
New Zealand's economic reforms: a model for change?

Don Brash, Governor, Reserve Bank of New Zealand

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Introduction

Over the last 14 years, the New Zealand economy has been through a very wide range of economic reforms. You have invited me to comment on whether those reforms have 'worked', and whether they can, in any sense, be seen as a model for change in other countries. While I appreciate your compliment in inviting me to give this address, I am mindful of the risks in accepting your invitation! Within New Zealand, there is still some debate about whether the reforms have worked, and, even though I myself believe that the reforms have been very beneficial for New Zealand, I am very reluctant to appear to be proselytising non-New Zealanders. Every country has its own unique set of problems, the product of its history, its culture and its political traditions.

As Governor of New Zealand's central bank, moreover, my primary responsibility is to deliver stability in the general level of prices, since that is seen, rightly in my view, as the best contribution which monetary policy can make to New Zealand's social and economic well-being. I do not have a responsibility for fiscal policy, trade policy, labour market policy, education policy or a whole host of other policies.

But, of course, monetary policy does not, and cannot, operate in a vacuum and, in particular, it cannot be considered in isolation from other aspects of government policy. For this reason, those of us who are responsible for formulating monetary policy must inevitably be well-informed about other aspects of public policy, and must be able to assess the implications for the way in which the economy will behave. So it is inevitable and appropriate that, from time to time, I get drawn into commenting on economic policy more broadly.

This is not the place to describe those reforms in detail,¹ but it is relevant to note that, while in many respects New Zealand's reforms were

very similar to those undertaken by other developed countries over the same period, the *extent* of the reforms, and in some cases the *nature* of the reforms, were internationally unique.

David Henderson, the British economist who spent most of the eighties and early nineties as head of the Economics and Statistics Department of the OECD in Paris, reviewed the New Zealand reforms in 1996 and commented that "the extent of liberalisation over the last 12 years places New Zealand in a class of its own within the OECD area." He went on to observe that "in no other OECD country has there been so systematic an attempt at the same time to redefine and limit the role of government, and to make public agencies and their operations more effective, more transparent, and more accountable."²

These reforms have taken New Zealand to fourth place in *The 1998 Index of Economic Freedom*, published by the Heritage Foundation and the *Wall Street Journal*, ahead of all the countries of Europe and North America. They also led to New Zealand's being ranked fifth in the Global Competitiveness Index published by the World Economic Forum in July/August 1997, behind only Singapore, Hong Kong, the United States and Canada.

Perhaps because of the extent to which the reforms have attracted the attention of newspapers such as *The Economist* and the *Financial Times*, there has been a steady procession of people – politicians, bureaucrats, and journalists – from a wide range of countries, keen to know what can be learnt from New Zealand's experience.

¹ I attempted to describe the reforms in *New Zealand's Remarkable Reforms*, the Fifth IEA Annual Hayek Memorial Lecture, delivered in London on 4 June 1996.

² David Henderson, *Economic reform: New Zealand in an International Perspective*, New Zealand Business Roundtable, August 1996.

So the question is certainly relevant. Have the reforms worked, and are they in any sense a model for other countries?

A great deal has been accomplished

Without doubt, a great deal has been accomplished.

We have made enormous progress in dealing with previously-persistent fiscal deficits, and are now one of the very few OECD countries running a genuine fiscal surplus (that is, a surplus without taking into account the proceeds of asset privatisation). Indeed, the financial year ending at the end of this month marks the fifth consecutive year of fiscal surplus (this one of nearly 3 percent of GDP) and, partly as a result, the ratio of net public sector debt to GDP has fallen from over 50 percent in 1992 to around 25 percent currently, one of the lowest such ratios in the developed world. The latest estimate by the New Zealand Treasury is that this ratio will fall to around 20 percent within two years. This decline in public sector debt will clearly help New Zealand to deal with the fiscal implications of our gradually ageing population and in due course permit reductions in the total tax burden, while on-going fiscal surpluses reduce the competition for the available pool of savings, allowing interest rates to be lower than would otherwise be the case.

We have made great progress in eliminating inflation, in part at least because we have created an institutional structure which insulates the day-to-day conduct of monetary policy from short-term political pressures, while leaving the *strategic* decision about the inflation rate clearly in the hands of the elected Government.³ Measured consistently with that of other countries,

New Zealand's consumer price inflation has been among the lowest in the world since 1991.

We have made great progress in 'getting the signals right' by eliminating quantitative import restrictions completely, substantially reducing tariffs, abolishing export subsidies, greatly improving the tax system (by introducing a no-exceptions single-rate Value Added Tax, abolishing wholesale sales taxes, reducing marginal income tax rates, and reducing scope to avoid taxes), freeing up the financial system, and reducing the distortions and inefficiencies caused by many unnecessary rules and regulations.

