Taking New Zealand Seriously
The Economics of Decency
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Introduction

Myths

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ALTERNATIVES[1]

Was there — *is* there — an alternative to the massive program of economic liberalisation that apparently transformed New Zealand in the decade after 1984? Well, would we *want* an alternative, anyway? That depends on how one sees the reform process panning out. Contrast the two following passages of interpretation of our recent economic history:

> By 1984, decades of heavy-handed state interference in the economy culminating in the wretched excesses of Robert Muldoon had left New Zealand as an economic basket-case, the 'Albania of the South Pacific'. The bold and sweeping program of reforms begun by Roger Douglas effected a remarkable transformation of the economic landscape, transforming New Zealand from the most to the least regulated economy in the OECD.
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> The results have been truly impressive. There was, of course, an initial period of adjustment to be worked through, but New Zealanders responded with impressive speed to the opportunities offered in their new, open, market-oriented environment. Since the year of the last (to date) of the major reforms, the 1991 Employment Contracts Act, real GDP has increased by more than 20%, unemployment has nearly halved, from around 11% to nearly 6%, consumer price inflation has been virtually eradicated, productivity has increased, and the government accounts have swung from massive deficits to substantial surpluses, used to pay down overseas debt ahead of schedule. Even including the adjustment period, economic performance in all these variables since 1984 has been markedly superior to the preceding decade.
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> New Zealand is now firmly set on the path of sustainable supply side-driven economic growth. There is, however, no place for complacency. The

recent falling away in the pace of growth -- though no doubt temporary — reflects a slackening in the pace of the reform process since 1991, as well as the surviving unconstructive resistance to the new era on the part of a small minority of leftish politicians and ivory-tower academic scribblers. But there is truly no alternative to New Zealand taking its full place in the modern, competitive world economy, and the great majority of workers, employers and consumers have whole-heartedly embraced that new world.

Now hear this:

Modern New Zealand history is divided into two periods. The first, covering the thirty years from the end of World War II, can be called *the years of external shocks*. After the high export prices of the Korean War boom, our terms of trade trended downwards, with wild year-to-year fluctuations, reflecting both the limited range of our exports and of our markets. In face of these difficult external conditions, the country performed remarkably well, maintaining throughout the period extraordinarily low unemployment rates, while building for the future more diversified and competitive primary and manufacturing industries.

Industrial development in New Zealand, as in other small or medium-sized economies (Canada, Australia, South Korea), was fostered by protective policies (tariffs, import controls) which in the NZ case were particularly important, given the very small size of the domestic market. However, as manufacturing industries matured, protection was progressively reduced, in a process which continued until overtaken by the sweeping liberalisations of the post-1984 regime.

Economic growth was lower than in other, less lucky countries struggling to catch up from underdevelopment or the ravages of war. But the key element of the 'wage earners' welfare state' — high wage full employment — allowed New Zealanders to build decent lives for themselves and their children with what now appear rather low levels of assistance from the state. How this would change!

The second period, of about twenty years from around 1976 to the present, is the *years of internal shocks*. In these decades, what happened to us was largely determined by what we did to ourselves, or — more accurately — what we allowed to be done to us by a sequence of determined, wilful individuals — Muldoon, Douglas, Richardson, Brash — who exploited the smallness and unicameral politics of the country to basically capture the policy process.

The external auguries were relatively good, in contrast to the earlier era. The terms of trade index trended upwards at nearly 1% per year, and its variance was only half that of 1956-76. The diversified agricultural and manufacturing tradables sector built up in the previous decades should have been well-placed to take advantage of these favourable external conditions, and indeed did manage impressive increases in export performance, in particular to the newly opened manufacturing markets of Australia.

But overall, economic performance in the second period has been woeful. Unemployment has gone from virtually nothing to average nearly 7% for the twenty years. Economic growth was nearly halved, to just over one percent per year. Productivity has stagnated. Inflation was either too high or too low, and averaged 9.1%. Government expenditure has doubled in real terms, though most citizens would say that the quality of public services received has deteriorated. Most miserably, real wages — the purchasing power of ordinary citizens — trended steadily downwards.

