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Structural reform:

Action and reaction in a small country: the case of New Zealand

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Preface

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Authorship

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1. Opening remarks

1.1 Overview

I would like to start by thanking the organisers for the opportunity to present a paper to this meeting. As the representative of small economic research organisation in a very small country, this is a great privilege.

The New Zealand Institute of Economic Research (NZIER) is a Wellington-based economic research organisation established in 1958 and with about 20 staff. About 90% of our revenue comes from contract research, mainly for public sector clients.

From a New Zealand (and our personal/NZIER perspectives) this is an interesting time at which to reflect on structural reform, around 20 years after the core reforms were initiated. And nearly 20 years since NZIER especially Dr Alan Bollard (former Director of NZIER, now the Governor of the Reserve Bank of New Zealand) became involved in analysing and writing about reforms.

The focus of this presentation is on some fairly broad themes that have arisen in the debate about New Zealand. It is unlikely that many of these are unique to New Zealand. But the process of implementation of reform and the subsequent action and reactions, especially in the political sphere, may have a peculiar New Zealand flavour.

And this is not just retrospective – we also comment on the current situation and look to the future.

Using rather crude medical analogy, our principal objectives are to examine:

> Section 2: The ailing New Zealand economy – the diagnosis (as seen circa 1984)
>
> Section 3: The treatment regime (1985–1995)
>
> Section 4: Reflections - treatment effects and prognosis (mid-2006 perspective).

In Section 5 we overview economic trends before and since the reforms, and in Section 6 offer some closing remarks on policy direction.

This examination is deliberately ‘high level’ and does not purport to do justice to the wealth of research that has been done on this topic.

1.2 Terminology

A brief aside on terminology. Changes in New Zealand in the period 1985 to 1995 in particular included a broad mix including macro policy (e.g. monetary policy), public sector restructuring, and industry specific reforms. Various labels including 'structural reform',' liberalisation', and 'deregulation'[1] are used to try to capture all these elements. None of these is an entirely satisfactory descriptor of individual elements or of the entire 'programme.' We use structural reform to convey a general thrust towards reduced government involvement with or influence on industries and markets.

1.3 The evolving debate

A huge amount has been written about New Zealand's reform experience and this brief presentation can only touch on the analysis and interpretation that has been done. We refer most frequently to one source, the 1996 volume *A study of economic reform: The case of New Zealand,* partly because it was published about half way between the start of the reforms and this seminar, and partly because it contains contributions from a broad cross-section of the New Zealand economics community – including current and former NZIER staff.

We should note that right from the start of the reforms to the present day views on the reforms have been polarised. There may be some agreement that something needed to be done – in response to the longer-term and immediate problems facing the New Zealand economy. Even this is disputed by some.

There has also been an ongoing political backlash involving some rather strident language with "the failed policies of the eighties and nineties" a popular by-line. This has been fairly successful in discouraging supporters of the reforms from airing their views.

2. The ailing economy

In line with our action and reaction theme, we comment briefly on the state of the New Zealand economy and policy settings leading up to the reforms, and provide some historical context.

The introduction to *Economic reform* states:

New Zealand has for a long time, presented something of an enigma: a developed high income economy with generally conservative governments,

[1] NB Clifford Winston (1993, page 1263, footnote) "Following George Stigler (1981) I interpret economic deregulation as the state's withdrawal of its legal powers to direct the economic conduct (pricing, entry, and exit) of non-governmental bodies.

but with radical law-making resulting in some distinctive policies. Many of these distinctive policies have involved state intervention to address economic, social and political wellbeing. Since at least the 1880s, New Zealand has been an international pioneer in women's franchise, compulsory schooling, factory legislation, wage bargaining arrangements, social security, compensation for injury, universal old age pensions and in other areas.

By the early 1980s, however, New Zealand's less distinctive, but highly interventionist, policies were being blamed increasingly for its relatively poor economic performance. This poor performance was indicated not only by most final outcomes (such as growth and employment) but also by many intermediate measures as well (such as inflation, the fiscal and current account balances and international debt). (*Economic Reform*, 1996, page 2)

2.1 Historical background

New Zealand has always looked offshore for markets and capital, and has at the same time, always been vulnerable to adverse economic shocks.

In the last quarter of the 19th century, New Zealand was very much part of the British colonial structure – a remote farm supplying the British metropole. There were good times, but these were sometimes followed by long periods of hard times. Historian Michael King, refers to the 'Long Depression'. "it began with falling wool prices in 1877 and merged into a period of worldwide recession in which the New Zealand economy did not grow for around 16 years."[2]

The introduction of refrigerated shipping in 1882 allowed meat, and then butter and cheese, to be added to New Zealand's major exports, previously comprising mainly wool, grain, timber, and gold. But in the great depression of the 1920s and 1930s, export prices fell rapidly, as did government revenues, and at the height of the Depression around 40% of the male work force was unemployed. (King, 2003, p.347).

