatically be 'worth' a lot more. We have also seen an end to most 'cost plus' pricing. Such pricing is now a dangerous game as is borne out by some manufacturer and retailer attempts to recoup margins last year, only to be left with excess stocks.

This continuing austere business climate comes at a time when balance sheets have still not properly recovered from the 1987 stockmarket crash. Many businesses have no, or at best very limited, debt and equity raising capacity, and without this buffer they are further exposed to difficult business conditions. For the finance sector the absence of growth in the economy and low savings preferences has meant a lesser volume of funds to channel business's way.

While low growth sets the general economic environment, management response obviously still matters, indeed becomes more important than in easier times. Some businesses have been able to redirect their output to offshore markets. However, in spite of lower inflation, the deregulation of some (but not yet enough) offshore markets and the reduction in trade protection internationally, exporters still struggle to be competitive - faced as they are with what remain internationally high unit labour costs and capital costs over which they all too often have little effective control.

But for those whose future prospects are confined to the domestic market there has been nowhere to grow except in market share. To grow in market share means businesses have to be more competent in targeting their markets and much more competitive both in pricing and service levels than was the case in those good old 'cost plus', 'demand exceeding supply' days. It would be foolish, to say the least, to assume that those good old days, when customers and their needs were not treated as being all that important, will ever return. For my part I have no wish to see that environment return.

Against this background we need, more than ever before, the certainty of sustainable fiscal and monetary policy settings in order to effectively control our own costs and make responsible, high quality investment decisions. This is one area where the government has most recently showed some disturbing signs of failing us. This is fundamentally why business is standing still right now and will, I'm afraid, do so for some time yet.

It is my belief that the government, despite the many commendable policy decisions it has taken, is no longer living up to its share of the task. By its inaction on some vital business cost fronts, and its failure to address fully its own spending appetite and a number of other priorities, the government is itself preventing the full benefits of our economic restructuring being realised - and being realised sooner rather than later.

THE ROLE OF BUSINESS AND WHY IT IS BEING THWARTED

Business has made a major contribution to the successes of the government's original blueprint.

The removal of import quotas, direct industry subsidies and tax preferences, and the reduction of tariffs have changed, sometimes profoundly, the high cost structure in individual companies and industry sectors. However, while the income and profitability generated by existing business assets have been much reduced in this process, business has, by and large, accepted this sacrifice with less complaint than other sectors of the economy.

The restructuring process has meant some very significant shifts in relative asset worth over the past few years and there have been no shortage of difficult decisions for New Zealand's business managers. It is my view that New Zealand business has responded well to these challenges and I have observed a tremendous improvement in company management abilities during these difficult times.

Not surprisingly, there has been a huge reshuffle of business assets over the last few years. This tough, market oriented approach to asset ownership and the management of them has been forced on businesses by greater competition for the consumer's dollar and the available investor funds.

It is the function of competitive markets to signal what the consumer values most. An intense competitive process requires business organisations large and small to keep striving to develop and offer those products and services which customers actually want, and to offer them at prices which the consumer is prepared to pay for them.

Businesses are therefore under much more pressure now to offer quality and value for money. This requires ongoing efforts to improve productivity in all possible ways, including better work practices. Implementing new work practices is a major headache for many businesses under the current labour relations legislation - yet new practices we must achieve.

The deregulation of the finance sector has added to the competition for the investment dollar. This has, quite rightly, put more pressure on New Zealand businesses both as equity raisers and as asset investors. There is much more pressure to meet investors' demand in terms of return on shareholders' funds. Quite simply, if we don't meet investor demand we will not get new capital. There is absolutely nothing wrong with that but when the government is paying historically high real rates of return on risk-free government stock, treasury bills and the like, this puts private sector investment at a relative disadvantage. In this sense I believe the government is crowding us out of the economy.

Investment to improve efficiency is one thing, investment to expand is quite another. Most of us can't invest to expand with any confidence while the government is relentlessly driving up its own spending and taxing, or if it makes it particularly hard for us to read the economic climate, or if it does not allow us to take control of our own costs - labour costs included.

WHAT IS THE GOVERNMENT DOING WRONG?

The government plays a key role in determining the business climate through the sheer magnitude of its own spending power. The most obvious sign of our economic problem is government spending - and for business and the New Zealand public at large, the flip side of that is the tax burden levied to meet that expenditure.

Government failure to deal satisfactorily with both the quality and quantity of public expenditure remains a case of a lack of will, not a lack of available options.

Government spending is currently running at \$25 billion a year. In just five years spending has risen from 36 percent of the country's income to over 40 percent. The biggest increase has been in social welfare - especially the cost of unemployment benefits - and debt servicing, much of which has its origin in spending to maintain employment in earlier times.

Much of this increase in spending is generated by major failures within our private sector labour market. Associated with that is the now critical malfunctioning of the incentive structures in our welfare system which cause people to voluntarily opt out of the workforce in favour of - often better paying - state dependency.

In an efficient labour market (that is to say one where unemployment is minimal) workers and employers would be able to negotiate terms of employment that would not only keep businesses viable but enable them to grow and prosper. The present Labour Relations Act very effectively thwarts that. While our international competitors reap the rewards of their own efforts to improve and maintain high productivity, we still have to go through agonisingly difficult and often fruitless efforts to introduce more efficient technology, higher skills and improved manning practices.

That we are failing is evident in our unemployment levels and the calls by exporters for a lower exchange rate - which is the same thing as admitting that labour costs are too high.

Monopoly unionism and the preservation of centralised award structures are the opposite of what is needed if a small open economy is to fully employ its available resources. While other private sector reforms have encouraged more competition and more decentralised decision making, political pressure groups have, it seems, forced the government to capitulate into doing just the opposite where unions are involved. There is nothing more certain than that in so doing the government simply delivers the opposite to what it seeks to achieve on other fronts. It delivers unemployment and denies the higher levels of remuneration which will inevitably flow from improved productivity, efficiency and profitability.

Unions are under very little pressure to provide satisfactory services for all their members because they have a captive client base, albeit dwindling as unemployment rises. Nor do they have any obligation to care about the interests of those who are unemployed but who do want to work. As a result it is not surprising that union advocates in many instances aggressively contest employer efforts to introduce new work habits and practices. It is not surprising that there has been only limited progress towards workplace or enterprise bargaining despite some strenuous efforts by business management. It is also not surprising that the 'them and us' mentality between unions and business remains widespread. Yet progress, major progress and soon, is essential if firms are to succeed in their aspirations for efficiency and growth in the more competitive environment.

The government has to take a wide view of the public good, not just bow to the central union executive view.

Some of you might have been lulled into some degree of satisfaction with the present award system because it seems to be delivering relatively low settlements. But there is no doubt in my mind that the rigidities of the Act seriously inhibit major industrial expansion in New Zealand. That is a cost to us all. Every business continues to miss out on the extra spending power and the demand for investment goods that an expansion of the industrial infrastructure would generate. If you really want an honest gauge of your true labour costs I suggest you should be adding this forgone growth. The less energy you apply to changing labour market arrangements, thereby enabling genuine relationships to develop between individual businesses and their staff, the longer our economy is doomed to mediocrity and the workforce is destined to further unemployment.

An efficient labour market should also ensure that people make the maximum effort to stay in the workforce and build up their skill levels and thereby their work achievements and reward levels. At the present time the welfare system positively encourages many people to do the opposite. The level of benefits can be higher than wages, and the very high effective marginal tax rates continue to act as a disincentive for people to move towards greater financial independence.

I fear we now have an in-built momentum for a rising welfare bill, the end result of which is that the government is competing, via the benefit system, for the very people business would

rather employ. I put it to you that this is bizarre and tragic. The proof is the now continuous growth in benefit payments. This means rising government spending, and for business and indeed most New Zealanders that simply means rising tax burdens.

Obviously, rising tax burdens will continue to stifle the ability of firms to invest and create jobs. As tax burdens rise it inevitably becomes more and more expensive for the government to extract more tax conventionally and/or obliges it to cast around for new avenues to tax, such as assets, savings or any other fruits of hard work accumulated by a diminishing workforce.

All this means that some of our present policy settings (or the lack of them) lock us on to a path of low growth and rising dependency. This unstable environment puts a risk premium on all New Zealand assets, inflates interest rates and means our business and other assets are thereby underpriced. Business wealth is depressed and, as a result, so is investment, the rate of new business start-ups and the new jobs which would accompany them.

This is why we have to insist that the government finishes the job it started and ensure that its potential successors won't shrink from the job when their time on the treasury benches materialises.

WHAT IT MEANS TO FINISH THE JOB

The government has to make rapid progress in winding back the highly inter-related debt, unemployment, and welfare dependency levels which add up to its own budgetary problems - and our own tax burdens and interest costs.

Just as businesses have had to reconsider where they have a comparative advantage and to shift assets accordingly, the government clearly has to recognise that it has no role in running trading operations which can be performed more efficiently in the private sector. It should therefore get its privatisation programme back into high gear. Proceeds should then be used to retire debt. Privatisation will assist in easing debt service costs and improve the efficiency with which a significant part of the economy operates.

To wind back unemployment, the government must substantially reform the regulation of the labour market. This means eliminating compulsory unionism and the artificial barriers which prevent competition between unions, enabling employee groups to contract directly with their own employer and opening up the right to contract individually. Only in this way will we get a better environment for achieving the more efficient work practices which are essential for New Zealand industry to survive and prosper and, at the end of the day, benefit owners and employees alike.

On the welfare front, the government has to go back to basics and look at the incentives (or disincentives) people face. Benefits in excess of wages and high marginal tax rates lock people into welfare. The government has to get rid of these sorts of poverty traps. The objective has to be to create an environment where most people can look after themselves while ensuring the system copes better with the genuinely needy. This would lead to massive fiscal savings and stop the deterioration in the work ethic which sadly is already well and truly underway.

It is these key issues which must be addressed with urgency if we are to enjoy the rewards of the economic restructuring efforts of recent times. I am confident that in doing so the government is more likely to be returned to the treasury benches than will be the case if it chooses to sit on its hands and to hope it has already done enough for the economic recovery to materialise, unaided by further firm policy initiatives.

AUCKLAND ROTARY CLUB

FATAL DELUSIONS

NEW ZEALAND'S REAL BARRIERS TO SUCCESS

**DOUGLAS MYERS
VICE-CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE**

**AUCKLAND
26 FEBRUARY 1990**

FATAL DELUSIONS

NEW ZEALAND'S REAL BARRIERS TO SUCCESS

When he spoke to the Auckland Rotary Club last month, the Prime Minister, Geoffrey Palmer, began by referring to the momentous developments in the Soviet Union and Eastern Europe.

He likened *perestroika* to the changes that have been occurring in New Zealand in recent years. But I want to suggest to you that the lessons we should draw from the developments in the communist world are rather different from the ones Mr Palmer appeared to have in mind.

There's an old Russian joke about the fellow who wanted to purchase a car and was finally told that he would be able to pick it up on September 11, 1994. "Will that be the morning or the afternoon?" the man enquires. "Why?" asks the autocrat. "Well, I've got the plumber coming in the afternoon," is the wistful reply.

The Prime Minister is right to see parallels with New Zealand. We were the nearest equivalent to a command economy outside the socialist bloc. Government advisers in the Muldoon era used to joke that if they ever lost their jobs their skills would be well-suited to work in a Soviet planning bureau.

The last hundred years – from the time Marxist and Fabian Socialist ideas took hold in Western politics – have been the socialist century. These doctrines were applied in social experiments that have turned out to be disasters. Last year Solidarity leader Lech Walesa told the United States Congress :

"All the countries of Eastern Europe are bankrupt... the communist economy has failed in every part of the world."

The Yugoslav Prime Minister, calling for an end to state interference in business in his country, recently stated:

"I consider the open market economy to be an ultimate achievement of mankind for which no alternative has yet been found."

Not just communism but all forms of statism of the left or right – including central planning, tripartite accords, Keynesianism and the welfare state – have fallen from favour as the evidence of disappointing results has mounted in country after country.

It is not surprising that both New Zealand and the Soviet Union have had such difficulties in changing economic direction. Years of wall-of-death controls led to horrendous distortions and inefficiencies. More importantly, what has been called into question is a whole set of beliefs and attitudes.

There is every indication that the outlook for the Soviet Union remains appalling. Things are likely to get far worse before they get better. The problems of coping with the budget deficit, inflation, plant closings and unemployment are massive. The policies adopted so far under *perestroika* are nowhere near equal to the task. The economy is not delivering the goods and is incapable of doing so in its present form.

Likewise the New Zealand economy, five years into a programme of structural reform, is still foundering. The reason is fundamentally the same: not enough has been done. The post Lange-Douglas government faltered and blew our chance of a really successful transition. An Australian commentator predicted accurately that:

"As the rest of the world realises that New Zealand has not got the guts to continue with a universally admired programme of economic reform, confidence in their economy will decline more or less rapidly."

Why is New Zealand going through a particularly acute period of confusion and indecision right now? The immediate answer is that we have only half-implemented a coherent reform programme. But I believe we need to look more deeply into the reasons why better policies have not been adopted. Why do some people still regard with disdain policies that have done a far better job elsewhere of delivering prosperity and high employment? What are the underlying ideas that explain the relative success of the free market democracies and the catastrophes of Eastern Europe?

We can look for clues in the eloquent testimony now coming out of Eastern Europe on the nature of the socialist system. Vaclav Havel, the new president of Czechoslovakia, has spoken of the contaminated moral environment which:

"...reduced gifted and autonomous people, skilfully working in their own country, to nuts and bolts of some monstrously huge, noisy, stinking machine."

The telling point he makes is that the contaminated moral environment was not something imposed on a resistant people:

"We all had become used to the totalitarian system and accepted it as an unchangeable fact... we have to accept this legacy as something we committed against ourselves. If we accept it as such, we will understand that it is up to us all, and up to us only, to do something about it."

I believe a very similar mindset took hold in New Zealand. As one commentator recently wrote:

"Roger Douglas, almost singlehanded, turned us forcibly from a bland, stuffy, complacent herd of line-toers and fillers-in of forms into a society showing the first signs of maturity."

Until the revolution lost its way:

"We were starting to look squarely at the facts of life and make up our individual minds how we should best deal with them, instead of sitting down sulkily and expecting 'the Gummint' to bail us out'."

Havel's point is that having change imposed on us is not good enough. We were all part of the fortress New Zealand, cradle-to-grave welfare state, 'she'll be right' syndrome. We have to understand why it didn't turn out to be right.

Many have still not understood - or wanted to understand - the imperatives that have driven our version of *perestroika*. They remain the prisoners of delusions that are being cast off in Eastern Europe. Havel's dream is of "a humane republic which serves the individual and which therefore holds the hope that the individual will serve it in turn." The success of market economies ultimately rests on their respect for individual values and freedoms.

Markets are not abstractions. The essence of markets is voluntary exchange between individuals. Transactions only occur if all parties benefit. The market system respects and coordinates the preferences of individuals in an uncoerced way. It harnesses widely dispersed knowledge. It is the only social order that is consistent with individual freedom.

In the Marxist vision, by contrast, individuals don't count. The masses are seen as a *lumpenproletariat* needing guidance and direction by bureaucrats or trade union leaders. The subordination of the individual to the collective is a positive good.

A radiant glow was given to the doctrines of socialism by writers and intellectuals who defended even the most tyrannical forms of social engineering. The intellectual classes have tended towards socialism; they have been contemptuous of commercial activity; they have often found their natural habitat and employment in government. The small bands of intellectuals who saw socialism as a road to serfdom were regarded as traitors to their class.

George Bernard Shaw, a leading Fabian Socialist, was a typical case. He explicitly expressed disdain for 'the masses' and was an enthusiastic supporter of dictatorship. He saw some good in Adolf Hitler, but the man he idolised was Stalin. He heaped praise upon Stalin for collectivising agriculture, because he had worked out in his study that this was what the Russian peasantry needed. As we now know, Stalin murdered millions of peasants in the implementation of his agricultural policies. Everything that Gorbachev is trying to undo excited the admiration of Shaw.

Latter day followers of Shaw are very much alive in political and intellectual circles in New Zealand. At a recent Labour Party conference a spokesperson for Labour Youth called for a U-turn in government economic policy – Stalin had achieved in 20 years what the West had taken 200 years to achieve, she said. An overseas consultant doing a project for the Business Roundtable recently remarked casually to a group of staff at one of our colleges of education that they must be pleased with the Rogernomics version of *perestroika* in New Zealand. "I couldn't possibly agree with that," one of them said. "I'm a Marxist, you know."

The same point was made in a recent National Business Review cartoon. "With the democratisation of the communist countries we now have a lot of useless stockpiles," one figure is saying. "Stockpiles of nuclear arms?" queries the other figure. "No – Marxists," replies the first. "The universities and the unions are full of them."

Amongst the so-called political and intellectual elites, it is difficult to know whether naive but well-meaning motivations dominate, or whether the primary objective is power. Some people get satisfaction from telling others how to run their lives. Administrators, inspectors, social workers and teachers are all people whose authority gives them an opportunity to engineer the attitudes of their fellow citizens. An activist judiciary can extend social and economic rights in ways that do not involve accountability to the electorate.

In many cases the true motivation has been revealed beyond doubt. White South African governments have maintained the world's most comprehensive system of minimum wage laws to prevent black workers competing for white jobs. In Russia the segregation of the ruling sect, the nomenklatura, into a class apart has been more rigorous than it ever was under the Czars. The inequalities of socialism have been known for years: as George Orwell warned, some animals are more equal than others.

Whatever the motivations, the applications of such doctrines almost invariably lead to paternalism and the nanny state in the milder forms, and to oppression and disastrous mistakes in the worst cases. Yet we go on committing the same errors. Mr Gorbachev recently attempted to prohibit alcohol consumption in the Soviet Union because of the widespread incidence of alcoholism. Banning alcohol neither reduced consumption nor effectively addressed the problem because the business went underground – but it robbed the government of revenue and compounded the fiscal crisis. He has now had the good sense to scrap the idea.

Paternalism – and increasingly its female counterpart – has a legacy of such unintended consequences. Helen Clark's ill-conceived proposal to ban cigarette advertising poses a major threat to sporting activities that New Zealanders value, and research suggests that it will do little to deter smoking. Do New Zealanders want similar bans on red meat, salt and butter – or anything else that someone in power thinks might be damaging to their health?

By all means let us inform, educate, persuade and protect the rights of third parties. But a hallmark of a free and open society – as opposed to collectivist regimes – is resistance to the

suppression of information, including advertising, and the upholding of the individual's right to choose.

No issue has been more prone to confused thinking than the issue of equality. The idea that wealth creates poverty, that some people are poor because others are rich, has created more poverty than any other concept in the canons of Marx. As the New Zealand-born philosopher Kenneth Minogue has pointed out:

"...ever since the French Revolution of 1789, the world has been haunted by the spectre of egalitarianism. Yet the pursuit of equality has benefited precious few. The belief that disparities, especially in wealth, are responsible for the major imperfections of the world has left a sour legacy. Inequalities being infinitely various, such a belief is the source of a stream of regulations that never dries up. It was the pursuit of equality which animated the totalitarian governments of the 20th century... at least until the evident consequences of egalitarianism – despotism and poverty – led to a little recent *perestroika*".

There has been a strong tradition of egalitarianism in New Zealand. In many respects it has been an honourable one. We believe strongly in equal life chances, the career open to talents, fair processes, equality before the law. But the outcome of fair processes will be differences in achievement: that is the nature and the wonder of human diversity.

Egalitarianism becomes harmful when a class of bureaucratic equalisers seeks to cut down 'tall poppies', promote 'affirmative action' - which is a euphemism for unequal treatment - or prescribe equal outcomes. Some recognition of this harm is now apparent in the Soviet Union. Dr Leonid Abalkin, the deputy prime minister in charge of economic reform, has recently written:

"The total income of an individual worker, made up by his wages, his share of profit, income from shares and securities... should not have an upper limit."

But in New Zealand we are still mired down in the debate over proposals for income equality masquerading under the banner of 'pay equity'. It was symbolic of our problems that these proposals, which would substitute bureaucratic pay-fixing for market-determined wage rates, were announced on the very day that the entire East German politburo resigned. An Employment Equity Bureau may determine – to use an example that a trade unionist proposed in all seriousness on national television – that a basic clerical worker should be paid the same as a stationary engine driver. Big Sister rules – a scenario that even George Orwell might have found difficult to imagine.

I believe that any notion that the pay equity proposals are a politically attractive bribe will backfire when it becomes apparent that virtually no category of women will benefit from them - not working women who retain their jobs but face cuts in other conditions of employment, such as training, as employers in competitive markets try to offset higher wage costs; not women who lose their jobs because employers can no longer afford to hire them; and not housewives who have to meet the costs of the policy in the form of higher prices for goods in the shops.

True forms of equality have always been at the heart of democratic constitutions. But forms such as pay equity have nothing to do with equality, any more than the personal circumstances of Presidents Honecker and Ceausescu which were recently revealed to the world. As the black American economist Thomas Sowell has written:

"Where did we get the idea that people are homogeneous and therefore could be expected to be evenly distributed? From intellectuals. Anybody else would have too much common sense."

Representatives of institutions such as trade unions and some elements of the church have enjoyed a good press because of their professed identification with the down-trodden, the vulnerable and the oppressed, to use their favourite vocabulary. But in recent years many voters around the world, including working-class ones, began to see some trade unions more as greedy power-players than as protectors of the underdog. They began to suspect privilege dressed up as compassion. When employers complained that measures meant to protect workers in fact disadvantaged hiring them at all, they got a hearing. Not coincidentally, trade unions have been in long-term decline and the church has been weakened by the successful advocacy of statist policies which undermined its former pastoral role.

Even in countries where the collectivist tradition has gone furthest, public opinion appears to be recognising that individual welfare and security depend fundamentally not on state-provided hand-outs and protections but on concepts such as freedom from dependency, choice, competition and incentives for self-improvement. There is also an appreciation that wealth and welfare depend basically on growth and progress - through an economic system that works.

A recent poll in the Soviet Union reported that 71 percent of the population believed that the policy of *perestroika* is right but that it should be pursued faster. The idea of competition was also attractive to 74 percent of those polled. In Sweden, a poll indicated that 72 percent of the population want to see an increasing privatisation of the country's public health and child care services. Even 60 percent of Social Democratic voters favoured such moves, which suggests support for the traditional welfare state is ebbing.

In the United States, it is now difficult to find anyone serious who believes that another Great Society programme is the solution to growing social ills - and many see such programmes as the primary cause. In addition to the economic costs of over-expanded welfare programmes, and the political corruption of middle class capture and vote-catching for 'compassionate' causes, the social and moral consequences of such programmes have turned opinion against them. Open-ended programmes of assistance to the able-bodied undermine self-help and deepen or prolong dependency. The 1990s are likely to see a return to principles of selectivity and conditionality, and the use of decentralised mechanisms which focus on deserving victims of adversity and combine income support with efforts to get people back on their feet wherever possible.

Introverted New Zealand has been slow to absorb many of these lessons, but it is catching up. As in the Soviet Union, the resistance of the *privilegentsia* has been fierce and labels such as 'monetarist' and 'new right' are thrown at those who challenge the existing order. Claiming that your opponents are engaged in union-bashing or welfare-bashing saves you the trouble of listening to what they are saying and responding to their arguments.

Such voices, however, are increasingly in a minority, albeit a noisy one. The title of a recent debate is perhaps indicative of their position: "Is the New Right all that's Left?" More to the point, as I have been emphasising and as the late Aubrey Begg, a former Labour MP and respected farmer-politician, once noted:

"Free marketing and deregulation are not right wing policy stances. They are the policies of those who believe in individual liberty and the availability of choice in a competitive environment. Right and left wings are of the same political ilk. They believe in controls and dictatorial government. There was, for example, no difference between Hitler and Stalin."

Begg's point is worth underlining. Hitler's National Socialism (i.e. Nazism) had its origins in the collectivist thinking of the 19th century Christian socialists. The students in Tiananmen Square labelled their communist oppressors fascists. Supporters of the liberal market economy stand opposed to the collectivism of both the left and the right.

For the time being, however, we seem to have reverted at the governmental level to old-style New Zealand habits of interest group politics and woolly pragmatism. Like some Eastern European politicians trying to find a 'third way' between markets and Marxism, Mr Palmer has recently been talking of more flexible policies and arguing that "reason tends to live in the middle ground". But this is just another form of dogmatism and a substitute for clear thinking. Truth may, or may not, be a half way place. As a Chinese proverb has it, the man who stands in the middle of the road is run over by chariots going both ways.

If the government wishes to escape from the paralysis of the last two years, it will have to make choices. It has been paralysed by the conflicting tensions of the reformists and the regressives – with a large group of tea-break supporters in the middle. In areas like health, welfare and the labour market, it is stuck between the old ways of looking at things and the new. It has not been prepared to accept that the arguments for introducing competition and empowering individuals that motivated its economic reforms apply equally to areas which remain state-backed monopolies. Sooner or later it will be forced to confront this gap in logic. It will have to choose whether vested interests or national interests will dictate its agenda.

Until clear choices are made, the economy will continue to founder. To date, the government has seemed unable to understand the reasons for the prevailing lack of business confidence. This time last year the Minister of Finance saw the economy as an elegant new motor vehicle that had just stalled at the traffic lights. The March economic statement would remove the 'black frost' hanging over the economic landscape.

Twelve months later the economy is still stalled and the climate is just as frosty. The reason is the continuing mixed signals. On the one hand the government deregulates shop trading hours, talks of further labour market reform and plans to privatise ports and Telecom. On the other it keeps raising the tax burden further and pushes proposals for bureaucratic resource management law, unwieldy securities legislation, pay equity, industrial democracy and the Compact. The government cannot have it both ways. Such a programme will do nothing to restore confidence. Business will just invest defensively and wait.

In economic terms, what the government must do is relatively straightforward, and in line with the actions of many OECD countries in recent years. Above all it must be consistent, predictable and credible. It must reverse the massive growth in government spending - up from 37 to 42 percent of GDP over a period in which government expenditure in the United Kingdom has fallen from 45 to 38 percent of GDP and Federal spending in Australia has come down from 30 to 24 percent of GDP. It must free up the labour market : most people now understand the folly of exposing the economy to the disciplines of global competition while maintaining a highly regulated labour market. And it must reform welfare arrangements so that earning an income is more attractive than living on welfare and employers are no longer competing with the Department of Social Welfare and losing hands down.

But as a prior condition to these policy changes, the government must front up to the myths, delusions and vested interests that have immobilised it in these key areas. They represent the real New Zealand barriers to success.

The litany of shibboleths is a long one:

- that economic life is a struggle between capital and labour;
- that a more flexible labour market will drive down wages;
- that unions (rather than productivity) are the source of wage increases;
- that the poverty of some is the source of the wealth of others;

- that differences in income or wealth automatically constitute inequalities, as though uniformity were the norm and departures from it a cause for remedial action;
- that essential social services have to be provided by state agencies - rather than bought from the private sector with state assistance if necessary.

And so forth.

It should be easier for New Zealand than some other countries to escape from the crippling influences of the socialist century. We have not suffered either the class divisions of Britain or the ideological indoctrination of Eastern Europe. The electorate in 1987 showed it understood the need for change and supported a government which sought a mandate to complete the task. But the mandate has not been honoured and the political debate has been derailed by those who sought to protect their own interests under the guise of community interests. If we are to move forward again, we must take heed of Havel's words:

"Let us not allow the desire to serve oneself bloom once again under the fair mask of the desire to serve the common good."

Time is not on our side, any more than it is on the side of President Gorbachev. Despite all the good work that has been done, New Zealand remains a weak, debt-ridden and distorted economy. The recent balance of payments statistics should shock the government out of its complacency and bring home the magnitude of the task of structural adjustment that still lies ahead. We still lack economic competitiveness, which is not about central planners fixing exchange rates but about getting productivity up and unit labour costs down. The government must accept that financial markets are not fickle and irrational and that interest rates are conveying a message about the state of government policy. They deserve to be listened to, not jawboned. After all, they reflect the combined judgment of countless individual investors and savers at home and abroad. As I have been stressing, individuals matter. Governments assume superior wisdom at their peril.

The optimistic possibility for New Zealand in the 1990s is that the electorate will force politicians to cast off the remaining delusions and pursue policies which would allow an escape from our long-run mediocrity. If there is one legacy Roger Douglas leaves New Zealand, it is the lesson that first best policies are possible.

Vicki Buck, the mayor of Christchurch, suggested in a recent guest editorial that the major discovery of the past decade was that government was not a huge bailing-out and propping-up machine, and that we did not need it to control every aspect of our lives.

She thought that the rest of New Zealand had realised that people afflicted with the 'Wellington syndrome' are less than helpful, basically a worry or quite simply irrelevant, and that if communities are going to succeed and thrive, they are going to have to do it by themselves.

"What we have learned," she concluded, "is that we no longer need to cut down the tall poppies. We've finally realised it's okay - in fact, it's great - to be excellent."

I hope she's right.

MOUNT VICTORIA ROTARY CLUB

**SHIFTS IN ECONOMIC THINKING
IN THE 1980s**

**ROGER KERR
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NEW ZEALAND BUSINESS ROUNDTABLE**

**WELLINGTON
18 APRIL 1990**

SHIFTS IN ECONOMIC THINKING IN THE 1980s

It is fascinating to follow trends in economic performance around the world and the approach of different countries to economic policy. The past decade has seen some interesting shifts in views about the workings of economies. On a recent visit to New Zealand, Rupert Pennant-Rea, the editor of *The Economist*, observed that it had become trite to say that:

"...everywhere now, economic policy is pointing in the same direction – that liberalisation is the order of the day and that governments of every conceivable label have all adopted basically the same economic strategy."

While this may have been something of an overstatement at the time, since then the Eastern European countries have joined the trend towards economic liberalisation. Practical experience of policy failures has combined with improved economic understanding to alter official thinking.

After the wrenching economic experiences of the 1970s, policy directions changed in the major countries and the subsequent economic record has generally been superior. In the 8 years from November 1982, 18.7 million new jobs were created in the United States, an all-time high for a comparable period in that country. Japan's national income grew by over 50 percent in real terms in the decade to 1990. The Asian tigers and a number of other developing countries did even better, narrowing the income gap with the industrial countries.

What led policy makers to alter direction? As I see it, there was an evolution of views about how economies work. It was not an academic matter of one school of thought versus another but of a gradual shift in perceptions in a number of areas and a pragmatic response to events.

Trends in economic thinking are always reflected in economic policy with a lag. The influence of Keynesianism, for example, had already peaked when President Nixon declared "We are all Keynesians now". Efforts by governments in the early 1970s to adopt expansionary policies to cushion the effects of the OPEC oil price increases led to inflation, recession and a build-up of debt. Incomes policies and public works programmes failed to halt the rise in unemployment. It is now said to be difficult to find a Keynesian economist under 40 in the United States.

By the end of the 1970s, the dominant economic view of the 1950s and 1960s that there was a long run trade-off between inflation and unemployment - that governments could buy a little less unemployment at the expense of a little more inflation by the use of expansionary policies - had been abandoned. A different consensus emerged, namely that there was no such trade-off in the long run, and no exploitable trade-off even in the short run. Sustained high inflation came to be seen as damaging to the maintenance of full employment. Simultaneous falls in inflation and unemployment occurred in a number of OECD countries in the latter part of the 1980s.

As Sir Terence Burns, the Chief Economic Advisor to the United Kingdom Treasury, has pointed out, this change carried some important implications:

"It has reinforced the idea that macroeconomic policy should concentrate on getting inflation down rather than trying to fine tune the balance of inflation and unemployment... A second implication has been accepting that getting inflation down was likely to lead to higher unemployment in the short run and that it was important to get through that period without reversing policy. And a third has been the tendency to lengthen the time horizon for policy decisions away from short term management and towards the medium term."

In effect, the shifts in thinking were a return to the beliefs of the 1950s and early 1960s that macroeconomic stability is a prerequisite for sound economic performance. Although the policies necessary to achieve it may be difficult to bring about, there is no mystery about what those policies are: non-inflationary monetary policy and its fiscal counterpart, tight control of public finance. In the 1950s inflation in the major countries was typically in the 0-3 percent range and budget deficits rarely exceeded 1-2 percent of GDP. By the end of the 1980s many OECD countries had returned to similar levels of stability. A number were endeavouring to move their budgets into surplus to reverse the growth in public sector debt burdens.

A more recent lesson concerns the dangers of giving up in the battle against inflation when it is only half won. This was the error of the Thatcher government in the mid-1980s and again following the 1987 sharemarket crash. Referring to the latter event, the British Chancellor of the Exchequer recently acknowledged:

"We relaxed [monetary policy] precisely at the moment when we should have made it more severe."

United Kingdom inflation moved back from a low point of 3.4 percent to around 8 percent and wage increases are hitting double digit levels again. Interest rates almost doubled over a 12 month period. By contrast Germany and Japan have recently increased interest rates in response to inflation moving into the 2-3 percent range.

A willingness to allow interest rates to take the strain of bringing about a tightening of monetary policy has been one of the important developments of the 1980s. But, as one Australian commentator has recently pointed out:

"[T]his does not constitute a return to the monetarist beliefs of the 1970s which rested on the key assumptions that:

- inflation is "always and everywhere a monetary phenomenon";
- there is a stable relationship between money growth and growth in nominal – unadjusted for inflation – GDP;
- inflation can be controlled simply by setting annual money supply growth targets and gradually lowering those targets until an acceptable level of inflation is achieved.

"In the 1980s, these assumptions proved quite inadequate foundations for the setting of monetary policy and the 'monetary rule' approach to such policy which rested on these assumptions was progressively abandoned."

In New Zealand, Sir Robert Muldoon was the only minister of finance to adopt a monetarist rule, in the form of a monthly target for private sector credit. But subsequent official policy has been based on the consensus view that 'money matters' and that sound monetary policy is a prerequisite for low inflation.

Views about exchange rates have also changed. In the 1970s exchange rate changes were seen primarily as a device for bringing about a change to a country's balance of payments. If a country needed to correct a current account deficit there was a general presumption that its exchange rate should fall.

By the 1980s, more attention was being given to the role of the exchange rate as a part of the inflationary mechanism. Exchange rates came to be seen less as a device for bringing about balance of payments adjustment and more as one of the channels through which changes in monetary policy had their effect. With the removal of exchange controls and the internationalisation of financial markets, capital movements - which are now some forty times larger than trade flows in the OECD area - also became a more important determinant of exchange rates. Current account positions have come to be interpreted more in terms of savings and investment imbalances. Global interdependence has severely constrained

national governments' freedom of manoeuvre not just in financial policies but over wide areas of economic management.

In respect of international competitiveness, the emphasis in policy thinking has switched instead to real economic factors, in particular the movements in an economy's unit labour costs relative to its competitors. As a recent official report on exports in Australia pointed out:

"Exporting firms cannot compete internationally with a combination of high wage costs, unstable labour relations and low productivity."

This lesson is apparent in the export success of Japan and Germany, both countries with low inflation and 'hard' currencies. Nominal exchange rate changes unaccompanied by changes in real factors cannot alter competitiveness beyond the short term. It is a country's real exchange rate that must fall to improve its competitive position.

Following the disenchantment with demand-led expansionary policies, we have seen a change of emphasis towards the role of supply side policies in promoting long run economic growth. Governments had progressively overlooked linkages in the economy and ignored the basics of economic growth such as productivity and comparative advantage; they tended to assume that growth just happened. The 1980s saw policy approaches shift towards deregulation, reductions in the role of government, greater reliance on private market initiatives and efforts to make markets work better. The abolition of foreign exchange controls, deregulation of financial markets, privatisation, reducing subsidies to industry, increasing competition and tax reforms have been a major part of the policy agendas of governments of all political persuasions.

Among the set of supply side policies, much research suggests that an outward-looking approach to trade is perhaps the biggest single reason why some countries have done so much better than others. The outward-looking approach requires nothing more than neutrality, not the deliberate promotion of one sector of the economy over another. Even apparently interventionist countries like South Korea have in practice matched a moderate and declining degree of domestic protection with a degree of export promotion and ended up with broadly neutral policies. There is no example of a country, particularly a small economy, pursuing a successful inward-looking strategy in the post-war period.

Australia and New Zealand, for long two of the most inward-looking economies, both embarked on programmes of trade liberalisation in the 1980s. These have now attracted wide community support, and look set to continue in the 1990s. Previous opposition came to be seen as based on flawed theories, vested interests and fear of change. It was odd to hear voices raised recently against tariff reductions on the grounds that other countries maintain restrictions on trade. This seemed like an echo of the Sutchian philosophy that deplored "making New Zealand an island in a sea of controls". The fact that other countries continue to shoot themselves in the foot is not a good reason for doing likewise. The cost of protection to one domestic industry is borne by another domestic industry; the actions of foreigners are nearly always irrelevant for a small country.

Another objective of supply side policies in the 1980s has been to restore greater flexibility to labour markets and reduce unacceptable rates of unemployment. As the OECD has noted:

"Countries have taken a number of measures to this end. Indexation has been scaled back and greater flexibility has been introduced into regulations affecting hiring, firing, part-time work, fixed term contracts and other contractual arrangements. The role and scope of minimum wage legislation have been curtailed. Unemployment benefits have been lowered in relation to wages and eligibility criteria tightened. And measures to enhance the skills and flexibility of the labour force have been implemented."

Less progress has been made in New Zealand in this regard. As Pennant-Rea commented:

"...the labour market is a classic target for liberalising and to the extent that it hasn't happened here, that seems to me to be a major failure, and probably the major contributor to rising unemployment."

It is naive to believe that much growth in output can be achieved without addressing the market which accounts for some two thirds of total resource costs in New Zealand and other OECD economies.

Another interesting phenomenon in the 1980s has been the halt in the growth of the public sector relative to the economy in nearly all OECD countries, and the reversal of the trend in some. The evidence of waste in many government activities, the damaging social effects of over-expanded transfer programmes and a growing awareness that high tax burdens retard economic growth all contributed to the moves towards privatisation and other efforts to shrink the public sector. The United Kingdom and Australia have been examples of this trend. The Australian Treasurer, Paul Keating, recently claimed credit for this achievement in the following terms:

"When we came to power in 1983, who would have believed that the ALP would reduce the size of the public sector to one of the smallest of the OECD and that in 1990 we will deliver a public sector of 1973 proportions and in 1992 a public sector of '50s proportions maybe."