What on earth went wrong? The ordinary, orderly progress of economic affairs was continually being massively disrupted. First came the authoritarian excesses of Muldoon (Think Big, National Super, SMPs...), which wrecked the macroeconomic ratios and distorted investment incentives. Then came the ideologically driven excesses of Rogernomics and Ruthanasia — ruthless shocks to economic and social life in the name of a so-called free market dogma. Even the long delayed cyclical recovery of the mid-1990s was quickly flattened by exchange and interest rates driven up to cruel levels in the name of price rigidity and blind openness to foreign investors and speculators, leaving an emerging balance of payments crisis symptomatic of the gutting of the productive sector in the name of consumer efficiency..

Are the persons who wrote these two passages breathing the same air? Well, yes they are — I wrote them both. And I used the same set of economic statistics as the basis for both[2]. The first passage could be a distillation of dozens of pro-reform pieces; the second is written from the heart.

Let us deconstruct these passages — first, their rhetoric, then the economics. The first passage makes heavy use of modifiers to frame the reforms in the most appealing way. The old state was ‘heavy-handed’, the ensuing reforms ‘bold’ and their results ‘remarkable’ and ‘impressive’. Even the word ‘reform’, the use of which has been conceded by many critics of the post-1984 events, is heavily loaded: my *Concise Oxford* defines it baldly as ‘removal of abuses, esp. in politics’. A more accurate and neutral noun would be ‘revolution’.

‘Adjustment’ problems — the wretched financial and property boom/bust of the 1980s and the wrenching recession of 1988-91 which destroyed one manufacturing job in three — are framed first as inevitable (‘of course’), and then in a positive light, as something to be ‘worked through’ which ‘New Zealanders’ did with ‘impressive speed’. The judgements embodied in these epithets may or may not be accurate, but they are not (of course!) supported by any evidence in the text.

Much is made of the post-1991 recovery. Changes in GDP, employment and unemployment are maximised by dating them from the very trough of the recession, and, in different narratives, one will find them serving multiple duties to justify various policies — here ascribed to the Employments Contracts Act, there to the Reserve Bank Act, somewhere else to the slashing of welfare benefits. The current ‘slowdown’ (by now of four years’ duration, with no end in sight) is actually turned to advantage by a brilliant rhetorical ploy: anything unsatisfactory about economic performance must be *because the reforms have not been taken far enough!* There is the obligatory sneer at the doubters, especially in academia, though this can backfire, since we (few) may thereby be emboldened to think that our opposition actually has an impact. But we are outnumbered by the 'great majority' of our countryfolk striding confidently off to join the magnificent brotherhood of 'modern, competitive' nations.

Now examine the second passage. It is a fine piece of prose, but is at least as rhetorically loaded as its precursor. Readers will be able to tease out the tricks for themselves. Note in particular one sly use of statistics — government expenditure 'doubled' — but over what period, and what about *per capita* expenditure?[3] At least the number referred to is 'real' — that is, corrected for changes due to inflation.

So let us move on to the economic substance underlying these two so different points of view. The key is the common ground — nobody wants to claim Muldoon. Both passages refer to his 'excesses', and consign his regime to their unfavoured period -- one to the past, the second to the present. To the pro-reformers, Muldoon's blunderings were just the culmination of decades of government meddling in the economy, preventing the natural state of affairs, laissez-faire — unregulated, 'free' markets, from having its head.

My own view is rather different. I emphasize the social foundations of economic activity and the damage to be done by up-heaving those foundations. In the years up to, say, the mid-1970s, there were in NZ many rules and regulations and considerable protection of the domestic economy from foreign competition. This provided a stable and secure framework within which the people — society — got on with the job of stitching together a quite serviceable set of economic arrangements. Though not always 'efficient' in the rationalist microeconomic sense (for example, cars were assembled locally more expensively than they could have been imported), this system was, as noted, remarkably effective at delivering high-wage jobs for everyone who wanted them[4], and it was also — an important but little known fact — very efficient in terms of what economists call 'transaction costs', which are all the costs of coordinating and controlling economic activity and market exchange.