A less prominent development was the inexorable mechanisation of farming in the 1930s and 1940s which had the effect of significantly reducing the amount of labour required for farming and which, coupled with technical developments[3], allowed substantial progress in farming productivity.

And it may have been the start of a long-term problem of 'Dutch disease' in which the highly competitive farming sector supported real exchange rates which put other 'tradables' under ongoing pressure. The country looked to manufacturing to create jobs that had been lost from the primary sector, but much of this was reliant on protection for its viability.

[2] Michael King *The Penguin History of New Zealand*. 2003, p.234.

[3] A string of agricultural innovations from aerial topdressing to enhanced breeds of sheep, and from improved grasslands management and mechanised milking to new shearing methods.

In the years leading up to the reform period it had become obvious that economic management in New Zealand not only had little coherence, it was no longer delivering. In the 'golden years' of the 1950s and 1960s, unemployment was virtually unknown. By the late 1960s, inflation and unemployment had started to rise, and the 1973 and 1979 oil shocks caused serious deterioration in New Zealand terms of trade.

Dalziel and Lattimore (2001, p.17) remind us that 1973 was a watershed in New Zealand's economic history for two main reasons. First, the United Kingdom formally entered the EEC, marking the end to 40 years of specially negotiated access to British Agricultural product markets by New Zealand exporters. Second was the threefold rise in oil prices with the strengthening of the OPEC cartel in 1973.

The direct consequence was a fall in New Zealand's terms of trade (by 30% in 1975) deterioration in New Zealand external current account (to 14% of GDP in the same year). Wells (1996, p.216) states that the average value of the terms of trade in the decade to 1983-84 was 21 percent lower than in the decade to 1973-74.

Closely associated with this were adverse trends in the country's fiscal position and a rise in public debt – domestic and overseas. Crown indebtedness, and other macroeconomic evidence of imbalances, were major areas of concern. For example the OECD (1985, p.11) on the problems inherited by the government elected in July 1984:

- A *fiscal deficit* of 9% of GDP;
- A growing *public debt problem* with borrowing often being used to support consumption and some investment with low rates of return;
- A persistent *current account deficit* and *overvalued exchange rate*;
- A *lax monetary policy* which, because of the unwillingness to accept higher interest rates, has led to excessive monetary growth; and
- A heavy reliance on *interventionist policies*, which were inhibiting the flow of labour and capital to the most productive uses.

In hindsight, this can be dismissed as 'scare tactics' i.e. an overstatement of the case for reform.[4] But I think it is fair to say that from the perspective of the group of people charged with thinking about the whole picture New Zealand did face some unpleasant scenarios.

And, furthermore, although external shocks had been important direct contributors to poor performance, domestic economic management had played a major role in the extent of the problems faced by the mid-1980s.

[4] Recently the Minister of Finance, Dr Michael Cullen, announced that New Zealand's net public debt had been extinguished. This closely followed a similar announcement by the Treasurer, Peter Costello, in Australia.

So the reforms can be seen as partly economic and partly political reactions to some very immediate ‘balance sheet’ risks, as well as longer-term underperformance.

3. The treatment regime and the patient’s response

Economic reform can be opportunistic, pragmatic and carried out piecemeal without a strong theoretical underpinning. The opposite situation occurred in New Zealand. The reforms were notable for being based on an integrated theoretical framework. Central to this framework were the ‘new microeconomic’ theories of contestability, principal-agency and public choice. The theories underlying the macroeconomic reforms, on the other hand were substantially mainstream, although their policy implementation in the second half of the reform decade was distinctive. (Economic reform, 2006, p.9)

3.1 Overview

The following table set out the main elements of reform implemented during 1984 to 1996 with examples of each.