We have greatly improved the efficiency of resource use in the public sector, by corporatising and privatising many of the trading activities and by insisting on much greater accountability in the core public sector, partly through the simple expedient of introducing proper accounting principles to the public sector. (In the case of the Reserve Bank, operating costs are some 40 percent lower now than they were at the beginning of this decade, even in nominal terms, despite essentially unchanged outputs.)

We have seen a considerable change in the relationship between employers and employees, both by opening up the economy to greater internal and external competition (which has made employers and employees recognise the extent of their common interest) and by changing the legislative framework within which industrial negotiations take place.

We have seen a transformation in the views of most of those close to the public policy formulation process, bureaucrat and politician alike. For example, all six political parties elected to Parliament in 1996 now support the importance of low inflation, and all but one party supports the present institutional framework within which monetary policy is conducted. All of the parties elected to Parliament except one supports the New Zealand economy remaining open to the global economy – meaning support for both a continued reduction in tariff protection and continued openness to foreign

³ A paper by Clive Briault, Andrew Haldane, and Mervyn King of the Bank of England, presented to the Seventh International Conference of the Institute for Monetary and Economic Studies, Bank of Japan, in October 1995, noted that 'New Zealand stands out (in their survey of 11 central banks) as an obvious outlier, with a greater degree of accountability per unit of independence than any other developed country.'

investment. As an illustration of that, motor vehicle tariffs, which stood at 55 percent in 1981 and which have been gradually reduced ever since, were removed completely in last month's Budget with almost no political debate, despite the resultant closure of the four remaining car assembly plants and some component manufacturers.

But the results of the reforms are, in some respects, perplexing

And the results of all this policy progress?

In some cases, measurably dramatic and positive, as in the reduction in the ratio of public sector debt to GDP, the improvement in our inflation performance from one of the worst in the OECD to one of the best, and the continued diversification of our export trade, both by product and by market. Our unemployment rate, at 7.1 percent, is much higher than anybody feels comfortable with, and indeed it is higher than the measured unemployment rate when the reforms began in 1984.⁴ But despite all the removal of protection, removal of subsidies, corporatisation, privatisation, and public sector reform – all of which had the effect of increasing unemployment in the short term – our unemployment rate remains lower than that in Australia and Canada, and well below the level of unemployment in most of western Europe.

In some cases, the results of the reforms have been dramatic and positive but not so easily measurable, at least in terms of conventional macroeconomic statistics. As a consumer, one is aware of the enormously greater convenience of seven-day-a-week shopping, of the vastly improved telecommunications, of the better quality of domestic aviation services, of the shift in bargaining power from bank to customer in the banking sector, and all the rest.

⁴ It is clear with the wisdom of hindsight that there was a great deal of disguised unemployment, and underemployment, in 1984, which subsequent reform brought out into the open.

In terms of productivity per person, however, the results are perplexing. This is, after all, where one would expect to see the dividend from all the reforms of the last 14 years. Yet the statistics on aggregate productivity do not show the dramatic improvement which one would have expected.⁵ Indeed, in recent years growth in labour productivity has been less than the 1 percent per annum which is the US norm, and well below the rates of productivity growth prevalent, at least until recently, in the fast-growing economies of East Asia.

The low rates of growth in labour productivity revealed by the aggregate numbers are particularly surprising when set against the innumerable stories of extremely dramatic improvements in productivity at the level of the firm – Solid Energy, the government-owned coal-mining company, cutting staff numbers by more than 50 percent while increasing the tonnage of coal mined; Railways cutting staff from 23,000 to 5,000 while increasing the tonnage of freight handled; the Reserve Bank cutting its staff by approximately 50 percent while maintaining its outputs; and literally hundreds of similar stories from both the public and private sectors.

And these anecdotes are supported by analysis of productivity changes at the industry level. One study, for example, based on 20 industries, concluded that for the majority of sectors (13) 'liberalisation appears to have improved productivity growth rates. On average, overall TFP (total factor productivity) growth increased from 0.7 percent in the pre reform period to 2.4 percent in the post reform period. Average TFP growth increased from 1.86 percent pre reform to 4.88 percent in the post reform period in those sectors selling their output primarily in the export market average TFP growth increases

⁵ Viv Hall has found that labour productivity averaged 1.9 percent per annum between 1985 and 1995, virtually indistinguishable from the 1.8 percent achieved between 1978 and 1985, while total factor productivity actually fell from 1.2 percent per annum in the earlier period to 0.9 percent per annum in the later period. 'New Zealand's Economic Growth: Fantastic, Feeble, or Further Progress Needed?', *Victoria Economic Commentaries*, March 1996.

in importables and non-tradeables were more modest between the two periods, from -1.16 percent and 0.9 percent to -0.14 percent and 1.66 percent, respectively.’⁶