Then along came Muldoon, followed eventually by Douglas and so on, with their massive disruptions of the received order. These were not only terribly wasteful in their own right — billions of dollars down the tubes forever from the mistakes of Think Big, from the over-hasty privatisations, from the share and property market booms and bust, from the great recession of 1988-91 — but wasteful in an indirect sense, as they destroyed the guideposts, the focal points that facilitate the conduct of private economic affairs. The symptoms of this are a substantial increase in transaction costs (see Chapter Twelve) and the rise of apparently endemic unemployment.

Thus, from my perspective, Muldoon and the more-market revolutionaries who overthrew him are to be lumped together as purveyors of disruptive shocks to the body economic. So-called deregulation is as much a state-sponsored intrusion in the economic lives of the citizens as are regulation and other direct interventions. However the substance of those shocks is also material. Muldoon was scornfully anti-theory (though of course this is itself a theoretical stance), but the rationalists have been relentless in imposing their ideology or theory on the parameters of our economic life — microeconomic efficiency to be generated by rigorously self-seeking, opportunistic behaviour in markets. — and it must be in the inadequacies of that theory that we should look to find fundamental causes of what, after more than a decade, seems a rather persistent failure of the economy to perform as planned.

Perhaps opportunism is not so opportune after all. New learning in Economics is finding that apparently irrational behaviour, such as cooperation with strangers, can in fact pay off in the long run for all parties. Could we have been better at cooperating with strangers, and at other economically productive strategies, under the conditions of the 1960s than now in the 1990s? Perhaps the clue to the discovery of the alternative path to economic rationalism is staring us in the face, from our own recent history.

The next chapter digs into this history. There are some myths to root out. It isn't just a matter of whether the 'old' New Zealand was better than the 'new" (or vice versa). It is a question of understanding what the old New Zealand really was, and where it was going. There is a good piece of advice for anyone making comparisons. It is this: *cave* the counterfactual. Rationalists often talk as though the only alternative to their model was continuation of the blunderings of Muldoonism. This is foolish and unfair. When I claim that the revolution has been a failure I have in mind an alternative which, at the very least, continued the path of moderate reform that began well before Muldoon and was actually continued by him (eg CER). We didn't need to turn the economy inside out in order to get a good meal in a restaurant or a decent cup of *latte*. These and many other enhancements to the quality of our lives were coming anyway. The macroeconomic crisis inherited by the incoming Labour government in 1984 did not itself justify a massive upheaval of our microeconomic institutions — rather, the reverse.

Still, the revolution happened, and its consequences must now be lived with. What is really needed is some *serious* analysis about where we could go from here to reclaim sovereignty over our economic lives, as individuals, communities and as a nation. If we do not learn from the mistakes of history we will be condemned forever to repeat them; but if we do take seriously the good and the bad of the past half century then no doubt there is some genuine progress to be made.

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[1] This chapter is adapted from my contribution 'Is there an economic alternative?', in Alan Lee (ed), *Business Reporting: A New Zealand Guide to Financial Journalism*, Wellington, NZ Journalists' Training Organisation, 1997.

[2] 1960-95 data on a quite wide range of economic variables are published in Paul Dalziel and Ralph Lattimore, *The New Zealand Economy: A Briefing on the Reforms*, Melbourne, Oxford University Press, 1996. I updated these statistics to 1996 and backdated them to the 1950s, using the same Statistics NZ sources. This book is also valuable for its lucid commentaries on the reforms and preceding events, in particular because these are written as the jointly agreed output of one who is quite critical of the reforms (Dalziel) and one is broadly in favour (Lattimore).

[3] In fact, per capita real government expenditure is now twice as high as it was in 1962.

[4] More accurately, there was a job for every adult male, *whether he wanted one or not*. A crucial but little-appreciated aspect of the old full employment regime was that it was the result of workers being expected to work as well as employers being expected to offer jobs. What it was <u>not</u> was jobs working for the government. Full employment was essentially a private sector affair.