Table 1: Economic reform categories and examples

Capital markets	Removal of controls on outward investment and external borrowing, free float of the NZ$
Financial sector	Removal of interest rate controls, credit growth guidelines
Industry regulations	Numerous changes especially in energy, agriculture, and transport
International trade	Phase-out of import licensing and lowering of import tariffs
Monetary Policy	Reserve Bank Act 1989 – focus on inflation objectives through monetary mechanisms. Corollary of regulatory changes in financial sector
Taxation	Broadening tax base through a Goods and Services Tax, flattening and lowering of personal tax rate with top rate and company tax rate the same
Corporatisation	Removal of almost all state regulated monopoly rights, State-Owned Enterprise Act 1986, corporatisation of 24 SOEs
Privatisation	Privatisation of Air New Zealand, Bank of New Zealand, Post Office Savings Bank, Telecom Corporation and many others
Public expenditure	Reform of management of core government departments through State Sector Act 1988, Public sector financial management reform through Public Finance Act 1989, Fiscal Responsibility Act 1994
Labour market	Voluntary unionism, contestability of union coverage, Employment Contracts Act 1991
Resource use and the environment	Resource Management Act 1991 – planning and environmental legislation
Social services	Changes to pensions, the education system, state housing, the health sector

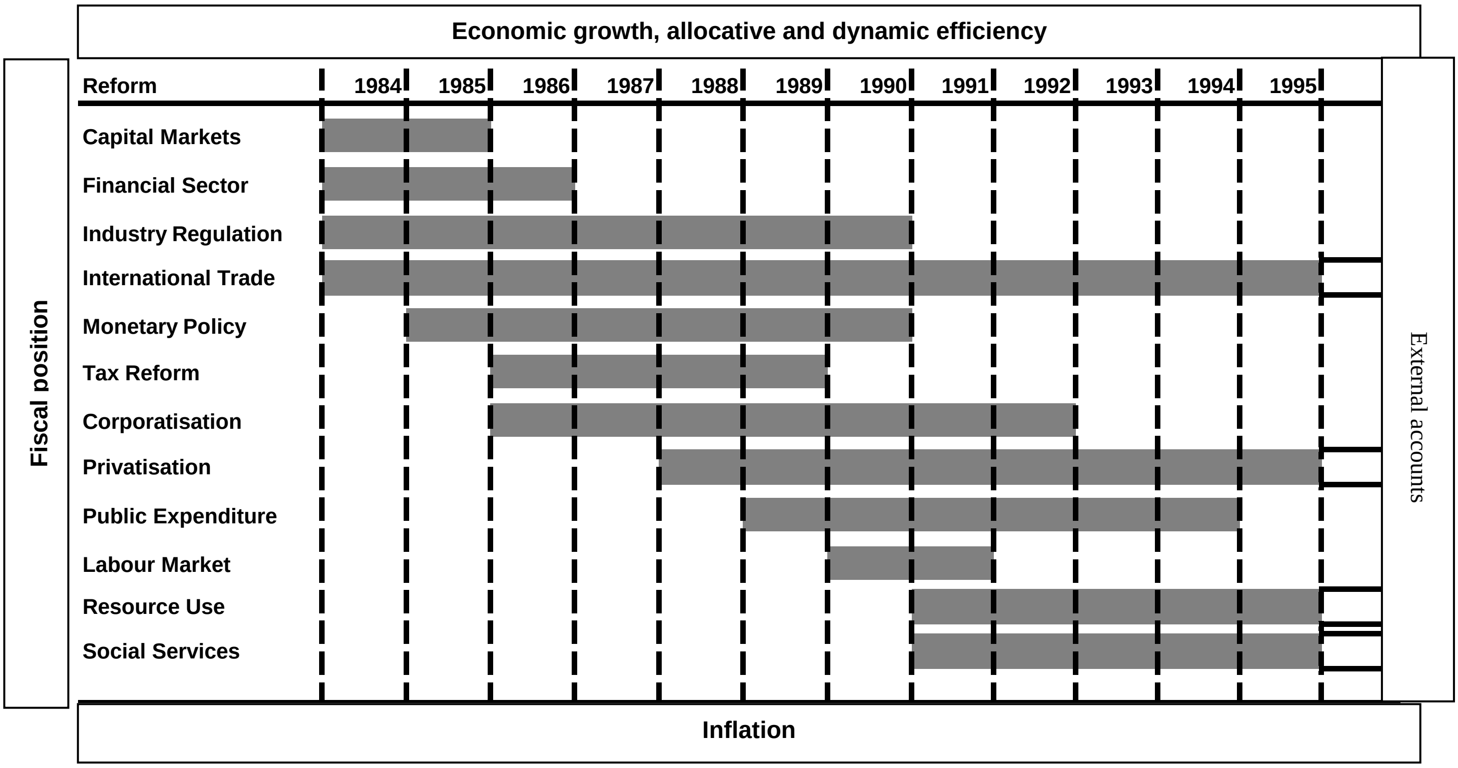
Source: *A study of economic reform,* 1996, pp24-28

In hindsight the claim of an integrated theoretical framework – principally microeconomic - is appropriate when applied to some of the changes, for example, corporatisation and privatisation, changes to the management of the core public sector, and labour market reforms. But the theoretical frameworks seem less relevant. to other areas of reform And this is probably what was meant. It would be a stretch to imagine any coherent framework for the whole spectrum of reforms, or any way of predicting how they would interact.