This attitude contrasts with the New Zealand record, where the government has at times appeared to see merit in a state role along Swedish lines - a model now seen by most observers as unsustainable - and has allowed government expenditure and taxes to increase sharply, even allowing for changes in accounting treatment. Pennant-Rea saw this as a further flaw in New Zealand's policy approach:

"It seems to me that as a rough rule of thumb, a successful liberalisation programme should go hand in hand with a decline in public spending as a proportion of GNP. I would find it very hard to imagine a fully coherent liberalisation programme that went hand in hand with rising public expenditure, especially as a share of GNP."

Interestingly, the National Party has recently committed itself to achieving a fall in government expenditure and taxation as a percentage of national income.

This trend may be extended in the 1990s as OECD governments grapple with the evidence that extensive and well-intentioned welfare state policies have made many social problems immeasurably worse. As one writer has summarised the position:

"[T]he welfare state as we know it... is not an adequate safety net, nor an instrument whereby the underclass is reintegrated into civil life, nor yet an effective machinery for redistribution, but virtually the contrary of each of these distinct institutions. The welfare state does not relieve poverty but institutionalises it. It does not emancipate the underclass but instead imprisons it in ghettos of dependency... It does not redistribute income from rich to poor but instead... serves as a middle-class racket whereby income transfers are effected from rich and poor to the majority in the middle."

A fundamental rethinking of many welfare state policies is likely in the period ahead in many OECD countries.

Perhaps the broadest lesson of the 1980s for countries seeking growth and higher living standards - as well as other objectives such as greater political freedoms - is that "governments must learn their place," as one recent economic survey put it.

"Government has several vital jobs to do", it said, "and no spare resources to waste on other things. The cost of an effective legal system is public money very well spent. This means rules that define property rights, contracts, limited liability, bankruptcy and so on... [I]t also means enforcing those rules impartially... Spending on infrastructure, education and health services will also pay, though stricter tests of efficiency than at present are needed, and none of these tasks requires the state to be a monopolist. Elsewhere, governments would be doing their economies a favour if they just did less."

Much academic inquiry has shown that the decision-making failures associated with market exchanges are typically swamped by the problems associated with political decision-making in the economic arena given the reality of self-interested behaviour by politicians, bureaucrats and special interest groups.

The ideas of ordinary economics have been found to be relevant to poor countries and rich countries alike. The study of 'development economics' as a separate branch of the discipline has largely collapsed. Third world countries have suffered even more than rich ones from misguided attempts at planning and state direction.

At the turn of the decade, it is interesting to study the advice being given to the Eastern European countries as they attempt to reform their crippled economies. The failure of the command economies has reinforced the lessons that economic performance is gravely impaired where sound incentive structures and private property rights are lacking and where politicised decision-making opens the way for rent-seeking and exploitation. Professor Jeffrey Sachs, a Harvard economist who has advised a number of Eastern European governments, recently summarised his recommendations for a reform programme as follows:

"There should be four simultaneous parts to a programme of rapid market transformation. First, let prices find market-clearing levels, in part based on free trade with the West. Second, set the private sector free by removing bureaucratic restrictions. Third, bring the state sector under control, by privatisation and by imposing tougher disciplines on the state firms which remain. Fourth, maintain overall macroeconomic stability through restrictive credit and balanced budgets."

In a recent *Listener* article, Brian Easton expressed horror at this prescription, in which he saw all the key features of the advice the incoming government in New Zealand received in 1984. "And look where it got us," he remarked. What Mr Easton appears to overlook is that the New Zealand liberalisation programme, while containing many orthodox elements, has been piecemeal and protracted and consequently its benefits have been modest and slow in coming. It is interesting to compare his reaction with that of Professor Steven Cheung, a distinguished Hongkong University economist, writing in the *Asian Wall Street Journal*:

"Jeffrey Sachs' prescription for reforming the Polish economy is impressive, and if everyone perseveres, it eventually would work. However, the reform experience in China suggests that Mr Sachs' plan, which restrains wages to help curb inflation before privatisation, is not bold enough...Piecemeal tactics of tackling one thing at a time, as China did, are doomed to failure because they allow vested interests time to manoeuvre."

Cheung emphasises in particular the productivity-enhancing role of moves to privatise firms and free up labour contracting:

"For example, in the garment industry in the Pearl River Basin, workers who on fixed wages took long afternoon naps and shirked, were waiting in line for the factory to open, stopped talking when they worked, and refused to leave at closing time, the very next day after the introduction of freely negotiated piece rate contracts."

"China's undoing," Cheung concluded, "which I am afraid may some day undo the Soviet Union and Eastern Europe, is that it did not do what needed to be done all at once."

Not all of the shifts in thinking that I have touched upon have acquired universal acceptance. Few ideas do in economics. Yet there has undoubtedly been a sea change, and there are no real signs of a reversal. It will surely be equally fascinating to study their evolution in the next ten years and their impact in places such as Eastern Europe, Africa and Latin America – not to mention New Zealand.

**NEW ZEALAND SOCIETY OF ACCOUNTANTS
AUCKLAND BRANCH**

**SEMINAR ON MORE MARKET OR
MORE MANAGEMENT**

**SIR RONALD TROTTER
CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE**

**AUCKLAND
26 APRIL 1990**

MORE MARKET OR MORE MANAGEMENT

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

system which is not working, and is a massive deterrent to confidence and international investment.

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

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

- First, with government spending not curtailed, there is a serious risk of further tax increases, if not in this year's budget then in 1991.
- Second, businesses are apprehensive that further costs will be loaded on to them by moves such as an extension of accident compensation to include sickness, without reforms to what is a totally unsatisfactory scheme. At the local government level some outrageous increases in commercial rates are being imposed.
- Third, the wage bargaining system still places wage costs outside the control of many employers. Control will be further weakened by the proposed moves on pay equity, equal employment targets and the reintroduction of compulsory arbitration.
- Fourth, major additional costs will be imposed by the proposed resource management law. The Prime Minister has disputed this assessment. Yet the government's own advisor on the Town and Country Planning Act has expressed the view that "the process may well be more time consuming, more complex and above all it will certainly be more costly." And the Ministry of Agriculture and Fisheries has stated that the agricultural sector will be adversely affected by the proposals.
- Fifth, the programme of business law reform has not reduced cost burdens and has imposed new ones. Competition policy is still driven by confused objectives. There have been some signs that the government has recognised that the statutory management regime and other re-regulatory moves have been misguided, but its agencies are still promoting similar initiatives. The latest is the Securities Commission's absurd proposals to import overseas rules on the disclosure of executive salaries.

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

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

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

something close to a political consensus on these and other issues such as inflation, monetary policy and the exchange rate.

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

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

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

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

CANTERBURY CHAMBER OF COMMERCE

THE MYTH OF THE MIDDLE WAY

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**CANTERBURY CENTRE
CHRISTCHURCH
2 MAY 1990**

THE MYTH OF THE MIDDLE WAY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

This will require a realism not yet demonstrated by the New Zealand Meatworkers Union. The country's largest meat company has been crippled by an extended strike about a

redundancy agreement that didn't exist and isn't urgently needed because no one is being made redundant. Outdated union attitudes have inflicted enormous damage on their members and the whole community.

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

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

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

1990 NATIONAL BUSINESS ECONOMICS CONFERENCE

**NEW ZEALAND ECONOMY : FUTURE
CHALLENGES**

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**DUNEDIN
4 MAY 1990**

NEW ZEALAND ECONOMY: FUTURE CHALLENGES

Over the last two days you have been considering a number of weighty and erudite matters concerning New Zealand's prospects for the 1990s. Being neither particularly weighty nor erudite, I thought it might be interesting in this closing session to reflect more broadly on some of the background factors in the public and professional economic debate that might influence those prospects.

If we have learned anything about economic development in the last 40 years, it is surely that a country's prospects basically depend on how well it runs its own affairs. They have little to do with resources in the ground, proximity to markets or the treatment meted out by the rest of the world. Resource-poor countries like Japan, Switzerland, Hongkong and Singapore have done well. Apparently lucky countries like Australia, Argentina and New Zealand have lucked out.

If anything, these lessons will be even more relevant in the period ahead. Raw materials are becoming less and less important in many forms of production. Falling transport and communications costs mean countries can easily import resources. Capital is an international commodity. Even many forms of labour and brainpower are now internationally mobile.

The countries that will succeed in the future are those that create an environment that attracts and retains internationally mobile resources. Businesses will be seeking out opportunities where the economic climate is stable and predictable, tax rates are not oppressive, regulatory burdens are light and the workforce is stable and productive. Governments can no longer trap mobile resources inside national boundaries even if they wished to. People and capital will flee, and those that will be left behind will be largely the old and unskilled. The new form of international competition will be about creating an attractive economic environment in which businesses will locate.

In forestry, for example, contrary to popular opinion, New Zealand does not have a lot of natural advantages. We can't grow trees much better than many other countries do. The world is not desperate for our supplies. If domestic and international investors do not like the look of our tax rates, our planning laws, our port operations or our labour relations they will walk away. Forestry assets will be sold at a discount. We live in an unsentimental world.

In many respects these lessons are not new. They are ones that New Zealanders appeared to understand in the early part of our history and then forgot. By the turn of this century and for the next 20 or 30 years New Zealand became one of the most prosperous countries in the world. The 19th century was one in which open economies flourished. Immigrants saw them as beacons of opportunity. Despite the biased picture of social conditions painted by novelists like Dickens, labourers' wages in England quadrupled over the century in real terms. In the period 1840-1860 in New Zealand the Maori community progressed in many areas of commercial life. The performance of countries like New Zealand, Australia and Argentina was not unlike the Asian tigers today.

It is interesting to consider the economic environment in New Zealand at that time. For the 50 years from 1860, New Zealand effectively had price stability – indeed mild deflation, not inflation was the order of the day. We had no central bank until 1933. Barriers to trade were low. A substantial manufacturing sector had already developed by the time import protection was piled on in the 1930s. We made sophisticated items like steam engines and agricultural machinery. New Zealand had no statutory planning law until 1926. Splendid cities like Dunedin took shape without the regulatory apparatus that has since been created. The medieval torture chamber of our industrial relations system was not invented until 1894, and compulsory unionism did not come in until 1936. The overall role of the government in the economy was limited. It stuck to the basics. We had the ability to muster resources for wars if

necessary. New Zealand's first income tax, effectively a flat rate tax of sixpence in the pound, was introduced in 1891. Roger Douglas, eat your heart out!

I am not wanting to suggest that 19th century New Zealand was some kind of golden age, nor that everything can be explained by what we would describe today as a liberal set of economic policies. The colonial link was obviously important. There were aberrations like Vogel's early experiment with a 'Think Big' programme and the depression which followed. The first New Zealand railway was a private one and railways were being built by entrepreneurs all over South America at the same time in difficult terrain and primitive economies; it is a myth that private capital could not have been mobilised to do the job in New Zealand. Sweating commissions could identify what they regarded as Dickensian conditions, although I suspect voluntary charities and friendly societies did a better job of dealing with many problems of poverty than today's impersonal bureaucracies. But for those who do not believe that wealth is created by fairies at the bottom of the garden, New Zealand must have looked for many like a land of opportunity, mobility and 'careers open to talents.'

I have often wondered what the role of economists was in New Zealand's early development. Did they exist in 19th century New Zealand? One historian suggests the first use of a recognised New Zealand economist in a governmental activity was the 1911 Royal Commission on the Cost of Living. Is there a lesson for us in the story of the May Day parade in Moscow where a motley group was seen walking along behind the parade of tanks and missiles? "Who are they?" one general on the reviewing stand said to another. "They're a bunch of economists," was the reply. "You should see the damage they can do."

Economics has certainly been a growth industry over the last hundred years. The Nobel prize winner George Stigler has recorded the lack of enthusiasm, and often downright hostility, with which economists greeted early antitrust legislation in the United States. However, Stigler goes on to note the growing professional liking for antitrust policy. Referring to his own experiences in several antitrust cases after many years of abstention, he observed first, that:

"The number of economists, ranging from Nobel prize winners to graduate students no better known than the Unknown Soldier, who are employed in antitrust actions is large, running into the many hundreds."

And second that:

"The rate of compensation for economists in this activity is not in violation of the federal minimum wage law."

Similarly in New Zealand, the Commerce Act and its administrative machinery has been a rich source of employment and income for economists, lawyers and bureaucrats. Ten years ago the Commerce Commission employed only a handful of staff; today there are dozens. One New Zealand firm is said to have faced professional and other direct costs of around a million dollars defending its position in recent years. The diversion of scarce management time is enormous. A chief executive of one of New Zealand's largest business units had to spend six weeks on Commerce Act matters in a recent 12 month period. And all this at a time when the New Zealand economy has never been more open to domestic and international competition and less prone to monopoly problems.

More generally, it seems to me that economists have been major sponsors – and major beneficiaries – of much of the enormous growth of government intervention in the economy in recent decades. They have searched for theoretical sources of market failure and proposed governmental remedies for them, neglecting the fact that the political cure is often worse than the disease. They have promoted planning and control approaches to the management of the economy which require new bureaucracies – like a Ministry of Energy, a Planning

Council or an Employment Equity Commissioner – for their administration. Governments have obliged, and economists have not wanted for jobs.

It is interesting that in recent years the moves towards liberalisation of the economy have owed more to official thinking in some quarters than to outside intellectual influences. Perhaps bureaucrats learn sooner from their mistakes than some others. But it has been a slow process. The record shows that through the 1970s the Treasury was strongly influenced by Keynesian thinking, favoured the use of import licensing and supported aspects of 'Think Big.' Only 10 years ago the Reserve Bank was explaining why a floating exchange rate would not work for New Zealand. In the last couple of years it has been busy again re-regulating the financial sector with more extensive prudential controls.

We are used to blaming politicians for what has gone wrong in New Zealand. Perhaps we should look more closely at the accountability of their professional advisors.

Outside government circles, it seems to me that much of the economic debate has remained locked in a time warp. At a time when collectivist thinking has just about become extinct in Europe – I am told that if you need a Marxist in France today you have to import one from a North American university – it still seems to be alive and well in New Zealand. Roger Douglas has recorded his discovery during his time in Opposition that:

"... a lot of academics have no flair for decision making. They qualified every statement and were not prepared to commit themselves to anything. Their particular profession does not insist on the practice of their theory. The real contributions to the formation of our policy came from those used to taking practical action – the business people."

I have often pondered the question of professional competence and liability in the economics field. Last year one well-known economist was advising corporate clients that there would be a devaluation of 10 percent around September. If any firms took his advice, they are probably no longer with us. Few New Zealand academic economists subject themselves to recognised professional disciplines such as publication in leading international journals. Any who expect to have standing in the public debate ought to be able to demonstrate such credentials. How can the economics profession do a better job of disciplining poor performance and exercising quality control?

There is certainly a good deal in the current public debate that ought to be exposed to challenge. Let me list a random sample of such issues.

First, I find the popular view that you can't get growth with a firm monetary policy quite bizarre. Merely a look at the facts would show that it is nonsense. Through to the 19th century the world enjoyed about 400 years of more or less stable prices, during which time living standards increased enormously. Many OECD countries in the 1980s achieved lower inflation and lower unemployment simultaneously. The proposition is coming from some of the same people who argued in 1984-85 that reductions in the budget deficit would drive the economy into a recession. With hindsight we can see that fiscal policy was not tightened fast enough in that period. Professor Robert Clower, then president of the American Economic Association, wrote in 1984 that:

"There can be no doubt that [inflation] has been the single most important source of economic inefficiency in Pacific Basin countries in the last two decades."

As to the cure, he added that:

"It is now generally acknowledged (though by no means universally – the economics profession will always have its lunatic fringe) that the only way to avoid sustained

increases in the general price level is to avoid any but moderate and predictable increases in the monetary base."

I hope this debate will go away so we can get back to the real issues.

Second, we still seem to be besieged by a tribe of compulsive devaluers. Why anyone would want to see our currency downgraded further after the slide of the last 20 years is hard to understand. That process did nothing to help our competitiveness. Saying you want to devalue is like saying you want to – or have to – become poorer. It is amusing to contrast the New Zealand mentality with the pressure from East Germans wanting to become richer by fixing their currency at parity with the West German mark. Certainly we are still living beyond our means and we are not competitive enough. But let's address that problem in an honest and direct way – either by taking a cut in real wages or, better, by raising our productivity – not by further futile attempts to fiddle with the exchange rate.

Third, we seem to be reverting to a tedious discussion of growth and growth targets. The National Development Conference set a growth target of 4 percent in the early 1970s; the Planning Council lowered it to 3 percent a few years later; we achieved next to nothing. Such talk is, at best, a distraction from the hard decisions that are needed to create a better economic environment; at worst it is a return to the planner's mindset. I have no doubt that many New Zealanders want to increase their living standards and they ought to have the chance to do so if we ran our affairs better. But others might prefer to go to the beach or give up some material welfare to preserve some environmental assets. Provided they pay for these choices themselves, why should they be prevented from making them? Surely the issue is about choices, and rules and institutions that give people the freedom to choose, not about narrow materialistic goals.

Fourth, the latest nostrum seems to be an urge to increase savings. I won't go on at length about this, as Bob Jones recently dealt with it comprehensively. Why people should be forced, or bribed with their own money through tax incentives, to increase savings is beyond me. Savings by themselves have little to do with economic growth; if they did, Romania, which has one of the world's highest savings rates, would be a world-beater. With open access to world capital markets, national savings by themselves have nothing to do with interest rates or the availability of capital for investment. Even more fundamentally, why should governments paternalistically try to influence how individuals split their incomes between savings and consumption? Surely all we should ask is that governments do not artificially discourage people from saving. People save - that is, forgo current consumption - in order to have higher consumption in the future and to protect themselves against future risks. If governments indemnify people against particular risks - say by providing generous state pensions - naturally they will change their behaviour and save less themselves; it would be irrational to do otherwise. Let us by all means not discourage personal savings by high income taxes, high inflation or high welfare safety nets. Let us also not indulge in deficit spending and external borrowing which supports consumption at the expense of a growing stock of debt. But provided we establish these preconditions, why should we not trust people to make their own decisions?

Finally, though this shibboleth is promoted more by vested interests than the economics profession, there is the charge that a freer labour market would drive down wages. I would ignore this charge for fear of reprimand from the Society for the Prevention of Cruelty to Straw Men were it not that this straw man is so popular in such circles. Its proponents would have us believe that it is not gains in productivity that make for wage increases but unions – "the union makes us strong." If unions made us strong, then countries like Poland and Argentina would be a worker's paradise and Hongkong would be a basket case. Mercifully I believe we are coming to an end of this nonsense; people can see that the new arrangements on the wharves, for example, not only raise productivity enormously but make workers better off as well. A freer, voluntary system will make workers more productive and wealthier, which should be the basic goal.

Having been mildly critical of economists, I want to acknowledge – at the risk of appearing reasonable – that business people are often at least as confused about the workings of a market economy. As one writer has put it:

"It is a rare businessman who not only believes in capitalism but also understands it. And why not? They are... almost as likely to absorb popular economic notions as other people."

Good business people are good at knowing how businesses work – which is not the same thing as knowing how economies work.

So the economics profession has the potential to help us all, but only if it improves the quality of its product. This is not an advertisement, but one of the reasons that I have been involved with the Centre for Independent Studies is to promote competition in ideas in New Zealand. Because ideas are always liable to challenge some vested interest or other, any such group is likely to attract its share of critics. The NZCIS's experience is not unlike that described by Steve Pejovich, the director of a similar North American think tank, and I believe his response is appropriate.

"Whatever we do," he said, "people will always accuse us of being ideological. This argument comes from two different sources in the academic community. Some people are openly hostile to the principles and ideas of free enterprise, but do not possess the analytical skills to question our propositions on scholarly grounds. Predictably, their approach is: "if you can't prove them wrong, call them names." For example, a faculty member told me once that we are selling ideology. I asked him which specific activity he was referring to. He said that he had better things to do than read our stuff. People in this group are intellectually dishonest and academically incompetent. They have earned a right to be ignored."

"The other group is intellectually honest," Pejovich continued, "but uninformed about the difference between ideology and analysis. We are all ideological in the choice of topics that we want to look into... The crucial issue, however, is what we do with those ideas and concepts. We could try to hard-sell them to others; or, we can analyse them and look into their testable implications. The latter is scholarship. And that is what the Centre has consistently tried to do and what it must do in the future to earn its credibility and reputation from those whose opinions count."

Whether New Zealanders have the wit to make the right choices about their economic environment in the 1990s will depend, as in any democracy, on the state of community understanding of economic issues. I believe we have made progress in this respect in recent years, but it is modest progress. If the economics profession can raise its game and contribute to better community understanding, it would provide a useful service. If it can't – perhaps because we can't afford to pay good academics enough, or because economists are too prone to capture by the interests they work for – then maybe we would be better off without such services. George Stigler, speaking of the United States, has written:

"One evidence of professional integrity of the economist is the fact that it is *not* possible to enlist good economists to defend protectionist programs or minimum wage laws. The groups who seek such legislation accordingly must seek elsewhere for their spokesmen and theorists – and judging by their success, the *ersatz* economists do their work well."

Stigler's *ersatz* category is plentiful in New Zealand. Unless good economics can drive out bad, it might be better to reduce the supply.

Adam Smith, by most accounts the premier economist of all time, did not get it all right but his basic accomplishment of explaining the workings and merits of a capitalist system has

stood the test of time for two hundred years. His ideas are being revalidated in dramatic ways. The communist spectre that was to haunt the world is being displaced by worldwide privatisation. Keynesian economic thought is likely to occupy a footnote in economic textbooks a hundred years from now. Smith's ideas were basically simple, and they served the United Kingdom and other countries well until the lessons were forgotten. We are rediscovering that in a more complex world there is an even greater need for simple rules and a greater penalty for transferring the power to make decisions to political authorities with neither the information nor the capacity to get them right.

A phenomenon of the 1980s has been the growing international consensus on economic policy. As *The Economist* has put it:

"All... governments that do not want to pauperise [their countries] are now obliged to run an economy that is open to the world, and within which the market determines what goods are produced, where and how... [T]he debate on economic policy has been squeezed into a narrower channel than seemed possible ten years ago."

The same trends can be seen in New Zealand. A wide area of common ground on economic management is shared by the main political parties. This is a source of immense frustration to those editorialists and other romantics still pursuing the socialist dream. I was accused by one of them this week of not being caring. Caring in my book is about doing something effective to get people out of poverty or ill-health, and to face the facts that alternative well-intentioned policies have failed.

The main rules of today's pragmatic economic synthesis are fairly simple. To cure inflation, you stop printing money. To stop piling up debt, you balance your budget. If you want full employment, you free up your labour market and make sure your welfare safety nets don't turn into hammocks for people to lie on. Interest rates and exchange rates must be allowed to do their jobs of sending the right signals to producers and consumers, and disciplining poor decisions. Seldom do we hear calls for interference in the stockmarket, the other market for financial assets, but proposals to control debt and foreign exchange markets have a habit of coming back.

What would the New Zealand economy look like in 10, 20 or 50 years' time if we followed such rules? The answer is that we do not know in any detail; anyone who pretends otherwise is a charlatan. The central fallacy - the fatal conceit - of the planner is the belief that, with a better model or a better telescope, the future can somehow be discovered and ordered. But the future is not discoverable because it is not pre-ordained; it is unknowable and there to be created. The creative role in business is pre-eminently that of the entrepreneur seeking profitable opportunities to meet consumers' needs.

There are a few things that we do know about the shape of business in the future. One is that businesses - especially big businesses - are biodegradable. How many companies listed on the New Zealand stock exchange in 1980 are still there today - in the same form or even at all? Few businesses in my experience have a heyday of more than five years or so. In a competitive economy, their success brings about their own demise; someone else is spurred into coming along with a better idea or a cheaper product. That is the dynamic nature of the capitalist system.

This process of 'creative destruction' has been at work in New Zealand in the last half decade. One of the great myths is that the main beneficiaries of Roger Douglas's economic policies have been large established businesses. The truth is that most of them have been hammered. They were shaped by a set of incentives which has now totally changed. They have had to adapt or die. Even in the present depressed environment, newer and smaller businesses are taking their place.

Supporters of economic liberalisation, contrary to the distortions of their anti-capitalist critics, have never argued that what is good for big business is good for New Zealand. Their

argument is that policies that are good for New Zealand will involve a tougher, less sheltered environment which will force businesses to be internationally competitive and do a far better job of creating wealth for New Zealanders.

The critics also raise the spectre of large businesses growing even larger - 'monopoly capitalism' in the vocabulary of the *SUP Tribune*. But the evidence is that there is no long run trend towards industrial concentration in open economies and the disciplines of global competition are becoming ever-stronger. Such problems are taken care of by the processes of creative destruction I referred to. You have probably heard the advice on how to start a small business : "Buy a large business and wait".

The final hoary chestnut is that a liberal market economy in New Zealand would produce inequality of wealth - a tendency for the rich to grow richer and the poor poorer. Those who make this claim have never studied the long run evidence. In competitive economies, to quote Stigler again:

"In plain historical fact, the inequality in the distribution of income has been diminishing, and the diminution has been due to market forces even more than to government forces. It is also worth noting that a modern market economy has a less unequal income distribution than either centrally directed or unindustrialised economies."

I conclude that economists have a role to play but it is not that of being instant gurus or prophets. Rather it is to undertake the difficult task of explaining, patiently and carefully, the complex workings of a market economy, and the subtle ways in which it creates wealth and opportunities with maximum freedom for its participants. The purpose of such explanation is not to glorify markets which are, after all, only a sub-set of a social order based on voluntary relations. It is simply to guard against the ever-present tendencies to interference with business and personal freedoms which lead, in the limiting case, to the Eastern European disasters.

THE LABOUR MARKET

NATIONAL PARTY KAIPARA ELECTORATE SEMINAR

**LABOUR MARKET REFORM
THE ROLE OF PUBLIC OPINION**

**ROGER KERR
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE**

**WELLSFORD
24 NOVEMBER 1989**

LABOUR MARKET REFORM THE ROLE OF PUBLIC OPINION

The President of the Council of Trade Unions, Ken Douglas, has made the valid point that the ideas that will prevail in the labour relations debate are ultimately those which are upheld at the bar of public opinion. I want to focus in my remarks on public opinion on labour relations issues in New Zealand and wider shifts in contemporary thinking that have been occurring around the world.

Earlier this year I took part in a radio talkback programme on the subject with Bill Andersen, the President of the Auckland District Council of the CTU. In reply to a question on his choice of the ideal society, he replied, "East Germany". It was rare to hear the beliefs and values of a leading trade union figure put forward for public scrutiny in such a candid way.

Mr Andersen's belief in the East German vision is not difficult to understand. The Socialist Unity Party, which is what the communist party is called in East Germany, has been the most ideologically-driven regime in the Eastern bloc. But the truths of this system have been revealed on television screens around the world in recent weeks. As closer observers have known for many years, East Germany has been a country of repression, pollution and stagnation. The remarks of ordinary citizens crossing into West Berlin told it all. "To think we worked so hard for 30 years and capitalism is so far ahead," one said. The 'welcome money' of \$100 given by the West German government to each visitor represented two weeks' wages for many of them.

East Germany of course is not alone. As Lech Walesa, leader of Poland's Solidarity trade union said recently, "All the countries of Eastern Europe are bankrupt... the communist economy has failed in every part of the world."

It has been interesting to follow the reactions to these events in the New Zealand Socialist Unity Party's newspaper, the *Tribune*. Editorials have blamed the exodus on Western propaganda. The East Germans failed to find "the true road to socialism". It is ironic that New Zealand is so often the last resting place for discarded ideas.

All the fundamental ideas on which the Eastern bloc models have been based are, of course, the same ones that have shaped the development of labour legislation and the privileges and immunities granted to trade unions in many western countries over the past century. In the ideology of Marxism and its Fabian cousin, economic life is a struggle between capital and labour. Employers of labour are better-off people who can exploit workers. Workers are in an unequal bargaining position with employers. This situation has to be rectified by the collective action of workers through trade unions. To be effective, trade unions need to enjoy special privileges. This is the essence of the conflict model on which New Zealand's industrial relations system was constructed in 1894. It has remained basically unchanged to the present time.

An example of such analysis was an article by Ken Douglas in the *Tribune* earlier this year. He argued that the fundamental requirement of capital "creates an antagonistic contradiction, opposing the needs of workers, of people, small business and even whole national economies". Mr Douglas called for a "campaign for the re-regulation of the economy" via the proposed Compact with the trade unions.

The Marxist-Fabian model has now been tested virtually to destruction. If collectivist economic systems and special trade union protections were a recipe for economic success and worker advancement, we ought to observe splendid results in the countries that have taken them furthest. The evidence is clear that East Germany has not turned out to be the workers' paradise, and nor have its western equivalents. Britain, Australia,

New Zealand and Argentina are examples of countries with the most developed tradition of Fabian-style trade unionism with strong legislative backing. Yet Britain, Australia and New Zealand have been the three worst performers in the OECD league in the post-war period and Argentina, one of the world's richest countries at the turn of the century, has spiralled down into third-world status.

By contrast, if the conflict model were valid, we would expect to see the worst cases of impoverishment and worker exploitation in countries without trade unions or extensive labour legislation. But Hongkong, for example, where employment contracting is largely unconstrained and trade unions are insignificant, has now reached per capita income levels close to ours and wages have increased at rates which not even a New Zealand waterside worker would dream of. The high income, high productivity, high employment economies of Japan and Switzerland have a minimum of restrictions on employment relationships.

The lesson here is that it is not labour law and unions that raise wages - it is productivity that raises wages. Poorly structured labour laws and unions lead to inefficient work practices, a bad industrial climate and lower real wages. In the United States, wages in non-unionised industries have risen faster than in unionised industries in the 1980s.

Despite this evidence, the lessons have not yet been understood in many quarters in New Zealand. The Labour Relations Act 1987 preserved the 1894 conflict model. The entire scheme of the Act revolves around the interests of unions, not employees. The elimination of small unions in favour of unions of 1000 members or more is based on the doctrine of unequal bargaining power. In the name of worker protection, the government has raised the statutory minimum wage to around 50 percent of average weekly earnings, one of the highest ratios in the OECD, exacerbating the employment difficulties of young and low-skilled workers. The latest initiative is the proposal to set wages for groups of female workers on the basis of assessments by an Employment Equity Office and an arbitration tribunal, a concept which would return us to the world of George Orwell and East Germany.

Because we have not absorbed these lessons, the economy is still foundering, our competitiveness remains weak and the unemployment problem is intractable. A host of commentators have pointed out since 1984 that the government's failure to reform the labour market would sabotage its economic programme. I would confidently predict that the Eastern European countries will face similar experiences as they set about partially liberalising their economies. The costs of change will be felt before the benefits, there will be frustration that half-freed economies are not delivering the goods and, as in New Zealand, many voices will be heard wanting to turn the clock back rather than to remove the obstacles that stand in the way of success.

The Business Roundtable, the Employers Federation, Federated Farmers, other employer groups, government agencies, the OECD and the IMF and many independent commentators have all argued in broadly the same terms for a move away from compulsory unionism, registered unions and national awards to a voluntary, decentralised, contract-based system of employment relations which recognises the essentially common interests of employers and employees. Whether or not this view will ultimately prevail will depend, as Ken Douglas has rightly said, on trends in public opinion - led, one must hope, by politicians who understand the importance of the issue for New Zealand's future.

Some information on public thinking is available from a number of surveys that have been undertaken, one of the most comprehensive being an *Insight New Zealand* poll released earlier this year. A basic finding of this survey was that:

"New Zealanders would like to see a roll-back of union power and influence. They believe there should be more free choice in the labour market and an emphasis on enterprise-based initiatives".

Let me list a few of the interesting findings of this survey.

- New Zealanders are not generally opposed to unions. They think they have a useful role to play in negotiating employment arrangements, dealing with workplace safety issues and handling grievances. This is consistent with the view of advocates of labour market reform that the problem is not unionism as such but the regulated and monopoly forms that unionism takes in New Zealand.
- An overwhelming 77 percent of New Zealanders support voluntary unionism. This is in line with overseas surveys and with practice in virtually all OECD countries other than Australia and New Zealand. It is in line with the policies of the ILO - hardly a 'bosses' organisation. Few political parties or trade unions around the world today actively promote compulsory unionism. In New Zealand, unionists like Sir Tom Skinner have supported voluntary unionism. It is odd that the present generation of trade union leaders in New Zealand appear to be more entrenched than ever in defending our de facto form of compulsion.
- Nearly three out of four members of the public believe workers should be able to join any union they wish. You will recall that proposals for choice in membership - the so-called "contestability" issue - were fiercely and successfully opposed by trade union leaders seeking to retain monopoly coverage at the time the Labour Relations Act was being debated. Trade unionism in successful economies is not characterised by monopoly coverage and the kind of demarcation practices that persist in places like the New Zealand waterfront.
- In respect of wage fixing, 85 percent of respondents preferred alternatives to national awards. Nearly half preferred individual contracts to collective bargaining. Around the world systems based predominantly on national-level craft-based bargaining are now confined to Australia and New Zealand. Overwhelmingly the focus elsewhere is on individual enterprises. Yet the rhetoric of central union officials has been about the need to "defend national awards".

At a more detailed level, a number of other interesting messages emerged from the survey.

- Most people think employers and employees have basically the same interests.
- A significant proportion of New Zealanders would still choose to be represented by a trade union even if they were not compelled to join.
- The public are very aware of the tendency for trade union activities to result in fewer job opportunities.
- There is an overwhelming view that productivity would be improved by negotiating wages and conditions at the workplace level.
- Contrary to trade union claims, there is no strong belief that union coverage for workers is more necessary in small firms or small towns.

Even among trade union members, half thought it made little difference.

- While people believe discrimination against women exists in the workforce, there is very little support for affirmative action programmes as the solution.
- There is no majority support for legislation to increase the wages of women employees. Women themselves are only narrowly in favour of the idea.
- Only 5 percent of the public think unions should be affiliated to a political party.

These are hopeful messages, and they have come through consistently in a number of surveys. Not surprisingly the CTU has disputed the validity of some of the findings. In the hope of providing a more definitive indication of public thinking, the Business Roundtable earlier this year proposed that a referendum should be held on key issues. Unfortunately the CTU's response was that such a procedure would be undemocratic and, in effect, that workers could not be trusted to make up their own minds on such issues - unions knew best.

I commend the initiative to hold seminars such as this one to bring these issues out into the open, and look forward to hearing the CTU viewpoint. Seldom does one hear an attempt to provide a reasoned defence of features of our legislation such as compulsory unionism. When the Hon Peter Tapsell recently suggested that the time had come to debate the issue, the CTU response was to jump on him. Our organisation has continued to publish research and engage the services of leading international scholars in the field in the belief that ideas should be tested and exposed to scrutiny. The opinion survey findings provide some reassurance that the public is not swayed by rhetoric, emotion and intimidation.

Labour market reform is vital for the future of New Zealand workers and the unemployed - whose interests should come first - but it should not be seen as a threat to progressive unions. There is a good future in some industries for unions that are voluntary, competitive and democratic and which provide good services for their members. In the deregulated Swiss labour market, union membership has remained stable at around 30 percent of the workforce for many years. Generally speaking, however, the trend has been for rates of unionisation to fall sharply, for example by some 10 percentage points in the United Kingdom and Australia over the last decade. In the United States the rate of unionisation in the private sector is now down to 17 percent and in some industries it is well below 10 percent. These trends reflect factors such as changes in the nature of work, the influx of women into the workforce, preferences for part-time work and moves to forms of performance-related remuneration. Collective bargaining is no longer the norm even in large sectors of New Zealand industry. These trends will continue, and unionism is likely to decline more rapidly if rigid structures are maintained.

Indeed a strong case can be mounted that the government has harmed, not helped, the long run interests of the union movement by legislative props such as the return to compulsory membership, monopoly coverage and forced amalgamation. Just as import protection ultimately weakened manufacturing industry in New Zealand, these legislative protections have arguably contributed to the weakness of union organisations and the bottom ranking in public esteem that they hold among all New Zealand institutions. Inadequate union leaders have not been subject to the competitive stimulus to performance faced by leaders in the commercial sector and elsewhere. The lack of pressure on them to reflect their members' interests has led to

workers dropping out of union membership and a greater resort to individual contracts. Self-employment and independent contracting have been growth areas at the expense of direct employment. We will only find out whether unions are still useful institutions, capable of attracting allegiance and loyalty, when the monopoly protections they enjoy are removed and participation becomes a matter of voluntary commitment.

Worldwide the task of explaining the Marxist-Fabian vision is not getting easier. Outside a narrow group of interests in positions of political influence, I believe there is a large constituency in New Zealand for freeing up the labour market. Trends in the political debate in the United Kingdom and Australia suggest that when a future National government introduces reforms in this area, no subsequent Labour government will turn the clock back. In the United Kingdom, a majority of trade union members have supported Mrs Thatcher - because they themselves have enjoyed the benefits of her policies.

It is to be hoped that whatever government makes the changes does so in a comprehensive and high quality manner. Our own experience and the likely prospects for Eastern Europe point to the pitfalls of operating in a half-free economy. As *The Economist*, speaking of the Soviet Union, pointed out last year, "you leap towards freedom, not shuffle".

H R NICHOLLS SOCIETY MEETING
'PUBLIC INTEREST OR VESTED INTEREST'

LABOUR MARKET DEVELOPMENTS
IN NEW ZEALAND
WHITHER LIBERALISATION?

DR PENELOPE BROOK
NEW ZEALAND BUSINESS ROUNDTABLE

SYDNEY
11 MARCH 1990

LABOUR MARKET DEVELOPMENTS IN NEW ZEALAND: WHITHER LIBERALISATION?¹

INTRODUCTION

The primary insight in economic policy in New Zealand in the mid-1980s was that the country's poor economic performance was to a great extent the result of the suppression of individual initiative and freedom of contract; that in the vast majority of circumstances governments and their bureaucracies are not so rational, wise and benevolent that they can outperform the market. There was also a recognition that, in terms of equity, the principal effect of pervasive and at times highly innovative intervention in the economy had been to create and protect pockets of privilege among those most adept at 'playing the system'.

