THE CHALLENGE OF CHANGE

This article is taken from an address by the Governor, Mr Spencer Russell to the Auckland Rotary Club on 10 December 1984.

"Over the last 20 years or so, the financial sector has undergone significant change, both in its structure and in the services it offers. This is also true of relative market share. In 1960 the Post Office Savings Bank was the single largest institution in the financial system. That position has been eroded and its market share of deposits has fallen by more than two-thirds. To a certain extent this reflects the increasing competitiveness of trading banks which have, since the early 1970s, increased their relative importance in the financial system. Even more rapid growth has been displayed by the finance companies. They have increased their share of M3 (the broad measure of money supply) from just over 1 per cent in 1960, to about 17 per cent. The trustee savings banks have also enjoyed considerable gains, though more so in the early 1970s than recently.

This continuous process of change in the financial system is also evident from the increasing range of services. Examples of these are credit cards, the wider use of term loans, more flexible credit arrangements, instant cash access cards, and a wide range of deposit facilities tailored to differing needs.

Closely related to these changes are the increasingly blurred distinctions between financial institutions. Some 20 years ago, or for that matter even 10 years ago, the distinctions between financial institutions and the type of services they provided were very clear. Recently, these distinctions have become less obvious. There has been a trend towards retail banking facilities being provided by financial institutions, such as large finance companies, that previously had no involvement in these areas.

The evolving nature of the financial system is the product of a number of factors; some technological, some in response to market forces, and others as a result of Government intervention or regulation. Technological factors have been particularly important, with the development of more elaborate yet lower cost communications networks and computing facilities. A recent example of this type of influence is the current evaluation of the potential for point of sale terminals.

Government intervention has also contributed to the evolution of the financial system, for example, the establishment of the Development Finance Corporation and the Rural Bank. Perhaps even more important have been the effects of Government intervention in the form of regulation. Successive Governments have applied or extended numerous regulations over the years, generally with the objective of promoting what was at the time perceived to be a desirable objective. More often than not, these forms of intervention had unintended consequences and did not always achieve the desired objectives. An example of one of these unintended consequences was the proliferation of a number of financial institutions which were not directly subject to monetary control. This weakened the broad thrust of monetary policy, and therefore made it that much more difficult to control monetary and credit aggregates. Equally, regulation prevented the price of money influencing the decisions of both borrowers and depositors. In many cases, it led to developments that were far from desirable, often encouraging the growth of inefficient and unstable market situations. While the public memory may be short, I need not recall to you the painful failure of a number of institutions.

Over recent years, and particularly since 1976 when most controls on interest rates were removed, the general objective of policy has been to promote competitive efficiency in the financial sector. This move towards a less regulated financial sector has been a major catalyst to change in the structure of financial institutions and the nature and variety of the services provided. There have, however, been some policy reversals, such as the reimposition from 1982 of various interest rate controls.

More recently, we have returned to the path of deregulation. The aims are the same: to promote competition and therefore, more efficient allocation of resources. The intention is to encourage greater competition in the financial sector by removing a number of unnecessary distortions and by placing greater emphasis on relative price influences. As a result, it is intended that financial institutions will be in a better position to react more flexibly to a changing economic environment and to meet the needs of those who use their services.

Turning now to the economy at large, the various factors and influences which have impacted on the New Zealand economy since the early 1970s include:

1. British entry to the European community.
2. Increasing protection for agricultural commodities not only in Europe but in most of the western world.
3. The oil shocks of 1974 and 1979.
4. The adverse and prolonged movement in our terms of trade.

These have been discussed and analysed on many occasions in recent times.

The fundamental error we all made was a failure to recognise that the world in which we lived and traded had changed drastically against us and that it was a permanent change rather than the ebb and flow of economic fortune which we had experienced in earlier years.

The signs, both as to the extent of the shift in our trading fortunes and its permanence, were there in the early 1970s and the lack of recognition of those signs was widespread throughout the community.

The summit conference of September last was well briefed on the fundamental problems which we had experienced and which were continuing to affect us, and there was general recognition of the need to change attitudes and policies.

It was also accepted that the transitional period would not be easy and indeed could be painful. This too was accepted by the conference but, now that an attempt is being made to share the discomfort and pain between various sectors, there is, not surprisingly, some adverse reaction. And indeed from all sides of the political arena doubt is being expressed both on the need for change and the speed with which it should occur.