There has also been an extensive debate about optimal sequencing, but the main conclusion seems to be that as with many things in life, this is an easier concept to apply in hindsight than in practice.

The following chart indicates the timing of the various categories of reform i.e. when they commenced and their overall duration. Most of these reforms were aimed at microeconomic objectives, but with macroeconomic outcomes along the lines of the surrounding boxes, also in probable.

Figure 1 Actual phasing of economic reforms in New Zealand from 1984



Note: This figure is conceptual in nature. Each bar represents the approximate duration of each reform (although the impact clearly took longer). The dotted lines indicated continuing reform.

Source: *A Study of Economic Reform (1996, p.10)*

3.2 Immediate impacts

The combination of industry specific restructuring and the macro-economic environment led to some immediate adverse impacts, most markedly in the labour market.

1. From about 1987 a severe slowdown in which employment levels actually fell and unemployment rates rose from about 4% to 11% (1987 to 1991) before declining gradually to an average of about 7% in the second half of the 1990s.

2. The main victims were those that had been employed by government agencies that were corporatised and privatised as well as manufacturing employees. But the loss of job security also affected a lot of middle management/middle class people who experienced a sea change in attitudes as formerly life-time employment public agencies and private sector corporates changed their ways. Much of this was in the finance sector which enjoyed a boom in 1985 and 1986 and then a severe crash in 1987, when overstretched balance sheets were exposed. These impacts were not all directly attributable to the reforms.

3. There is no question that the structural reforms played a big part in this. But there are also arguments that a seriously overvalued real exchange rate added to the economic damage and delayed the recovery. For example Chapple *et al* (1996) estimate that one measure of the Real Exchange Rate (base 1984=100) rose from 96 in the year ended March 1987 to 112 in the following year.

4. For some years New Zealand was lauded (both by local and overseas commentators) for progress with reform and at least in the early years contrasted favourably with Australia's much slower progress. (Albeit Australia's macroeconomic performance for most of the last 15 years might suggest their upside from reforms was limited).

5. As a result a steady stream of overseas delegations, journalists etc. visited New Zealand in the late 1980s and early 1990s and did the rounds of government agencies and research organisations like NZIER. They were interested in both the experience of reform and the implementation practicalities.[5]

6. When these visitors were government representatives from countries struggling with public sector payrolls and not much in the way of private sector employment growth, they were especially interested in how to manage the political implications of the reductions in public

[5] Wallis and Dollery (2001, p.260, Notes) cite Allan Schick (1998, p123) with reference to the many delegations that visited New Zealand to interview officials about the effects of new public sector management approaches on the cost and delivery of public services. "Despite the interest and the sales effort only a few developed countries (such as Iceland and Singapore) have adopted selected features of the model; others (such as Sweden and the United Kingdom) have embraced a managerial ethic without subscribing to the hard-edged contractualism that differentiates New Zealand reforms from those tried elsewhere.

Careful investigation by subsequent observers might change the harshness of this judgment. Most of the 'hard edge' related to the drive for fiscal consolidation, rather than heralding a new public delivery model.

costs they were looking to achieve through corporatisation or privatisation for example.

4. Reflections

In this section we stand back somewhat from the data and technical economic perspectives and adopt what might be called a political economy perspective in reflecting on reform processes and outcomes. The aim here is to broaden the context through examining:

- Attitude changes as a result of the reform process
- The implications of thin markets
- The 'fog of war' and its effect on process.
- Attribution and the ongoing debate
- The political backlash.

4.1 Economic management to centre stage

The reform process and its impacts moved the economy and especially economic management on to centre stage in New Zealand. In the broader community it signalled the end to a relatively comfortable few decades in which the effects of terms of trade shocks were felt most directly in agricultural industries and some other tradable goods industries, but in which job security for the vast majority was a given. It also highlighted the extent to which economic management in New Zealand had become a 'house of cards' and the costs and risks associated with that ad hocery. Further that it was no longer good enough to blame the EU and other external scapegoats for the growing gap between living standards in New Zealand and those of our neighbours across the Tasman.