The response was a fundamental shift in the way in which government involvement in the economy was viewed. This was described by Roger Douglas in the following way:

"[O]ne of the major philosophical differences in the new Government of 1984 was a change in the understanding of the roles of government and its ministers. The proper role of government is to ensure that the people get the best possible value from the country's limited human, physical and financial resources and to provide the maximum benefit for the whole population, in this case 3.3 million New Zealanders, and not just for favoured sectors of industries. Value for money from our resources and equity - basic fairness for everyone in the community - are the two basic goals of economic policy."²

This role was seen as best fulfilled by a shift away from central planning, 'picking winners' and legislating for particular outcomes (whether through import quotas or price-fixing); from attempting to replace market outcomes with outcomes judged more 'socially desirable'. Instead, the emphasis was to be placed on setting the basic rules required for markets to be able to function, and leaving outcomes to individuals to decide - replacing central planning with planning by individuals.

The central planning mentality was as well entrenched in the labour market as anywhere - even if the fact that what was going on was central planning was somewhat obscured by the delegation of the power to plan to central union and employer organisations. However, in contrast to the reforms introduced in other sectors, the response was not to replace centralist, outcome-oriented policy with basic rules aimed at encouraging individual initiative in employment relationships. Instead, and despite claims to the contrary, the Labour Relations Act of 1987 involved a little tempering and a little streamlining, but has if anything reinforced the collectivist labour relations system first set in place by the passage of the Industrial Conciliation and Arbitration Act in 1894.

The intention of this paper is to review labour relations developments in New Zealand since the passage of the 1987 Act. It begins by sketching developments in the field - changes in union organisation and bargaining arrangements. It then considers the emerging role of the Labour Court in developing new legal precedents in redundancy and 'unjust' dismissal cases. Thirdly, it surveys some legislative initiatives currently being considered by the government, which if implemented would reinforce central control of labour market relationships. It then concludes with some brief comments on the prospects for moving to a more liberal labour relations system.

¹ This paper draws extensively on a forthcoming book, *Freedom at Work*, Oxford University Press.

² Douglas, R.O. (1989), "The Ends and the Means", Walker, S. (ed), *Rogernomics: Reshaping New Zealand's Economy*, Auckland, New Zealand Centre for Independent Studies, pp 22-23.

THE IMPACT OF THE LABOUR RELATIONS ACT

The Labour Relations Act has in some quarters been trumpeted as a means to decentralisation of control over employment relationships and increased labour market flexibility. In practice, subsequent developments have been rather less significant than the Act's supporters might have expected.

The degree of competitive pressure faced by unions does not appear to have increased as a result of changes in the mechanisms for electing and enforcing compulsory unionism, and for instituting changes in union coverage. Only a handful of ballots on compulsory unionism have been held under the new regime, with compulsory unionism clauses being retained. Voter turnout in these ballots has typically been low³. There is some suggestion that the requirement that unions, rather than employers, enforce membership has led to a decline in membership in small towns, where policing is relatively costly. However, the continuing willingness of employers to deduct union dues from employee pay has probably dampened this decline.

With regard to union coverage, there have to my knowledge been only two attempts to initiate changes in union coverage⁴, both of which have lapsed, and only two new unions have been formed since the Act was passed. The introduction of a 1000-member-minimum rule has, on the other hand, led to the creation of a number of relatively loose affiliations among small existing unions, often with little in common from an economic perspective - the Canterbury flour mill workers have merged with the Furniture Workers' Union; the sports bodies workers and the fish workers with the Allied Liquor Trades Unions; the Northern Fertiliser Workers' Union with the food workers, and:

"[s]hipwrights, boat builders, ship joiners, ships machinists, iron, brass and aluminium moulders, coach workers, pulp and paper workers (at Kawerau), boilermakers and optical technicians have formed an unwieldy union founded primarily on ideology".⁵

There have also been some moves towards the creation of 'mega-unions', for example between the Electrical Workers' Union, the Printers' Union and the Post Office Union; and between the Clerical Workers' Association and the Distribution Workers' Association. In 1986, membership of unions with over 10,000 members accounted for 44 percent of the unionised workforce; by late 1989 it accounted for 66 percent.

While the Act was promoted as facilitating bargaining at an enterprise or workplace level, there has in practice been only limited, and hard-won, progress in this direction. Some enterprise-level agreements have been negotiated, notably at Nissan and Mitsubishi. However, composite agreements of this kind were also possible under the pre-1987 legislation. There has been little use of the new provision for unions to cite individual employers out of national awards, so as to negotiate separate agreements. For the most part, this practice has been used only where voluntary separate agreements existed before the Act was passed. Nor has there been any success in using Section 152 of the Act, in which there was provision for groups of workers to negotiate directly with their employers - in the 1988/89 award round, an attempt by Ventec workers to activate this provision was disallowed by the Labour Court.

³ For example, the compulsory unionism ballot for farmworkers was decided by a vote of 102 for, 46 against, from a total membership of over 20,000. (This ballot was subsequently disallowed.)

⁴ The right to initiate changes in coverage is limited to existing unions. Central union organisations have recorded opposition to use of these provisions.

⁵ *New Zealand Herald*, 27 March 1989, p. 9.

Within awards, there have been some attempts to promote changes in working conditions that would enhance productivity, generally in exchange for wage concessions. These have on the whole been more marked in the state than in the private sector, and in particular in the state-owned enterprises - the Electricity Corporation, for example, has developed seven separate agreements for its individual business units, with differing wage adjustments and some significant changes in conditions⁶.

A further, potentially significant development in the 1988/89 round was that some awards were not settled (although individual employers have independently passed on wage increases to workers covered by these awards). This has led to increased union pressure for a return to compulsory arbitration. However, the costs of non-settlement are for the meantime muted, as under the current legislation an award that is not renegotiated continues in existence for a further two years.

There seems to be a number of reasons for the retention of traditional bargaining structures. First, decentralisation is strongly opposed by central union officials, who favour instead a shift to centralised industry-level bargaining. The combination of effective compulsory unionism, barriers to shifts in union coverage and the 1000-member rule strongly limit the potential for worker initiatives for decentralisation. Secondly, this initiative cannot be taken readily by employers, as it is only unions who can cite employers out of existing awards. Thirdly, where there have been attempts to shift towards enterprise-level bargaining, as in the case of Nissan and, more recently, moves to port-by-port agreements on the waterfront, the costs in terms of industrial disruption of making this transition have been high. At least in the short run, it is likely that many employers view these costs as exceeding the benefits to be gained from the transition. Fourthly, there are for some employers few incentives to change, as, among other things, the present system minimises their need to pay attention to their employment relationships, reduces competition for workers, and has in recent rounds delivered wage increases that are low by historical standards. At least in the short run, the award system remains a means by which some union officials and employers can collaborate in protecting their own interests at the expense of workers and other companies.

DEVELOPMENTS IN THE LABOUR COURT

One significant change introduced in the 1987 Act was the separation of the former Arbitration Court into an Arbitration Commission, now primarily concerned with the registration of awards and agreements and related functions, and a Labour Court, charged with adjudicating disputes of right. A number of recent cases suggest that the Court is taking an increasingly activist role in the areas of redundancy and dismissals, establishing a body of precedent intended primarily as 'protective' of workers - rather than of sanctity of awards and agreements. In the process, it has arguably moved well beyond simply enforcing the requirements of the Labour Relations Act.

In the area of redundancy, a number of recent cases suggest that there is now no clear right on the part of employers to transfer staff to a new employer when a company is sold, without the consent of those staff, unless this is specifically provided for in the employment contract. Where there is no such specific provision, workers who refuse to transfer are regarded as technically redundant, and the seller is liable for redundancy compensation. In one case, the *seller* was held liable for redundancy compensation when the *buyer* made two workers redundant eight months after purchasing the company⁷. If this case is adopted as a

⁶ It should be noted that state sector labour legislation, embodied in the state-owned enterprise reform legislation and the State Sector Act of 1988, is more permissive of disaggregation and worker choice than the private sector legislation.

⁷ *NZ Storeworkers, Packers, Warehouse Employees IUOW v Tulloch Road Limited and Mogal Freight Services Limited*, Christchurch Labour Court, 62/89.

precedent, the effect will be to impose a liability of unknown magnitude on any employer selling his or her business as a going concern.

In another recent case, an employer was taken to the Labour Court for attempting to replace an employee cleaner with cleaning contractors, a change which would have afforded an annual saving of around \$5000⁸. The employer claimed that this was a redundancy, necessitated by a downturn in its business. The court, deciding that it was instead an unjust dismissal, claimed that it had insufficient evidence to show that the company was in fact in need of financial restructuring. The implied readiness to interfere with commercial decisions is a cause for considerable concern. (In this case, the company involved apparently had insufficient resources to be able to take the decision to appeal.)

With regard to 'unjust dismissal', a recent decision suggests that in some circumstances non-renewal of a *fixed-term* employment contract will be taken to constitute an 'unjust' dismissal, liable to compensation and/or reinstatement⁹. Commenting on his decision, the presiding judge asserted that:

"the simple fact that a contract had expired was not sufficient reason for not renewing it. There must always be an inquiry into whether the termination of a contract was justifiable, even though the contract was determinable at will and expressed to expire at a fixed date... An employer may not, without good reason, impose a fixed term contract of employment on a worker, and this court is entitled to examine those reasons. If not satisfied by the employer at the very least that the reasons are such as might prevail with a reasonable employer giving due consideration to award obligations, then we are entitled to say that from the start the employer has set the stage for a dismissal which in the end will turn out to be unjustifiable".¹⁰

The possible adverse implications for employers seeking to increase the flexibility of employment by relying more extensively on fixed-term contracts, and for workers using these kinds of contract to escape some of the strictures of the labour relations system, are substantial.

The separation of the Labour Court from the Arbitration Commission was arguably a step forward in that it placed adjudication of disputes over the implementation of awards and agreements in what was ostensibly a branch of the normal court system. However, this does not appear to have been translated in the Labour Court into a concern to uphold the law and contracts made according to the law; rather it has taken upon itself a role not unlike that of the earlier Arbitration Court of deciding cases according to its own notions of bargaining power and substantive justice, and of providing a kind of paternalistic running commentary on the relationships of the parties who come before it, rather than testing the legality of their actions.

To summarise, there is a tendency towards increased central oversight of employment relationships, and increased restrictions on contractual terms - implying higher overall costs of employment. Although the decisions of the Labour Court in unjust dismissal and redundancy cases are probably benevolently motivated, their ultimate effects are likely to be quite detrimental to the workers they are ostensibly trying to protect, through decreased choice over employment structures and conditions, and decreased aggregate employment opportunities.

⁸ *NZ Cleaners, Caretakers etc. Union v Ferrymead Historic Trust*, Christchurch Labour Court, 1 December 1989.

⁹ *NZ Food Processing Chemical Related Union v ICI Limited*, Wellington Labour Court, 98/89.

¹⁰ quoted in *The Evening Post*, 27 December 1989.

NEW LEGISLATIVE INITIATIVES

Since the passage of the Labour Relations Act, there have been a number of significant proposals for legislation on particular aspects of employment relationships. These include the introduction of an 'employment equity' Bill, proposals for 'industrial democracy' legislation, proposals to bring independent contractors within the purview of the Labour Relations Act, the introduction of a Bill reforming occupational safety and health regulation, the establishment of an employer- and state-funded Trade Union Education Authority, and union-government negotiations over the establishment of a 'Compact', with a view to a more coordinated union influence not only over labour market policy but in general policy formation.

In each case, there is a tendency in the direction of more, not less, central government control over the features of employment relationships. This reflects a view that remains common among academic commentators and social policy advisors that more reliance on the market in other areas of economic activity, rather than increasing pressures on employers to upgrade their employment relationships, has made workers more vulnerable. Thus the Royal Commission on Social Policy in 1988, firmly convinced that freedom in labour markets was a euphemism for wage slavery, reported, with approval, that:

"The free market model is argued by some as not being appropriate for New Zealand conditions. That model is argued to be based on 'Western European values of freedom and individual rights and a belief that active pursuit of these will result in the greatest good for all'... [It is argued that] this approach is monocultural, taking no account of collective values, ignoring existing structural inequalities, and creating greater inequalities. Similarly, ... the free market ethic [is viewed] as resulting in a society which serves the needs of those who command power and financial resources: in New Zealand this group is predominantly white, middle class, middle aged, able-bodied and male'. The Commission is broadly in agreement with these criticisms."¹¹

Late nineteenth century concerns about 'bargaining power' and exploitation, and a belief in the comforts of Fabian Socialism, are clearly alive and well in late twentieth century New Zealand.

I shall concentrate here on two of the recent policy initiatives - the Employment Equity Bill and the 'industrial democracy' proposals.

- The Employment Equity Bill

The Employment Equity Bill, providing for mandatory, results-oriented equal employment opportunities programmes (that is, affirmative action) and comparable worth, was introduced late in 1989. This was despite widespread opposition from the business community and from government officials concerned about incongruities between the Bill and at least the announced intentions of the Labour Relations Act, and about the likely costs of comparable worth, both fiscally and in terms of unemployment. The government, however, regards itself as having made a strong electoral commitment to the policy, and the Minister of Women's Affairs has threatened resignation if legislation is not put through.

The key assumptions underlying these proposals are familiar ones: the concentration of women in a limited range of occupations and a gap between the average wages of women and men are seen as reflecting discrimination; discrimination is seen as inherent in market relationships (according to some, markets are little more than a tool of white male oppression), and the only means of countering this 'discrimination' is thought to be the creation of a rational, wise and caring 'gender-neutral' bureaucracy - charged not with uncovering and penalising discriminatory behaviour, but with promoting equal outcomes -

¹¹ Royal Commission on Social Policy (1988), *The April Report, 2: Future Directions*, Wellington, Royal Commission on Social Policy, p. 512.

whether in paid rates or in the distribution of women and cultural minorities across jobs and job hierarchies.

Comparable worth and affirmative action policies have been attempted elsewhere - and have been shown to have significant costs in terms of reduced efficiency and employment opportunities, and a *deterioration* in equality of opportunity. The problems that they would cause in New Zealand are likely to be of a greater magnitude than in countries such as the United States, because of the nature of our labour relations system. Notions of 'just price', comparable worth and 'fair' relativities are already strongly enshrined in this system, and the market is already substantially squeezed out. (In so far as discrimination is a problem in the New Zealand labour market, it is enshrined not in 'the market' but in the heavily bureaucratic system that has sought to replace it.)

These sorts of policies will harm productivity and workplace equity regardless of how they are implemented. However, the means by which they would be implemented under the New Zealand proposals are an added cause for concern.

The implementation of the proposals would be in the hands of an 'Employment Equity Commissioner', given extensive powers both to set and to enforce policy, given information-gathering powers and rights of entry that would be the envy of the police, and subject to minimal appeal rights. The resulting combination of virtually unlimited power over employers and workers with very limited accountability is completely at odds with attempts in other areas of government activity to separate policy advice from policy implementation, and to increase bureaucratic accountability.

The 'equal employment opportunities' part of the Bill is highly prescriptive (including requiring 'targets'). Detailed programmes are required for a wide range of 'designated groups' - women, Maori, Pacific Islanders, workers with mental or physical disabilities, 'any group of workers who have the same ethnic or national origin', and any other group of workers that the Commissioner cares to designate. It is difficult to conceive of any group that could *not* be brought within at least one of these designations, but it must be presumed that some means would be found of excluding white, able-bodied men. The Commissioner is given the right to set minimum standards for programmes, and also to require amendments to programmes, both when they are first being prepared and after they have been in force for two or more years - without any right of appeal.

The part of the Bill concerned with comparable worth (under the misnomer 'pay equity') is even more bureaucratic and cumbersome. Simply carrying out a 'pay equity' assessment would require nine distinct procedures and paper mountains. 'Female' occupations would be defined according to almost infinitely flexible Statistics Department categories that in any event bear scant relationship to real job requirements. Women not represented by a union or with a recalcitrant union would effectively have no means of having a claim implemented, as implementation is solely through the existing award system; in other words, there is a strong bias in favour of existing unions. Minimal provision is made for recognising 'economic' factors in assessing and implementing claims - so that disemployment effects are likely to be glossed over. Further, this part of the Bill is directly at odds with the Labour Relations Act, providing for comparable worth claims, based on *paid* rates of pay, to be fed into *award* rates, and for access to compulsory arbitration of comparable worth claims.

The 'employment equity' proposals were promoted by their creators as furthering both efficiency and equity. In practice, the proposed legislation is likely to harm both, and at a considerable cost in terms of compliance. And its reassertion of bureaucratic power and centralised decision-making represents a significant step away from the kind of system that would empower workers by broadening their opportunities.

- 'Industrial Democracy'

In 1989, the Government established a Committee of Enquiry to consider legislation for 'industrial democracy', defined as 'meaningful participation' by workers in the decisions affecting their working lives, at the workplace, enterprise, industry and national level. An important motivation seems to have been an interest in the applicability of the 'corporatist' models of the middle European and Scandinavian countries to the New Zealand system - with 'codetermination' at the company level, industry-wide planning and participation by union officials in economic planning at the national level. (This interpretation was adopted with some enthusiasm by the Council of Trade Unions.) The Committee was constrained by the requirement that its recommendations should conform with the intentions of the Labour Relations Act - when in practice the only effective means to improved workplace relations and the development of participation schemes tailored to workplace circumstances would be substantial reform of the Act.

The report of the Committee of Enquiry was released late in 1989. It recommends (highly prescriptive) legislation for participatory councils to be established within enterprises, a move towards more industry-level consultation, and an expansion of national tripartite initiatives. These recommendations appear to have been taken seriously by the Minister of Labour, who is now contemplating legislation.

Both the quality of the Committee's report and the Minister's willingness to give credence to their recommendations serve to reinforce the concerns about the direction of labour market policy created by the likes of the 'employment equity' initiatives. The Committee's report is a strange mixture of assertions of pragmatism and crude pseudo-marxist ideology, of logical inconsistency and confused empirical reference. It illustrates no understanding that competition in the labour market is *not* competition between employers and workers but between employers for workers, and between workers for jobs. Its treatment of empirical examples (such as the Swedish system so beloved of advocates of collectivist 'social justice') is confused. And its recommendations are both highly prescriptive (despite expressed admiration for Australian literature insistent on voluntary solutions) and biased in favour of unions at the expense of workers poorly represented by their unions (and of the fervently biased Trade Union Education Authority, of which one of the Committee members is Director).

The one strong impression that the report creates is of a will to legislate, contrary to the Committee's own assertions about the importance of voluntary solutions, and against all evidence that legislation would cause more harm than good. (Its approach is nicely summarised in its own assertion that: 'Our approach is pragmatic. We do not intend to embark on philosophic, academic or broadly principled analyses.'¹²)

- Summary

In each of the cases discussed here, there are real and important concerns to promote the well-being of workers - to promote equity in the workplace, and to promote communication and cooperation between workers and employers. The problem rests in the chosen means of approaching these concerns - means that are primarily coercive, and that rely heavily on the involvement of bureaucrats and elected officials. In much of the rest of economic policy, it has been recognised that government agencies - no matter how well-intentioned and intelligently staffed - face insurmountable information problems when it comes to bettering market outcomes in most spheres of activity. As Hayek has expressed it:

"At least before the obvious failure of East European socialism, it was widely thought by ... rationalists that a centrally planned economy would deliver not only social justice but also a more efficient use of resources. This notion appears eminently

¹² Horn, J.R.P., Sissons, L. and Wilks, R. (1989), *Report of the Committee of Enquiry into Industrial Democracy*, Wellington, p. 26.

sensible at first glance. But it overlooks the fact that the totality of resources one could employ in such a plan *is simply not knowable to anybody* and therefore can hardly be centrally controlled."¹³

This is particularly true in the case of the infinitely variable needs, preferences and circumstances of workers and companies. And the problem is compounded by the fact that, in practice, those given positions of authority in a centralised regime *cannot* be expected to act solely for the general good. This is a lesson that has been learned only slowly by countries caught up in the romance of collectivism. Apparently it has yet to be learned in the context of labour market regulation in New Zealand.

CONCLUDING REMARKS

The Labour Relations Act of 1987 has proved a disappointment in so far as anyone expected it to increase choice and flexibility in employment relationships. This is hardly surprising, in that it maintained statutory protection of a highly hierarchical and centralised system, in which worker interests and the interests of companies in investing in employment are given minimal weight. Subsequent policy proposals have sought a strengthening of this essentially coercive approach to labour market regulation. This is in spite of increasing awareness - including among workers themselves - that the kinds of rigidity and political game-playing perpetuated by this system are harmful to job security and income prospects in an economy trying to adapt to increasing domestic and international competition.

Recently, the government has begun to speak of the need for some kind of labour market reform aimed at increased flexibility. What would seem most likely is a limited reform package - for example allowing employers to cite themselves out of awards (an initiative currently restricted to unions). Such a move would, of course, be beneficial - but also insufficient as a means of giving workers effective control over their property rights in their labour, and giving employers and workers together full scope to develop contracts that met their mutual interests. There must also be a concern that any such beneficial move would be 'traded off' politically against increased rigidities elsewhere in the system - such as the proposed 'employment equity' legislation, increased emphasis on industry-level bargaining, or a return to compulsory arbitration.

The prospects for real and lasting reform will depend instead on a fundamental change in perceptions of what labour market relationships are really about - a recognition that relative freedom in employment relationships is both economically desirable and essential to the self-worth of workers. And here there is some cause for optimism. Public opinion polls on industrial relations issues, for example, consistently show support for freedom of choice both about whether to join a union and about which union to join. Employment relationships are widely perceived as based on mutual benefit, rather than as adversarial, and there is strong support for the more decentralised bargaining that would foster the pursuit of mutual benefits¹⁴. The key question now is not *whether* further reform is required, but *how* the transition from the present system should be managed.

The labour market is by its nature slow to adjust. Even dramatic reforms would therefore need some time to take effect, at least in terms of those structural changes necessary to strengthen worker choice and union accountability. The most immediate changes in any reform process

¹³ Hayek, F.A. (1988), "Central Planning: The Fatal Conceit", Anderson, A. and Bark, D.L. (eds), *Thinking About America: The United States in the 1990s*, Stanford, Hoover Institution Press, p. 501.

¹⁴ See, for example, Heylen Research Centre (1987), *Public Opinion Survey of Industrial Relations Issues*, Wellington, Heylen Research Centre, and Insight New Zealand (1988), *Industrial Relations Issues in New Zealand: A Survey of Public Attitudes*, Auckland, Insight New Zealand.

are likely to occur in companies that are under strong competitive pressure, and that have used their present capacity for enhancing productivity and protecting jobs to the absolute limit. For this reason, widespread product market deregulation and a tight monetary policy can be seen as providing an essential backdrop for a relatively speedy transition towards more liberal labour market arrangements. In this regard, the extent of product and finance market liberalisation in New Zealand can be seen as an important determinant of the changes achieved under the Labour Relations Act to date.

Relatively rapid, decisive change in labour market law would seem to offer benefits over more gradual change in terms of the greater certainty it would create for companies in planning employment and related policies, and for workers making decisions about employment and career plans. As such, it could significantly reduce the risks of 'bad' decision-making based on faulty expectations about the extent and direction of future reforms. It would also reduce the risk, typically associated with gradual reforms, that impediments to opportunity would be removed in an unbalanced way so that the burdens of adjustment were unfairly distributed.

The cry of "political impossibility", Shenfield writes, "is the bane of good government and good social arrangements"¹⁵. Emerging popular support for fundamental labour market reform in New Zealand suggests that 'political impossibility' is decreasingly credible as an excuse for failing to reform, or for espousing only gradual, incremental reform.

¹⁵ Shenfield, A. (1986), *What Right to Strike?*, London, Institute of Economic Affairs, p. 49.

**ADDRESS TO THE 68TH CONFERENCE OF THE
NATIONAL ASSOCIATION OF RETAIL GROCERS AND
SUPERMARKETS OF NEW ZEALAND**

**WORKING TOWARDS EMPLOYMENT
EQUITY**

**DR PENELOPE J BROOK
NEW ZEALAND BUSINESS ROUNDTABLE**

**AUCKLAND
17 MAY 1990**

WORKING TOWARDS EMPLOYMENT EQUITY

Over the past two years, many New Zealand businesses and business and employer organisations have put a lot of effort into fighting the introduction of 'employment equity' legislation. This process began with the formation of a working group chaired by Margaret Wilson, a former president of the Labour Party, which reported in mid-1988. The recommendations of this working group formed the basis of an Employment Equity Bill, introduced to Parliament late last year.

The recommendations of the working group were two-fold: the introduction of 'equal pay for work of equal value', or comparable worth, legislation (which in New Zealand goes under the inaccurate title of 'pay equity'), and the introduction of what was referred to as 'results-oriented' equal employment opportunities [EEO] legislation. These two policies would be administered through an Employment Equity Bureau.

Initial opposition to these proposals focused on comparable worth, with concerns being raised that the kind of manipulation of pay rates that it implied, with scant regard for economic factors, would lead to increased prices, reduced employment, and reduced expenditure in such areas as training. (For example, one supermarket chain in New Zealand has estimated that accommodating a comparable worth claim to raise check-out operators' pay to the level of that earned by check-out operators in retail liquor outlets would require an annual increase in turnover of \$400 million.) Further, it was warned that the women most likely to lose their jobs as a result of such a policy were those who were already in a very weak position as a result of limited work experience, low skills, or long periods of absence from the workforce while raising children.

There was initially relatively limited opposition to the equal employment opportunities part of the proposals. This is not especially surprising, in that an increasing number of New Zealand companies were voluntarily introducing EEO programmes; indeed the Employers' Federation has actively promoted the adoption of such programmes.

The New Zealand Business Roundtable was probably a lone voice in opposition at that stage. I should emphasise that its concern was not with EEO programmes as such, but with the working group's emphasis on numerical results, and its proposal that a particular kind of EEO programme should be made mandatory. It argued that a preoccupation with achieving targets for the number of women employed in different parts of a company would lead to all the problems that are associated with affirmative action programmes in countries such as the United States. These problems are threefold - productivity losses where people are employed and promoted according to sex or race rather than merit; increasing income disparities as better-off women or members of ethnic minorities advance while their most disadvantaged fellows fall further behind; and worsening workplace tensions, as resentment at what is seen as unfair treatment spills over into sexual harassment and racial conflict.

With the introduction of the Employment Equity Bill late last year, concern about so-called 'pay equity' has escalated, and much more concern has emerged with the 'equal employment opportunities' part of the proposed legislation. There are good reasons for this. The proposed EEO policy is cumbersome, interventionist and complex, demanding special schemes for each of a wide range of 'designated groups'¹, requiring formal consultation with all relevant unions over the content of EEO schemes, and providing for the proposed Employment Equity Commissioner to set (undefined) minimum standards for schemes as he or she sees fit. The Commissioner is also given considerable powers to require information, a right of entry to

¹ Specifically, women, Maori, Polynesians, workers with physical or mental disabilities, "any group of workers who have the same ethnic or national origin", and any other group designated by the proposed Employment Equity Commissioner. It is difficult to imagine any group that could *not* be brought within at least one of these designations.

employers' premises which, it is said, would be the envy of the police, and the right to require changes in any proposed scheme, and in any scheme that has been in place for two years or more. There is minimal provision for employers - or workers - to appeal any decision made by the Commissioner.

At the very best, what we are looking at here are considerable costs of complying with the demands of the legislation and of any Employment Equity Commissioner - costs that reduce the amount that can be spent on creating jobs and actually getting on with promoting equity in the workplace. At the worst, we are looking at significant bureaucratic intervention in such matters as who is employed and promoted and how personnel policies are run, with potentially huge costs in terms of both productivity and fair treatment.

The effort that organisations such as NARGON have put into opposing the Employment Equity Bill, including its 'equal employment opportunities' provisions, is well justified. We can safely say that the proposed legislation isn't about equity at all; that it is in fact likely to harm the interests of the very workers that it purports to promote, in both its comparable worth and equal employment opportunities provisions.

However, equity in the workplace is a valid goal. In opposing the Bill, we are doing something important in terms of avoiding unnecessary barriers to workplace equity. But there is also a more positive response to be made. I will argue here that there are two parts to this response.

The first is a part to be played by individual employers, and by all their managers involved in formulating and implementing personnel-related policies. The second is a part to be played by organisations of employers and businesses in pushing for the kind of broad policy environment conducive to fairness in employment relationships - and, indeed, in all commercial relationships.

The first task is actively to promote equitable practices in employing, promoting and deciding the remuneration of workers. This is not simply a matter of warm-heartedness, though a strong dose of hard-headed warm-heartedness certainly helps. Rather, it is a matter of good business sense.

One of the most important lessons of the economic reforms of 1984-87, reforms that have greatly increased competition both domestically and in our international markets, is that anything less than the best performance ultimately costs in terms of falling turnover, company collapses and lost jobs. New Zealand companies can simply no longer afford low productivity or poor service. And high productivity and good service depend importantly (though of course not exclusively) on attracting good, well-motivated workers, willing to adapt, to train, and to go the extra mile.

I think that we would all agree that creating and maintaining the kind of environment that attracts the best possible workers and responds to their needs isn't exactly easy in our present labour relations environment. But there is still a lot that can be done to make employment relationships work better and to raise productivity.

A well-thought-out equal employment opportunities programme - or at least an understanding of the concepts underpinning such a programme - can be a valuable way of boosting productivity, in both the short- and the longer-term. One way of looking at this is as an investment in a better personnel policy - an investment that increases your chances of hiring and holding on to the best possible workers in each part of your organisation.

One aspect of this is to look at the way in which you select employees for different jobs, or decide whom to promote when a senior position is opened up, or whom to offer the kind of training that will lead to a promotion. Often, certain categories of workers simply aren't considered in such situations, both because of the way in which we define jobs, and because we tend to get fixed ideas about the kind of worker we are looking for.

For example, in thinking about a job with management responsibilities, we may think of it as a 9.00 to 5.30, 5-day a week job to be carried out by one person. And we may think of it as a 'man's' job, and as a rung on the ladder of an unbroken career. In so doing, we will sub-consciously rule out the possibility of employing someone wanting more flexible hours, such as a working mother, or someone whose career may be (or may have been) broken by time off raising children. We are also likely to rule out the possibility of hiring two workers who could share the job.

Another way of thinking about this is as a matter of weighing up the kinds of investments that you will make in your workers in order to attract and retain the best worker for a job - including promoting an existing employee who has performed well. For example, if you are going to employ a working mother in a management position, you may need to consider helping her with childcare. This is an investment that can pay off if it means, first, that you get a very good manager that you couldn't have had otherwise, and, secondly, that her absenteeism is low because her children are being looked after. (Both American and Australian surveys have shown dramatic drops in absenteeism and sick leave where childcare is sponsored or provided by companies.) An employment equity programme that helps to bring such choices into the open can be a major asset in improving your overall personnel policy.

More generally, workplaces simply don't work well if people don't feel that they are being treated fairly. The very existence of an equal employment opportunities scheme, and recognition that it is actually changing how employment and promotion decisions are being made and attitudes about such issues as flexible hours and childcare, can promote among women workers and workers from disadvantaged minorities the sense that they are being taken seriously and given the weight they deserve. An important factor in developing a successful EEO programme will be ensuring that it is understood and accepted by employees. In this way, a commitment to equal employment opportunities can contribute to the quality of workplace relationships, which is valuable in itself, but also good for productivity. In short, a well-designed EEO scheme can be a very good investment, as well as a means to greater fairness.

I will turn now to the second task - the task of business and employer organisations in seeking a more general policy environment conducive to good workplace relationships and equity in the workplace.

The whole focus of the Employment Equity Bill is on disparities in the earnings of women and men, and on the fact that women and disadvantaged minorities are 'under-represented' at the higher levels of job hierarchies, and in relatively high-paying jobs. One of the key reasons for this in the case of women is that they continue to carry most of the responsibility for raising children. This leads to broken work experience, and special needs on the part of working mothers. For example, women trying to combine child-rearing with work are more likely than men to seek flexible hours, part-time work, work close to the home and their children's play centre or school, and access to childcare. It is these sorts of factors that have led, for example, to the great concentration of women in part-time work or work at 'irregular' hours in your own sector.

The introduction by employers of EEO schemes and efforts to accommodate the special needs of such women can go a long way to improving their prospects of employment, training and promotion - and thus to narrowing the kinds of 'gaps' on which the proposed 'employment equity' legislation is based. But some significant, government-made barriers remain to making a proper job of this, and I see it as a continuing role of employers' and business organisations, such as your own, to push for these barriers to be removed, in the name of productivity, jobs and equity.

The sorts of barriers that we should be concerned with are those laws and regulations which make it unnecessarily difficult for women and disadvantaged minorities to express their work preferences and for employers to respond to these.

For example, our current labour relations system makes it very difficult for a worker whose interests are not being represented by his or her union to do anything about this: he or she can't leave that union (other than by leaving the workforce) and look for another one more willing to listen to his or her needs. Nor can he or she negotiate directly with an employer. Compulsory unionism, the union registration provisions, 'blanket coverage' and the 1000 member minimum rule all conspire to prevent these things from happening.

As union officials tend to represent full-time workers and, more generally, the traditional workforce in their occupation, they are usually unwilling to pursue the interests of part-time workers. This can be seen in the case of the retail awards, and of the clerical workers' union's fight in 1988-89 for the maintenance of a rigorous definition of full-time work, at the expense of part-time workers.

Similarly, unions tend to be unwilling to push for conditions that would increase the competition faced by their traditional members - for example to seek the kinds of flexible hours or childcare support that would enable more women to enter a male-dominated occupation. The readiness of a union to ignore the interests of some members was well illustrated by the case of the Air New Zealand stewards' union, which was found by the Human Rights Commission to have deliberately blocked the promotion of female air stewards.

Changes in the Labour Relations Act to give workers choice about whether to belong to a union, and, if so, which union to join, would be an important step towards increasing the chances that the special needs of groups such as working mothers could be met in a wider range of occupations. They would also increase the scope, in the case of medium to large firms, for workplace and enterprise agreements, which could well be used to incorporate the kinds of equal employment opportunities objectives that I have described.

Labour market restrictions are probably the most important shackle on women and disadvantaged minorities trying to make their way in the workforce, but they aren't the only ones. Others include town and country planning by-laws that proscribe the provision of childcare at or near the workplace, or that make it impossibly costly.

Similarly, occupational licensing arrangements can make the advancement of women unnecessarily difficult. For example, restrictions on pharmacy ownership in New Zealand have traditionally meant that pharmacy can only be practised as a career by those in a position to own their own pharmacies - an option less likely for women who want time off to raise a family. By contrast, in countries such as the United States, where supermarkets can include fully-fledged pharmacies, there is much more scope for women who want to have a family to make a career of pharmacy.

To summarise, we should be concerned about equity in employment, both for its own sake and because it is very good business to strive to treat all workers fairly. The increased competition faced by all New Zealand businesses has made it all the more important to seek out effective ways of finding and promoting the best person for any job, and for investing in the careers of workers so as to encourage the kind of job attachment and interest in training that will lead to gains in productivity over time. Not employing the best person for any job, or not paying and promoting according to merit, has become a much more costly business than it was in the days of heavy protection. Discriminatory treatment is simply no longer affordable.

We can promote employment equity at the level of the individual business by such means as revising personnel policies and giving thought to the returns to investing in childcare or increasing the flexibility of working arrangements. The retail grocery and supermarket industry, already a major contributor to women's employment, is well placed to be a leader in this process. An effort can also be made to communicate with and educate workers about the importance of these issues, breaking down traditional stereotypes, for example, and coming down heavily on sexual harassment.

However, as long as government policies remain in place that protect the privileges of established groups of male workers at the expense of women trying to break into new careers, or the privileges of full-time workers at the expense of those wanting part-time work; and as long as unnecessarily rigorous barriers remain to such important processes as the expansion of childcare, the progress that individual businesses can make towards equity in employment will be limited.

**NEW ZEALAND BUSINESS ROUNDTABLE
LABOUR MARKET SEMINAR**

**REALISING THE POTENTIAL OF THE
MEAT INDUSTRY**

**JOHN FOSTER
CHIEF EXECUTIVE
RICHMOND LIMITED**

**WELLINGTON
29 MAY 1990**

REALISING THE POTENTIAL OF THE MEAT INDUSTRY

It is not surprising the export meat industry attracts considerable study, analysis and comment.

- It is New Zealand's No. 1 export earner at \$4 billion per annum.
- It accounts for some 40 percent of the international lamb trade and 10 percent of the international beef trade.
- It is a seasonal industry.
- It is capital intensive with approximately \$2 billion of assets.
- It is labour intensive employing some 23,000 people.

The industry is big and it is complex.

Throughout the period 1934 to 1980 the processing sector was licensed. Under this protective law 39 established slaughterhouses typically tripled in size to accommodate the burgeoning farm production. In this period only one significant lamb plant and two beef plants were built from green fields. Just two plants closed in the 46 year period. By the late 1970s the industry was a 'hospital' case with weak management, engineers building extravagant plant extensions, unions making insatiable demands, and the bills being added up and subtracted from the farmer.

During the 1960s and '70s inflexible work practices grew equally rapidly with rates of pay, which were out of proportion to the work content and skill required. Compression of time arrangements whereby a full person's rate was still paid into the department's pool even though the person was removed because of an altered system, and 'attendance' money for merely turning up for work were common. Strikes or threats of strikes occurred almost weekly at one plant or another.

The situation was epitomised by Gear Meat's attempt to buy industrial peace with a \$40 per day wage for mutton butchers in 1976 and Borthwicks-CWS 4 days' work for 5 days' pay proposal at Longburn in 1982.

In 1978 when the employers had resisted yet another high wage demand from the unions, the government stepped in and gave an increase merely to avert another strike. No question of ability to pay or increased productivity arose. The government arbitrarily increased award rates by statutory regulation and the employers had to pay them.