Put in the simplest of terms there are three basic options available to us. We could shun change completely and therefore revert to the fortress mentality that first emerged in the 1930s, we could accept the need for change but move along the path of gradualism or we could adjust to it with greater and more realistic speed.

The fortress approach is not tenable and it is surprising that it still has some adherents. New Zealand is a trading nation with a high level of overseas trade per capita. We must export to survive. You cannot live in a fortress environment when for 24 hours a day you have to leave the drawbridge down in order that traders can come and go without hindrance.

On the surface, the gradualist approach seems attractive. It allows judgements to be made over a lengthy period making the pain of change so much more bearable.

But once again the problem is that, because of our dependence on trade, we are not masters of the rate of change with which we have to cope.

There was nothing gradual about the entry of Britain to the European community or the community's move to an agricultural protectionist policy. The two oil shocks of the 1970s were the opposite of gradual. The changes taking place in the economies of Singapore, Korea and Japan are dynamic, not gradual, and even in the developed countries of the United States, Europe and Australia, technology is producing rapid change.

As I mentioned earlier, as a people we have been reluctant to accept the need for change and have favoured the gradualism approach. The costs have been high: low growth, periods of sustained inflation, persistent balance of payments deficits and relatively high unemployment.

So, in my view, we should accept the need for more rapid change and adopt appropriate policies to implement it. The objectives of these must be to promote efficiency in the allocation of resources and to make the economy more adaptive and more responsive to changing external circumstances. This process involves the progressive removal of protection both at the border and within the economy; the freeing up of price and cost disciplines and the reduction of arbitrary intervention in the economy. In other words the open economy approach.

Our first essential is the export requirement. We have to earn whatever standard of living we desire in a competitive world.

Our traditional grassland farming is no longer enough. That dream has gone and the terms of trade of the last decade prove it. While the move to alternative uses of land must continue, we should recognise that this cannot happen in the short term.

Looking at alternative export possibilities and acknowledging what has been achieved in recent years, by the manufacturing sector, new land based production and the service sector, we have to recognise that we have some disadvantages, particularly in the small size of our domestic market and our distance from overseas markets. We can overcome those problems by channelling our resources into those areas where we can be most efficient and where we can take advantage of our natural talents. With it there must be an acceptance that efficient industries, and efficient units within industries, will grow. These will be able to give higher rewards to those employed in them than will be the case in those sectors and companies whose products do not meet a market demand.

I mentioned earlier the impact that technology is having in growth economies overseas. I would hope that in the review of corporate tax promised for 1985 there will be recognition of the importance of research and development expenditure by all sectors of the economy. We must keep up with the growth countries in the application of technology in all we do. The commodities we buy have become so much more valuable because of the application of technology. For example, the car we import today is so much more valuable and sophisticated through advanced technology than was the vehicle of a decade ago.

We are still a developing country and we still need international investment, provided it meets reasonable criteria. Government will need to provide a predictable framework in which economic activity can take place. We shall need stable but not static fiscal and monetary policies. We should avoid repeating the wide fluctuations in the financial sector which resulted from moves over the last few years from a free to a controlled then back to a free market environment.

Government intervention in the economy should be kept at a minimum and when it occurs it should be across the board and not discriminatory in its application.

In common with all New Zealanders, I believe the community has a responsibility to assist those who are unable to provide adequately for themselves. But I also believe that there is a similar responsibility to help and encourage those whose efforts provide the growth in which our welfare system ultimately depends.

In case you may think I have come only lately as a supporter of the open economy and the need for change, may I quote an address I gave in 1968 as President of the Wellington Chamber of Commerce. Speaking of the need for change in attitudes and policies I said then: "We need to free up the economy and we could well start with the financial sector". Indeed when I spoke to your club in 1982 I said something very similar.

There is a general acceptance that change is inevitable and, I suspect, a feeling that it is better sooner than later. As I mentioned at the beginning, it is already taking place in the financial sector and its effects will be felt in all those activities that the sector services. Change will spread. If we resist it, we break faith with the past and deny the future the legacy which should be theirs. If we accept it as a challenge, we can achieve a brighter and more secure future for all our people".