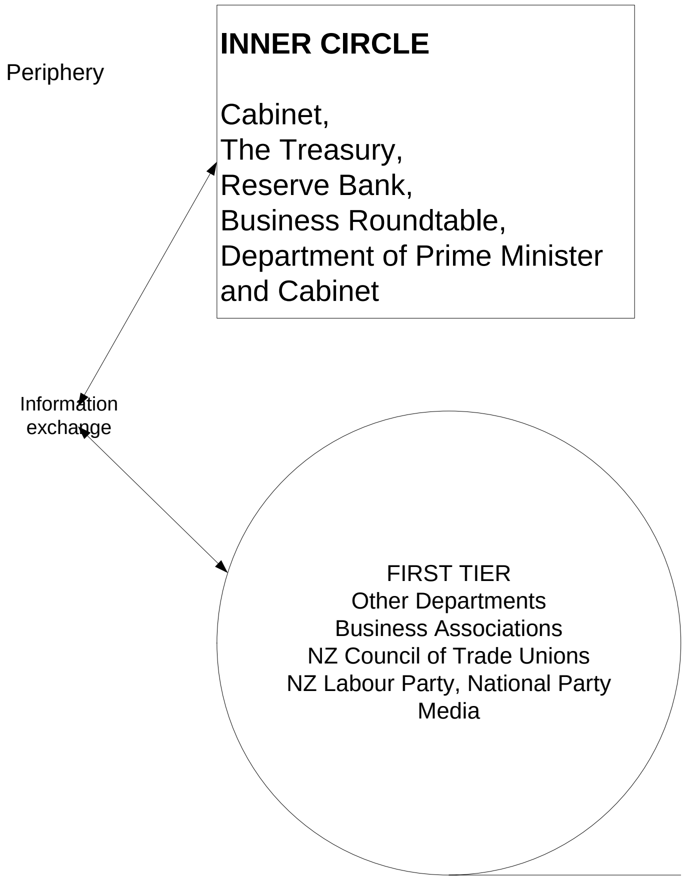
4.2 Thin markets for policy advice and debate

Goldwater (2000, e.g. pp. 27-30) contrasts the pace and extent of the structural reform process in New Zealand with that in Australia. He comments on New Zealand's small population, unitary Westminster system of government, and institutional simplicity, as factors increasing the likelihood that economic policy-making would be dominated by a small number of individuals based in key institutions. In addition First Past the Post (FPP) electoral system prevailed until the introduction of the Mixed Member Proportional (MMP) system from 1996.

FPP magnified the 'winner take all' aspects of the unicameral system, concentrating power in the hands of an 'elected dictatorship.' MMP has never produced a single party majority; minority governments are becoming the norm.

Goldwater refers to an ‘inner circle’ in economic policy-making, consisting of the cabinet, the Treasury, the Reserve Bank, and the Business Roundtable, and their dominant role in economic policy under Labour (1984-1990) and National governments (1990-1999).

Figure 2: Institutional influences in economic policy making in New Zealand 1983-93



Source: Goldfinch (200, p.65)

On the periphery were a mixture of organisations including various interest groups, but as stated by Golfinch (2000, p81) “…in a climate influenced by public choice theories, and by the elitist beliefs of politicians and policy makers that saw interest groups as vested interests, they did not have as great input as they might have prior to 1984.”

Also in the periphery were various consultancies, law firms, accounting firms, and investment banks, in a lucrative market for advice and transactions, and of course the likes of NZIER. Most of these peripheral organisations were followers rather than significant influences on policy formulation.

So the overall, the policy formulation process, both at a general level and in design of the specifics, was driven by quite a small number of individuals and organisations, and the opportunities to mount any effective opposition were very limited.

4.3 Crashing through and the fog of war

A feature of the New Zealand structural reforms was the breadth of the reform front and the pace at which change was planned and executed. This was allowed by the thin policy market as discussed above, and encouraged by some of the leading players. It was also encouraged by the sense of crisis and the perception that after years of resistance to change, this was a 'window of opportunity' to make rapid progress.

According to Goldfinch (2000, p.94) in reference to the Minister of Finance Roger Douglas (and his role in formulating the 1984 Budget) this 'window of opportunity' "… sat well with Douglas's preference for large 'packages' of policy changes. He believed one could do more and do it more quickly through such a large package, and as the package contained a number of policies, if someone lost on one, they might gain on another. Douglas saw this as likely to achieve greater consensual support. The sheer size of the packages also meant a large volume of changes could be 'crashed through' before opposition could organise itself."[6]

In the fog of war – in which the process of structural reform was the main target – it was difficult for anyone to keep track of the specific impacts of each reform or of the impact of the whole package. Adjustment costs (e.g. business closures, loss of jobs, loss of income) were not given much consideration, partly because of the desire to maintain the reform momentum, partly because they did not loom large in current thinking.