With a pause from national negotiations during the wage freeze, followed closely by the removal of SMPs and the realisation that our markets were simply not able to sustain the farmers' subsidised standard of living, the meat industry tackled its largest controllable cost which was labour.

There was a realisation that the best way to control costs was to do away with the inflexible practices that had been taken for granted as an integral part of the meat industry, and most importantly, to have bargaining as close as possible to the actual workplace. This would allow productivity to be measured and rewarded on as close to an individual basis as possible.

UNION POLICY

Union policies have been used over the years in the meat industry as a means of furthering the views of the union hierarchy who are often motivated by factors quite divorced from the viewpoints of members. By deciding on such 'policies', however, union officials have successfully imposed restrictive practices which in many instances have represented a cost not only to the companies within the industry but also to their members. For example:

- The West Coast Branch of the New Zealand Meatworkers Union has a policy of not acknowledging the disputes procedure in the award and resorting to industrial action rather than pursuing a matter through the proper channels. The 'legality' of this policy was referred to by the Labour Court in 1987 when an individual used the policy as a basis for having his personal grievance heard directly before the Court. In more recent times our company has taken a very firm stand against this policy by lodging an application for a compliance order and damages against the union when the meatworkers took industrial action over an individual at our Oringi plant rather than follow the personal grievance procedures. In the light of our action the West Coast Branch of the Union agreed that it would institute the correct procedures.
- In the Canterbury district the union policy is a refusal to work Saturday overtime unless three consecutive Saturday mornings are guaranteed and unless all chains in the district are fully manned. This policy is coupled with the 'Canterbury quota' which is an attempt by the union to restrict the amount of throughput allowed on each chain at each plant. Yet another Canterbury policy has been the taking of Christchurch Show Day as a holiday as well as the three days between Christmas and New Year and also Easter Thursday and Easter Tuesday.

The Canterbury companies have, over the last few years, largely convinced their workforce that it is in their interests to ignore such policies which directly inhibit an employee's ability to earn more money. As far as the holiday situation is concerned, Alliance, through its Canterbury plants, tested the union's restrictions through the disputes procedure by obtaining a definitive answer as to what was Canterbury's Anniversary Day and also took injunction proceedings against the union to have normal work carried out on the days before and after Easter.

- The question of refusing to work overtime is a major area involving inflexible practices. Overtime is allowed by the national award but is impinged upon by union policy. The Auckland district union, for example, has a policy of refusing to slaughter more than half an hour overtime in any one day. The Auckland district union has overridden the wishes of one plant in their area which wished to, and in fact commenced, working an hour's overtime a day. When a district official became aware of it, it was stopped. Again, at another plant in the Auckland district, an approach was made to the company by the employees at the plant to work all day Saturday. The Auckland union stopped them using so-called 'Auckland rules' which limit overtime on a Saturday to four hours, before 12 noon only. A further Auckland policy was that no overtime in other departments could be worked if there was short time during that week unless forty hours pay was made up. Affco New Zealand Limited challenged this practice at a disputes committee hearing and the practice was ruled to have no basis in law and was therefore rejected.

ACCEPTED PRACTICES

There have been practices within the industry which in the past were accepted by both employers and unions as being a 'logical' way to deal with industrial relations. Two examples of note were the payment by companies of full time plant union officials, and a practice of establishing that once a person had been employed the seniority provision in the award applied and that person was automatically called in the next season. Ironically, two Labour Court decisions, which were both in favour of the union in each particular case, gave rise to the companies' ability to dispense with these two practices.

In the first instance Alliance had decided that it could see no purpose in continuing to pay for two full time union officials in each plant who merely devoted themselves to try to find ways of disrupting the company's business. It gave notice of intention to cancel the arrangement. The Labour Court held that it could not do so during the term of the union officials. However,

there is nothing to stop the company refusing to pay union officials at the election of new officers, and companies, including our own, are making use of that decision.

In the second situation the Court held that workers who refused to accept their usual work at the start of the season were not on strike because there was no contract of employment in existence. If there is no contract of employment then the seniority provision in the award cannot apply and companies are now able to use this to simply not offer employment to those persons who are considered unsuitable. Our company is making use of this in the situation where branch officials have traditionally retained seniority at the plant they were employed at before taking up national office. We are now saying that once a person leaves our employment we have no further obligation to that person.

WAGE BARGAINING

It is perhaps in this area that the industry has responded most positively to the loosening of the inflexibilities in the industrial relations system brought about by the Labour Relations Act 1987, but has still found itself completely stymied in what it actually wants to achieve.

The meat industry has always had a national award which set out the minimum terms and conditions of employment, including minimum pay rates. In addition there is a formalised system of second tier bargaining which sets, for each department in each plant, actual throughput, manning, work performance and bonuses. With the introduction of the Labour Relations Act which stipulated that only a single document could be registered and thus enforced through the labour relations system, the employers decided that rather than make the award a national paid rates document or attach all 1200 departmental agreements to the award (both options favoured by the unions), it would instead opt for individual plant agreements covering meatworkers only. It was the employers' wish that terms and conditions from the award applicable to all workers be placed in the current departmental documents which in turn would be formed into one plant document.

Of course, the legislation did not allow this to happen and although it was initially thought that an exception would be provided if the workers at the plant, rather than the union hierarchy, wanted it, this option was quickly closed by the Labour Court.

However, the employers in the industry took steps to set in place a framework in the hope that amended legislation would one day remove all restrictions from what parties actually wanted to do.

The major step was to remove clause 13 from the award. This clause gave authority for the parties to enter into departmental arrangements. Our action was a clear indication to the unions that we would simply not accept a de facto situation that was not in fact lawful, but would remove any possibility of the departmental agreements having some validity. Although the award in force at the time of the Labour Relations Act's introduction expired on 31 December 1987 and agreement in principle on the monetary increase of \$24.12 per week was reached in February 1988, the award was not settled and no increase was paid until 4 August 1988 when the unions agreed to have clause 13 deleted. A 7 months' pay increase was lost. That new award expired on 31 December 1988. In the following year an increase of \$10 per week was agreed to but not until May 1989. Again, as the employers did not backdate, 4 months' pay at increased rates was lost. That year the term was for a full 12 months. With the low level of wage settlements and the time delays in achieving agreement, the award is becoming less and less relevant to employees. Their unregistrable, unenforceable plant arrangements account for up to 60 percent of their actual remuneration.

During the same period the employers have taken positive steps to change the awards for tradesmen employed in the industry. Again, because a two-tier system of wage fixing existed - national-occupation based awards and a freezing industry tradesmen's wages agreement setting a common rate for all trades groups with equal qualifications - change had to occur in

1987. The industry therefore negotiated a full composite award covering all terms and conditions, including pay rates, for all tradesmen in the industry with the exception of the electrical workers who have an industry-specific award.

This flexibility under the existing industrial relations system is a start, but full change will only occur when there are no restrictions or even guidelines that are imposed by legislation.

The currently proposed amendment to the Labour Relations Act to allow for enterprise bargaining will not assist in achieving our objectives. Our industry is not suited to having all employees under the one agreement. Permanent, year-round maintenance tradesmen and clerical workers are paid on a completely different basis from seasonal meatworkers who work on a throughput based system. If all restrictions were removed plant agreements for meatworkers could be entered into for the benefit of employers and employees which would reflect the productivity achieved and the unit costs at each plant, while industry-specific awards could still remain for other non-production-related workers.

NEW SMALL PLANTS

The changing relationship between unions and management has also been facilitated by a sharply altered commercial environment. Delicensing in 1990 triggered the decline and eventual closure of 10 old plants. No less than 17 small new export plants have been built or created out of regional abattoirs. The new small plants have a demonstrable advantage over existing plants in one key area. They tend to have a greater flexibility in the use of labour than that provided for in the traditional plant agreement. Productivity per person is typically higher.

Plants which hold rigidly to outdated manning levels and work practices are accelerating the time of their own death.

Nevertheless the meat industry has made real gains in the past six years in breaking down restrictive work practices. This has been achieved by each company taking stock of its future requirements for individual plants and implementing policies to increase plant competitiveness. In addition the national award settlements have been the lowest in the country.

Major concern remains at the extent of legislative interference in industrial relations. One example is the inability to legislate all the different forms of bargaining that would be best for each sector of an industry. Our position is that no legislation at all is necessary in this area.

Another major area of interference is in a redundancy situation. All the awards applicable in our industry require four weeks' notice of redundancy to be given. That, in our view, should be sufficient - the parties should in that period be able to determine what level of compensation should be paid. For legislation to not only define redundancy but also to state that lawful strike action can be taken at any time in furtherance of obtaining a redundancy compensation agreement is interference in the extreme. What it means in practice is that a redundancy situation may not be about to occur at all, but that strike action can be taken using the situation as the pretext. Because it is 'lawful' strike action, the basic protection of review by a Court as to whether one party is being prejudicially affected out of all proportion to the other cannot be initiated.

A further restrictive factor is the ability of the Labour Court to become involved in interpreting and applying that legislation. An example, again in the redundancy area, is the recent decision that allows the Court to determine that making a person redundant is not open to an employer merely as a cost-cutting measure - the economic survival of the company must be at stake. It completely ignores the reality that if cost-cutting measures are not taken by down-sizing an operation then full scale closures and redundancies may follow. Every

opportunity missed to eliminate cost, especially in a contracting and highly competitive industry, is a step towards a company failure.

Such legislative interference must be stopped. With all such restrictions removed, employers and employees in the meat industry will be able to create an environment that will encourage further support and investment.

ACHIEVING INDUSTRY POTENTIAL

The progress the industry has made in cutting its unit costs during the 1980s is impressive, even after allowing for the obvious room for improvement that was foreseen in 1980. Since then processing fees have risen at only 40 percent of the rate of inflation. In Richmond we have not increased killing charges for two and a half years in spite of declining volumes.

There remain three major areas of improvement to be addressed if we are to attain international cost competitiveness in meat processing. They are:

- utilisation of plant
- flexibility in labour practices
- lower real interest rates (a point outside the scope of this paper).

The need for shift work in plants has long been recognised. Capital is utilised up to 24 hours a day in yards, chillers, freezers, and rendering but very poor utilisation applies to the slaughterhouse. Many boning rooms are now working shifts but slaughtering shifts remain rare. Because companies would have to invest in follow-on departments to make shift slaughtering possible, the current excess of slaughtering capacity makes such expenditure uneconomic. When stock numbers rise the industry should adopt shift slaughtering in existing plants as opposed to building additional plants or chains.

Flexibility in labour practices varies from plant to plant. My guess is that the industry could achieve a saving of \$1.00 per lamb (equivalent) through removing all unreasonable restrictive practices. The initial effect of such a move would be to see 2,000 jobs disappear from the industry, but if this saving was - as it should be - returned to the farmer, increased farm production would recreate lost jobs.

Since 1985 a net 15,000 people have left the industry, a drop of 42 percent, reflecting the devastation of farmer incomes brought about by economic and climatic factors.

It has been assessed that, in today's situation, for every \$1 per lamb a farmer receives in extra income, 60 percent of it will be spent on farm maintenance, mainly fertiliser. This equates to \$660 for the average farm. It would only need the average farmer to produce an extra 110 lambs to lift meat works throughput sufficiently to replace the 2,000 jobs lost. The equation of \$660 extra inputs to produce an additional 110 lambs is not unrealistic. Farms are underutilised through sustained low inputs. Marginal costing applies. Farmers are keen to increase income and will do so with reasonable inducements and confidence in the reliability of prices.

The 2.5 million extra lambs would generate export receipts of \$125 million in a year.

The interests of the whole community are served if costs are minimised. Only those industries which are internationally cost-efficient have an assured future.

NEW ZEALAND BUSINESS ROUNDTABLE
LABOUR MARKET SEMINAR

LABOUR RELATIONS IN THE
TOURIST INDUSTRY

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AUSTRALIA

WELLINGTON
29 MAY 1990

LABOUR RELATIONS IN THE TOURIST INDUSTRY

Many thanks for your warm welcome and the kind invitation to participate in today's seminar on labour market issues.

Your seminar is well timed. There is pressure for far-reaching changes in the labour market and in tourism, but the rules and regulations are not keeping pace.

As one of your industry leaders has remarked, with just a touch of frustration:

"The tourist industry is dependent on being able to provide excellent service over a 24 hour period, seven days a week, 52 weeks of the year, in all aspects of its business.

"This requirement is frustrated by outdated and conservative union provisions which have remained static over a long period. The Federation therefore believes that Government should deregulate the labour market to allow greater flexibility in working patterns, specifically providing for a 40 hour week over any period without incurring penalty rates. In return the industry should be expected to improve the basic pay rates and develop greater reward and career structures over the wider industry.

"Full labour market flexibility, which should enable industry to provide greater employment opportunities, would also be assisted by voluntary unionism."

*President of the NZ Tourist Industry Federation,
'Tourism 2000' Conference, Wellington, 1989*

Clearly, he sees the labour relations system as a major impediment to the competitiveness of the New Zealand tourism industry.

Is this an issue? Does tourism matter that much? And how important is the labour market anyway?

Without doubt, tourism is big business and is very important to the economy. When people from home and abroad travel around the country, stay overnight, eat out, go shopping, visit resorts and so on, they spend money which ultimately flows through to the entire community.

Tourism matters because it contributes about \$2.24 billion, or 4 per cent, to GDP. That puts it on a par with the meat industry – and ahead of wool – in importance to the economy.

It matters because of its export earnings – which are more than meat or wool.

Tourism also matters because of the employment it creates. Almost 80,000 people are employed in providing services to tourists. That's about 5 per cent of total employment. How much tourism contributes to the economy – and how much employment it creates – depends on how attractive its services are compared with all the other possible choices for consumers. That comes down to how competitive tourism services are.

The ability of the tourist industry to compete is absolutely crucial because it is playing in the international league. Potential tourists – both home and overseas – have many options. New Zealand is only one, so it has to offer something different and something of better value. Every effort must therefore be put into providing better services and reducing real costs.

It's not easy. There are many impediments to future profitability and growth in tourism.

In a nutshell, tourism is falling short of its potential because of some related reasons: high costs, excessive regulation of activities which provide services to tourists, and rules affecting the workplace which stop people from having a go.

However, these problems have to be overcome or removed. Other countries are doing it – or at least most are – and so must this industry to survive.

This seminar focuses on the importance of the labour market to the tourist industry. Since labour is a substantial part of the cost of delivering tourism services, it follows that the productivity of labour is central to the industry's ability to compete.

It also cuts the other way. Because the tourist industry is so labour intensive, it also has enormous potential to create employment. But either way the industry must be internationally competitive. That's the test.

The key, therefore, is to understand how to improve labour productivity.

Labour productivity does not simply mean working harder or for longer hours. It means working smarter; allowing people to use their ingenuity to provide better services more efficiently.

The question then becomes "How do we improve labour productivity?" The answer is in the institutional environment in which people work. That environment is the combination of the rules, regulations, attitudes, practices and incentives which influence people. Productivity growth is fastest in an environment that fosters entrepreneurial skill and innovation, and rewards performance.

Any labour market which creates this environment will be good for tourism and good for employment.

How do we know if the environment is right? It has some simple features which can be regarded as standard tests for all labour markets. Those features are openness, flexibility, competitiveness and keenness to 'have a go'.

If the tourist industry wishes to be more profitable and grow, and at the same time generate more employment, it should apply these tests to the labour market. Is the market for labour open, is it flexible, is it competitive and does it reward performance?

We should keep these tests in mind when looking at the labour market as it affects tourism. How does it measure up?

From talking to many people involved as owners, managers and operators in both large and small firms providing tourism services, the overwhelming response is that the labour market is too restrictive. It discourages better performance. It discourages investment.

One of the main problems for tourism is the lack of flexibility under the system of industry awards. The rules allow for the designated employer panel and the appropriate union to negotiate pay rates and conditions. Those then become blanket standards which are imposed on all enterprises, regardless of the individual circumstances of each firm.

The concept of a single industry award is especially inappropriate for tourism because the industry consists of several product and service industries – which themselves may change considerably according to location and season. As many of those industries may depend to a highly variable extent on tourism, it is impossible to cover them all with an 'industry' award which has any logical or consistent basis.

Moreover, even within an industry such as accommodation, there is such a broad range of enterprises – from international hotels, to motels, to caravan parks, to camping grounds, to

youth hostels and farm/homes – that it is quite absurd to seek to subject them to the same industrial 'rules'.

Given the diversity in the accommodation sector, let alone the whole tourism industry, the only practical basis for many employment contracts is by enterprise.

Actually, there is no legislation preventing enterprise agreements or unions. Most of the barriers to them are the outcome of other features of the Labour Relations Act which work in the interests of established unions and at the expense of anyone who tries to establish an alternative arrangement for negotiating pay and conditions.

The Labour Relations Act is the centrepiece of the whole labour market environment. It sets rules and regulations, and 'legitimises' attitudes and practices. Its worst features are that it gives a union sole (monopoly) coverage of an industry and makes union membership compulsory. The environment it creates encourages people to seek 'rents' from the system. All this is done through the force of law.

This is bad for competitiveness and bad for jobs. Many of the rules, regulations and labour market practices which bedevil tourism today evolved years ago in quite different industries in which margins were protected and times appeared to be prosperous. The anti-competitive attitudes and practices of those times have to some extent been carried into the present tourist industry, but in other respects it has virtually none of the features of the immediate post-World War II era. For example, the decline in the scheduled passenger shipping market that followed the introduction of intercontinental aircraft in the 1960s resulted in the movement of stewards from shipping lines to hotels and airlines, taking with them their entrenched prejudices and practices. Through the era of full employment in New Zealand and an inflexible, highly regulated and protected economic environment, the ability of firms and their workforces to respond to external change became dulled. The rules and regulations in force today still bear the characteristics of that era.

- In the air transport industry, for example, most things have changed dramatically, but not the labour market environment, where change has not kept pace.

Deregulation of domestic air services has brought:

- a new range of prices, including lower prices;
- a new range of services, including better services;
- better facilities;
- better aircraft; and
- a big increase in people traffic.

Competition has forced some flexibility in that the Air Line Pilots' Association (ALPA) has a different award with Ansett than it does with Air New Zealand, but ALPA still has monopoly coverage.

Retaining the pilots' monopoly power along with that of stewards and ground staff, but at the same time making air transport more competitive, is blatantly one-sided and has been particularly hard on Air New Zealand. As an outcome of its background in a highly regulated and cossetted environment, Air New Zealand had a reputation for paying very high salaries and an array of perks to pilots and cabin crews. But these could cripple it in the face of competition from overseas operators and new entrants such as Ansett which have fewer restrictions in their labour relations.

To illustrate the sort of nonsense which Air New Zealand has to put up with, in the loading of aircraft cheese and biscuits are loaded by 'aircraft workers', but hot food involves a different union – the ground stewards. Obviously such silly and wasteful practices should not be protected by the effect of labour market legislation.

A more ominous cloud in the skies is that the Air Line Pilots' Association looks like using the monopoly power given to it by the Labour Relations Act to tighten its grip on the airline industry by taking over the air traffic controllers.

You can look out when ALPA gets control of all air traffic activities. ALPA's publicly stated strategy is to counteract the effect of airline deregulation by establishing, and getting control of, centralised collective bargaining.

It is all the more amazing that the government allows its airline deregulation policy not only to be contradicted, but also jeopardised, in this way by the monopoly powers in its Labour Relations Act and that it refuses to extend the jurisdiction of the Commerce Act to cover labour market practices.

Elsewhere in the tourist industry labour market regulations are heavily tilted in favour of established unions and their officials. For example:

- groups of workers who do not belong to a union have no legal standing if a union decides it wants to cover them;
- a new union cannot be registered if an existing union is deemed to have coverage of the industry in question; and
- the '1000 member' rule makes it virtually impossible for most groups of enterprised-based workers to form a new union.

As a matter of principle, workers should be able to choose or establish their own bargaining agent. But the Labour Relations Act says "no". Instead it protects the existing union officials at the expense of employees.

I've painted a somewhat critical picture of the Labour Relations Act. This is appropriate, for it is damaging the tourist industry.

However, that is not to say that all labour relations are an inherent problem in tourism.

Labour relations generally – as distinct from the Labour Relations Act – are changing dramatically in response to the combined impact of changing social attitudes and consumer preferences, and widespread deregulation of product and services markets.

The sale of liquor, for instance, has been liberalised since 1 April 1990. At the same time the traditional nexus between the Hotel Workers' Union and liquor sales was severed, thus clearing the way for more flexible trading hours to be decided by retailers as the market requires, rather than as the union demands. Flexible working hours with 'normal' rates of pay will follow suit – eventually.

Indeed, one major employer in the liquor and food industry has recently concluded an enterprise-based agreement which incorporates flexible arrangements tailored to the needs of the firm.

Shopping hours are being deregulated in response to market pressure, but only after fruitless attempts by the unions to resist what the public was demanding. A comical aspect of the union's opposition to extended shopping hours was its demand that if Sunday trading should go ahead, its members should receive first offer of employment at the higher (penalty) rates of pay! So much for principles.

Penalty rates do remain a severe handicap for the tourist industry. Tourism, and especially accommodation, is a 24 hour per day, 7 days per week service. It is self-defeating of unions to persist with the outmoded concept of 'penalties' for work outside hours that were established in manufacturing ages ago.

One of the more encouraging signs for tourism is that employees themselves want enterprise agreements and flexibility. The staff in a number of hotels are keen to work under a more flexible award because it means higher pay, the opportunity to do a variety of tasks and the opportunity for more free days.

The attitude of their union – or, to be precise, the officials – is causing its own demise. Hotel staff are leaving the union because they are disillusioned by its negative attitude to what they want in the workplace. The reduction in union membership in the large hotels shows up in the fall in deduction of union dues to about one third of its amount in 1987. This would be reversed if the union officials involved served their members instead of themselves.

To sum up, against the tests for productivity growth – openness, flexibility, competitiveness and rewards for performance – the environment in the labour market for industries providing tourism services does not score all that well. As a result, tourism is less competitive than it could be and the level of overall activity and growth is reduced. Most importantly, the level of employment is also reduced. The Labour Relations Act is causing unemployment.

The main reason is institutional. The Labour Relations Act grants monopoly rights over key areas of the labour market to the union movement. That power, unfortunately, is not used for the benefit of tourism or for the benefit of workers or – for that matter – the benefit of New Zealand.

The most important change required is quite straightforward. Simply allow employees and firms to make their own agreements if they want to.

**NEW ZEALAND BUSINESS ROUNDTABLE
LABOUR MARKET SEMINAR**

**LABOUR MARKET REFORM
IN AUSTRALIA**

**RAY EVANS
WESTERN MINING CORPORATION
AUSTRALIA**

**WELLINGTON
29 MAY 1990**

LABOUR MARKET REFORM IN AUSTRALIA

For reasons which will become clear in due course, I am most grateful for the invitation from the New Zealand Business Roundtable to come to Wellington to discuss the state of the debate in Australia about labour market reform.

There are two major problems facing Australia as we contemplate the prospect of economic crisis in the next year or two. The first is our monetary system. Australian inflation is now heading for 10 percent. Our interest rates were engineered down a little before the election but the overdraft rate for large, well-established corporations is 18.5 percent and for small business is over 20 percent. The bankruptcy rate is rising and receivership applications have gone from 40,000 to 140,000 since July last year. Projections for bad debt provisions by the three big banks are now approaching \$2 billion. Non-performing loans for these banks now total \$5 billion. Our current account deficit comes in month by month between \$1.2 and \$2 billion, sometimes more. These things are all symptoms of monetary disease.

The second problem is the state of our labour market. There is no industry which is not deeply and adversely affected by our lunatic system of industrial relations. Australia and New Zealand were the richest nations in the world just before the first world war. The major cause of Australia's decline has been protection and labour market regulation, these two things comprising an interlocking and intertwined bundle of ideas and interests. They were given statutory form in the very early years of the federal parliament, and have only begun to be successfully challenged in the last twenty years.

The origins and growth of the connection between protection and labour market regulation is a fascinating and complicated story. Protection was first sought in Victoria in the early 1850s, and it was sought by wheat growers on the Bellarine Peninsular, at the entrance to Port Phillip Bay, twenty miles by paddle steamer from Melbourne. The wheat growers there could not compete with wheat imported from Britain. The reason they could not compete was the high cost of Australian labour in what was then a labour intensive industry. The price of labour in Australia was set by the pastoral industry and, once the gold rushes were underway, the opportunity cost of not being at the goldfields. Australia, from the beginnings of the wool industry, was a high wage country. Protection was proposed, and implemented, to protect Australian workers from competition from 'exploited' cheap labour, originally in Britain, but subsequently in China and Japan. Since protection was instituted to enable first wheat growers, and then manufacturers, to pay wages established by the export industries in import substitution industries which could not compete with imported goods, it was inevitable that the state should eventually step in to regulate the wages which were to be paid. The connection between the rewards in a protected industry, and the tariff on competing imports, was an obvious one.

My paper today concentrates solely on our labour market problems, ignoring the linkages with protection. Let me begin, therefore, at the beginning. I go back, briefly, to the fateful debates of 100 years ago, when the Australian constitutional fathers accepted the terrible words of Section 51/35 of our Constitution. Those words empower the Commonwealth Parliament:

"...to make laws for the peace, order, and good government of the Commonwealth with respect to conciliation and arbitration for the prevention and settlement of industrial disputes extending beyond the limits of any one State."

In the 1890s the left wing of Australian politics, gathered together under the name 'liberal', was convinced they had the answer to the industrial unrest of the times. The early 1890s was a time of falling commodity prices, particularly wool, and of declining gold production, and the whole structure of credit in Australia had been built up on the premise that commodity prices, and the pastoral land prices based on them, would not fall. The Baring Bros crash in

London had severely dented imperial confidence and the land boom in Melbourne collapsed in 1891. Over twenty banks shut their doors in Melbourne at Easter in 1893 and some did not re-open.

These were times of real hardship in a country which had known nothing but growth and prosperity since the gold rush days of the 1850s. The prosperity of the '70s and '80s had fostered trade unionism. The working class movement, in all its manifestations, had grown substantially during the 1880s, and charismatic leaders such as William Lane had built up strong followings, mostly through their journalism. The collapse of the economy fuelled the emotional drive behind the Marxian rhetoric of class and struggle, and industrial unrest exploded with the maritime and shearers' strikes of the 1890s.

The response of the left to these events was to look to the state to impose peace and harmony. As Dicey had predicted, the age of liberty was being extinguished and the age of collectivism had arrived. Hitherto the law of contract had governed the labour market. In particular the 'contract at will' had become the preferred arrangement during the extraordinary growth of incomes and population in the nineteenth century. The 'contract at will' was the contractual relationship under which an employer could discharge or retain employees 'at will', and an employee could stay or leave 'at will' - or, more significantly, a group of employees, in unison, could leave 'at will'.

However, the future lay, so the 'reformers' devoutly believed, in government control and regulation of the relationship between employer and employee, or to use the prevailing term between 'master and man' or 'master and servant'. The prestige of the state, so it was believed, would solve the problems which then seemed so intractable.

The reformers' primary source of inspiration, as is clear from the convention debates, was the New Zealand Industrial Conciliation and Arbitration Act of 1894. In the Adelaide convention of 1897, the Premier of South Australia, Mr Kingston, who was, with H B Higgins of Victoria, a champion for a Commonwealth role in labour market regulation, claimed:

"The Premier of New Zealand, Mr Seddon, has calculated that through the efforts of the tribunals and officials appointed under legislation (the 1894 I.C.&A. Act) he has been able to carry, as much as a million pounds sterling has been saved to the colony."

In 1897 the industrial relations clause proposed by Kingston and supported by Higgins, very similar in form to Section 51/35, was defeated 22 to 12.

A year later, in Melbourne, Higgins and Kingston pushed again for an industrial relations power for the Federal Parliament. Again the New Zealand model was the authority to which they appealed. In his last performance (and he spoke many times) in this debate, Higgins observed that since the 1894 Act was passed in New Zealand sixteen disputes had been referred to the boards:

"The trades concerned have been the bootmakers, seamen, gold miners, tailors, coalminers, bakers, furniture makers, builders and painters. During that period there have virtually been no strikes or lockouts. Out of twelve disputes settled about one half of them were settled by the boards without appeal to the court."

Because the conservative West Australian premier, Sir John Forrest, suddenly decided to back the liberals, the constitutional clause we know as Section 51/35 was passed in January 1898, by 22 votes to 19. Whether or not Forrest was persuaded by the New Zealand example is unknown. Writing in 1952, after 50 years of observing the result of that majority of three, the eminent constitutional lawyer, H S Nicholas, remarked that what was said of the Statute of Frauds might be applied to this clause, namely that each word has cost a ransom. A very large ransom it has been and there is still, in Australia, some way to go before we can cease paying that ransom.

Having briefly described the origins of Australia's labour market institutions, let me now try to describe the contemporary Australian labour market. On the surface, we have three players, government, capital and labour, using the familiar Marxian framework. The Commonwealth government, originally in 1904, legislated for the Industrial Relations Commission (formerly the Conciliation and Arbitration Commission) and has appointed since that time the president, deputy presidents and commissioners.

Labour is 'represented' by the Australian Council of Trade Unions (ACTU), and capital is 'represented' by the Confederation of Australian Industry (CAI). I will discuss these institutions in greater detail subsequently.

The consequences of 86 years of ever-increasing commonwealth arbitral intervention in the labour market is most easily seen in the figures of union membership. At the time of federation, 1901, the proportion of trade unionists in the workforce was 6 percent. By 1911, it was 28 percent, and by 1919 50 percent. These figures come from the Hancock Committee's Report. (The Hancock committee was established in 1983, by the Commonwealth government, to investigate and report upon the need for reform in industrial relations legislation.) These figures show, and the Hancock Committee conceded, that membership and, presumably, support for trade unions did not precede, but followed, the legal privileges bestowed upon them by the 1904 Commonwealth Conciliation and Arbitration Act.

The nature of these privileges, as they currently stand, was summarised by Clyde Cameron, Minister for Labour in the Whitlam government, in a letter to George Crawford, the Federal Secretary of the Plumbers' and Gasfitters' Union, and a leading member of the Socialist Left.

Mr Crawford, as General Secretary of the Plumbers' and Gasfitters' Union, had strongly objected to amendments to the Conciliation and Arbitration Act which Mr Cameron, as Minister for Labour, had piloted through the Parliament, amendments which gave rank and file union members some measure of redress against tyrannical union officials.

Mr Cameron wrote to George Crawford, in 1973, in these terms:

"Let the unions run their own affairs you yelled.... I have never heard you object to the law giving your union monopoly rights to enrol plumbers and gasfitters. I have never heard you object to the law that permits you preventing another union seeking award coverage for plumbers and gasfitters. Nor have I ever heard you complain against the law that permits the Commission to give preference of employment to plumbers and gasfitters who belong to your union. I have never heard your objection to the law that prohibits victimisation against your union members. I have never heard you complain about the law that gives you the right of entry to places employing plumbers and gasfitters. I have never heard you protest against the law that permits your union to sue an employer for breach of award and for wage arrears... I could go on and on, for I have already listed 23 additional powers which go with registration under the Conciliation and Arbitration Act."

Those legal privileges form the basis for an elaborate power structure, much of it de facto, and much of it illegal. The Dollar Sweets case and the Mudginberri case were examples where, after long drawn out and expensive legal action, substantial damages were paid by trade unions to the people they had harmed.

From a labour economics point of view what is of greater significance than the membership figures for trade unions (which continue to fall) is the proportion of the workforce that is regulated by arbitral decisions. It is now commonly accepted that that figure is about 80 percent of the workforce.

Between two of these main players, government and labour, we have the 'Accord'. The Accord is a concordat between the Australian Labour Party (ALP) and the ACTU which was signed a few weeks before the March 1983 election. The political purpose of the 'Accord' was to

convince the electorate that the ALP could handle the 'union problem' better than the 'confrontationist and divisive Fraser government'. It was an effective ploy since the newly installed ALP leader, Bob Hawke, defeated Malcolm Fraser in an election within weeks of the signing of this document.

The economic theory behind this first Accord was that the government would kickstart the economy by increasing the money supply, and to a lesser extent government spending, and that the unions would not ruin everything, as they did in 1974, by taking all this new money, and more, in higher wages. The ACTU would supervise the reduction in real wages as inflation eroded current awards.

The quid pro quo, set out in the Accord, was that the government would repeal Sections 45 D&E of the Trade Practices Act (which have proven very useful for businesses under union attack in obtaining relief from secondary boycotts or black bans) and override the tort provisions of the common law for trade unions when engaged in industrial action. The Australian trade unions wanted the same immunity from tort as their British counterparts obtained in 1906 with the Trades Disputes Act.

The Senate failed to repeal Sections 45 D&E of the Trade Practices Act by a tied vote, the Democrats splitting on the issue. The Industrial Relations Bill (1987) which would have effectively given trade unions immunity from tort, was withdrawn prior to the 1987 election in the face of a television advertising campaign which had been launched by the National Farmers Federation.

There has been a significant reduction in real wages under the Hawke government, and an impressive growth in employment, particularly in part time and female employment, as a result. Some people say this is the result of the Accord. Others say it is the result of the lessons learnt in 1981 when a wages blowout initiated by the metal trades unions resulted in a rise in unemployment from 7 percent to 10 percent of the workforce in just over 3 months. Others say this is the same thing in different words.

The original Accord was signed in February 1983 and we are now into Accord Mark VI. The problem with the Accord, as with all central planning, is that it doesn't work. Productivity growth since 1983 has been effectively zero. As various symptoms of economic decline become the dominant topic of public debate, so a new variation of the Accord is put together to try to handle the current account deficit, the persistent decline in the savings ratio, falling investment, no-growth productivity, or whatever. What is not negotiable, as far as the government and the ACTU is concerned, is centralised direction and control of the labour market. And that, of course, is the fundamental problem.

The commitment to 'centralised wage fixation', the 'Accord', and the regulatory apparatus which discharges that commitment, was demonstrated in the pilots strike which began in June 1989 and greatly disrupted air transport for over six months. The pilots' sin was to operate 'outside the system'. As Bill Kelty and Simon Crean repeatedly stressed, the claims the pilots were making could largely be accommodated 'within the system'. What was intolerable was the pilots' early contempt for 'the system'. As the government measures to break the strike proved successful, the Australian Federation of Air Pilots (AFAP) ate many slices of humble pie and crawled back into the comfortable arms of 'the system'. The AFAP is currently seeking, from the Industrial Relations Commission, restoration of its monopoly rights of employee representation for airline pilots.

Let us now briefly look at the Australian Council of Trade Unions and the Confederation of Australian Industry. The ACTU was supported, encouraged, and promoted by a succession of Menzies government ministers in the 1950s and 1960s who saw the ACTU and its then President, Albert Monk, as a counterweight to the communist unions. Bob Santamaria, the President of the National Civic Council, a catholic action group which played a decisive role in opposing communist penetration of the trade unions in the 1940s and 1950s, was also

influential in raising the status and prestige of the ACTU. Bob Hawke, first as advocate, and then as President, was good public relations material for the promotion of the ACTU.

Prior to the emergence of the ACTU as the dominant player, the six state trades hall councils, or trades and labour councils as they are variously known, based in the state capitals, were the centres of trade union power and influence. The conflict between the states and Canberra is not confined to politics. A December 1989 NSW Labour Council discussion paper, written by two research officers, Mark Duffy and Michael Costa, made this point:

"The guiding principle in this planning must be to secure the future of the Labour Council of NSW not the ACTU."

Nonetheless, the essential feature of trade union institutions in Australia over the last forty years has been the rise of the ACTU and the decline of particular unions and the state labour councils.

Against this background it is not surprising that a clone organisation for the purpose of representing employer interests came to be seen as an essential counterweight to the ACTU. Mr Ian Spicer, when discussing his recent appointment as head of the CAI, was explicit on this point, emphasising that the dominance of the ACTU required a strong CAI.

Just as the Menzies government promoted and fostered the ACTU, the Fraser government sought to promote a single peak employers' body, and the CAI emerged as a result of this government-inspired promotion.

The desire of governments to have single bodies representing different interests in the country seems to be a universal thing. Caligula is alleged to have said that he wished the people of Rome had but one head, so that he could cut it off with a single stroke. The CAI seems to have been created to provide the present Federal government with that single head.

The CAI was created as, and still is, a federation of other employer organisations. And because of the collegial structure of the CAI, changes in attitudes and perceptions within the business community take many years to filter through to the policy making committees of the organisation.

The very complex collegial structure is important in diffusing responsibility within the CAI. More significant, however, is that in industrial relations, which more than ever is the *raison d'être* of the CAI, the professionals who work for the CAI, the people who are full time in the member associations, and the people from the companies who are active in the member associations, are almost entirely professionals in the Australian industrial relations system.

This has a most profound effect on the workings of the CAI. Industrial relations in Australia is a uniquely and extraordinarily complicated business. The present structure takes years to learn. There is a major investment in human capital, therefore, by the professionals who are involved. One can compare this investment with the intellectual investment required to perform arithmetical operations and geometrical calculations using Roman numerals. The Romans were able to do these things. But when Arabic numerals came along, there is no doubt that if those who were proficient in the use of Roman numerals had been able to prevent, by legislative decree, the use of Arabic numerals, they would have done so.

Being unable to prevent the Arabic takeover meant that many years of intensive and diligent application in learning to use Roman numerals, and constant practice with them, became worthless. And this history summarises the problems now facing the industrial relations professionals within all of the employer organisations, including the CAI.

The fundamental conflict in Australian business life, ever since the first Commonwealth Tariff Act of 1902, is the conflict between the export industries and the protected industries, notably covered by the Metal Trades Industry Association and the old Victorian Chamber of

Manufactures. It is the latter group which has, by obtaining protection through the political process, exacted very substantial rents from the former. The key to the continuing success of this massive rent transfer, for many years, was the ability of the Country Party leader, Sir John McEwen, to keep his farming constituency in ignorance of the consequences of what he was up to.

It was an original and fundamental purpose of Australian labour market regulation to ensure a politically fair distribution of the rents from protection. Although there were state regulatory systems in place prior to federation, the crucial event was the 1904 Commonwealth Arbitration and Conciliation Act. This Commonwealth Act removed any prospect of long term competition between the states as to which state could provide the best labour market. Higgins' Arbitration Court, established as a result of the 1904 Conciliation and Arbitration Act which H B Higgins, as Attorney General in the first Labour government, piloted through the Federal Parliament, was the acorn which has grown into the enormous oak tree we now have.

The size of this oak tree is of great interest. There are 126 members of arbitral tribunals. This figure covers only the major commonwealth and state tribunals and does not include members of 45 other tribunals such as the coal industry tribunal and the equal opportunity tribunals. By members I mean presidents, deputy presidents and commissioners. The support staff for these 'titans', as Edward Shann described them, is another matter.

Let me run through the numbers. There are 47 members of the Australian Industrial Relations Commission, 25 members of the Industrial Commission of NSW, 15 members of the Victoria Industrial Relations Commission, 16 members of the WA Industrial Relations Commission, 11 members of the Industrial Commission of SA, 7 members of the Industrial Court and Industrial Conciliation and Arbitration Commission of Queensland, and five members of the Industrial Commission of Tasmania. The total is 126. Then add 15 for various Equal Opportunity Boards, 23 for registrars and deputy registrars around the country, and at least 10 more for various special tribunals such as the WA Government School Teachers Tribunal, the Coal Industry Tribunal, and the Flight Crew Officers Industrial Tribunal.

There are also 31 judges of the Industrial Division of the Federal Court of Australia.

These people are the professionals who have made it to the top of the heap, the visible part of the iceberg so to speak. Dr David Clark, in a recent column in the Australian Financial Review, referred to an industrial relations 'industry' costing \$250 millions per annum.

This is a very big and expensive oak tree. It is the outcome of seeking a 'fair', that is to say politically expedient, distribution of the rents obtained from tariffs, government monopolies, and other forms of compulsory income transfer between different sectors of the community.

The fundamental contradiction which is deeply embedded in Australia's labour market institutions is that Australia, like New Zealand, is entirely dependent for its prosperity on efficient production of commodities for world markets, and that the prices for those commodities are both market determined and notoriously volatile. However, the fundamental assumption underlying the establishment of the Commonwealth Arbitration and Conciliation Court in the 1904 Commonwealth Act is the Aristotelian doctrine of the 'just price', and the discovery and proclamation of that price, in relation to labour, by judicially modelled arbitral tribunals.

This contradiction first became unavoidable in the Broken Hill case of 1909 when the President of the Arbitration Court, Mr Justice Higgins, ruled:

"If a man cannot maintain his enterprise without cutting down the wages which are proper to be paid to his employees... it would be better that he should abandon the enterprise."

At the time the price of lead had slumped and many of the mines at Broken Hill had become unprofitable to operate at the award wages. Higgins was telling the workers and management at Broken Hill that legally enforced unemployment was better than reduced wages, even if those reduced wages were still, in international terms, quite attractive.

Over the last twenty years Australia, like New Zealand, has moved away from the soothing and comfortable concepts of protection and fortress Australia (I understand you use the term 'fortress New Zealand'), and is slowly accepting the need to be internationally competitive. Financial deregulation, in particular the abandonment of controls over international capital movements in 1983, was an important milestone in this process. Since 1983 many business leaders have moved, sometimes reluctantly, to a position where they find Australia's labour market institutions an intolerable barrier to international competitiveness.

This is a major new development. The small business sector, a very important part of the Liberal Party's heartland, has always been suspicious of trade unions, and with the emergence of small business organisations such as the Australian Small Business Association (ASBA), this suspicion has hardened into deep-seated hostility. The farmers, who are small business people on the land, share identical experiences and have identical views. It has been the NFF and the small business sector which has underwritten the legal and industrial relations battles such as the Live Sheep Dispute, the Wide Comb Dispute, Dollar Sweets and Mudginberri, which have done so much to change expectations and perceptions in the last ten years. It was the small business sector which provided the support for the then Deputy Leader of the Federal Liberal Party, John Howard, when he pushed strongly, and against stiff opposition from within his own party, into labour market deregulation back in 1983. His main problem, in those days, was to avoid provoking an open and damaging row with organisations such as the Business Council of Australia (BCA).

The first political breakthrough in this historic debate came when the Coalition Opposition went into the 1987 election with a policy of legislating for the opting out of the industrial relations system of those enterprises in which employers and employees agreed to do so. In order to sidestep great unhappiness amongst the industrial relations professionals and the large corporations, this option was to be limited to enterprises with less than 50 employees.

This emphasis on small business flexibility was de facto recognition that a substantial portion of the small business sector is working illegally. We do not know how large the proportion is. The further away from the major centres of union power, and the smaller the business, the more likely one is to find a careful indifference to the dictates of the labour market regulators.

In the 1990 election this caveat requiring less than 50 employees was dropped and the policy was looked upon favourably by many employer organisations. Although the Hawke government sought assiduously to produce employer opposition to the Opposition policy, it was unable to do so in any credible way.

Now the Coalition parties lost both those elections, albeit winning more votes than the government on both occasions. What is significant is that the mood and temper within the Opposition is to sharpen its attacks on the Accord and on the industrial relations system. Two new members of the Parliament, Ian McLachlan and Peter Costello, have made national reputations as antagonists to the present system and they have gone straight into the Shadow Ministry.

There have been a number of crucial industrial relations battles since 1980. I have mentioned Dollar Sweets and Mudginberri, and it has been a key ambition of the H R Nicholls Society to accurately record the history of these events. These battles have provided reference points for public debate. They have become symbols for both sides of that debate, and the meaning which those symbols come to have for the general community will help to determine how soon we can fix up our labour market mess.

Another of the key industrial relations events in Australia since the War was the SEQEB dispute in Queensland in December 1984 and January-February 1985. The dispute was about the employment of contractors by SEQEB, the electricity distribution authority which services Brisbane and the south-east corner of Queensland. The full story is described in *Arbitration in Contempt*, the first volume of proceedings of the H R Nicholls Society. In summary, after a series of black bans and limitations, including the refusal to reconnect 60,000 consumers after the worst storm in recent Brisbane history, the Electrical Trades Union was turning the heat on the Queensland Industrial Relations Commission and that body, in turn, was requiring SEQEB to yield to union demands.

When this pattern of behaviour became apparent the Queensland government, at a time when large numbers of consumers were without power, declared a state of emergency and withdrew the electricity industry from the jurisdiction of the State Industrial Commission. This took place on 7 February 1985. On 11 February, some 1000 ETU members failed to obey Orders in Council and dismissed themselves by failing to report for work.

On 22 February, after a giant battle of will between the government and the trade unions, full power was restored and the people of South East Queensland began to return to normal life.

After this violent confrontation between the ETU and the trade union movement generally, on the one hand, and the government of Queensland on the other, a confrontation which the government won in spectacular fashion thus adding greatly to its prestige (and to the standing of the Premier, Sir Joh Bjelke-Petersen), the issue of union membership of those who stayed at work in SEQEB, and those who joined SEQEB during the extremely bitter days of the strike, had to be faced.

Workers at SEQEB formed the Queensland Power Workers' Association, and employees signed, if they wished, common law contracts with SEQEB which established terms and conditions of employment for three years.

This was the genesis of the Queensland legislation allowing voluntary agreements, organised largely outside the industrial relations system, legislation which was strongly opposed by trade unions, employer organisations and arbitral tribunals alike.

Two significant agreements, Power Brewing and Metway Bank, were organised in the declining years of the National Party government in Queensland, and the State Industrial Commission did everything it could to delay and forestall other agreements in the pipeline.

The National Party government was defeated in the Queensland elections last November and the Goss ALP government has announced that SEQEB employees who forfeited their superannuation rights when they refused to return to work on 11 February 1985 will have those rights restored, and that the 1987 amendments to the Queensland Industrial Conciliation and Arbitration Act, which allowed for voluntary agreements between employers and employees, will be repealed.

I see this as nothing more than a temporary setback in the development of a climate of opinion which will compel governments at both federal and state levels to accept and initiate major deregulation of the labour market.

The major corporations, which have come together to form the Business Council of Australia, include export-oriented companies such as the mining companies as well as protected industries such as the automobile manufacturers, not to mention government monopolies such as Telecom. The response of the BCA to the difficult politics it now faces with the debate over labour market reform has been to raise the flag of 'enterprise bargaining'. This has been good politics. Enterprise bargaining has a nice, firm, positive flavour about it. Who could be against it? Enterprise bargaining can, and does, mean all sorts of different things to different people, but it is difficult for the ACTU to work out how it can embrace the concept and still retain its role as the key decision maker in the labour market regulatory apparatus.

Enterprise bargaining, on any definition of those words, and central planning of the labour market are, ultimately, incompatible.

The academic professionals in the industrial relations industry are now beginning to climb on board the enterprise bargaining bandwagon. Professor John Niland, who has been arguably the leading academic in the industrial relations field, has come out quite strongly for enterprise bargaining in his green and white papers for the NSW government, and his arguments have resulted in some attempts to allow for enterprise bargaining in the legislation the NSW government is bringing forward. Regrettably that government does not have the numbers in the Upper House, and the Democrats, who hold the balance of power, are insisting that a 'public interest' test, to be applied by the arbitral tribunals, has to be met before an enterprise agreement will be recognised.

This will kill the possibility of enterprise agreements except for the largest corporations which have the time and money to invest in the required legal and political processes.

Nonetheless the ACTU has come out very hot against the Bill. I quote from a report in *The Australian* of 17 May 1990:

"The ACTU executive condemned the legislation yesterday and its secretary, Mr Bill Kelty, vowed he would personally intervene to ensure the Bill was defeated.

In a strong attack, a resolution unanimously passed by a meeting of the 38-member executive in Melbourne described the legislation as spiteful and cynical and claimed it would lead to the establishment of a "New Right industrial relations laboratory". Mr Kelty said he would join with officials from the NSW Labour Council and speak to members of the State Opposition, the Australian Democrats and other parties to encourage the defeat of the legislation.

"The NSW Bill contains a concoction of traditional Tory prejudices and hard line New Right dogma," Mr Kelty said.

The executive resolution said the legislation would "destroy sensible industrial relations reform" which was now taking place through the award restructuring process.

The resolution said the Bill:

- Encouraged the proliferation of 'phoney' unions under the guise of enterprise associations.
- Robbed the industrial relations system of the protection of award standards through the substitution of miserable minimum standards.
- Discouraged speedy resolution of disputes through arbitration.
- Introduced the American notion of 'interests' and 'rights' which would open up the NSW industrial relations system to an endless charade of legal complications."

The notion of 'rights' and 'interests' to which the ACTU takes strong objection comes not so much from America but from New Zealand. Professor John Niland, the author of the NSW Green Paper on Industrial Relations Reform of March 1989, believes the distinction between these two concepts is the key to future progress. I have to say I regard the distinction as a non-distinction, and the structure built on it as a nonsense.

There is limited scope for enterprise bargaining under Section 115 of the 1987 Commonwealth Industrial Relations Act, and because of the activity which has been generated under this section there are already persistent demands from the trade unions for its repeal. The new

Minister for Industrial Relations, Senator Cook, formerly the Secretary of the WA Trades and Labour Council (TLC), has promised to introduce amending commonwealth legislation in the budget session.

The response of the ACTU and the Commonwealth government to sustained criticism of its approach to labour market reform has been to push for 'award restructuring' and union amalgamation. Award restructuring is an attempt to determine new awards around guaranteed productivity increases, based generally on 'multiskilling' and an end to demarcation disputes. The ETU has been particularly adept at persuading tribunals to rule that only its members can perform the most elementary tasks, such as pulling out fuses for disabled machines.

The building up of union membership in closed shops has been the main preoccupation of trade union officials over many decades. There is thus very great scope for removing barriers between tradesmen in manufacturing and big industrial establishments. Nonetheless, it appears that the price of every small improvement is a pound of flesh, and the agony of dealing with union officials and arbitral tribunals located many miles away from where the work is done is deeply felt.

The ACTU, particularly, has argued that union amalgamation is essential to successful economic reform. Support for this argument seems to have faded away, except in government and ACTU circles. There have been some amalgamations. A number of others have been defeated by the rank and file. The ACTU's response is to seek amendments to the Act to make amalgamation much easier. Once again, the Minister has promised to bring down such amendments in the Budget session.

The justification of attempts by the ACTU, and its allies in the political arena whether in government or opposition, to stave off reform and protect existing rights and privileges of key institutions, can be summarised as follows. Whilst our industrial relations system may not be perfect, it does work; it is hallowed by custom, tradition, and expectation; and if attempts to deregulate the labour market and bring it back within the ordinary civil law of the land are successful, we will have to contend with lawlessness and anarchy. Union power, it is implied, can only be constrained through the good offices of the ACTU and its union affiliates.

These doctrines are increasingly incredible. My view is that a major economic crisis will render them totally obsolete, and that even a not too severe recession will place enormous additional strain on them.

The climate of opinion in Australia is moving steadily towards a position where, in the right political and economic circumstances, freedom of contract will again become the operating principle in the Australian labour market. The fundamental conflict is between central planning and a free market. The flag of enterprise bargaining, which the BCA has raised, disingenuously makes a decision for or against central planning inevitable. In the current intellectual climate it takes a bold philosopher to come out four square for central planning.

The campaign against protectionism, twin sister to labour market regulation, has taken nearly thirty years to move from iconoclastic eccentricity to conventional wisdom. The campaign against our destructive and impoverishing regulation of the labour market has piggybacked on the moves against protectionism and will succeed, in my view, within a much shorter time span.

The forces driving these movements, in Australia and New Zealand, are the irresistible forces of international competition. If New Zealand moves quickly and accepts the efficacy of the law of contract in the labour market, then New Zealand will gain a temporary 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 the New Zealand economy, 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.

It would be a great irony of history if New Zealand demonstrated the efficacy of freedom in the workplace before Australia can get its act together. If that should happen, then, once again, the New Zealand model will become a major issue in Australian debates about labour market regulation.

MANAGING CHANGE IN INDUSTRIAL RELATIONS CONFERENCE

INSTITUTE FOR INTERNATIONAL RESEARCH

WHERE TO NOW IN LABOUR RELATIONS?

**DOUGLAS MYERS
VICE-CHAIRMAN
NEW ZEALAND BUSINESS ROUNDTABLE**

**AUCKLAND
31 JULY 1990**

WHERE TO NOW IN LABOUR RELATIONS?

This conference is about managing change in labour relations. Transforming the laws that govern employment and work practices in New Zealand is one of the absolute imperatives for an incoming government after the general election. Labour market reform ranks only with the need to reverse the growth in government spending and to fundamentally rethink policies in the areas of health, education and social welfare as the top priorities a new government will face.

New Zealand has implemented a partial set of economic reforms. Quite predictably, it has derived a partial set of benefits from them. We are experiencing the benefits of lower inflation and higher productivity in many public and private sector enterprises. Through exposure to international competition, a pattern of production is slowly emerging which more closely reflects real economic costs and consumer demands.

But the economy is only on a weak recovery path. We are still not competitive enough internationally, still not working hard enough or smart enough. Our levels of debt remain extremely high, making us vulnerable to adverse external events.

The tragedy for New Zealand, not least for the 7 percent of the workforce now unemployed, is that the bold and courageous programme of economic reform initiated in 1984 has not been carried through. This is not just the analysis of the Business Roundtable but of many groups and observers both here and abroad. The OECD, for example, recently told the government that:

"[S]low progress in improving the flexibility of labour markets, reducing protection, reforming the tax-benefit system and cutting Government expenditure may explain why the broader economic benefits of the comprehensive reforms adopted since 1984 have been slow to appear."

The government's failure to get its own house in order has been a central cause of the weak state of economic activity over the past two years. Despite the massive cutbacks in assistance to the private sector and subsidies to state-owned enterprises, government spending has continued to rise. The government's insatiable appetite for tax has starved the private sector of resources. The contrast with the Hawke government's record in Australia is striking. Through tough budgetary disciplines, particularly on welfare benefits, federal government spending has fallen from 30 percent of GDP in 1984/85 to 23.4 percent in 1989/90. Last week's Budget bequeaths a major deficit blow-out to an incoming government. As one sharebroking firm put it, "It turns the retreat of the 1989-90 Labour government from the reform principles driving the 1984-87 Labour government into a rout".

To enable the private sector to play its role of generating growth and wealth, an incoming government must take decisive action to shrink the public sector. The deteriorating state of our public finances as revealed in the Budget and ambivalent attitudes towards inflation are major factors in the risk premium on interest rates and the high cost of capital faced by firms. The Wellington Chamber of Commerce has recently argued that by cutting government spending that is not cost effective, the government share in the economy could be reduced to 25-30 percent of GDP over the next 10 years. The National Party endorsed the concept of a smaller public sector in its Economic Vision statement in March, but it has yet to back this up with specific policies. Indeed its plans for the single largest item of government spending, superannuation, involve additional costs of around half a billion dollars - on top of a \$2 billion deficit.

New Zealand's fiscal problems are closely linked to the failures in the areas of labour market and social policy reform. The slow progress in creating a more flexible labour market has meant that the restructuring and disinflation process has condemned many people to

unemployment, and for longer periods. At the same time, welfare arrangements make benefits a rational choice for many. With the growth in the number of beneficiaries, we have replaced nationalised industries with nationalised households. Consequently the cost of welfare benefit payments has mushroomed. Similarly the poor decision making structures in health and education have meant that large increases in funding have been dissipated with no obvious overall improvements in performance. The extension of an unreformed accident compensation scheme to sickness, announced in the Budget, will only make this problem worse.

As the Nobel laureate James Buchanan argued recently, socialism is dead but Leviathan - the over-expanded state - lives on. He pointed out that there remains a residual unwillingness to leave things alone, to allow the free market, governed by the rule of law, to organise itself. The special-interest, rent-seeking, income-churning state finds fertile ground for growth in this environment. Despite the abundant evidence of failure ranging from 'Think Big' to psychiatric hospitals, New Zealand has still not drawn the right conclusion. This is that the romance of state provision (as opposed to financial support for those in need) is a delusion and a barrier to the achievement of social goals.

Instead of a vicious circle of a rigid labour market leading to increasing numbers of beneficiaries leading to higher spending and tax burdens, an incoming government must initiate a virtuous circle. In many respects labour market reform is now the most straightforward part of the task. Both practical developments over the last few years and shifts in the public debate have prepared the ground for accelerated progress.

In fairness to the government, it has to be acknowledged that a great deal of change has occurred in New Zealand workplaces in recent years, and most of it has been positive. In the harsh business climate many firms and their employees have cooperated in finding better ways of working. Not before time, managements have put more effort into employee relations. Workers have become more realistic, more conscious of firm profitability and job security, and more sceptical of militant union behaviour. A positive foundation is developing for much further progress in the 1990s.

The main factors that have brought this about have been the new competitive environment, the refusal by the government to validate soft wage settlements by loosening monetary policy, and the government's insistence that industrial disputes are a matter for the parties to resolve, not the government. These factors have greatly altered bargaining behaviour. It is an achievement that rates of nominal wage increase have fallen with falling inflation, contrary to experience in Australia, the United Kingdom and Sweden. If this progress is cemented in during the next wage round, in line with the performance of, say, Holland, where both inflation and wage increases are running at about 2.5 percent per annum, we shall have laid a basis for sustainably low inflation and improvements in competitiveness and employment growth.

Regrettably, the government has done little to facilitate these changes by consistent reforms of our labour laws. The changes have occurred despite the impediments of the current outdated system, not because of improvements to it. For every step forward, the government has taken another step back. In 1984 it brought in voluntary arbitration but reintroduced compulsory unionism. In the 1987 Labour Relations Act it introduced limited mechanisms for moving from national awards to enterprise bargaining and more productive work practices but imposed a minimum union size of 1000 members which effectively made it harder for many firms to do so. This year, recognising at last that bargaining reform under the Labour Relations Act has been disappointingly slow, it has proposed legislation aimed at speeding it up which at the same time involves a step back to compulsory arbitration. Its employment equity legislation would return us to bureaucratic wage-fixing instead of breaking down barriers and monopoly positions in the labour market which have disadvantaged women. Basically, trapped by the vested interests in its ranks and the confused thinking of Ministers of Labour and their advisers, the government has gone round in circles in this area.

Clinging to straws, ministers point to agreements in companies like Firestone, Nissan and Fortex, and in the dairy industry, as evidence that change is occurring. But agreements of this sort are not novel; they could and did occur under the previous legislation. As Lindsay Fergusson pointed out to this conference last year, the contention of advocates of greater change is not that nothing has happened. It is that not enough has been done, and done fast enough, to help New Zealand firms and workers cope with adjustment and global competition and to avoid the unnecessary unemployment costs associated with restructuring.

The relevant bottom line is not a handful of constructive settlements; it is an uncompetitive economy with a large current account deficit and 160,000 New Zealanders who are not working. The Budget tables show that no improvement in the unemployment situation is expected over the next 3 years. The Reserve Bank has estimated that to achieve full employment by 1995, 40,000 new jobs would have to be created each year. The only time we ever approached this figure in a 12-month period in the last decade was after the 1982-84 wage freeze as the benefits of real wage reductions came through in lower costs to firms. If our present unproductive labour relations system is maintained, any rigorous analysis suggests that only by achieving massive real wage cuts could the government deliver on its commitment to full employment.

My strong impression is that comprehensive labour market reform is an idea whose time has come. Public opinion surveys show majorities of around 70 percent or more in favour of enterprise bargaining, voluntary union membership and worker choice of union representation. With support of this magnitude, on whose behalf is the government really acting? A recent *Evening Post* editorial referred to the realisation that unions are about to lose their uniquely protected status and their ability to act as monopolists: "more rapidly under a National Government but just as likely, if not as far-reaching, under Labour." It argued that the complex array of restrictive practices and other protections unions enjoy should be challenged in the interests of raising productivity, and pointed out that unions would have to demonstrate to members that they are meeting their needs in a modern economy "with its demand for more skills, the greater numbers of female workers and moves away from manufacturing into service industries."

With the bill amending the Labour Relations Act still before the House, there is time for the government to rectify its mistakes in this area. The OECD said that further labour reforms should be an urgent priority. Employer groups have pointed out how the current amendments to the Act could be improved in a way that would assist progress in renegotiating forthcoming awards, and the government could put before the electorate some positive plans for the next parliamentary term. But I am not optimistic about such a change of heart. This is not because of attitudes among realistic union leaders. Angela Foulkes has been warning unions that they will have to prove their worth when they lose the protection of compulsory membership and the automatic right to bargain. Colin Clark of the PSA recently acknowledged merit in the state sector reforms. Many senior Labour politicians are talking openly about the inevitability of changes and the likelihood, as in the United Kingdom, that no future Labour government will turn the clock back.

Rather the resistance comes from the hard left in the party and caucus. At a time when socialism is being branded as the economics of the lunatic asylum, Ruth Dyson describes herself as a socialist and calls for marches in the streets against voluntary unionism. Pat Kelly, who has always appeared uncomfortable with the trend towards greater workplace cooperation and trust, is spoiling for a return to a world of confrontation. He will be disappointed. Further out on the ideological spectrum, CTU member Bill Andersen was last year praising corrupt and bankrupt East Germany as the ideal society. This year it will disappear from the map: not even Germans could make a collectivist regime work. What is to be done about such people? The answer, as one of my favourite columnists has pointed out, is nothing. Like the dinosaurs, they are part of a passing era, and we shall not mourn their passing.

In such quarters, there is still an abundance of Marxist rhetoric that the agenda of those calling for a more flexible labour market is downwards wage flexibility and the creation of wage slavery. The Minister of Labour seems to have adopted this mantra. Marx was a rhetorical genius, and the socialists had the best songs, but their economic analysis was a total fraud. It is understandable that many people remain prisoners of past habits of thought. As one participant in the recent Soviet Communist Party Congress put it:

"You have to remember that for seven decades our propaganda drummed home the message that market economics means fat capitalists exploiting starving workers and peasants. You can't change everyone's thinking overnight, but the terrible state we are in now is compelling many people to move away from the old stereotypes."

This is certainly the case in the New Zealand debate. Recently a Planning Council paper correctly defined labour market flexibility as a policy leading to sustainable full employment whilst maximising growth in real incomes. Self-evidently, these are outcomes which New Zealand has not had. Our unemployment rate is now above the OECD average and while BERL forecasts that it will rise to 200,000 by the end of the year are nonsensical, there is no sign of it coming down. In respect of earnings, the Trade Development Board recently drew attention to the extraordinary statistic that real wages in New Zealand have stagnated - not grown at all - in New Zealand since 1960. The apparently exploited workers in freer labour markets have seen their real wages double or nearly treble during this period. This is a staggering indictment of our economic and labour market policies.

I believe most New Zealanders have understood the meaning of these statistics. Developments in the real world have blown away the myth-making about labour market deregulation. A centrally planned labour market works no better than a centrally planned economy. A highly visible demonstration is the recent waterfront reforms. The abolition of the hyper-regulated port employment system from 1 October 1989 has led to extraordinary changes. The productivity improvements have been dramatic. Stevedoring charges have been reduced by between 20 and 50 percent. Ship turnaround times have been halved. Annual cost savings are already estimated at \$58 million. The 'them and us' attitude is going. Stevedores are quicker to question what they are told by their union. Casual staffing has been a great success. Women are being employed. And employees are earning more than ever before - around \$48,000 a year on average. Bill Jeffries deserves enormous credit for tackling a problem which governments walked away from for years. There is still a long way to go on the waterfront, and the restrictions of the Labour Relations Act remain an obstacle to greater achievements. But it is a microcosm of what ought to be possible on a much larger scale in a freer environment.

Our own company is a similar example. Over the two years 1989-91, we estimate employee numbers will fall by 7 percent. Profit per employee is expected to rise by 28 percent and average wages by 14 percent. The idea that labour relations reform means lower wages is ludicrous.

Another rhetorical theme is that a labour relations system based on freedom of association and freedom of contract may be all right for larger employers and metropolitan workforces but will work against the interests of 'unprotected' workers in small firms and small towns. Similarly it is argued that measures like voluntary unionism will weaken the position of workers in industries like retailing but do nothing to break down industrial power in problem areas like the meat industry or construction.

These propositions are so silly as to be almost incomprehensible. A case study released by the Business Roundtable this week gives the lie to both these myths. The study looked at a prototypical 'small firm in Otaki', in this case a meat processing works. Both the firm and its workforce wanted to break away from the conflict and inefficiency which brought the meat processing industry to its knees. They were prepared alternatively to operate a non-union site, to have a plant agreement, or to be covered by a union other than the Meatworkers' Union. They were thwarted by the law and the union at every turn. Two years later the

company is in receivership and many of the workers have lost their livelihood. It is a classic illustration of everything that is wrong with labour relations in New Zealand, and of the difficulties of starting a small business in this environment.

There is little or no support in the community for the view that the relationship between employers and workers in small firms needs government nannying any more than in larger ones. One survey showed that there is no strong public belief that union coverage for workers is more necessary in small firms or small towns. Even amongst trade union members, half thought it made little difference. Not just large employers but 80 percent of employers covered in an Employers Federation survey wanted to move to enterprise bargaining. A poll last year showed that employees in the retail industry were more strongly in favour of voluntary unionism than most other occupational groups. When it is realised that around half the New Zealand workforce is already non-unionised, that most New Zealand enterprises are small, and that most of them are characterised by close and harmonious employee relations, it becomes clear that it is absurd to suggest that a freer regime would disadvantage workers in small firms. Overseas the idea would be laughed out of court.

Politicians and journalists who cling to these ideas should get out into the real world, including the high growth, high employment economies in the Asia-Pacific region, to see what good employment relationships are all about. In its latest *World Development Report*, which focuses on poverty, the World Bank has argued that the poor should be helped by reducing labour restrictions, such as minimum wages, which reduce legal employment opportunities and force workers into the black economy or out of the workforce altogether.

What sort of labour law would give New Zealand the best chance of competing successfully in the global economy and reintegrating into the workforce those who have been marginalised by the current system? Certainly just reintroducing voluntary unionism and giving employers the right to opt out of national awards is not a sufficient answer. The starting point for reforms should not be the medieval apparatus of our conciliation and arbitration system. It is the much simpler requirement to give people the freedom to enter employment contracts on any terms which they find acceptable.

For most people, their skills and aptitudes are their most important asset. They must be allowed to improve their lot by trading freely in their labour services. They must be able to enter into individual contracts with employers or to join collectively with others in making contracts on whatever basis they choose. Voluntarily-formed unions may be their choice of agents for bargaining, but they should be free to use other agents if they so wish. The law should protect employers and employees against contracts resulting from duress, fraud or incompetence, but otherwise should not preclude any contractual arrangement acceptable to them. Contracts could provide for strike action in the event of a breakdown in negotiations or contain no-strike provisions, but employees would be free to quit and employers would be free to dismiss workers or hire new labour unless otherwise stipulated in contracts. The rights of third parties would be upheld under normal tort law. The general courts would take over from the Labour Court in administering this ordinary body of civil law. The Commerce Act sanctions against the abuse of monopoly power and restrictive trade practices would apply in the same way to the labour market as to any other.

Wide freedoms of contract and association would provide vastly improved protections to workers compared with current arrangements. At present, as the Otaki example shows, employment terms acceptable to both workers and firms are simply illegal. By far the strongest protection for workers is the ability for them to compete freely for jobs and for firms to compete freely for their services. That environment would generate real momentum in productivity growth, and hence in profits and wages. Workers would also be protected more effectively through the right to bargain directly with their own employer and to choose the union or other agent they wish to represent them. Because such arrangements would be much more productive most wage rates would soon move upwards, and I would be surprised if many fell. Productivity and growth protect workers far more powerfully than any unions or laws. A rising tide lifts all boats. The benefit system in any case puts a floor under market wages, and

could be used to maintain at acceptable levels the incomes of workers with dependents or others in genuine need.

I do not want to suggest there is no downside to moves towards a freer system of employment contracts. Freedom involves challenges as well as benefits for the vast majority of people who have suffered under control regimes. Union officials hitherto protected by compulsory membership rules and exclusive coverage will have to adjust and improve their performance, or they will lose members and their jobs. If existing retail unions do not agree to modify rigid policies about penalty rates, for example, jobs and members will go to unions who will. The alternative is to price goods and services out of the range of many consumers and forgo job opportunities. Some unions whose members have won extravagant conditions at the expense of other workers will be threatened by new competition. Some employers who have coast-tailed on national awards, used them to impose costs on weaker competitors, or to avoid facing up to their own employee relations issues, will lose out to those who adopt more productive strategies. But it goes without saying that those interests should not be allowed to prevail over the interests of the majority of New Zealand workers and firms and the unemployed, as they do at present. These groups are unlikely to be well served by the creation of big centralised unions and broad industry awards, which is the current agenda for advancing unionists' interests at the expense of everyone else.

I said earlier that I believe comprehensive labour relations reform is an idea whose time has come. But much remains to be done to put it into effect. Clearly there will be vested interests who continue to oppose change. At the policy level, they will include the Department of Labour, which is a creature of the industrial conciliation and arbitration system and which fought against proposals for major reforms at the time of the debate on the Labour Relations Act. They will also include the Labour Court, which has progressively sought to extend its reach and has been delivering a series of extraordinary judgments which pose a huge threat to small business growth and job creation. Much thought needs to be given to the details of a legal regime based on contractual freedoms, including the statutory guidance needed to get the interpretation of the law back on track.

At the workplace level, I believe the task will be somewhat easier, particularly for those firms which have invested heavily in fostering employee involvement and building a sense of mutual interest and trust in recent years. A few unions, oblivious as always to their members' real interests, are said to be planning to offer employers minimal wage increases in the coming award round, on condition of preserving national awards. As soon as policy changes occur, however, I believe workers will quickly see where their best interests lie. Speculation that the changes will lead to conflict and disruption are likely to be wide of the mark. For most industries they will represent an extension of changes in employment and work practices that are already well underway, rather than a quantum leap. Some who have been holding back will be able to move quickly, while others will take their time. Not everyone will want to move to enterprise arrangements; through free choice some industry agreements and even a few national occupational awards are likely to survive. But the direction will be clear, and the rate of change towards more productive arrangements will be greatly accelerated.

The forces that are driving us away from a centrally planned bargaining system towards a free labour market are the irresistible forces of international competition. With all forms of centralism crumbling around the world, the 1990s may turn out to be the most dynamic decade of economic progress this century. An Australian visitor recently expressed the view that if New Zealand deregulated its labour market and brought it within the province of ordinary contract law, our growth rates would leap to a minimum of 7 or 8 percent per annum. I don't know what the figure would be, and I suspect firm action will be needed in the other areas I mentioned before we could enjoy gains of that magnitude. But I have no doubt that the benefits of comprehensive labour market reform will be immense, and that the sooner we achieve them the better.

LOCAL GOVERNMENT

NEW ZEALAND INSTITUTE OF LOCAL AUTHORITY MANAGEMENT

LOCAL GOVERNMENT

MANAGING FOR PERFORMANCE - OR
JUST MANAGING TO PERFORM?

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AUCKLAND
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LOCAL GOVERNMENT MANAGING FOR PERFORMANCE - OR JUST MANAGING TO PERFORM?

INTRODUCTION

The public sector shake-up has reached the local authority level. As part of the national exercise in going back to basics, local authorities are now being challenged to ask some fundamental questions. What business are they in? Are all their activities necessary public sector functions? How should they go about performing them?

In the past, the popular conception was that the business of local authority managers consisted of roads, rats and rubbish - and, under extreme pressure, a concern about rises in rates. Like many other things in New Zealand, local authority functions grew up in an ad hoc way, shaped more by political pressures than by a conceptual framework that made sense from the standpoint of the general community.

The new local government legislation is a starting point for changing all that. It applies to your activities the kind of decision making structures that have already brought massive improvements to the performance of parts of the state sector. Business activities are to be run as businesses. They are to operate on a competitive basis - whether in local government ownership or through contracting out. Non-commercial functions have to have a clear-cut rationale. Managers will have greater freedom to determine how to carry out their responsibilities. They will be accountable for their performance, not merely for whether they have followed the rule book.

These are all principles which have the potential to bring about a huge improvement in the performance of local government. If central government experience is any guide - and I'm sure it is - the extent of inefficiency in many local government operations may well be of the order of 30-50 percent. As managers, you have the exciting challenge of making changes that will be of real benefit to the community. Your competence will be tested. You will be under much greater pressure to perform. But like many other managers and workers elsewhere in the economy, you will have the satisfaction of knowing that, perhaps for the first time in your lives, you have real scope to create value and have a measurable impact on living standards.

One can speak with feeling on the subject of inferior performance because only the day before yesterday that was where New Zealand business was at. Our productivity levels relative to our international competitors were a disgrace. In some cases they still are. But with greater commercial freedom and pressures to perform, progress is being made. In two years, worker productivity in one major tyre manufacturing plant has jumped by 110 percent. What's more, businesses have welcomed the new environment. Many of the larger corporations represented on the Business Roundtable have faced more drastic adjustments than any other groups in the economy. Yet they have backed the changes in the belief that they will benefit New Zealand, and concentrated their attention on areas where too little change has occurred. I see no reason why attitudes in local authority management should be different. We know there are superior strategies that work, that they are more stimulating for organisations and more rewarding for those involved in them.

My task is to discuss the topic of managing in a commercial environment. Specifically, I want to focus on three things.

First, just what do we mean by a commercial environment? In examining this question, I want to look particularly at the concept of efficiency. This is important since it means a lot more than generally "pulling our socks up and taking a shorter tea break". Contrary to popular accounts, it is not about willy-nilly firing of staff, random cost cutting, or reducing the quality of publicly provided goods and services.

Secondly, I want to look at how we allocate resources, since that is the fundamental difference between a government environment and a commercial environment.

Finally, I wish to sketch out some possibilities for using the principles of efficiency and commercial approaches to allocating resources, as they might be applied in local government.

These are all themes which the Business Roundtable has been applying consistently in its approach to policy reform. We believe them to be equally relevant for local authority management.

Let me begin by making a few points about the kind of economic environment we find ourselves in at present. This is critical because it helps explain why this programme of reform is essential.

THE OPERATING CLIMATE

Like all commercial managers, local authority managers are part of the general economic and social environment. For years New Zealand politicians and business groups acted as if we could isolate and insulate ourselves from the rest of the world. We found to our detriment that we were wrong. The cost has been our plummeting standard of living relative to others in the Asia-Pacific region.

The government sector too has worked in splendid isolation from economic reality for many years. Only now is it beginning to become exposed to scrutiny, competition and pressures for change. Local authorities are no exception. One commentator recently described local government as "a heavily-sheltered bastion of economic inefficiency and political infighting".

If it is to shrug off both the fact and fiction of this image, local government needs to respond positively to the challenges the government has now set it. It also needs to develop an awareness of the outside world and manage with some idea of the operating climate in which it functions.

I have to say that that climate is not good. New Zealand is far from over the worst of its problems and it is in the economic area that this is most apparent.

At the macro level we are still fighting to lock in the lower levels of inflation necessary for sustainable employment growth, we still face massive debt problems, we have yet to make significant inroads into government expenditure and we are currently suffering from an increasing inability to resist pressure groups.

In a number of big spending areas like health, we still show no ability to face the critical issues and replace low quality spending with high quality reform. Dedicated professionals are struggling with a system that does not work. Because of the system their productivity is low, they are not well rewarded, and those needing health care are getting a raw deal.

At the micro level things are not a great deal better. We still have absurd restrictions on shop trading hours, our liquor laws remain antiquated, we continue to follow archaic labour

market practices which are at the heart of the unemployment problem, and reforms to the resource management statutes show every sign of producing a regulator's paradise.

Into the bargain we appear to be heralding new forms of distortion and privilege with the introduction of so-called 'pay equity' legislation and extended ACC coverage. It was extraordinary that on the same day that the entire East German politburo resigned, the government announced proposals for pay equity which, by substituting administered wage fixing for market valuations, are a great leap backwards to the bureaucratic economy. Having threatened to resign if she did not get her own way, the Minister of Women's Affairs seems happy to preserve her own job at the expense of the jobs of 25,000 New Zealand women, according to official estimates. We are back to the habits of vote catching and interest group politics which brought New Zealand to its present difficulties.