4.4 Attribution, counterfactuals, and the private sector

One of the challenges in assessing structural reform (or any other significant policy change) is that the costs tend to be concentrated, and the immediate effects (in New Zealand's case mainly job losses) becoming the overwhelming image of the reforms.

Trying to analyse the issues and debate them in terms of counterfactuals is always an uphill battle. Thus opponents of the reforms including politicians, commentators, and those whose careers were derailed by the changes, would never acknowledge that there might have been significant adverse consequences to New Zealand in any case i.e. in the absence of reforms.

[6] Douglas (1993)

The counterfactual for the trend in real per capita incomes was at the heart of the debate between Dalziel (1998) and Teece et al (1996). E.g. as per the abstract in Dalziel:

> *Evans, Grimes and Wilkinson's (1996) essay on New Zealand's economic reforms claims that real per capita income has risen above its pre-reform trend, overseas debt has fallen, and the number of households experiencing poverty is no greater than before the reform program. This communication documents that the data producing these claims are not reliable. Instead, there is still no clear-cut measured improvement in New Zealand's growth performance, overseas debt was significantly higher in 1995 than in 1984, and substantial income sacrifices between 1988 and 1993 doubled the number of households in poverty.*

4.5 The political backlash

The following quotes (from *Economic Reform, 1996*) take us back to a significant aspect of the debate, from a political standpoint especially, the process of reforms, rather than their substance or sequencing.

The reforms, then, were widespread and many were implemented and completed rapidly with relatively little consultation. There was limited concern for the transitional period and typically compensation for the losers. It was classic 'big bang' reform. (p11)

The political story' of the changes is intriguing. It is the story of a reformist minded trio of senior cabinet ministers … being elected unexpectedly in a fiscal and foreign exchange crisis in mid 1984. They did not have a full mandate for the reform agenda they were about to pursue. Nevertheless, their reforming zeal was maintained by different ministers from different political parties over the next ten years. (p.11)

In 1993, New Zealanders voted to change their electoral system to proportional representation. This change was partly a response to the manner in which the economic policy changes in the previous decade had been implemented. Under the new political system, it appears less likely that further radical economic reform will take place in New Zealand in the near future. ***Conversely, it is unlikely that there will be a major rolling back of the existing reforms.*** *(p13)* (Emphasis added).

Reform zeal (and potential) waned with various governments through the 1990s and with the election of the Labour government in 1999 came an end to anything that could be labelled as structural reform or any whiff of corporatisation or privatisation.

Indeed, and partly countering the 1996 comment (in bold above) government involvement in recent years e.g. with TranzRail. Air New Zealand, TVNZ, and Telecom, could be seen as some rolling back.

5. Economic trends

In this section we comment briefly on longer trends macroeconomic trends and the microeconomic story post-reforms.

5.1 The macro picture

Economic growth picked up in New Zealand from around 1993 and apart from a slowdown in the late 1990s – associated with the coincidence of the Asian crisis and drought in New Zealand – has been quite buoyant relative to the pre-reform decade and growth in most other OECD countries. Consequences have include low and declining unemployment rates and a strong fiscal position. While there have been inflationary pressures recently, CPI inflation over the last decade has been very low relative to historical experience.

The table below presents some summary data for the last four decades.

Table 2: Macroeconomic trends

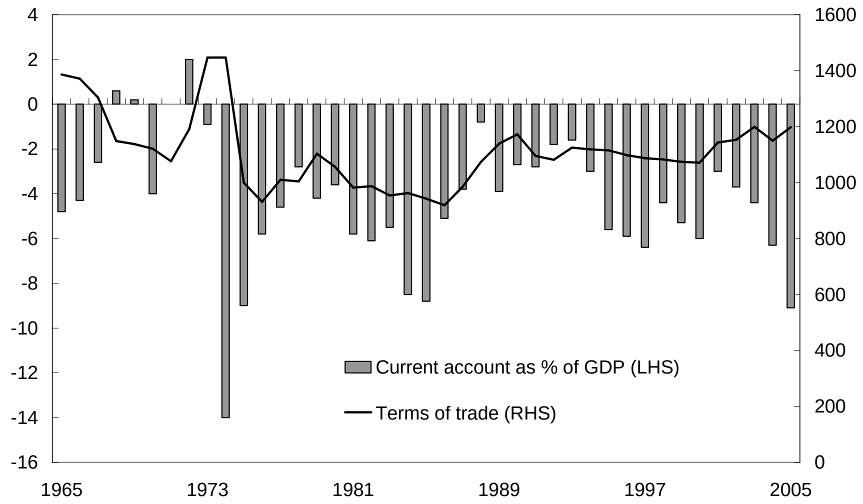
Percentages – annual averages

	Real GDP growth	Employment growth	Unemployment rate	CPI inflation
1965-1975	4.4	2.3	0.3	7.5
1975-1985	1.6	0.5	3.0	13.5
1985-1995	1.8	1.1	7.1	6.3
1995-2005	3.4	2.4	6.1	1.5