Perhaps saddest of all, there are still large numbers of people in the community who don't understand why we had to suffer the recent pain and what is required to ensure that we don't go through it all again.

It was baffling that the recent taskforce on New Zealand's international competitiveness came out recommending some form of government determined exchange rate and a new venture capital fund in the same week that the remains of the government's last foray into this field, the DFC, failed in such spectacular fashion at considerable cost to the economy.

The micro level problems tell us we have much to learn; the macro problems tell us we haven't got much time to learn. Our politicians are rapidly reverting to the belief that facing problems and going for sound, long term solutions rather than band-aids and compromises is not popular. In my view they are underestimating the intelligence of the electorate and their willingness to support necessary changes if properly informed.

There are some positive developments. The present economic recovery is a more soundly based one than we have seen for many years, even if the medium term growth outlook is still relatively anaemic. The international economy continues to be kind to us, but as night follows day we know there will be rough patches ahead in the 1990s.

Closer to home, and of interest to local authority managers, there are success stories in the state-owned enterprise reforms and the asset sales programme. We have summoned up sufficient courage to sell a steel mill, an oil and gas business, a shipping company, an airline and three banks. With a fair wind the next year should see the sale of a major insurance company and the government's enormous forestry resource. Of course many other countries find it difficult to understand why New Zealand governments got into these businesses in the first place.

Among the SOEs, strong performances are common with most of them returning much higher dividends to shareholders and providing consumers with better choices of higher quality goods and services at lower prices in real terms. Those who fought tooth and nail against the reforms such as the state sector unions and the State Services Commission up to 1986 have been proven conclusively wrong.

At the local government level there have been signs of progress too. Notable among these are the port reforms. In spite of various costly teething problems, mainly related to our inability to reform the labour market, the port restructuring process is showing considerable promise.

A good example is the Auckland port company which set itself the target of reducing costs by 10 percent within two years. It seems likely not only that the objective will be achieved, but that it will be done within twelve months.

Significantly for delegates to this conference, these success stories all originate in reforms which sought to promote commercial management in a commercial environment. The earlier rhetoric that the commercial model would mean profits at the expense of service and a poor deal for consumers has been shown to be hollow. The costs of services like telecommunications and postal deliveries have been held or reduced, and standards of service have generally improved out of all recognition. There is still much work to be done. But we can now see how the so-called public service model, based on government ownership and monopoly, sanctioned waste and inefficiency and if it served any interests at all, they were certainly not those of the public. There is an important message here for management in local authorities.

EFFICIENCY

Whatever else it may involve, managing in a commercial environment involves the pursuit of efficiency. So local government managers need to get concerned about efficiency. In the new environment, poor performance will stand out.

Efficiency as a concept is often misunderstood. It is critical to improved performance in the New Zealand economy generally and, in the present context, in local government.

You have to improve efficiency because improved efficiency benefits ratepayers and consumers through lower prices, better service and wider choices. It is about using scarce resources well, not wastefully.

Efficiency comes in two forms. First, getting the right kind of resources allocated to the right areas - the right level of investment in water supply as opposed to roading, the right level of employment in park maintenance as opposed to parking meter enforcement, and so on.

In simple terms matching production as directly and closely to consumer demands as possible.

Secondly, efficiency is about using least cost methods to produce the goods and services demanded. This might mean leasing someone else's fleet of trucks instead of owning your own, contracting out EDP services instead of maintaining your own costly computer centre or even counting votes by hand rather than opting for high tech/high risk/high cost methods.

In simple terms efficiency means using methods which deliver goods and services to the consumer at the lowest possible cost for a given level of quality.

The level of efficiency with which local authorities operate is a measure of how well they perform in terms of these criteria. At present there is room for substantial improvement. Just in the last few weeks the Audit Office has estimated - I suspect conservatively - that local councils could save \$9 million annually by operating their buying and stores functions more efficiently. It has been critical of the extravagant golden handshakes given to retiring staff. The Aotea Centre in this city has been completed well over time and budget. *Frontline* has devoted a programme to the questionable behaviour of the Northland Harbour Board. The Local Government Commissioner has condemned the action of the former Auckland Harbour Board in establishing trust funds.

These are serious charges. But the full cost to the community of poor performance in local government has far larger dimensions. By itself, local government spending accounts for around 6.2 percent of GDP. It is an activity that ranks in size with electricity generation and distribution, motor vehicle manufacturing, the meat industry or public hospitals. A poor use of resources in local government represents as great a sacrifice of potential income as inefficiency in these other major parts of the economy.

But in addition, with its regulatory power, local government influences or controls the direction of a great deal more economic activity. In Auckland, for example, it will determine whether an exciting Princes Wharf project with major hotel and port developments proceeds, to the benefit of thousands of Aucklanders, or whether a handful of organised interests will block it. Around Westhaven, the political process of decision making - supposedly established to ensure that wise decisions are made in the public interest where commercial decisions would lead to poor outcomes - has resulted in oil storage vessels, warehouses and bus depots occupying land with enormous property and amenity value. Seen in these terms, the impact of local government decision making on the use of resources in the economy is indeed pervasive. One has to wonder whether many past decisions meet the efficiency criteria I discussed.

For local authority managers the message is simple. New Zealand as a country is not rich enough to sacrifice efficiency. Greater efficiency is the basis - and the only basis - for long run improvements in the community's living standards. That is what managing in a commercial environment is about.

FROM POLITICS TO PRICES

Without a doubt the most powerful weapon available to local government reformers in seeking more efficient outcomes and better levels of performance is the price system.

A fundamental aspect of the reforms of recent years in New Zealand has been the change in the mechanisms we use to allocate resources. The essence of this change is a move away from administrative and political systems to using prices formed in competitive markets as the basic mechanisms for guiding resources to their most valuable uses. It is this concept which underlies competitive interest rates, a floating exchange rate and open borders.

The use of prices most clearly distinguishes the commercial environment from the government environment. It is this point that local government managers will have to understand if they are to deliver. Placing prices on inputs, intermediate products and services, and outputs offers great benefits over using the traditional administrative methods.

Administrative methods of allocating resources are fraught with problems. Three of the most important arise because:

- administrators do not have the necessary range and depth of information to make the most informed decisions. Nor do they face the right incentives to become informed;
- administrators do not bear the costs or reap the rewards of their decisions in any meaningful sense so they do not face good incentives to 'get it right'; and
- administrators are subject to tremendous pressure from interest groups looking for free lunches. Their political bosses find these pleadings hard to resist.

Too often the result is promotion on the basis of ability to work the system, not performance; soft options and compromise rather than excellence; and empires based around egos as opposed to efficiency.

The price system on the other hand is both a hard master and a rich rewarder:

- prices summarise information economically, and more importantly they summarise information which is relevant to consumers not bureaucrats;

- prices penalise poor performance and they penalise it rapidly, sheeting home responsibility and leading to mistakes being corrected, not hidden from view; and
- prices make strong performances apparent, they reward supply which matches demand, and they distinguish good service from poor service.

If consumers and ratepayers are prepared to pay the price for the services local government managers deliver them, then the product is worth producing. If they won't, it's time to change the product.

Making decisions in the face of unlimited wants and scarce resources is never easy. In business you have to develop a decision making structure which increases your chances of getting things right. This leads you to focus on activities with high returns and shed those with low returns. The same principles apply to local government - and not just to activities with straight commercial returns. I suspect we are suffering from an overload of low value activities in local government and that a sound first step will be simply to drop many of them. Making valuations transparent through prices will make decisions easier, allow voters to monitor elected representatives more effectively, and help those involved resist pressures to serve special interests rather than community interests.

SEEKING OUT EFFICIENCIES USING PRICES

I wish to turn briefly to some ways in which the strengths of the price system might be harnessed and how efficiencies might be sought in local authority management.

The functions of local authorities overlap to some extent. Nevertheless there are three relatively distinct areas in which the potential for greater efficiency can be identified.

- Trading activities

Many local authorities are still involved in trading activities of different kinds. These include managing property portfolios, running transport systems and supplying various forms of energy.

In most of these areas efficiencies can be gained by simply selling the operations. In deciding whether or not to sell, the criteria are very simple and are the same as those any commercial manager must continually review:

- Do I have any comparative advantage in running this business? Better, do I have any competitive edge which doesn't arise from artificial factors such as regulation.

For local authorities, like most government operations, the answer is no. There is no reason to suppose that a local authority could consistently run a commercial operation well and there are many reasons why it will do more poorly than the private sector on any long run basis;

- If the business serves some non-commercial purpose is the trading operation the best way of achieving the desired objectives given the alternatives? Again the answer is very likely no.

Mixing up commercial objectives and social goals usually means that management takes its eyes off the ball and neither goal is met in a cost-effective fashion.

In selling trading enterprises the most important aim should be to ensure that the privatised entity faces normal private sector disciplines and to achieve the best sale value for ratepayer-owners. This means paying attention to getting the regulatory regime right, removing any implicit or explicit monopolies and using a competitive sales process in which prices, not politicians, determine the outcome.

The new legislation gives local authorities the chance to make the same gains for their communities as have been achieved at the central government level by corporatising and privatising trading operations. It is to be hoped that the government also resists parochial pressures and presses on rapidly with the privatisation of port companies and electricity supply authorities, as the more forward-looking managers in these industries are themselves advocating.

Only a decade ago, the gains from privatising and contracting out many government functions were only dimly perceived. Moves in that direction have been gathering pace worldwide in the 1980s. New Zealand has been one of the late starters in this area. We have a long way to go to cut back the role of government to those activities which the public sector is best equipped to provide or finance.

- Public goods and services

Local authorities are involved in the provision of a number of so-called public goods and services. I say 'so-called', because many apparently public services are in fact private goods funded publicly.

The distinction between services which are public and those which are private is blurred. Views have been changing around the world about whether the services of libraries and museums, for example, should be provided 'free', or whether they should be paid for, at least in part, by those - often from higher income groups - who use them.

What we do know is that contracting out many of these services produces remarkable increases in efficiency.

A good example is the provision of water, which has been taken for granted in New Zealand to be a public sector function. Yet we know that in recent years the cost of supply has been increasing as maintenance and capital costs have increased and the supply of high quality water has become more scarce.

The French, faced with similar problems, have run a private water system for many years. Some 36,000 local mayors strike individual contracts with privately owned water companies.

The length of the contracts depends on the amount of capital the companies have to invest in the infrastructure. The popularity of the system can be seen in the percentage of the population opting for privately supplied water. This has increased from 44 percent in 1970 to 72 percent in 1989.

The British government is currently privatising its water authorities. A number of French water supply companies may buy into them.

An even more dramatic example of what is achievable is provided by the small city of Ecorse, just south of Detroit in Michigan. This city of 13,000 now has a permanent local

government staff of 18 - down from 140. Its rubbish collection, now subject to competitive tendering, costs US\$120,000 less than it did previously. The cost of road maintenance, water supply and reserves work has been cut by 30 percent, saving the city some US\$35,000. A US\$6 million deficit has been cut to US\$1 million in two and a half years and is projected to disappear altogether in the next 12 months.

The point is not that we should follow blindly the examples of overseas local authorities. There are important differences and we need to work out our own solutions. What the evidence does suggest, however, is that dealing with roads, rats and rubbish is almost always more costly than it needs to be, that changes can be made provided the incentives are right, and that levels of service for consumers increase as a result of the changes.

- Regulation

Finally, a function close to the heart of all local authorities is the generation, maintenance and enforcement of regulation. As we all know, such regulation is far-reaching and not infrequently bizarre, ranging as it does from dog control through licensing of street vendors and attempts to control noise, to the entire edifice of land use and construction regulation. I question whether moving the Topp Twins off the footpath and prosecuting them in court is a priority use of community resources.

The body of regulations manufactured by local authorities significantly increases the costs of living, working and doing business in New Zealand, and the benefits of many of them are elusive. The field of town and country planning administration is replete with horror stories. Local government ordinances are a significant impediment to the supply of affordable housing, especially at the low income end of the market. Not for nothing has it been said that an elephant is a mouse built to government standards.

By way of example, I am told it takes on average two years to develop a section to the point where it can be sold, but only four months of this time is spent on physical work. The rest is time spent waiting for decisions and approvals. Because of the risks involved in the whole planning process, private land developers are now almost non-existent. The only development work undertaken is by building companies or part-time speculative developers. Those genuinely concerned about housing problems in New Zealand would do better to agitate for fundamental issues of this kind to be addressed rather than for ever-larger allocations to the Housing Corporation.

In my view the new local authorities should review from a zero base the entire array of regulations and by-laws that they have inherited to see whether they are necessary, properly designed and cost-effective.

Managing in a commercial environment means that local authority managers should strive to resist regulation which is sought by self-interested groups, which stifles innovation and which narrows the choices of the communities they seek to serve. The best place to start is to take a sceptical view of all regulation because the number of regulations which are of overall benefit to the community is one of the smallest numbers known.

This is not easy because regulation concentrates benefits so intensely upon interest groups and disperses costs so widely across the community. An example is noise control at Wellington airport, where local residents have persuaded the council to impose operating restrictions which will raise the value of their properties at the expense of adding millions of dollars to the costs of airlines and the travelling public. The outcome of the resource management law reform exercise will profoundly affect whether we can find better ways of balancing competing interests and reducing the costs, delays and red tape of planning procedures which

are stifling business development and job creation. To date the indications have been that the government is as oblivious to the costs imposed on business in this area as in its extraordinarily inept commercial law initiatives and financial market re-regulation. The common themes in these areas, an indifference to property rights and sheer ignorance of business decision making, goes a long way to explaining the lack of confidence in the investment climate in New Zealand.

At the national level, those policy makers who have understood business requirements and worked to design regulatory policies which have created a freer, more competitive and secure environment for investment have helped achieve massive increases in performance. So too at the local level a more discriminating approach to regulation and more efficient administration of regulatory functions would mean major reductions in the costs of doing business, create jobs and make household dollars go further.

CONCLUSION

I have talked in a rather abstract fashion about some of the factors involved in managing in a commercial environment. That is because the ideas are abstract in one sense and they require careful thought.

I believe that is a good thing. Managing successfully in a commercial environment is about thinking rather than following administrative recipes. It is about developing strategies, maintaining focus, innovating and making continuous improvements, not about rigidly following precedents and manuals.

For a long time managers in New Zealand business tried to 'tough it out' by enlisting the aid of the government in a vain attempt to beat the market into submission instead of harnessing its power. Managers and boards of directors in state-owned enterprises are far from having completed the task of dragging their operations into the commercial environment. Achieving world class excellence in economic performance may take a decade or more - or may never be achieved - especially if we insist on taking regular tea-breaks and leaving critical issues in the 'too hard' basket.

I suggested that our politicians continue to underestimate the willingness of the electorate to accept necessary change. Local government reform itself was regarded as 'no go' territory only a few years ago, but sweeping and long overdue changes have now been made. They will receive increasing support if new managements are successful in putting a stop to longstanding waste and the associated escalation of rates that has occurred in recent years.

It is undoubtedly an appropriate time for managers in local government to pick up the challenges that their counterparts in SOEs have enthusiastically grasped. Given the difficult economic climate they are operating in, the benefits to be had from better performance and the bleakness of the alternatives, local authority managers have nothing to lose from grasping the nettle and the communities they serve have everything to gain.

The new legislative framework is only the first step. A lot more thinking needs to be done about the role and functions of local authorities in New Zealand. A great deal will depend on the ability of people in the new structures to turn their potential into reality. The working assumption should be that the pressures for improved performance will not go away. If the present reforms fail, future policy makers will have to look for other solutions. Experience in the business sector is again relevant. Many of the slow adjusters to the new environment - or those who did nothing in the hope that policies would be reversed - are no longer with us. Those that knuckled down are now doing better.

Managing in a commercial environment will require a leap forward. Lloyd George had the last word on that. "Where a leap is indicated," he said, "take it. No one ever crossed a chasm in two short steps."

NEW ZEALAND LOCAL GOVERNMENT ASSOCIATION : ZONE 2

BUSINESS AND LOCAL GOVERNMENT

**LINDSAY FERGUSON
GROUP MANAGING DIRECTOR
MAGNUM CORPORATION**

**EDGECUMBE
25 MAY 1990**

BUSINESS AND LOCAL GOVERNMENT

INTRODUCTION

The economic policy changes of the past six years have caused the business community to take a far greater interest in a whole range of government activities. In the more open, deregulated economy the performance of all levels of government affects the environment in which businesses have to operate. Recently the spotlight has been turned on local government. Your future performance will be subject to much closer scrutiny than it has been in the past.

Resources absorbed by local government activities account for around 6.2 percent of GDP. Looked at as an industry, local government is larger than our car or textiles industries and our public hospitals, and half as large as farming. The efficiency of local government and the enterprises it runs is as relevant to national economic performance as these other activities. Of equal significance are the regulatory powers conferred on local and regional government. These can be used constructively, or in a way that is destructive of private enterprise and job creation.

THE BUSINESS ENVIRONMENT

Before addressing the issues of direct concern to you, I want to say a word about the New Zealand business environment and its future in an increasingly competitive international marketplace.

The changes of the past six years were a shock to many New Zealanders because we had to catch up fast on the reality of the outside world. The farming community took the tough medicine up front. The effects spread to manufacturing and other areas including the government apparatus itself.

While many existing jobs have been lost, the improvements in efficiency have been dramatic. It became clear that many of them were not real jobs in the first place. As in the Soviet Union, they were of the "you pretend to pay us and we pretend to work" variety. In two years worker productivity in one tyre manufacturing plant has increased by 110 percent. SOEs such as Telecom and Electricorp have achieved major productivity increases. The arguments of public sector mandarins and unions that there was no waste in these operations have been exposed as nonsense.

The tragedy is that too many workers displaced from these wasteful activities have not been absorbed elsewhere. We are paying a heavy price for an inflexible labour market and a social welfare system that has all but eliminated work incentives for many.

The business environment is going to become more competitive. We still have a long way to go in reducing trade barriers and deregulating activities as diverse as postal services, agricultural marketing, pharmacy retailing and accident insurance. There is no possibility of a return to the apparently easy, soft life of yesterday. It has gone forever. If we want to survive as a modern nation we have to become part of an increasingly integrated, global commercial environment.

In order to succeed in the global economy, countries must create an attractive environment in which businesses will invest. Those that fail to do so will miss out. Businesses and jobs will go to countries with stable and consistent economic policies, tax regimes that are not oppressive, a quality workforce, efficient central and local government services and straightforward regulatory regimes. In today's world, the availability of local raw materials, the size of the domestic market and transport costs are less important factors for many industries.

Despite everything that has been written and said, I doubt whether the magnitude of the challenges we face as a country is really understood by most New Zealanders. We still have people who think that we should have one more fix of inflation before we kick the habit, that education is about something other than excellence, that business is bad and needs to be further regulated, that unions or governments can mandate pay rates regardless of productivity, and that the state should bail out all and sundry without asking too many questions. It is this sort of thinking that will further undermine our competitiveness as a nation and lower our living standards relative to the rest of the world.

Most of the reforms initiated by the government have forced business to become more efficient and innovative. Because policy was consistent, purposeful and even-handed in the 1984-87 period, confidence in the programme remained high. But since the end of 1987 the government has talked too much about 'speed wobbles' and the need for a 'breather', with the result that we are now on a slow-adjustment path and investors are sceptical about New Zealand's growth prospects. In reality the people who were most vocal in demanding this breather were those in areas like the union movement and the health, education and social welfare sectors that had not been forced to adjust. The government's decision to protect them from change has meant that most of the pain of the recession has been borne by the lower income groups and the market sector. We now seem to be back to timid gradualism, re-regulation in areas like pay equity and resource management and the prospects of a fiscal headache being handed to an incoming government.

LOCAL GOVERNMENT AND BUSINESS

Until recently, local government could have been included in the list of sectors that has faced few pressures to adjust. It is to the credit of Michael Bassett and the Local Government Commission that this nettle was finally grasped. They have made changes to structures and policies which will fundamentally affect the way local government operates.

Underlying the changes is the acceptance of the reality that, over the long haul, the private sector is capable of providing most goods and services more efficiently than the government. This is not a criticism of individuals in the public sector. It is simply a function of the incentives and disciplines in the organisations in which they work. When it comes to operating trading enterprises and providing most services, on average and over the long haul the private sector has demonstrated superior performance.

In principle the changes behind the legislation are sound. The requirement to operate transparently, the separation of trading activities and the concept of user pays are a good start. How well they work depends on people like you. The new framework requires the sort of radical and innovative thinking that survivors in the business sector have had to demonstrate in recent times.

A fundamental difference between the private and public sectors is that if firms seriously miscalculate they go out of business but governments do not. At worst the odd mayor or councillor may lose their seat but mistakes are often hidden and the real cost is borne by ratepayers. The failure of the Sesqui project in Wellington is a recent example. Neither central nor local governments should become involved in commercial ventures.

Local governments must now take a clean slate approach to all their operations. Chief executives should carefully review every existing function. Objectives should be clearly established and the correct mix of resources allocated to meet them. Staff should be given encouragement and incentives to raise the productivity of their operations.

Basic questions should be asked. Is there a real need for the service? Is it being provided efficiently? Could it be put on a user pays basis with full or partial cost recovery? Can the service be contracted out by competitive tender to the private sector? This could involve

people who have worked for local authorities, provided the contracts are awarded on an open, competitive basis.

Even functions like museums and libraries fall into this category. Those using them are typically middle or higher income ratepayers. Should all ratepayers be taxed to provide 'free' services to them? Is there a case for at least a partial user pays policy through entry fees or a donation system, and an offsetting reduction in rates? Great museums such as the Metropolitan in New York are financed partly on this basis.

There will be a natural tendency for many people to want to continue with current practices. This mindset has to be abandoned if you are to do a proper job for your ratepayers.

Your trading operations are covered in the 1989 Local Government Act No 2. You have the opportunity to convert these operations into Local Authority Trading Enterprises - LATEs - and to consider full privatisation. The concept is long overdue even if the label is not particularly elegant - I guess the thought was better late than never. Local authorities should make maximum use of this option.

The first question is to determine what activities could be set up as LATEs. Works departments are an obvious candidate and I understand a start has been made by some authorities. The operational functions of water and sewerage offer similar possibilities; water is predominantly a private industry throughout France, for example, and has recently been privatised in the United Kingdom. Other activities in my view should be sold forthwith; for example there can be no justification for councils retaining an interest in milk or abattoir operations. If you establish LATEs, make sure the objectives are correctly and clearly established and that you obtain the best possible business people as directors. Unless this is done the results will be no better than they were with former government corporations which were placed in the hands of the party faithful. LATEs should not be given any explicit or implicit financial guarantees by their local authority shareholders, and should be required to compete on level terms with private enterprises.

PORT AND ELECTRICITY SERVICES

Local government presently holds an ownership stake in port companies. There is no good reason for this situation to continue. Ports are just businesses providing a service to users. No one in their right mind would suggest local government should get into the trucking or sea freight businesses, so why should it be involved in ports? Ports are now competing with each other and real cost efficiencies are starting to be achieved. These will be enhanced with privatisation and further moves to free up employment arrangements.

It is a commentary on the performance of local government that the initiatives for these moves had to come from central government. It is also a commentary on the capacity of people to adjust in a positive way that the boards and managements of most port companies are now pressing for full privatisation. They are meeting resistance from local authorities who are still wedded to dabbling in business and using port revenues to subsidise other activities. The idea that port users should be taxed in this way is an outrage that cannot be allowed to continue. If local authorities do not take the opportunity now open to them to quit their shareholdings, the government should take stronger action.

By contrast with the achievements of the Minister of Transport in the ports industry, far less has been achieved with electricity supply authorities. Although they like to blame the Electricity Corporation for power charges, ESAs in fact account for nearly one third of the cost of electricity to final consumers. Many supply authorities are over-manned, their financial management is archaic, and there is a grossly distorting and politically motivated pattern of cross-subsidisation of charges which penalises industrial consumers. Contrary to the attitudes in the ports industry, they have been mounting a highly political campaign to resist deregulation and privatisation. The government should resist such pressures and the

Electricity Corporation should be more aggressive in supplying industrial customers who are being charged more than a fair price by ESAs. In the deregulated business environment of today's New Zealand, industrial customers cannot afford to subsidise other electricity users.

ACCOUNTABILITY

The provisions aimed at upgrading the reporting of local government are a positive step forward. At present information on which to judge the performance of local authorities is hopelessly inadequate. For example, the annual financial statement of the Wellington City Council, one of the largest local authorities, is almost worthless as a source of information about its activities and performance. It provides only very broad financial results and no reporting on what the council has done or is planning to do.

The new legislation requires local authorities to produce detailed business plans. This is a real step forward as far as accountability is concerned. These should set out performance targets for all functional units and publish a range of financial and productivity indicators by which performance can be measured. Comparisons with other authorities should be included.

EXPENDITURE

There has recently been an outcry against the rate increases proposed by some local authorities. It is true that some of the increases have been thoroughly irresponsible and they provide a warning of how far the reform process still has to go. But to focus on rate increases alone is to put the cart before the horse. As Brian Elwood recently pointed out:

"Spending was the key problem and the sad thing to emerge in the aftermath of restructuring was that the public ignored spending and focused on rate rises.

"If people wanted lower rates, the solution was in their hands : make councils cut spending."

Like central government, local government is constantly being prodded to expand into new areas including housing and social services. Such pressures should be resisted. Probably the best way of reducing the pressure would be to cease differential rating. This would serve to remind the residential ratepayer of the true cost of local government.

The Vice-President of Federated Farmers, Owen Jennings, was recently strongly critical of a regional government conference which spoke of an expanded role for regional councils in unemployment, tourism, social spending and other activities. I share this attitude; indeed I believe questions can legitimately be raised, as Richard Prebble has recently done, about the need for three tiers of government.

There is no limit to how much in the way of resources some will demand for so-called social services. New Zealand has created a dependency syndrome where many expect the state to provide a giant security blanket for just about anyone who stakes a claim. It sends the wrong messages and undermines the incentives for people to look after themselves and find better ways of doing things.

The large rate increases announced in recent weeks reflect in part transitional costs, but also suggest local government bureaucracies continue to place their own interests above those of the public requirement to lower costs and maximise efficiency. Elected representatives must challenge such pressures and roll them back.

REVENUE

Local government seems wedded to systems of rating which do not relate charges to the value of services provided. It is unfortunate that this area was not reformed in the recent legislative review. Under existing law local authorities can rate on a variety of bases, and differential rating is permitted. Should this be allowed to continue?

It raises a fundamental question about the role of local government. The legislation spells out the role of local government as being to provide services and facilities on behalf of central government and to operate trading undertakings on a competitively neutral basis. The legislation says nothing about using rating as a device to redistribute wealth.

If property-based rates are to be the prime source of revenue they should be levied on a consistent and fair basis. Under differential rating businesses can be unfairly loaded. Recently some local authorities have used their powers to impose massive rate increases on major industries. Some of these have now been challenged in the courts, and if the cases are not successful business will be pressing for legislative amendments. No business could get away with charging some customers more than others unless there was a very sound business justification. The power to discriminate against a class of ratepayers because they have few votes is an unacceptable feature of any system of government.

It might be argued that differential rating is valid on ability to pay grounds and that businesses should therefore pay more. This does not stand up to critical examination. Businesses are owned by people. Some businesses are small and not very profitable whereas the reverse applies to many residential property owners. In any case wealth redistribution is, if necessary, the role of central government.

Leaving aside issues of equity, artificially loading the rates burden on to firms is bad business practice for local authorities. It means extra costs for firms located within their boundaries, a less attractive environment for investment and fewer jobs. Just as nation states are now competing for investment in the international economy, local authorities should be competing not with subsidies and incentives but by action to reduce tax and regulatory burdens to attract industry to their areas.

REGULATORY POWERS

Local government has a range of regulatory powers. Regulations which are poorly designed and administered can have an enormous impact on the costs of doing business.

Local authorities should conduct critical reviews of all their regulations to establish whether they are useful and, if so, whether the benefits outweigh the costs. The results of similar exercises at the central government level in recent years have been decisions to eliminate or reform many areas of regulation. Few similar deregulatory initiatives have been taken by local government.

Building controls are a major local government function. The government has recently endorsed the outcome of the review exercise and claimed that it has the potential to reduce building costs by up to 10 percent. It appears that those responsible for the review are not prepared to claim that cost reductions will result, despite the universal agreement at the beginning of the exercise that costs could be reduced significantly. If so, the value of the exercise must be called into question. It needs to be thoroughly scrutinised to ensure that no unnecessary costs are imposed on the building industry and on commercial and residential property owners.

Subdivisions are notorious for bureaucratic delays and cost-increasing procedures. They mean higher house prices and thus lower quality housing for the average New Zealander. Reform in this area would appear to be urgently required.

The Resource Management Bill, if implemented in its present form, would confer major new responsibilities on local authorities. There is merit in decentralisation of many resource use decisions, since the impact of the majority of them is strictly local. However, it is a major disappointment that the review process did not call into question the need to maintain a highly intrusive body of regulation in this area. Instead of critically assessing the need for intervention and the scope for using more market-oriented approaches such as pricing mechanisms for resource use, the direct purchase of environmental assets, and financial compensation for changes in property rights, the Bill has maintained the existing regulatory structure and added to it. In the view of many business, professional and farming groups, the Bill will increase rather than reduce the costs of our planning process and create new roadblocks to investment and job creation. Local government should be adding its voice to those who are concerned about New Zealand's capacity to attract investment in a competitive and un sentimental world.

CONCLUSION

Local government has often been seen as inefficient and very bureaucratic. Whether true or not, New Zealand cannot afford a system of local government that meets that description.

The ability of local government to play a positive role in creating an environment that allows private enterprise to flourish will influence the future prosperity of New Zealand. This requires new thinking and a readiness to abandon the ways of the past, just as most companies have been forced to do in recent years.

The new legislative framework provides the tools and gives some direction. It is now up to the practitioners to get on with the job.

I have no doubt that their role will be monitored much more closely than in the past. The Business Roundtable is currently undertaking a major study of the role and performance of local government. Federated Farmers is also taking a close interest in this area.

The new framework should be seen as a challenge and an opportunity for elected representatives and managements, not a threat. In many ways local authorities have been unshackled and now have both the responsibility and the authority to make decisions which can benefit their communities. As in other public and private sector organisations, the intention is that good managers should be given the freedom to achieve new standards of performance. The job of elected representatives is to monitor their performance, not to meddle in management, and to spend their time on objectives and strategy, not the size of council offices or the mayoral car.

The business community now expects no less than total effort and a commitment to excellence in all areas of public life. I was amazed to hear a teachers' organisation complaining recently that the chief executives of some schools were now 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 chief executives of schools enjoy.

If New Zealanders don't want to become a Pacific Basin backwater, they need to get real. She won't be right much longer. A final ingredient for success in your sector as well as others can be summed up in two four letter words : 'hard work'.

EDUCATION

KING'S COLLEGE OLD BOYS DINNER

WHEN WILL WE EVER LEARN?

**DOUGLAS MYERS
MANAGING DIRECTOR
LION NATHAN**

**AUCKLAND
22 JUNE 1990**

WHEN WILL WE EVER LEARN?

It is a genuine pleasure to be here with you tonight. This splendid reunion is evidence of the bonds that good schools create in the community long after students have passed through their gates. It is also evidence of the vitality of private educational enterprise in New Zealand today. In spite of the apathy or downright hostility of successive governments, the demands for private education and its standards have never been higher.

But is that enterprise nevertheless as vital as it should be? Have recent reforms in New Zealand pushed education down the right tracks or into some false sidings? Has the private sector been prepared to make its case and to stand up and be counted? And have those who support private education - and good public education - been effective and outspoken in defence of the values we cherish?

Much has been said and written, sometimes intelligently, about the accelerating rate of change in the world and the need for New Zealand to respond to it. Certainly the 1980s have seen momentous changes which few had predicted. The decade that began with the Reagan and Thatcher revolutions ended with the dismantling of the Berlin Wall and the overthrowing of Eastern European regimes. It is not easy to foresee what will flow from the sudden shunning of ideologies that gripped a large part of the world for several decades. However, as an economic system, capitalism has clearly triumphed.

Commentators in New Zealand who see these changes as some kind of rightward shift in politics and economics miss the point spectacularly. As Adam Michnik, a Solidarity dissident jailed for 6 years by the previous Polish government, told the World Economic Forum in Davos earlier this year:

"The old European notions of left and right just don't fit what is happening in our region now. I have known Vaclav Havel for 12 years, and I cannot tell you if this new president of Czechoslovakia is a man of the left or of the right. Not only is socialism dead, but the language of that kind of politics is dead. What remains are values, not notions of left and right."

In the new political order we are seeing a redefinition of the relationship between the individual and the state. We are seeing an assertion of the values of individual freedom and responsibility; of a belief that the function of government is to serve individuals, not to dictate to them. As one writer has put it:

"Liberalism has faced the challenge of Marxism, Fascism, welfare statism and Keynesianism, and it has won : except for a few desperate, hopeless fanatics, no one believes in central planning, nationalisation, wage and price controls or incomes policy, deficit spending, inflationary growth, protectionism, the superiority of public health care, and all the associated paraphernalia of excuses for bigger government that were so overwhelmingly popular only a generation ago."

It is unkind to kick a doctrine when it is down. But although New Zealand, like the Eastern bloc countries, has started down the path of economic liberalisation, there is still much confusion over why socialism has been such a failure.

Many would see the problem as an absence of markets. But markets exist in some form in all societies. If a state monopoly supplies a service which citizens can purchase, you have a market - people can either buy the service or not. The truly distinguishing feature of a free enterprise system - and the thing that makes markets efficient - is the combination of private property, competition and freedom of entry into any and every field of economic endeavour. What makes hardline socialists really go ape is proposals to reduce state ownership and state monopoly. Communism was defined by Lenin as socialism plus electricity. We have

seen the intensity of these feelings in the debate over the privatisation of Telecom, a debate which is hard to fathom in terms of logic.

While the wealth-creating superiority of a free enterprise system is now beyond doubt, many western countries are engaged in soul-searching about the performance of their education and health systems. On many measures they appear to score no better than their counterparts in the Eastern bloc. Some education commentators in the United States, in particular, have argued that this should be no surprise: in both cases schools are largely state-run. Why should their performance be markedly different? Much interest has accordingly focused on the educational success of countries like Japan, where private education and competition play a greater role.

In Japan, school attendance beyond age 15 is not compulsory. Yet some 94 percent of students continue their education voluntarily. Japanese high schools charge fees amounting to roughly \$3000 a year on average or 60 percent of costs. Central government subsidies are paid on a per capita enrolment basis – an indirect voucher system – and loans are available to help families meet fees at both public and private schools. As a result large elements of competition have appeared in the system, and between 40 and 50 percent of urban parents choose private schools.

Japan's superiority in teenage educational achievement is impressive. It caters especially well for those from poorer backgrounds. Only a fraction of the top 1 percent of 18-year-old Americans now does better in maths than the average Japanese student. In standard intelligence tests, the average westerner scores 100, Japanese students 117. Modern Japanese uses two alphabets and 2000 Chinese characters. Yet dyslexia is so rare that it is not recognised as a medical problem, and functional illiteracy among adults is almost unknown.

Teachers in Japan enjoy a social status that they have long since lost in most western countries. The heads of top performing schools are exhaustively interviewed on television. Individual teachers become famous and have their salaries bid up by other schools.

What should be even more worrying for western countries is that Japan is far from happy with its education performance. There is a lively debate in progress about ways to make the system less rigid, more open to individual thinking.

The landmark education report in the United States, *A Nation at Risk*, commented that:

"If an unfriendly foreign power had attempted to impose on America the mediocre educational performance that exists today, we might well have viewed it as an act of war."

Yet at least the American education system has the merit of attempting to measure and report educational performance, not conceal it. It is an indictment of our system that beyond knowing that only 54 percent of our workforce have a formal school qualification, that among OECD countries only Turkey has a lower percentage of 17-year-olds in training and that failure rates among Maori children are appalling, we have very little information about how our children measure up. How proficient are they in numeracy, literacy and science? We do not know. The system has specialised in downgrading assessment and suppressing the reporting of results. Tall poppies must not be distinguished from short poppies; our educational equalisers would have them all end up the same height, or conceal the differences from view. Certainly there are good and bad forms of assessment, but we depart from objective standards at our peril.

Where do such attitudes and modes of thought come from? Do they too have their roots in the socialist icon I referred to earlier? The American theologian Michael Novak has recently noted that:

"People were taught by communist regimes to despise those who get ahead, and to pull them down. They were not taught that envy is a cardinal sin; they were told it

is the first of the virtues, they were taught to call it 'justice' and 'equality'. The spiritual air of Central Europe is polluted by this poison."

The Picot review was a response by the government to a groundswell of public opinion that all was not well in education. Some of its basic ideas had considerable appeal. Many saw merit in devolving decision making and resources to schools and eliminating centralised bureaucracy. The idea of allowing charters to reflect local community aspirations and standards was also attractive. Although it was not spelt out in these terms, the aim was to reduce the power of the educational establishment and teacher unions and transfer it to parents. Not surprisingly, this was resisted by those same groups and the upshot was a Clayton's reform with central bureaucratic control over the real levers left largely intact, or even strengthened. The government's latest 'Today's Schools' review is an attempt to recover some of the lost ground.

These failures, and the associated initiatives to weaken assessment procedures and to engage in blatant social engineering through the initial charter guidelines, have been widely recognised and criticised, though inadequately remedied. They were eloquently documented in John Graham's recent annual address to his school, which should be compulsory reading for anyone concerned with the state of education in New Zealand. As he predicted, the downgrading of national examinations is now resulting in attempts to find private substitutes. However, the 'never-can-fail', no absolute standards, false egalitarianist schools of thought have become deeply entrenched. At a time when our children are having to come to terms with an integrating world, they are being fed an increasingly insular literary and cultural diet. There is an urgent need for an incoming government to repair the damage that has been done.

But there is also a need to re-examine whether there were not some basic flaws in the architecture of the Picot scheme. While a model which emphasises heavily the role of boards of trustees is, in principle, one way of giving parents a greater say, is it really the best one? Have we in fact spawned the equivalent of over 2500 hospital boards with too little real authority and accountability, and too many incentives to spend their time lobbying for more resources? Picot ducked the question of whether a more consumer-oriented system, with more competition within the public sector and between it and the private sector, might be superior. It is an odd response to consumer dissatisfaction to suggest that consumers should form cooperatives to produce the goods or services they require. Most parents do not want the chore of having to run their own schools, nor are they necessarily good managers. But that does not mean they are not good judges of the quality of their children's education.

A closer examination of the private school model could have prompted some alternative lines of thought. The performance of King's College is not primarily determined by the performance of its board of management, though that is important. It is much more strongly determined by whether parents want to send their children to King's, or to withdraw them from it. There is no monopoly, no forced clientele; parents can vote with their feet. If King's does not perform, it will go out of business.

The Picot review failed to address inequities in the present system that cry out for remedy. John Gray of Oxford University has written with respect to Britain that:

"It is inequitable that those who elect for private schooling should in effect have to pay twice. It is inequitable that the quality of state schooling should so often depend on the neighbourhood in which a family can afford to live. It is inequitable that the poorest, whose marginal tax rates are often the highest, should also often receive the worst schooling."

All these inequities are present in New Zealand as well. They could be remedied by greater reliance on per pupil funding or an 'education cheque' to all parents coupled with the removal of zoning, or, as Gray suggests, by moves towards privatisation of the schooling system with the bulk of the population benefiting from much lower taxes and the use of targeted voucher

schemes for those on low incomes. Comparisons of private and government education costs in Australia suggest that the costs of the most expensive private school are 60 percent of those of the average government school.

There are interesting signs of changes in opinion even among those who have been most ideologically opposed to notions of choice and competition in education. As *The Economist* reported recently:

"It is a measure of the extent to which educational politics have moved away from the comfortable orthodoxies of the 1960s that the TUC now prefers vouchers, although it prefers to call them training credits. Indeed, the politics of education in the 1980s could largely be written in terms of the rise of free-market solutions to social problems."

In particular, more people have recognised that competitive solutions offer the greatest advantage to lower socio-economic groups. They provide them with the means of escape: schools that do not measure up lose students to those that do, and immediate pressure is placed upon the failing schools to improve their performance. Milton and Rose Friedman raise the issue in the following terms:

"Are the supermarkets available to different economic groups anything like so divergent in quality as the [public] schools? Vouchers would improve the quality of the [public] schooling available to the rich hardly at all; to the middle class, moderately; to the lower-income class, enormously."

In the United States, the inclination to take advantage of education tax credits has been greatest among nonwhite and lower status parents. Private schools in Britain are thriving by attracting a record number of pupils from less privileged backgrounds.

In all this, what is important is not just educational achievements as measured by literacy and numeracy scores but also the values to which Michnik referred. The 19th century philosopher, John Stuart Mill, put it this way in his celebrated essay, *On Liberty*:

"All that has been said of the importance of individuality of character, and diversity in opinions and modes of conduct, involves... diversity of education. A general state education is a mere contrivance for moulding people to be exactly like one another: and as the mould in which it casts them is that which pleases the predominant power in the government... it establishes a despotism of the mind... An education established and controlled by the State should only exist, if it exists at all, as one of many competing experiments, carried on for the purpose of example and stimulus, to keep the others up to a certain standard of excellence."

In terms that seem particularly modern, Mill argued that the government had a fundamental responsibility to ensure that all citizens enjoyed a good basic education, but that this did not imply that the government should be the universal provider. He argued that the government should mainly concern itself with enforcing compulsory education, and funding access to it for those who would otherwise be excluded.

One lesson many of our politicians have yet to learn is that throwing more money at existing educational structures does almost nothing for student performance. The National Party is promising to spend more on education despite a 40 percent increase in real terms since 1984, and few apparent returns on it. Nor do lower average class sizes do much for students as opposed to teachers: the top school in Japan – originally subsidised by brewers, I was interested to learn – has average class sizes of 55. Time and again studies have shown that the crucial factor in student achievement is teacher quality, and the systems and incentives that encourage teachers to perform well.

Around the world, the business community has been taking a greater interest in education performance, and I am sure this will increasingly be the case in New Zealand. The emphasis will be on the need for schools to be more conscious of the job market, of the needs of industry, and of the imperative for New Zealand to become more competitive in the world marketplace. The challenge will be not just to achieve an improvement in technical skills but to train students to think, analyse and learn how to learn, so as to keep up with a changing world. And we must remember that our competitor nations already have a significant lead in quality and are not standing still.

I would like to think that the private education sector, and all those who are concerned with what is going on in our schools, will also make their voices heard more strongly for educational excellence in New Zealand. The primary issue is not private versus public schools; it is about throwing competition rather than money at the education system so that the best schools flourish and the worst schools lift their standards or go out of business. To help make the case for better education, private schools must come out of the closet. Their representatives have seldom been heard in the education debate. Those who would squeeze the private sector still further are neither too afraid nor too lazy to state their views, insistently.

There is a story to be told. We have discovered that the state is, on average and over time, an unsuccessful manager of businesses; why should we suppose that its competence in the sphere of education is any better? It has been pointed out that the word 'state' is merely a euphemism to describe an apparatus controlled by politicians and bureaucrats. They are unlikely to understand the educational needs of a child better than its parents, but they are equally unlikely to bring about reforms from the top that would threaten their own existence. That is the lesson of the recent abortive efforts at reform: until the system is opened up to real choice and competition, bureaucratic capture will prevail.

If I have learned anything during the last few years, as New Zealand has been forced kicking and screaming into the world's mainstream, it is that proponents of change must do their homework and lay out proposals which convince ordinary people that there is a better deal. Then they must make their case fearlessly to politicians; individuals must lose their fear of the state. More importantly, however, they must make their case to the media and the public at large. As one writer has observed:

"It would be gratifying if politicians led the retreat from the politicisation of ordinary life, but that is unlikely. Only when they see votes in it will they accept a more modest role."

Changing community opinion in the face of vested interests is not a popular role in all quarters: you can confidently expect to have a Frontline programme dedicated to your efforts. There is a political constituency for such changes, and I believe an even larger public one. But Yeats could have been speaking of education reforms when he wrote his famous lines:

"Things fall apart; the centre cannot hold...
The best lack all conviction, while the worst
Are full of passionate intensity."

In my view, the education system we get will not be dictated by individual politicians or governments but by what the larger community demands. We in this room are an important part of that community. I conclude with the questions I posed at the outset. Is the private education sector prepared to stand up and be counted? Are we doing enough? Are we doing anything?

SUBMISSIONS TO SELECT COMMITTEES

**SUBMISSION TO THE SOCIAL SERVICES
SELECT COMMITTEE
OF THE HOUSE OF REPRESENTATIVES**

SOCIAL WELFARE BILL

**NEW ZEALAND BUSINESS ROUNDTABLE
JANUARY 1990**

SUBMISSION TO THE SOCIAL SERVICES SELECT COMMITTEE OF THE HOUSE OF REPRESENTATIVES

SOCIAL WELFARE BILL

1.0 INTRODUCTION

1.1 This submission is made on behalf of the New Zealand Business Roundtable (NZBR), an organisation 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 content of our submission is limited to the guaranteed retirement income provisions of Part I of the Bill. Our comments are based on an NZBR study, *Retirement Income Provision*, undertaken in response to the government's discussion paper on income security for the elderly. A copy of the study accompanies this submission.

2.0 ANALYSIS OF THE RETIREMENT INCOME PROBLEM

2.1 The key point made in the NZBR study on retirement income provision is that the only way in which New Zealand will be able to ensure that the growing proportion of the population which is elderly has access to an adequate supply of goods and services is for the economy to perform well enough to provide a satisfactory and growing standard of living for everyone. If the economy continues to perform as poorly as it has over the last few decades, the prospects for the future elderly are dim. This is true irrespective of how generous present governments may appear in promising future state benefits for the retired. Seen in this light, a 'guaranteed retirement income scheme' is a misnomer. Only a superior economic performance will assure the availability of a satisfactory level of real resources to the future elderly.

2.2 The Royal Commission on Social Policy recognised this fundamental point when it wrote that "the greatest contribution that any government can make in this regard is to provide a stable economic environment in which individuals are able and encouraged to make their own provision for retirement as far as possible". Self-provision is facilitated by a stable and growing economy. New Zealand's growth performance has been poor despite average levels of investment by OECD standards. The primary explanation for this record has been a pervasive set of economic distortions arising from badly conceived economic policies. Economic analysis and the experience of successful economies suggest that the most important set of policies which would enable most people to provide for their old age would comprise:

- monetary and fiscal policies which ensure zero or minimal levels of inflation and so protect the value of retirement savings and provide a more predictable environment for retirement income planning
- reductions in government expenditure which would allow a lowering of the tax burden
- lower rates of income tax in particular, which would increase the ability and incentives for people to save
- a free and efficient financial sector without interest rate ceilings or other distortions to financial intermediation

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

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

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

2.4 In this context the high fiscal cost of national superannuation as it is presently structured would make the achievement of a desirable set of economic policies difficult. National superannuation payments comprise the largest single item in government spending, representing more than 7 percent of national income. The 1988 OECD report on the New Zealand economy observed that the state pension system is 'unusually generous' by the standards of most OECD countries. It noted that the qualifying age for pensions is low and the income replacement ratios resulting from the present benefit levels are higher than in most other OECD countries and are probably only exceeded by Sweden. The OECD also referred to data suggesting that "perhaps 90 percent of NSA [national superannuation] recipients have incomes or receive transfers in excess of the average national wage". While this figure seems high, the numbers are certainly significant. At the same time, such recipients generally have higher levels of accumulated wealth (e.g. housing) and lower commitments (e.g. family raising) than young people, while items of high consumption (e.g. health care) tend to be heavily subsidised by other taxpayers. In other words present national superannuation arrangements, on average, transfer income from those with a lower to those with a higher standard of living. The OECD argued for policy reforms which would take full account of the need to contain the long term fiscal costs of any retirement income programme.

2.5 Reductions in expenditure outlays and the associated tax burden are part of the set of policies required to achieve a superior economic performance and to safeguard the position of future retirees. The NZBR study discussed the inhibiting effects of a high tax burden on economic growth. The steep rise in government spending and the tax burden in New Zealand in recent years is a major factor in the sluggish economic recovery. Economic performance has been uniformly poor in centrally-planned countries where the government sector accounts for a dominant share of the economy. In Sweden, which has the largest government sector share among OECD economies, economic performance has been weak since the commencement of massive programmes of income redistribution and social security spending in the late 1960s. Between 1970 and 1985, Sweden's growth in real per capita income averaged 1.1 percent annually which, along with New Zealand, is one of the lowest of all OECD countries. A continuation of this rate of growth would see per capita income in Sweden double over the next 63 years. By contrast, in an economy with a 2.5 percent per capita growth rate, income would double in 28 years. If its present rate of growth were maintained through to the middle of the next century, the per capita income of Swedes would double while an economy with a 2.5 percent growth rate would generate 4.5 times more income per head than now. These figures illustrate the importance of differences in growth rates in determining the capacity of the economy to provide for the needs of future retired people. While a variety of factors influences a country's rate of economic growth, there is widespread agreement that poor quality public expenditure and high fiscal burdens blunt incentives to work and risk-taking and contribute to inferior performance. From around the mid-1980s, a number of OECD countries have moved to reduce the relative share of public sector and transfer programmes in their economies.

2.6 The NZBR study concluded that reductions in the cost of national superannuation were a necessary part of any programme for lowering the fiscal burden and raising the rate of growth of output. These could be achieved by increased reliance on private retirement provision over time while maintaining a state income support programme to prevent those without alternative means from falling into unacceptable poverty. A reduction in the high costs of national superannuation would make room for higher levels of private savings and consumption or expenditure on other priority areas such as health and education. Greater private savings for retirement purposes would take a variety of forms, including investments in businesses and houses as well as financial assets. The key parameters in a reformed income support programme were seen as a lower level of benefits in relation to wages, a higher age of eligibility and tighter targeting of assistance, combined with appropriate transitional arrangements.

3. THE GOVERNMENT'S RETIREMENT INCOME POLICY

3.1 The essence of the government's planned reforms to national superannuation is to gradually reduce the rate of benefit relative to wages and to raise the age of eligibility between the years 2006 and 2025 from 60 to 65. A loose form of targeting will be maintained via the national superannuitant tax surcharge. The effects of these measures, according to the government's calculations, are to stabilise the fiscal cost of state retirement income payments up to the year 2021.

3.2 These are positive moves, but it is highly questionable whether they contribute in a decisive way towards resolving the serious economic, fiscal and demographic problems which New Zealand is facing. They merely prevent the fiscal problem getting worse rather than help to reduce it, and they do not send a strong and immediate signal to the community that more reliance must be placed on private retirement provision. By not providing a convincing resolution of the problem, they maintain a level of uncertainty among present and future retirees about the prospect of further changes.

3.3 It is submitted that there is a present opportunity to achieve more beneficial changes to future arrangements while protecting the position of currently retired people who are fully dependent on national superannuation and who have limited ability to adjust to changes. An attached table compares the approach to retirement income policy adopted by the government, the National Party, the Royal Commission on Social Policy and the NZBR. The striking feature about the comparison is the number of common elements in the directions proposed for reform. Many other submissions to the government's review contained similar elements, and also accepted the validity of the present framework for state pensions (as opposed, for example, to a social insurance approach). There would appear to be scope for consideration of more conclusive changes in respect of each of the key parameters, viz:

- **Benefit Rate**

The proposed range of 65-72.5 percent of the average wage for married couples remains relatively high by comparison with other (more wealthy) countries and with the standards judged appropriate under the old age benefit applying up to the 1970s. It is submitted that further consideration should be given to an appropriate long run relationship, based on more research into the consumption requirements of the elderly. This is not an argument for cutting the purchasing power of present retirees who are wholly dependent on national superannuation. Provided a superior economic performance and growth in real wages can be achieved, it would be preferable to achieve a changed benefit/wage relationship by maintaining (but not increasing) the value of benefits in real terms for an extended period.

- **Age of Eligibility**

Discussing retirement income policy, *The Economist* recently argued that:

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

It added that in Britain, activity rates among older people (including the over-70s) have been creeping up since the mid-1980s. By contrast, there has been a significant fall in participation by over-60 year olds in New Zealand. This seems to have been attributable in large part to the availability of generous and early state retirement benefits.

There appears to be substantial agreement that the qualifying age for state pensions should be raised to at least 65 years. However, a number of OECD countries have higher pension ages or are considering increases. Some OECD calculations suggest that if 65 was the right age for an American man to retire in 1940, and if the rise in life expectancy since then were used purely to extend working life, a man retiring now ought to do so at the age of 73, rising to 75 in 2025. In combination with a move to greater self-provision and the maintenance of other forms of income support (such as sickness or unemployment benefits) the NZBR study suggested there was a case for a gradual increase in the qualifying age to around 70. If this were considered too radical a step, an increase to age 68 as suggested by the Royal Commission on Social Policy (for the universal component of a pension) would be a reasonable compromise. Individuals would, of course, be free to choose earlier retirement (without state assistance) and efforts should be made to modify those features of employment arrangements which encourage the adoption of artificially mandated retirement ages and penalise elderly members of the workforce.

- Targeting the Benefit

Of all the feasible reform options, closer targeting offers the most scope for reasonably rapid fiscal savings, while guaranteeing people a minimum level of retirement income. These fiscal benefits are considered to outweigh the trade-offs associated with targeting, in particular the higher administrative costs and the higher effective marginal tax rates for those receiving the benefit. Universality avoids these disadvantages but at a high cost. Universal schemes are very expensive. They must be funded by high taxes which discourage work initiative and saving by the younger population. They also foster a 'welfarist' culture. The preferable approach is to target retirement income support on the basis of the recipient's ability to meet retirement needs from private resources. That would require targeting on the basis of income and assets along Australian lines. (An assets test is desirable in addition to an income test since consumption can be financed out of accumulated wealth and income may be diverted into asset forms to avoid narrow income tests.) It is inconsistent to apply more orthodox forms of targeting to parts of the welfare system and rely only on the tax surcharge in relation to national superannuation. An exploration by the Select Committee of the scope for agreement to a more tightly targeted approach which would be more transparent and less confusing than the surcharge and yield significant fiscal benefits is strongly recommended.

- Transitional Arrangements

There is common ground that changes to retirement income policy should be introduced in such a way as to minimise disruption to people who are in or near retirement and who are in no position to adapt to changes. Different time scales are indicated for changes in the level of benefits, the age of eligibility and the form of targeting. A serious deficiency of the proposal in the Bill to raise the qualifying age is the delayed starting date and the extended period over which it would be phased in. The justification offered for this decision, namely that the starting date will coincide with the expected increase in the number of elderly people, has little merit. The need for fiscal savings is immediate. We cannot afford to defer for no readily apparent reason the recognised benefits from lower taxes, better economic performance and clearer incentives for private provision. Moreover, the equity of requiring taxpayers to continue to fund a retirement income scheme that they will not benefit from themselves is at best dubious. Similarly, a more expeditious increase in the qualifying age, for example by one year every two years (rather than one year every four as proposed by the government) would not appear to be unduly disruptive. The Royal Commission on Social Policy suggested that the changes it recommended should be brought in over a 12 year period commencing in 1995.

4.0 CONCLUSION

4.1 New Zealand's economic outlook remains poor, and it is poorly placed to handle the far-reaching adjustments implied by an aging population with its present retirement income policies. The economic and social implications are of a vastly greater magnitude than the oil price increases of the 1970s or other economic shocks that New Zealand has experienced. Both present and future retirees have a large stake in decisions which will make New Zealand a more dynamic economy. While it is important in reforming retirement income policies to be fair to those who are in or near retirement, it is also important to be fair to current taxpayers (tomorrow's elderly) and future taxpayers. Failure to do so will impair New Zealand's growth prospects, lead to rising inter-generational strife and promote a migratory response on the part of the most productive and enterprising New Zealanders. Such developments are not in the interests of the elderly section of the population.

4.2 There seems to be a widespread community acceptance of the need for re-establishing a sound, sustainable environment for long term retirement planning. This must be based on a greater role for self-provision, which can best be pursued in an environment of low inflation, reduced taxes and greater opportunities for employment in a freer labour market. Self-provision is clearly feasible as well as desirable, since no more income is available for redistribution by the government beyond that which is privately produced. The measures proposed by the government go in the right direction, but the signals they send are not strong enough and will create ongoing uncertainty. As the Associate Finance Spokesman (Social Policy) for the Opposition has observed:

"If reduced access to tax-funded retirement income is one of the signals needed to convince people of the need to start saving, there is a good case for getting on with the job much sooner than 2006."

4.3 There is a range of options for resolving the dilemma of the state's role in retirement income provision in a more satisfactory and sustainable way. The proposals of the Royal Commission on Social Policy provide a useful and, it is submitted, minimum benchmark for a desirable reform package. We urge the Select Committee to explore the scope for modification to the provisions of the Bill and other aspects of retirement income policy, if possible on the basis of bi-partisan agreement. The key elements to focus on are:

- the appropriate level of state-provided benefits;
- the age of eligibility;
- the scope for closer targeting; and
- an earlier starting date and a shorter period for transitional arrangements

along the lines considered in this submission. At the present juncture there is a large premium on high quality decisions which face the future issues squarely.

**SUBMISSION TO THE COMMERCE AND MARKETING
SELECT COMMITTEE
OF THE HOUSE OF REPRESENTATIVES**

DISASTER INSURANCE BILL

**NEW ZEALAND BUSINESS ROUNDTABLE
JANUARY 1990**

SUBMISSION TO THE COMMERCE AND MARKETING SELECT COMMITTEE OF THE HOUSE OF REPRESENTATIVES

DISASTER INSURANCE BILL

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 interest taken in this topic flows from the importance of establishing an adequate set of policies to mitigate the economic consequences of a major natural 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 Our comments on the Bill are based on an NZBR study, *Disaster Insurance Policy: A Submission to the Associate Minister of Finance*, undertaken in 1989. (A copy of the study accompanies the submission.) It was prepared in response to the Minister's request for submissions on the government's White Paper, *Disaster Insurance Policy*. The essential features of the Bill are similar to those proposed in the White Paper and thus the analysis outlined in our previous study is relevant to the Committee's deliberations.

1.4 The thrust of our submission is that compulsory disaster insurance in respect of most homes has not been justified and that, consistent with the government's general policy on state-owned enterprises (SOEs), the Disaster Insurance Commission of New Zealand (DICNZ) should be privatised at the earliest opportunity.

2.0 THE GOVERNMENT'S PROPOSALS

2.1 The key provisions of the Bill are as follows:

- the introduction of mandatory disaster insurance cover for the replacement of most homes; and
- the establishment of the Disaster Insurance Commission of New Zealand as the successor to the Earthquake and War Damage Commission and as an insurer of homes and other property against damages due to natural disaster. It would compete with other insurers for such business.

2.2 Under the Earthquake and War Damage scheme, a homeowner can avoid or reduce earthquake and war damage cover and levies by not insuring the property against fire in New Zealand or by understating its value. Where such a property is insured against loss from fire, earthquake and war damage insurance is required up to its indemnity value (which approximates its current fair market value). This would generally be less than the property's replacement value. Thus in respect of homes, the proposal significantly extends the requirement for compulsory insurance against loss from earthquake and certain other kinds of disasters. The exemptions provided for in clause 18 of the Bill are likely to exempt few private homes.

2.3 In respect of property other than homes, the Bill effectively provides for the abolition of compulsory insurance for earthquake and war damage where fire insurance is taken out in New Zealand.

2.4 The Earthquake and War Damage Commission (EQWDC) currently supplies cover for property insured under its scheme. Other insurers write policies in respect of the difference between indemnity and replacement value. Under the Bill private insurers will have a greater opportunity to compete for disaster insurance business in respect of property.

2.5 There is provision in the Local Government Act 1974 for local authorities to require a dangerous building to be repaired or taken down at the owner's expense. This power could be exercised in the event of a natural disaster. The policy incorporated in the Bill is directed at the permanent reinstatement of housing rather than public safety and our evaluation of it has been prepared accordingly.

2.6 These proposals raise the following two main issues on which our submission focuses:

- is compulsory disaster insurance justified?; and
- the role of the Disaster Insurance Commission in the insurance market.

3.0 IS COMPULSORY DISASTER INSURANCE JUSTIFIED?

3.1 This question is examined on pages 8 to 14 of the NZBR study. The main points are summarised below.

3.2 The key argument for compulsory disaster insurance, as the White Paper puts it, is as follows:

"Compulsory disaster insurance was favoured because it was felt that the absence of compulsion would lead to two interrelated problems. One is the likelihood of widespread non-insurance among residential property owners, and the resulting disruption to accustomed standards of living following a major disaster. The other is the effect non-compulsion would have on the finances of a Government that felt obliged to assist people with reconstruction."

3.3 In respect of the first point - that individuals would choose not to insure against loss from disaster - we make the following comments:

- The decision to buy insurance is essentially the same as other spending decisions. An individual's preference for accepting or avoiding risk, the likelihood of a loss occurring, the size of the potential loss and the individual's income are likely to determine the demand for disaster insurance.
- Individuals are continually required to make decisions concerning the wide range of risks which they face every day, for example those involved in travel or work. There is no compelling reason to treat disaster risks differently from other risks.
- There are valid reasons why an optimal level of disaster insurance may be less than full cover and could involve no insurance at all. It is not rational to fully insure against all risks. Homeowners may prefer to bear some of the risk of a disaster themselves rather than buy insurance. They may prefer to diversify their risk by holding a portfolio of assets. In the event of a major disaster they may intend not to fully replace their existing properties. Homeowners may also believe that the cost of insurance is higher than it

actually is, because of the difficulties involved in assessing the probability of a natural disaster and the expected loss.

- These factors influencing the decision on whether to buy insurance apply to people throughout the income spectrum. Wealthy individuals may prefer to self-insure rather than be forced to buy insurance. The consumption choices of low income people are already tightly constrained. It may be rational for such people to assume higher risks, especially in respect of events which have a low probability of occurring. The expected cost to households of compulsory insurance is not a trivial amount; it will represent a significant proportion of an annual electricity or telephone bill, for example.

For these reasons (and others discussed in our study) arguments relating to under-insurance should be viewed sceptically. Individuals and financial institutions involved in mortgage finance have incentives to consider whether disaster insurance cover is appropriate in particular circumstances. We believe most New Zealand financial institutions would require insurance as a condition of a loan. There is no sound basis for determining, in a centralised and prescriptive fashion, an optimal insurance strategy for a diversity of individuals, properties and contingencies.

3.4 The related argument advanced in the White Paper for compulsory insurance - that the government would be obliged to meet uninsured private property losses in the event of a disaster - is also, in our view, an invalid reason for the proposal contained in the Bill.

3.5 The proposition is apparently based on the unproven assertion that, in the absence of a compulsory scheme, the government would meet the loss or a large proportion of it. While governments have, in the past, contributed to losses sustained in natural disasters, including droughts, no systematic study has been undertaken of the extent to which such assistance compensated for the losses incurred by private property owners. (The assistance has often been provided in non-transparent ways, for example through tax concessions, which limit their applicability and value to some property owners.) We suspect that such assistance has in fact been modest, with most of the uninsured loss falling on property owners. Overseas experience also points to a similar conclusion.

3.6 More importantly, in the case of a major catastrophe, the costs of civil defence, public safety, health services and emergency aid to victims, together with the costs of restoring government-provided services (for example schools), are likely to be such that generous compensation for private property losses would be inconsistent with broader economic objectives. It does not seem believable that a government would tax a community devastated by a natural disaster in order to reinstate the homes of its wealthiest or even its average-income members. In short, we do not accept that the government could afford to be anywhere near as generous as implied in the White Paper.

3.7 In our view, individuals ought to be responsible for decisions on whether to insure their properties for loss from disasters and on the level of such insurance. The type of thinking behind the compulsory insurance provision is reminiscent of what has been labelled the 'nannying' state. The government may have a role in providing information on the risks of a natural disaster if it has superior information on such risks. Beyond this, the government's role is to provide regular safety net assistance. In the event of a disaster, this would involve health care, accident compensation and welfare benefits, including emergency housing assistance.

3.8 We also submit that the government should grasp the opportunity to establish a credible policy with regard to disasters, thereby setting the constraints within which private provision for disasters can be made. In this regard, acceptance of the perceived belief that the community would expect the government to compensate them for most of their property losses is inconsistent with the policy approach adopted in other areas where the conventional wisdom has been overturned. If the government made clear that its

responsibilities in the the event of a disaster would be limited to those listed in the previous two paragraphs, we believe people or their agents would be in a position to make rational decisions on their own needs.

3.9 The welfare costs arising from compulsory insurance appear to have been excessively discounted. These would be considerable with any compulsory insurance scheme. This is, for example, one reason why a compulsory social insurance approach was not favoured in the government's review of national superannuation. The welfare costs involved include the following:

- distortions of consumption patterns. Spending on items which are of higher priority to homeowners would need to be reduced in order to pay for compulsory insurance;
- the resource cost involved in the administration of, and compliance with, the scheme;
- the unpleasantness of being told what to do by an agent beyond one's control; and
- constraints on the terms and conditions on which insurance is offered as a consequence of the DICNZ's role in the market. As noted in the government's Discussion Paper, the Earthquake and War Damage scheme has reduced the range of contracts available in New Zealand. It can be expected that the DICNZ will have a similar effect on the market for disaster insurance.

These costs can be expected to be significant while the economic benefit is at best doubtful.

3.10 In summary, we submit that the government has not established a valid case for compulsory disaster insurance in respect of most homes. Most countries exposed to natural disasters, for example Japan and the United States, do not require compulsory disaster insurance of homes. We recommend that the provision imposing compulsory disaster insurance on homeowners be deleted from the Bill.

3.11 Clause 14 of the Bill provides that homes are generally to be insured at 'replacement' value. The term replacement is not defined in the Bill and detailed rules relating to its calculation are to be prescribed by regulation. Even if the White Paper arguments for government intervention cited in paragraph 3.2 were to be accepted, we fail to see how they would constitute a basis for requiring compulsory insurance at replacement value. If the Bill's provision for compulsory disaster insurance is proceeded with, we submit that the amount of insurance required should be reduced to the amount required to afford a minimum level of basic housing. This might be generally defined as the lesser of the current market value of a basic modular unit or the current market value of the property. Homeowners could, if they wished, take out additional insurance.

4.0 THE ROLE OF THE DISASTER INSURANCE COMMISSION IN THE MARKET

4.1 A curious feature of the Bill is that it does not fully apply the government's general policy on SOEs, including privatisation, to the DICNZ. This contrasts with the recent decision to offer the State Insurance Office for sale. The businesses of the DICNZ and the State Insurance Office are similar and the same approach should logically be taken to each. Furthermore, in other countries disaster insurance business is generally written by private sector firms. These observations raise the question of why a straightforward privatisation approach has not been adopted in the case of the DICNZ.

4.2 The provision of insurance services is not a natural public sector function. The efficiency of insurance (and other) markets can be impaired by the activities of SOEs operating in the industry. Such entities create special problems because they do not face the same incentives and disciplines as privately-owned businesses.

4.3 The explicit backing of the DICNZ by taxpayers (provided for in clause 12 of the Bill) places it in a preferred position in competing with private sector insurers. Prior to taking out disaster insurance, consumers need to assess whether the insurer is in a sufficiently sound state to meet its obligations if called upon to do so. Clearly SOEs (such as DICNZ, EQWDC and the State Insurance Office) have a special advantage in that they have an explicit or implicit government guarantee. While a charge for the guarantee (as provided for in clause 13) would help even up the competitive position of the DICNZ and other insurers, the value of the guarantee is likely to be difficult to quantify.

4.4 It is most unlikely that an insurance business restricted to disaster risk in New Zealand would emerge in a competitive market. The limited scope to diversify such risks within New Zealand and the transaction costs of reinsurance could be expected to preclude this. New Zealand disaster risk might be diversified by insuring similar and other risks overseas and, to a lesser extent, by insuring other risks in New Zealand. If the DICNZ were to engage in offshore insurance business (as the Bill may permit), this would accentuate the problems of monitoring its performance and of the DICNZ's government guarantee. It is not envisaged that the DICNZ would insure New Zealand risks other than those arising from natural disasters. To the extent that the DICNZ is less able than other insurers to diversify exposure, its risk premium would be higher and therefore its prices should be higher. Such a form of insurance would be inefficient.

4.5 It should be noted that monitoring the performance of an SOE in the disaster insurance market is likely to be unusually onerous. Because of the uncertainties, risks and premium levels are especially difficult to establish and apparent profits over long periods of time may mask the real risk of claims exceeding the available assets. In view of these problems, it is particularly important that market disciplines apply to insurers in the disaster insurance industry.

4.6 The Bill provides for the DICNZ to be both a participant in the disaster insurance market and the chief regulator of the market. The government's general policy on SOEs has recognised the need to separate such functions in order to clearly identify objectives. We see no grounds for departing from this approach in the case of the DICNZ.

4.7 Even if compulsory insurance in respect of residences were accepted, this does not require an SOE to write insurance contracts. The case for the DICNZ to write contracts has not been established in either the Discussion Document or the White Paper. It would be necessary to demonstrate both that compulsory insurance is justified and that cover is best provided by a government insurer. The concerns expressed above suggest that it is unlikely that a valid case for government participation in the insurance market could be established.

4.8 We submit that there are no valid grounds for government provision of insurance services. Furthermore, the difficulties involved in establishing a competitively neutral environment and in monitoring the performance of SOEs engaged in the insurance market suggest that they should be privatised. The first step would be to place the DICNZ on a competitively neutral footing to the furthest extent possible and then to privatise it at the first opportunity.

5.0 CONCLUSION

5.1 The onus is on the government to demonstrate that the benefits of compulsory insurance for the replacement of most homes outweigh the costs involved. We do not believe that this test has been met. We submit that compulsory disaster insurance of most homes

should not proceed. At most, the level of insurance required should not be greater than that required to provide a basic level of housing.

5.2 We also submit that the proposals relating to the DICNZ are inconsistent with the government's general policy on SOEs. The DICNZ should be placed on a competitively neutral basis with other insurers by, for example, separating regulatory and commercial activities, and it should be privatised at the earliest opportunity.

**SUBMISSION TO THE REVIEW OF
THE OMBUDSMEN ACT 1975 AND
OFFICIAL INFORMATION ACT 1982
IN RELATION TO
STATE ENTERPRISES**

**NEW ZEALAND BUSINESS ROUNDTABLE
JANUARY 1990**

SUBMISSION TO THE REVIEW OF THE OMBUDSMEN ACT 1975 AND OFFICIAL INFORMATION ACT 1982 IN RELATION TO STATE ENTERPRISES

1. 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 performance of state-owned enterprises has been a topic of major concern to our organisation. A general study on the subject entitled *State-Owned Enterprise Policy : Issues in Ownership and Regulation* was published in 1988, and work has been undertaken on a range of specific SOE issues. A significant number of NZBR members have served as chairmen or directors of SOE boards.

1.3 The Business Roundtable has been supportive of the view that better use can be made of the large volume of resources controlled by SOEs if they are run as commercial businesses facing market competition and transferred to private ownership where there are no compelling reasons for retaining them in the public sector. The programme of corporatisation and privatisation is now well advanced and the organisations concerned have been freed of many of the constraints that formerly impeded their performance, with notable benefits to shareholders and consumers. It is therefore timely to review the constraints imposed by the Ombudsmen Act and the Official Information Act.

1.4 The review needs to be based on a general framework for considering the disclosure requirements applying to commercial enterprises. All effective policy is founded upon a rigorous and sound analytical base which enables the objectives of the policy to be expressed with precision. The test that needs to be applied to any role proposed for the government is that the net benefits of its involvement should exceed the costs, and that the best option for achieving the desired objective is chosen.

1.5 With respect to the two Acts in question and their application to SOEs, the points at issue relate primarily to disclosure policy and in particular - but not exclusively - financial disclosure of various kinds. Inappropriate disclosure policy imposes significant economic costs. Applying the disclosure policy inherent in the Acts to SOEs has the potential to reduce shareholders' and therefore taxpayers' wealth. In addition, it jeopardises the SOE policy and its objectives as set out in the State-Owned Enterprises Act 1986.

1.6 This submission sets out a general framework within which the issue of disclosure can be examined. It is stressed that decisions to disclose or not confer costs and benefits on all of the parties involved. Because disclosure practices involve the production, distribution and consumption of costly information in a world of scarce resources, decisions about disclosure require trade-offs to be made. The nature of these trade-offs is discussed as it applies first to commercial enterprise in general and then, more specifically, as it applies to SOEs in terms of their present objectives.

1.7 It is concluded that in respect of this issue it is not possible to draw any meaningful distinction between SOEs and their private sector counterparts. For this reason and because of the potentially heavy burden which excessive disclosure requirements place on all firms, it is concluded that there is no longer a valid case for subjecting SOEs to the provisions of the Acts.

2.0. THE NATURE OF DISCLOSURE

2.1 Disclosure is not an end in itself, either for firms in general or SOEs in particular. Since information has different meanings for different individuals and groups, the same information may have a quite different value to them. Disclosure is therefore a means of achieving some desired goal.

2.2 It follows that disclosure policy, at its most basic level, needs to be based on an understanding of the benefits which are sought in compelling disclosure where it otherwise would not occur, or where voluntary disclosure would be considered to produce sub-optimal outcomes.

2.3 In the present context, once a valid purpose for disclosure has been established, it is necessary to show:

- that adequate disclosure will not occur through private voluntary mechanisms;
- that public policy instruments are capable of producing the requisite disclosures; and
- that such instruments provide net overall benefits which exceed those of all other options.

The two Acts, as they apply to SOEs, would have to meet each of these criteria to be considered sound policy instruments.

3.0. THE PROCESS OF DISCLOSURE

3.1 In understanding the nature of disclosure processes it is helpful to ask why firms disclose certain information and seek not to disclose other information.

3.2 Reduced to its simplest terms, firms face strong incentives to disclose appropriate information because disclosure has the potential to reduce costs or prevent costs from rising. For the reasons outlined below, disclosure can reduce the risks of all those who do business with the firm including investors, creditors, employees and consumers.

3.3 Conversely, the reason why firms face strong incentives not to disclose certain information is that disclosure has the potential to erode their competitive advantage relative to other firms. There are two limbs to this argument:

- disclosure of 'trade secrets', research information, sources of cost savings and so on, is likely to undermine advantages which the firm has over its rivals and thus reduce the opportunities for maximising shareholders' wealth; and,
- there are costs - which may be significant - in producing information, having it verified so that it is accurate and credible, and distributing it to all relevant parties.

These factors combine to produce incentives for not disclosing some information at all, or disclosing only to a certain level or to certain parties.

3.4 Since disclosure involves both benefits and costs, firms trade off the gains to be had from disclosure against the potential penalties which disclosure can entail. This trade-off occurs at the margin, i.e. once a point is reached where one more dollar spent on disclosing

information provides only one more dollar in gains from disclosing, voluntary disclosure will go no further because the firm will have spent 'just the right amount' on disclosure.

3.5 As commercial enterprises created by and obliged to comply with the provisions of the State-Owned Enterprises Act 1986, the SOEs are directly involved in the processes described and face the need to make the same trade-offs as any other firm in evaluating the costs and benefits of disclosure policies.

4.0. VOLUNTARY DISCLOSURE

4.1 The motivation for appropriate forms of voluntary disclosure cannot be over-stressed. Disclosure tends to be seen as being an almost totally involuntary practice which takes place only because of legislative compulsion. This view is misleading and confounds the analysis of regulating for disclosure. Consequently it is a poor foundation for policy development.

4.2 Voluntary disclosure of information is common among firms of all types. Some random examples of disclosure beyond the requirements of the law include:

- Fletcher Challenge's Annual Report which incorporates financial information which is broken down to a level of detail which goes beyond statutory requirements;
- The voluntary posting of a 'Don't Sell' notice by Rank Group Ltd prior to the announcement of their acquisition of the Government Printing Office; and,
- Electricorp's voluntary disclosure of productivity figures, Trans Power's financial results, the Corporation's international safety rating policy and a range of other performance indicators.