Sources: Dalziel and Lattimore 2001, NZIER *Quarterly Predictions*

The following graph shows New Zealand's external account position over the last four decades highlighting some of the positive and negative terms of trade shocks (e.g. 1968, 1972, 1973 and 1975) and the comparative stability since then.

Figure 3: Current account deficit and the terms of trade
Percentages (LHS), Index numbers (RHS)



Source: NZIER

5.2 Microeconomic trends

*A study of economic reform (*1996, p19*)* observes the difficulty of observing the economic effects of the reforms, despite the magnitude of the economic shocks. Amongst the difficulties of assessing the reforms they noted:

1. Lags in effects meant that the subsequent half decade to 1995 was in most cases too short to assess the lasting impacts of the process.

2. The liberalisation process between 1986 and 1991 was overlaid by contractionary stabilisation policies. At least some of the subsequent expansion (i.e. to 1996) was catch-up.

3. The counterfactual issue of what might have happened economically and politically in the absence of reform.

The microeconomic elements of the reforms i.e. removal of costs imposts pricing distortions, and opening up markets to local and external competition, were expected to lead to efficiency improvements (productive, allocative, and dynamic) which would at least in part be picked in productivity trends.[7] We earlier referred to the debate about this from a late 1990s perspective (i.e. Dalziel vs Evans *et al*).

[7] For example, Dalziel and Lattimore (2001, p.79) "The previous section has described how the State Owned Enterprises Act 1986 created a framework within which the government's commercial operations could be corporatised in order to improve efficiency and productivity growth. Economic theory suggests that these objectives can be further promoted by allowing competition to determine market prices, since genuinely competitive markets will produce prices that produce the opportunity cost of both production and consumption.'

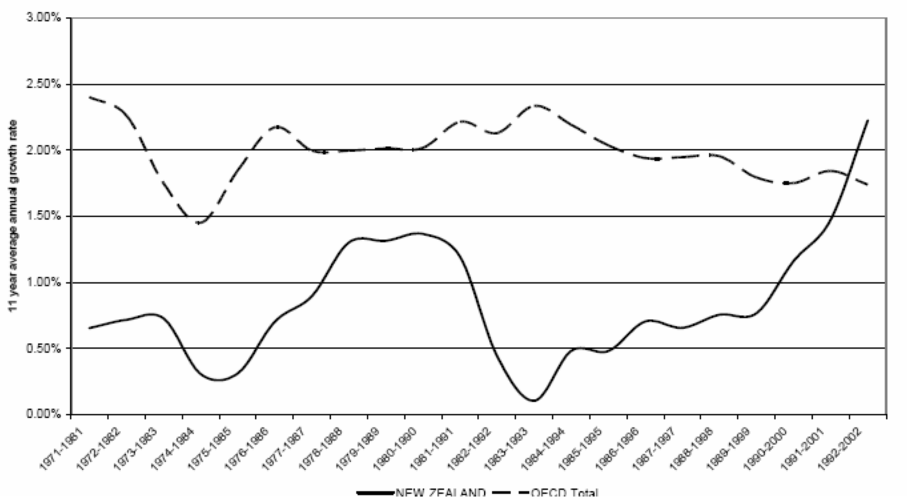
Does more recent data and analysis shed a different light?

The following is an extract from a New Zealand Treasury paper in 2004 with reference to economic growth from 1992 to 2002.

> *New Zealand's growth recovery has been largely sourced from growth in the service sector (particularly trade, transport and communications, business services, and personal and other services) and from increases in labour utilisation. In addition, the composition of labour productivity growth changed with most growth being sourced from growth in multifactor productivity rather than growth in the capital-labour ratio.*
>
> *In the period from 1992 to 2002, multifactor productivity growth in New Zealand's 'market sector' was similar to that for the Australian 'market sector'. The qualitative distribution of multifactor productivity growth across New Zealand industries was similar to the industry distribution of multifactor productivity growth in Australia. Nonetheless, there are quantitative differences.*

While average multifactor productivity growth has been similar in both countries, the difference in labour productivity growth between Australia and New Zealand is associated with differences in the evolution of the capital-labour ratios between the two countries. Since the early 1990s, and perhaps also in earlier years, New Zealand's rate of physical capital accumulation has been slower than average rates of accumulation in OECD countries.