4.3 Firms face strong economic incentives to disclose - and regularly do disclose - in the following common cases:

- **To Equity Investors** - both directly to shareholders and indirectly through broking houses and investment analysts. This builds confidence in share prices, quashes speculation, attracts investors, creates competition for the firm's equity and, as a result, lowers the firm's cost of equity capital.
- **To Holders of Debt** - in order to raise debt capital it is essential to disclose financial information, business plans and to a lesser extent corporate strategy. Inadequate disclosure forces debt holders to raise interest charges to compensate for uncertainty. Disclosure reduces the cost of debt to the firm.
- **To Employees and Labour Markets** - in a similar way, disclosures which provide assurance about the security of employment for the labour force, explain internal arrangements for such things as occupational safety and health or equal employment policies, and inform employees about the firm, reduce the need for employees to demand wages which incorporate compensation for uncertainties about job security and conditions.
- **To Suppliers** - disclosure is often required so as to ensure continuity of supply of raw materials and intermediate products and especially to maintain supply on credit. Without such credit firms' costs increase through having to carry excess inventory or risk missing orders. Incentives to disclose are thereby created.
- **To Local Communities** - where it is important to the firm to obtain the medium and long term backing of the community, especially over issues such as environmental management and employment security, firms face incentives to disclose.

- **To Consumers** - firms face strong incentives to disclose information of various types to consumers so as to build long term relationships and promote confidence in the quality of their products and after sales service.

Thus firms face incentives to disclose information to all of the groups commonly known as 'stakeholders' in the firm. Studies have shown that these include incentives to disclose 'bad' news, since a firm's reputation risks being affected in an adverse way if it is responsible for putting out a biased or misleading pattern of information.

5.0 REGULATED DISCLOSURE

5.1 Forcing information disclosure where it would not otherwise occur can impose significant costs upon the firms affected and ultimately on society at large.

5.2 The regulatory procedure itself imposes costs, not just in the form of compliance costs but also because such benefits as are conferred apply in a relatively small number of cases while the costs imposed are incurred by all firms.

5.3 By definition decisions about the type and level of information to be disclosed must be made by persons:

- who have a less adequate knowledge of the firm, the industry and the market place in which it operates than those who work within it; and,
- who do not stand to bear the full costs of an inappropriate decision. The accountability of regulators is, in this sense, weakened.

The combined effect of these two factors is that decisions are likely to be arbitrary, are unable to take account of differences between firms, and tend to reflect fixed rather than dynamic views of the firm.

5.4 It is also likely, largely as a result of these problems, that information made available through forced disclosure will be poorly matched to the needs of those doing business with the firm. For example, most disclosure regulation relates to financial information. This is unlikely to be of interest to workers whose concern is with occupational health. By the same token, occupational health may be of little interest to creditors. Thus resources consumed in complying with disclosure regulation may be diverted into irrelevant areas while more appropriate needs are starved. The net result is likely to be inadequate disclosure as well as inefficient use of resources.

5.5 Forced disclosure is particularly harmful where it affects the ability of the firm to use incentive systems, and where it results in a loss of competitive advantage for the firm. A prime example of the potential for imposing costs is the disclosure of executive salaries. Costs arise because:

- the market for executives is a competitive one in which confidentiality of remuneration is normally considered to be of importance both to the individuals involved and the firms hiring them;
- if salaries are disclosed then the firm must normally either remunerate at a higher level to compensate the executive for the loss of privacy or accept a lesser quality employee or a reduced level of motivation;
- where bonus payments are linked to performance, the incentive effect is completely lost if the individual faces the possibility of personal criticism or prurient interest in the basis for bonus payments.

5.6 The structuring of executive contracts and remuneration packages is a matter to which chairmen or directors of companies give the closest consideration. They are one of the important mechanisms for ensuring that managers of firms act in the interests of their principals, the owners of equity in the business. No useful purpose is served by public disclosure of such information, as is evidenced by the fact that it is almost never voluntarily revealed. Within firms in the commercial sector, no information rates higher security provision, reflecting a belief in the importance of confidentiality both to shareholders and individual executives. Instead, the chain of accountability from managers to shareholders in public companies runs via directors, and it is appropriate that the company constitution provides for directors' remuneration to be known to shareholders unless they elect otherwise. In the case of private or closely held public companies these considerations may not apply, and even the disclosure of directors' remuneration may be unwarranted. Legislation requiring the disclosure of managerial salaries, e.g. by salary bands, as has been enacted in some countries, is an example of intrusive business regulation which imposes unwarranted costs and undermines economic competitiveness. For these reasons, pressure by the Ombudsmen on SOEs to reveal executive remuneration was resisted in most cases and proposals which the Securities Commission is reported to have put forward requiring similar disclosure in the private sector will be vigorously opposed by the business community if they are taken up by the government.

5.7 Where disclosure policy leads to a loss of competitive advantage through the disclosure of technical, market or other proprietary information, the incentives to search out new opportunities and innovate are weakened severely. The direct losers are obviously the shareholders, management, employees and others who do business with the firm. Importantly too, society loses out because incentives to develop confidential means for innovating, cost cutting and improving service are weakened.

5.8 A final problem with the use of legislation to enforce disclosure, especially the Official Information Act 1982, is that the full costs of producing and distributing the information are not met by those who use it. As with other forms of regulation, benefits are conferred on a limited number of people, often seeking some kind of political or media advantage, who do not wish to pay for the costs of disclosure. Clearly they do not meet the costs of lost competitive advantage either. These costs are instead transferred to shareholders and consumers of the goods and services produced by the firm. In the case of voluntary disclosure, however, costs are borne by these groups only up to the point where there are net overall benefits to disclosure and therefore where such disclosure is effective and relevant.

5.9 The conclusion is that disclosure which is engendered purely as a result of legislation is often ineffective in terms of the parties served, costly to the firm and society at large, and inequitable in terms of the costs it imposes. A narrow range of interests is served at the expense of wider community interests. This does not mean that there is no case for requiring some standard forms of disclosure and, as noted earlier, certain obligations (such as the filing of accounts and audit requirements) are laid down in companies and securities legislation and stock exchange listing requirements. In each case, however, policymakers must be sure that the benefits of a particular disclosure rule exceed the costs, and many proposals for mandatory disclosure fail that test. Beyond a certain level of disclosure, the interests of owners are likely to be better served by other mechanisms, such as the ability to bring actions against the directors of the firm. In considering disclosure policy in relation to SOEs, these points and the alternatives to legislatively-enforced disclosure should be borne in mind.

6.0. STATE-OWNED ENTERPRISES

6.1 In terms of both government policy and the State-Owned Enterprises Act 1986, SOEs are deemed to be commercial enterprises and are enjoined to operate on a basis that is comparable with their private sector counterparts. To promote efficiency and facilitate

performance monitoring, the government has sought to place SOEs on a competitively neutral footing vis-a-vis private firms, and to remove barriers to competition in their markets. Consequently the analysis of disclosure policy applies to SOEs just as it does to private sector firms. Any justification for applying the Acts to these entities would need to establish significant differences between them and other firms and to demonstrate that net benefits are likely to accrue from applying the Acts to them.

6.2 The principal difference between SOEs and publicly listed firms lies in their ownership which takes the form in most cases of a 100 percent shareholding by ministers on behalf of taxpayers. This results in two features not commonly found in private firms:

- the absence of listed equity means that monitoring mechanisms other than those associated with equity markets must be used to ensure adequate performance; and
- under normal circumstances, the shareholding ministers are unable to 'sell down' their equity if they are unsatisfied with the performance of an SOE. Again monitoring mechanisms are required to deal with this issue.

With other organisational forms like private companies or partnerships, the close involvement of owners in the business and other mechanisms help protect their interests.

6.3 Special mechanisms exist through the SOE legislation and other less formal government policy to deal with these problems. These include the Statement of Corporate Intent, the Business Plan and the performance reporting mechanisms. Further accountability is created through the shareholding ministers' responsibilities to Parliament for the performance of the SOEs. In addition the Controller and Auditor-General exercises certain responsibilities in respect of SOEs. SOEs also face the same regulatory regime as private sector firms, which includes the requirements of the Companies Act 1955 and its amendments and the Securities Act 1978 and its amendments.

6.4 Consequently, such differences as do exist between SOEs and private commercial firms are dealt with through specific legislative mechanisms and policies. While these are not generally as satisfactory as the monitoring mechanisms and capital market sanctions that provide the ongoing stimulus to superior performance in the case of privately-owned businesses, the response to that problem is to transfer them to private ownership, not impose additional forms of regulation. Disclosure through the Official Information Act 1982 thus has no necessary or useful place in the monitoring of SOEs.

6.5 The success of the SOE policy and the effectiveness of individual SOEs is heavily dependent upon the maintenance of competitive neutrality. If SOEs do not face the same set of disciplines and freedoms that comparable private sector firms face, their performance is likely to suffer. The net result is likely to be the imposition of higher costs on shareholders and taxpayers, as well as the myriad groups which do business with SOEs. The costs arising from the application of the two Acts to SOEs are not ones that private sector firms have to bear. At the margin they impede the performance of SOEs and their ability to sustain competition, maintain market position and provide jobs. Wherever possible, limitations on SOE performance (such as special information disclosure requirements and the inability to acquire competitive audit services) should be removed.

6.6 The considerations relating specifically to the Ombudsmen Act (beyond its role as a vehicle for monitoring and enforcing the provisions of the Official Information Act) are similar. The requirement for competitive neutrality means that SOEs should not be subject to administrative interventions that are not faced by their private sector competitors. General legislation (such as the Commerce and Fair Trading Acts and the personal grievance procedures of the Labour Relations Act) can serve similar functions to those carried out by the Ombudsmen and should apply equally to public and private commercial enterprises. The requirements placed on some SOEs as a result of action under the Ombudsmen Act have on

occasions been onerous and time consuming. SOE policy has now evolved to the point where the role of the Ombudmen's office in monitoring public administration is no longer an appropriate model for ensuring performance and accountability in SOEs.

7.0. CONCLUSION

7.1 Any review of the applicability of the Ombudsmen Act 1975 and the Official Information Act 1982 to the SOEs should be undertaken bearing three points in mind:

- inappropriate disclosure policy applied to any form of commercial activity has the potential to impose significant costs on both the firm and society at large. In the case of the SOEs it is difficult to see how net benefits can arise from applying the Acts to them;
- SOEs are totally different entities from the former government departments they replaced in terms of the policy objectives they embody and the requirements for performance and accountability. It is therefore difficult to see how they fall within the policy objectives which the Acts address; and
- the application of the Acts has the potential to put at risk the integrity of the SOE policy, the operation of the individual SOEs and the benefits which they bring to taxpayers, consumers and other groups in the community.

7.2 The focus of both Acts is on general public administration rather than commercial activity. Even when trading activities were conducted within government departments, the intent of the Acts was to afford protection to commercially sensitive information. Now that SOEs have been exposed to actual or potential competition in most parts of their business, and alternative monitoring and accountability mechanisms have been established, unnecessary handicaps to their operations should be removed. We submit that it would therefore now be appropriate to exclude SOEs from the provisions of the two Acts.

**SUBMISSION TO THE GOVERNMENT ADMINISTRATION
SELECT COMMITTEE
OF THE HOUSE OF REPRESENTATIVES**

PRODUCTIVITY COUNCIL BILL

**NEW ZEALAND BUSINESS ROUNDTABLE
JANUARY 1990**

SUBMISSION TO THE GOVERNMENT ADMINISTRATION SELECT COMMITTEE OF THE HOUSE OF REPRESENTATIVES

PRODUCTIVITY COUNCIL BILL

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 national interests.

1.2 The Business Roundtable welcomes the concern for improving the productivity performance of the New Zealand economy which motivates the Bill. The thrust of its submission is that the establishment of a government quango would not help to achieve that objective but that more effective policies are available which should be promoted vigorously by those concerned about New Zealand's productivity record.

2.0 THE NATURE OF PRODUCTIVITY

2.1 Productivity is about creating the greatest value from the resources available to the economy. More technically, it consists of obtaining the maximum output from the units of input to a productive process. A more productive use of resources is normally the dominant factor in long run economic growth. Productivity increases are therefore the key to improved living standards.

2.2 Because a number of resources - such as capital, labour, land, other natural resources and entrepreneurial skills - are used in most forms of production, productivity is a broadly-based concept. A measure that endeavours to encapsulate a wide view of the concept is total factor productivity. Another measure commonly used is labour productivity, which is an important indicator since direct and indirect labour inputs typically represent around two thirds of the cost of production in an advanced economy. Poor labour productivity is accordingly a major drag on living standards.

2.3 Because the concept is a broad one, a wide range of factors influence the productivity achievements of an economy. The development experience of many countries has shown that the list of factors conducive to sustained productivity improvements begins with secure private property rights and a sound legal system. The nature of political and social institutions, values such as thrift and the work ethic, and other cultural factors are important. In the more purely economic domain, policies which enhance growth and productivity include efficient markets for capital and labour, a minimum of restrictions on domestic and international trade, a limited public sector and low tax burdens, a non-inflationary environment and efficient processes for human resource development. It follows that any programme to promote productivity growth must be broadly-based and encompass the entirety of the machinery of government and the private sector.

3.0 LESSONS FROM PAST EXPERIENCE

3.1 As far back as 1962, the former Monetary and Economic Council was drawing attention to the fact that 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 trend has continued, with New Zealand recording the slowest rate of productivity growth in the OECD area in the following two decades.

3.2 Responses in the 1960s to the problem identified by the MEC took the form of attempts at long term economic planning. The National Development Conference of the late 1960s established targets for growth rates and other economic aggregates and a series of councils were convened to study specific industries and ways of assisting their growth. A productivity unit to promote productivity programmes in industry was established in the Department of Trade and Industry. This tradition was carried on by the Planning Council.

3.3 Experience in New Zealand and elsewhere has demonstrated that efforts to centrally plan and guide a modern economy are unrewarding. The essential reason is that the information necessary for the myriad of economic decisions that must be made each day is dispersed and cannot be acquired in a central fashion. Moreover, those engaged in central government agencies do not face strong incentives to make good decisions or terminate bad ones. In the 1970s and '80s, policies in many countries shifted away from centralised economic planning and associated endeavours such as tripartite councils, incomes policies and long term economic modelling towards policies in which the primary government role has been seen as creating a stable and open environment for private enterprise and running an efficient public sector, including efficient social services.

4.0 EVALUATION OF THE PRODUCTIVITY COUNCIL BILL

4.1 The Bill envisages the establishment of a Productivity Council with the function of promoting research on productivity and advising on schemes to increase productivity in the public and private sectors. It would be a tripartite body serviced by a government agency.

4.2 The thinking behind the Bill does not appear to have taken account of the unsuccessful nature of past initiatives of this kind referred to in the previous section. The former Productivity Advisory Council was not regarded as having made a useful contribution. The very generalised aspects of productivity which, of necessity, are the only feasible subject matter for a centralised body are of little interest to firms and individual public sector organisations. Officials employed in government agencies do not typically have the experience or skills that are valuable to private sector managers concerned with raising productivity in their firms. The comparative advantage of competent government officials, by contrast, is in helping to establish the policy framework within which enterprise can flourish and in carrying out genuine public sector functions in a cost-effective way. All the functions envisaged for the Council that are relevant to sound economic management can be, and are, carried out by existing branches of government.

4.3 Three examples of the more specific functions envisaged for the Council illustrate the limitations of the underlying thinking in the Bill.

4.3.1 It is proposed that the Council should formulate and implement guidelines for worker sharing in productivity gains. This idea appears to be based on an incorrect understanding of the relationship between productivity gains and employee compensation, specifically wages. First, productivity gains can arise in a variety of circumstances which should not give rise, other things being equal, to wage increases. Examples are where the gains are due to improved capital productivity and where the gains have arisen as a response to reductions in industry assistance which has maintained the viability of the firm but has not created any additional surplus for distribution. More importantly, 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. A firm or industry experiencing high rates of productivity growth should not increase wages if there is an ample supply of workers with relevant skills seeking jobs. To do so 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. Conversely a firm experiencing only low rates of productivity growth may need to increase wages to retain staff in a tight labour market and be forced to contract its marginal operations. Clearly the link between productivity and gain sharing does not operate in the way envisaged in the Bill, and cannot be formulated in a centralised way.

4.3.2 The Bill envisages a role for the Council in respect of industrial democracy. The concept of industrial democracy which is apparently envisaged was also linked with the ideas of national and industry planning prevalent in the 1960s and was adopted around that time in countries like Germany and Sweden. It involved a politicisation of the employment relationship and led in those countries to laws mandating employee codetermination of business plans, works councils and union representation on company boards. These developments have not been conducive to firm performance or worker interests, for reasons elaborated in the NZBR study *Industrial Democracy: A Case for Regulation or Deregulation?* They have fallen generally out of favour around the world. The recent New Zealand Committee of Enquiry on the subject, in its majority findings, failed to demonstrate an understanding of this experience or the essentials of a productive labour relations framework. These entail wide freedoms for employers and workers to structure their relationships in mutually beneficial ways which encourage trust, cooperation and high productivity. Centralised prescriptions for 'industrial democracy' inevitably do not fit the circumstances of many individual workplaces and the preferences of those who work in them. No useful role is seen for the Council in this regard.

4.3.3 A similar prescriptive approach is inherent in the suggestion that the Council should "formulate and implement guidelines for employee share ownership plans". In a freer labour relations system, there is every likelihood that a greater variety of compensation packages would be devised mutually between employers and employees, either individually or collectively. Some of these would contain performance-related elements. However, it is wrong to assume that share ownership schemes are necessarily a desirable component of such packages. There are good reasons why wages are the dominant form of employee compensation and are likely to remain so, one of which is that most workers are not well placed to bear the risk associated with fluctuating business profits and prefer fixed claims on the firm's income. Another drawback of ESOPs is that it may be undesirable for workers employed by a firm to have a high proportion of their savings committed to the same firm in the form of equity, thus making them doubly vulnerable to the failure of the firm. Further, in the case of many firms there will often be a very tenuous link between the performance of an individual and the performance of the firm as reflected in its share price, and any incentive effects will be weak. Alternative reward structures which also encourage worker productivity (e.g. promotion policies, bonus systems) may be superior forms of gain sharing. This can only be determined in the circumstances of particular business units and groups of workers, not in a centralised tripartite fashion.

4.4 Despite these objections to the approaches taken in the Bill, there is full agreement on the part of the Business Roundtable with the objective of enhancing productivity, and especially with the focus on labour productivity implicit in the three preceding examples of concerns identified in the Bill. The better use of labour resources is crucial to the performance of many key industries in the economy. Labour productivity issues are at the heart of problems in industries such as the waterfront, shipping, meat processing, pulp and paper and construction. In all these the difficulties stem primarily from New Zealand's archaic trade union and collective bargaining structures. They take such forms as inflexible hours of work and associated poor utilisation of capital plant; rigid union demarcations; inadequate scope for multi-skilling; and pay structures that do not provide adequate rewards for skill and

responsibility. These problems cannot be solved by a remote agency, however competent and well-intentioned, and require fundamental changes to the way in which employment relationships are organised in this country. Rather than new forms of centralism or tripartitism, they require a focus on the enterprise and an ability to enter into voluntary and decentralised contracts, on an individual or collective basis, which will incorporate incentives for productivity and job creation. The promotion of reforms to existing labour relations arrangements along these lines is commended to the committee as the single most important contribution that could be made to raising labour productivity in New Zealand.

5.0 CONCLUSION

5.1 There have been major advances in productivity in New Zealand in recent years in response to policies which have encouraged competition and innovation and created incentives for people to work hard and reap rewards for their efforts. In some areas such as the state-owned enterprise sector and parts of manufacturing, gains have been staggering, in some instances exceeding 100 percent. This is a measure of the waste and inefficiency that developed in the previous regulated and state-dominated environment.

5.2 Nevertheless, the productivity gap between New Zealand and the most successful OECD nations remains large. This can be seen at an industry level in measures such as rates of container turnaround at port terminals and person-hours involved in the production of a tonne of wood pulp. It can be seen at the aggregate level in the form of the income gap that has opened up between us and countries with which we previously shared a similar per capita income. The adoption by New Zealand of the type of economic policies responsible for the success of the best-performing OECD countries has been slow and partial. Where reforms have been pursued vigorously, the gains have been substantial. For example, the deregulation of financial markets has led to huge improvements in the use to which New Zealanders' savings are put, and has stimulated new financial services and cost reductions in transactions which have benefited savers and borrowers alike. By contrast, the failure to make comparable progress in freeing up the market for the other key factor of production, labour, has meant that most of the gains available from fully employing and better utilising our human resources have not been realised.

5.3 In relation to the goal of higher productivity and hence higher income growth inherent in the Bill, the government's economic programme has suffered from three principal weaknesses:

- a failure to implement comprehensive reforms to labour relations legislation so as to facilitate job creation and better working methods;
- an uncontrolled rate of growth of government spending and a rising tax burden which is siphoning resources away from the private sector and stifling incentives for business investment; and
- the lack of a coherent approach to social policy reform, and in particular the creation of a set of welfare arrangements which has led to a vast increase in the numbers on benefits, and inadequate incentives to engage in productive employment.

These problems are inter-related. The combination of an inflexible labour market which is constricting job opportunities and a set of badly-designed income support programmes is making the fiscal problem virtually unmanageable.

5.4 The key to boosting New Zealand's productivity performance lies in developing policies which directly address the problems in these three areas. The establishment of a Productivity Council as proposed in the Bill would not make a useful contribution to this process. It would represent a return to bureaucratic approaches to economic management

which have comprehensively failed in New Zealand and elsewhere. The Committee should grasp the opportunity provided by the welcome interest in productivity to advance superior solutions. We submit that it should set aside the Bill and instead put forward constructive proposals in the three areas identified which could make a tangible impact on New Zealand's productivity growth.

**SUBMISSION TO THE COMMERCE AND MARKETING
SELECT COMMITTEE
OF THE HOUSE OF REPRESENTATIVES**

PHARMACY BILL

**NEW ZEALAND BUSINESS ROUNDTABLE
JANUARY 1990**

SUBMISSION TO THE COMMERCE AND MARKETING SELECT COMMITTEE OF THE HOUSE OF REPRESENTATIVES

PHARMACY BILL

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 Business Roundtable has been supportive of policies aimed at creating greater freedom of consumer choice, opportunities for entrepreneurship and competitive stimulus to efficiency and innovation in all markets of the economy. In respect of retailing, for example, it has supported the removal of restrictions on shop trading hours. In respect of the labour market, it has advocated the removal of inappropriate restrictions on employment contracts so as to enable firms and individuals to structure their relationships in mutually beneficial ways. These principles apply equally to the place of pharmacies in the retail sector and to the professional sector of the labour market. They provide the basis for the approach taken in this submission.

2.0 NATURE OF SUBMISSION

2.1 The principal focus of this submission is on the proposed retention of ownership controls for retail pharmacies. Reform of the regulatory regime for pharmacy should be seen in the context of three general factors:

- the burgeoning cost of health care to the government and the increasing difficulty in maintaining a sufficient level of quality of care in the public system;
- the significant contribution of the cost of pharmaceuticals to that cost and the potential for government expenditure savings with a more competitive market for pharmacy services; and
- the now significant extent to which the regulation of retail pharmacy is out of step with other approaches to industry regulation. To our knowledge, pharmacy retail business is the only one in which ownership is limited to one class of professionally qualified people.

The present review provides an opportunity to address these issues and contribute to lowering the costs of health care while improving its quality.

2.2 For any regulation to be justified, it must be possible to point to the way in which its overall benefits exceed its costs and to demonstrate that the form of regulation chosen is superior to all feasible alternatives. In the case of ownership controls these conditions are not satisfied since:

- such controls are not capable either in theory or practice of addressing the problems which they seek to ameliorate; and

- they impose both equity and efficiency costs which are not justified on net benefit or other grounds.

The overall effect of ownership regulation is likely, in fact, to be harmful to consumers in terms of the quality of service, the price of goods and services and the conditions under which they are provided. While the pharmacy industry, like other formerly regulated industries, may assert that it provides a high standard of service, this simply cannot be tested in the absence of competitive alternatives. Competitive responses to deregulation in industries such as airlines and telecommunications in New Zealand have yielded a vast range of consumer benefits. In many cases the scope for such service improvements was not previously suspected.

2.3 Assessing the costs and benefits of ownership regulation in pharmacy differs from many other such assessments because it is possible to make direct comparisons between regulated and unregulated situations. Comparison is possible because of the presence in New Zealand of the Boots pharmacy group. International experience of pharmacy retailing in the absence of ownership restrictions is also available.

2.4 The submission proceeds by examining briefly the concerns about the retailing of pharmaceuticals and how these are and should most appropriately be dealt with. This is followed by a consideration of the benefits and costs of ownership restrictions as a means of dealing with the issues of concern.

3.0. PHARMACY AND THE PUBLIC INTEREST

3.1 Legitimate public interest concerns about the retailing of pharmaceuticals may be divided into two related categories as follows:

3.2 Retailing of Potentially Hazardous Substances

3.2.1 The retailing of pharmaceuticals involves potentially significant hazards since potent drugs may be involved, treatments which require careful administration, including instruction, may be prescribed and persons taking prescriptions may be in a position of diminished responsibility, for example children and the elderly.

3.2.2 There is no question that these are valid concerns. The issue is the most appropriate means of dealing with them. In particular, the question of whether ownership restrictions reduce the hazards must be addressed.

3.2.3 The potential hazards are currently addressed through the Medicines Act 1981 and its regulations which categorise medicinal substances in such a way that only persons of suitable qualification may retail them. This regulatory regime is comprehensive, is fully reviewed annually with particular substances being considered on an ongoing basis, and has proven to be effective over a good many years. The regime has the benefits of being relatively well targeted at the issues of concern and provides means for review where this is deemed necessary.

3.3 Competency in Retailing Pharmaceuticals

3.3.1 This is a valid concern especially in the light of the growing amount of informal health care advice proffered by pharmacists. Again the issue is not so much the validity of the competency objective but whether or not ownership restrictions are the best means available to achieve it. The relevant question in the minds of clients collecting a prescription is not 'am I dealing with the owner?', but rather 'am I dealing with a qualified pharmacist?'

3.3.2 The current regulatory response to the potential for incompetency involves a procedure for registration of pharmacists, by which unqualified persons are excluded from

dealing in a variety of pharmaceuticals or holding themselves out to be pharmacists where they do not meet a set of stringent requirements. This is backed by a comprehensive disciplinary system. The Bill maintains registration and disciplinary procedures, and introduces a form of competency testing. While government-based compulsory registration schemes impose costs of various kinds, the regime does at least attempt to address the issue directly.

3.4 Other Mechanisms

3.4.1 While registration and the Medicines Act 1981 are the principal government interventions to protect the public interest, several more broadly-based mechanisms should also be noted. These include:

- the commercial need to maintain a good reputation through the proffering of competent services;
- the protection provided by elements of the common and criminal law in relation to drugs;
- the need for continued competency so as to benefit from government business;
- competitive pressure from agencies such as hospitals and other health professionals; and
- competition from other pharmacists.

3.4.2 Further, it is worth noting that numerous retailers sell products which are potentially harmful. Almost all garden supplies shops retail poisons and substances which can be used to produce explosives. Hardware shops and service stations all retail products which are or have been involved in substance abuse, and many retailers provide products which are potentially harmful unless competent instruction in their use is provided. In each case the need to maintain a good reputation, the pressures of competition and the discerning nature of consumers provide powerful forms of protection.

3.4.3 These mechanisms supplement the competency and qualification requirements that would be laid down in the case of dispensing pharmacists. Additionally there might be a case for prohibiting people who have committed certain offences (e.g. drug convictions) from working in or owning a pharmacy if this is not already dealt with under separate legislation.

4.0. ARGUMENTS FOR OWNERSHIP RESTRICTIONS

4.1 Arguments for retaining the current ownership restrictions (or some modified version of them) revolve around a general proposition that the potential problems inherent in the retailing of pharmaceuticals can be reduced through ownership restrictions. More specifically it is commonly argued by pharmacists' trade organisations that, without ownership restrictions, either:

- chemists will resort to unethical and unprofessional conduct as a means of meeting non-pharmacist competition; or
- chemists will be directed to indulge in unethical and unprofessional conduct and will accede to such direction.

Neither of these arguments is tenable. Moreover they impugn the integrity of the profession severely and in an unwarranted way.

4.2 The first argument implies that chemists have to be paid to be ethical and professional or, more precisely, that if their income falls below a certain level because of competition they will no longer act ethically or professionally. The argument further implies that unless they have an ownership interest in their place of employment of at least some given percentage they will act in an unethical fashion.

4.3 These notions are patently absurd. There is no evidence in the many extensive studies of the regulation of pharmaceutical retailing to suggest that there is any link at all between the ownership structure of pharmacies and the professional conduct of the pharmacist.

4.4 The second argument is equally nonsensical. Numerous professionals work under the direction of owners who are not members of the profession or who have a profit motive in being in business, without finding themselves under pressure to resort to unethical and unprofessional practices. Examples include lawyers, teachers in private schools, architects, engineers and doctors. In each case, professional integrity is part of the 'product' being sold. For the owner, any action which endangers that integrity is likely to be detrimental to the business and thus owners face strong incentives to promote the highest of standards. Further protections available to pharmacists include professional bodies, disciplinary tribunals and the provisions of the Labour Relations Act (for example the personal grievance procedures in the event that refusing to undertake unethical practices led to dismissal).

4.5 Contrary to these arguments, a case could be made that requiring pharmacist ownership arbitrarily forces pharmacists to face the stresses of self-employment and bear all financial risks themselves. Some may be tempted to cut corners when times are bad. This may pose a greater threat to ethical standards in such cases than if the pharmacist was in secure employment.

5.0. A PRACTICAL TEST: BOOTS PHARMACIES

5.1 The longstanding presence of Boots the Chemists (NZ) Ltd in New Zealand provides an ideal test of arguments about ownership restrictions. If there were any validity in the arguments commonly advanced in favour of ownership restrictions then we would expect to find:

- evidence of unethical behaviour among the company's staff;
- evidence of professional incompetence resulting in harm to the public;
and
- pressure from the company's management and shareholders for the staff to act unethically.

Clearly such is not the case. The company enjoys the highest of reputations in all aspects of its operations, is commercially successful and provides what are understood to be attractive employment prospects to pharmacists. Moreover, the very success of the business may be seen to stem in large part from the high degree of integrity which is promoted in the company and upon which a profitable existence is founded.

5.2 The origin of the current ownership restrictions and the entry of Boots into the New Zealand market is of relevance. It is evident that the origin of these restrictions coincided with attempts by trade interests in pharmacy to prevent the expansion of Boots. Successive amendments to the Pharmacy Act have tightened up ownership restrictions. The arguments at those times and (unsuccessfully) before the Privy Council were of the same nature as those currently being advanced. Time has shown that they are as spurious in practice as they are weak in concept. They can now be seen as motivated by a desire to limit competition, contrary to consumer interests, and to maintain forms of occupational protection. The government has quite properly rejected such arguments in a wide variety of contexts, most recently in the case

of taxi licensing. There are no grounds for treating pharmacies differently provided quality controls to protect consumers are in place.

5.3 Similar arguments apply in respect of pharmacists employed by other independent owners or institutions such as hospitals. In such cases the public interest is not affected by the ownership of the business. Instead reliance is placed upon competition and the integrity of the pharmacist. There is no evidence to suggest that this is or has been inappropriate.

5.4 To make these points is not to suggest that the integrity of all pharmacists employed by independent owners can be guaranteed for all time, any more than the same guarantee can be given for self-employed pharmacists. As the officials report observes, every profession has its rotten apples. The argument is simply that there is no systematic evidence, from experience in New Zealand or the many independent pharmacy chains overseas, which points to lower professional standards in employment pharmacy. Other mechanisms are superior for the purpose of upholding professional standards.

6.0 EFFECT OF THE PROPOSED RESTRICTIONS

6.1 It is clear that the benefits claimed for ownership restrictions are illusory. The beneficiaries of such restrictions are in fact incumbent pharmacists rather than consumers and the public at large.

6.2 By contrast, the costs which ownership restrictions are likely to impose are significant. Several changes in retailing generally and in the pharmaceutical industry in particular should be considered.

6.3 Changes in Pharmaceutical Retailing

6.3.1 Changes in the manufacturing techniques for drugs, the automation of medicine production and the prescription practices of health professionals have altered the work of pharmacists out of all recognition. The net result is that very few products are now 'manufactured' by the chemist, although accurate filling of prescriptions and instructions to the patient require professional supervision. As a consequence, the approach to retailing by chemists has altered.

6.3.2 Two general changes may be identified as arising from these changes and the consequent need to meet competition:

- chemists have broadened the lines of business in which they are involved. They have tended to expand their product lines to include any items involving the body such as fashion articles, hair dryers, shavers and similar electrical appliances. They have also moved into more general items such as babyware and stuffed toys;
- a large number of chemists have moved to stress their health care advice - as illustrated in their advertisements for the chemist as 'the health care professional you see most often'.

In short, chemists have, to a considerable extent, become standard retailers. Any uniqueness depends upon adding value through advice and their function as a conduit for government-subsidised pharmaceuticals.

6.3.3 Their form of business organisation may well be outmoded in some cases. Given the changes which have been seen in all other forms of retailing, the 'one person' business as currently operated seems likely to suffer from two problems which can raise costs and prices.

6.3.4 First, significant business costs are likely to be incurred through an inability to benefit from economies of scale (for individual products and services), economies of scope (in relation to the range of services supplied), and the more sophisticated management expertise which is available through larger scales of operation, as well as through the limitations imposed by combined ownership and control functions. There may well be cheaper ways of doing business.

6.3.5 Second, access to capital is severely limited in the one person - one pharmacy form of organisation. Thus the ability to adapt, expand and innovate is likely to be curtailed by the cost of capital resulting from ownership restrictions. This may, for example, restrict some pharmacies to low turnover, high margin business, to the detriment of wider consumer choice. The current provision for 49 percent outside ownership only alleviates this constraint in a very limited way. For example, it precludes the establishment of pharmacies within supermarkets and the acquisition of the controlling interest in independent pharmacies that larger operators might require.

6.3.6 These two factors suggest that, if there were no ownership restrictions, a wide variety of ownership patterns might emerge with the retailing of pharmaceuticals and services currently associated with chemists being performed by differing forms of business organisation. To the extent that the current forms of organisation are optimal, as is argued by groups such as the Pharmacy Guild, they would of course survive unaided by government-imposed ownership restrictions.

6.4 Efficiency and Equity

6.4.1 The existing restrictions also have effects which are not consistent with normal standards of equity. It has been noted that restrictions are likely to lead to two forms of inefficient resource use. Because the form of ownership is restricted, options for the supply of services, such as the retailing of pharmaceuticals through supermarket chains under the supervision of a chemist, cannot be tested. Under alternative structures, fewer independent pharmacies may be required, producing economies in the use of land and buildings. There are far more pharmacies per head of population in New Zealand than in less regulated countries. Secondly, inefficiencies are likely to arise where technological and other changes which would lower costs to consumers do not occur because of ownership restrictions and associated capital constraints. For example, increased computerisation is costly for individual pharmacists but may be economic for larger operators.

6.4.2 These inefficiencies tend to generate equity effects as well. Those who are least able to pay the additional costs imposed by the regulations may bear the brunt of those extra costs. It is typically the elderly, those on lower incomes, and those with chronic health problems who are the largest consumers of pharmacy services. In respect of employment, the ownership restrictions operate against career opportunities for women pharmacists given the difficulties in combining child-rearing with running a business. Female participation in employment pharmacy, by contrast, is typically high. Women, who constitute the majority of shoppers for pharmacy-related goods, would also benefit from being able to combine the filling of prescriptions (which involve waiting time) with other shopping in joint pharmacy - other retail outlets.

6.4.3 Given the magnitude of expenditure - both public and private - on pharmaceuticals each year, efficiency and equity effects should not be neglected. In the case of equity considerations, it should be particularly remembered that the controls result in a transfer of income from one group to another.

7.0. CONCLUSIONS

7.1 Several studies of the effects of allowing changes in ownership have been undertaken in New Zealand, Australia and the United Kingdom. The evidence generally indicates that:

- the operating costs of pharmacies in regimes with ownership restrictions are 7-9 percent higher than they would be otherwise (Australian Bureau of Industry Economics study);
- the government as a major generator of prescriptions bears a significant proportion of this cost since chemists charge the government on a cost plus basis;
- consumers bear the remaining costs in the form of higher prices. Other factors such as lack of choice, queuing time and opening hours also impose costs on consumers; and
- no diminution of standards or quality of pharmacy services accompanies wider ownership and control of pharmacies.

7.2 It is clear that the restrictions also impose wider efficiency costs and fall inequitably across the community. To the extent that there are legitimate grounds for government involvement in the retailing of pharmaceuticals, the use of ownership restrictions is an extremely blunt instrument which is unlikely to prove effective. Certainly the costs imposed will exceed the benefits delivered. We are aware that there is serious commercial interest in New Zealand in offering other forms of pharmacy service to consumers. It should be possible for these to be tested in open competition with existing operators.

7.3 Self-interest groups involved in the promotion of ownership controls in pharmacy have a long and successful record in New Zealand. This reflects the relatively emotive nature of the issues, the ease with which seemingly relevant but, in practice, spurious arguments can be drawn into the debate, and the way in which the issues can be politicised, thus making logical decisions difficult.

7.4 Most of all it reflects the significant nature of the benefits conferred upon incumbents by government-imposed restrictions on ownership and the losses which could arise if such protection were to disappear. These benefits arise at the expense of the consumer - often the consumer in a position least able to bear unwarranted costs. The government has not favoured the retention of such privileges in other contexts, despite the possibility of income losses for those who do not adjust successfully to their withdrawal. Such privileges have no basis in logic nor any place in the provision of an effective, efficient and high quality health care system. We concur with the conclusions of officials that ownership restrictions on pharmacies cannot be justified and submit that the relevant provisions of the Bill should therefore be removed entirely.

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