Figure 1: New Zealand's GDP per capita growth compared to the OECD average



5.3 International reform experience

Much of the case study experience of reform has been drawn from former Soviet countries and their economic transition since 1989. Fischer *et al (*1996, pp.45, 46) states that mainstream analysis of the transition process called for: *action in six areas: macroeconomic stabilisation, price liberalisation, trade liberalisation and current account convertibility; enterprise reform (especially privatisation); the creation of a social safety net; and the development of the institutional and legal framework for a market economy (including the creation of a market-based financial system).*

With reference to the 'big bang' versus 'gradualism' the authors note that *the big bang could only apply to certain aspects of the reform process – macroeconomic stabilisation and price and trade liberalisation – for the other three elements of the reform process inherently take time.*

And on the question of optimal speed and sequencing they note the need to make decisions on how to proceed well before the evidence could be gathered.

This particular paper, one of many on the transition economies, focuses on one set of outcomes, the relationship between stabilisation and economic growth. The results strongly suggest that reducing high inflation is a precondition for the revival of growth.

As in these countries, New Zealand was trying to achieve stabilisation (after a sustained period of double digit inflation) through fiscal consolidation and monetary policy. But an important point of difference between New Zealand (and the transition economies) was the strong institutional and legal framework, based mainly on UK models, that had been built up over many years. This was helpful in the process of reform. While New Zealand did suffer a period of recession in the late 1980s and early 1990s we avoided the scale of disruption that was experienced in the transition economies.

6. Broad reflections

In trying to pull this together we review:

- The economic 'case' for reform versus outcomes
- The implications of political reaction.

6.1 The case for reform

The economic indicators in the lead up to the reforms, and the story of ad hoc policy response in the 1970s and early 1980s told a fairly stark story at the time of the reforms and still do. Even casual observations from holidays in Australia, and for example, comparisons of consumer durable prices here with those in other countries, told Kiwis here that we were falling off the pace.

Reform, and some fairly quick actions were needed e.g. in response to the foreign exchange crisis. But even though we were drawing on 'mainstream models' of reform, in exploiting the opportunity for reforms on a wide front we were entering unknown territory in terms of:

- The extent and nature of the benefits
- How quickly these would be realised
- The adjustment costs in the meantime.

The 'crash through' approach can be criticised mainly in the fact that this inevitably involved large shocks to businesses and households, so we were flying blind in economic terms and consequently in political terms.

Does this mean that the reforms individually and collectively were a mistake, or at least not worth the candle? The answer is probably no.

On most measure, the New Zealand economy is in good shape now, on the back of some very positive performance over much of the last decade. The unemployment rate is around 4%, inflation is low, and the government's books are healthy. And this is not just a post-1999 picture, economic trends here were decidedly positive through much of the 1990s. It would be hard to argue that the reforms did not contribute, in some parts significantly, to these positive outcomes.

6.2 Implications of reactions to reform

The use of political rhetoric to discredit political opponents associated with unpopular policies is part of the democratic process. But has the political reaction in New Zealand been so sustained, that it is somehow warping policies here in a way which is currently or prospectively costly?

The table below provides a simple assessment of long-term influences on economic performance:

Figure 4: Structural scorecard – New Zealand

	Institutions	Markets	Policies
1984	Good	Poor	Poor
2004	Better	Very good	Good

Source: NZIER *Update,* November 2004.

A recent rallying cry is for New Zealand to move from its current position 15th to 20th in the OECD per capita income rankings to the top half. Whether or not this is realistic it does keep focusing us on productivity. Much of our growth in recent years has come from higher employment rates than from labour productivity. And we do not seem to be achieving the capital deepening evident in Australia.

Looking ahead major concerns are in the following main areas:

- A longer term shift from New Zealand export competitiveness being based on land-based industries to a situation where increasingly our competitiveness lies in the service sector.
- Changes in the structure of world trade as epitomised by the emergence of new forces (China and India), The impacts these countries have on the structure of world demand and supply across many sectors (including agriculture) will inevitably affect the shape and style of global markets, and thus our opportunities.

Our small local market has limited potential to propel us ahead, and thus we must continue to strive for new opportunities in international markets. The policy/political problem relates to the way we see growth being enhanced:

There are many small policy initiatives that would each slightly improve the long-term growth prospects, but few obvious big things; on the other hand there are probably even more numerous small decisions that could undermine our growth potential. Hopefully, we can keep our eye on the ball [8]

[8] NZIER *Update* April 2005.

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