The explanation for this apparent paradox – of very rapid improvements in labour productivity at the level of the firm while productivity in the economy as a whole has been improving only slowly – is not at all clear. In part, the explanation may lie in the extent to which we have taken out improvements in productivity in ways which are not picked up in GDP statistics (such as more convenient shopping hours, better quality restaurants, and greater responsiveness from the telephone company to requests for new phone connections). In part, the explanation may lie in the way in which the value of much of the public sector’s output is measured (for example, since the value of the Reserve Bank’s *outputs* are, for the purposes of calculating GDP, assumed to be equal to the cost of our *inputs*, productivity growth is *assumed* to be zero, and of course some of the most dramatic examples of productivity improvement in recent years have been in the public sector). In part, the explanation may lie in the fact that, especially in the last five years or so, we have been creating a huge increase in jobs for people who had been made unemployed during the process of restructuring the economy, people who, almost by definition, were relatively less productive than the average of those already employed.

There are two other possible explanations which may be relevant. The first concerns the quality of New Zealand management. In a recent article in *The Times*,⁷ Anatole Kaletsky argued that what he described as ‘British industry’s abysmal record of inefficiency and low productivity growth – a record of almost miraculous under-performance stretching back to the start of this century unmatched by any other country, with the possible exception of a few African and

Communist dictatorships’ might be due not to recalcitrant trade unions and restrictive labour practices and not to the quality of British schools, but rather to the quality of British management.

I am certainly in no position to judge that question in the case of the United Kingdom, but there are at least some people beginning to worry in New Zealand that our management skills have not been up to the demands of operating in a global environment. If indeed poor quality of management is one of the reasons for the relatively poor productivity performance of New Zealand in recent years, there are probably grounds for expecting this situation to improve in the medium term. There was little reason to invest in management skills when operating in a highly protected environment, with high inflation and a depreciating exchange rate making it relatively easy to make satisfactory nominal profits. Those days are now gone. Certainly, to the extent that poor management has been part of the reason for our relatively poor productivity performance, one might reasonably expect this problem to disappear, now that we have a very open, competitive, economy, with low inflation creating no artificial distortions. Our openness to foreign investment and immigration can also be expected to help in this regard, and it is already true that the senior executives of some of our most dynamic organisations, in both the public and private sectors, are non-New Zealanders.

Secondly, and less related to productivity as such than to our overall growth rate, it is unfortunately true that the industries in which New Zealand has traditionally been most productive – those based on our natural resource endowment of land and sea – are also those industries which face very high entry barriers in the markets of the world. For example, over the last year or so, the New Zealand dairy industry has developed a new ‘spreadable butter’ with considerable market appeal, only to find barriers to its sale in Europe on grounds which appear, at least to this observer, totally specious. Similarly, although we are one of the world’s largest cheese exporters, and have developed a range

⁶ Fare, Rolf, Shawna Grosskopf, and Dimitri Margaritis, ‘Productivity Growth’, in B Silverstone, A. Bollard and R. Lattimore (eds), *A Study of Economic Reform: The Case of New Zealand*, 1996.

⁷ *The Times*, 24 April 1998.

of sophisticated cheeses in recent years, we are limited to a tiny quota of about 0.5 percent of the US cheese market. If New Zealand producers want to sell butter to Japan, they find that Japan has limited total butter imports, from all sources, to less than 2,000 tonnes each year, with sales beyond that tiny quota facing a 700 percent tariff. Measures of this kind, designed to protect special interest producer groups in the major markets of the world, damage the consumers in those markets and inhibit growth in both importing countries and New Zealand.

In the Reserve Bank's judgement, New Zealand's sustainable economic growth rate is now around 3 percent annually. This may seem disappointing compared with the much faster growth rates which have been common in East Asia, or with the much faster growth which New Zealand itself achieved during the early nineties, when we were able to achieve a once-only increase in the number of those employed by reducing unemployment from 11 percent to 6 percent. But New Zealand starts from a level of national income per head which is already well above that in most of the countries of East Asia, and as a result there is very much less scope for 'catch-up growth' by simply adopting the technology of more affluent countries. Growth of 3 percent per annum would still be markedly better than the growth which we achieved prior to the implementation of reforms.⁸ It is higher than the estimated US sustainable growth rate of about 2.5 percent annually.

Moreover, it is just possible that, as the household sector reaches a point where it no longer wishes to increase its debt levels as rapidly as has been the case over the last decade, interest rates will fall somewhat, and a higher proportion of available investment funds will find their way into the form of plant and equipment, with resultant benefit for growth in both productivity and aggregate output.

⁸ As Fare, Grosskopf and Margaritis have observed, 'in the period 1960 to 1984, the New Zealand economy had one of the lowest rates of real economic growth in the OECD.' *Op. cit.*, p. 74.

So have the reforms worked, and are they a model for others?

Given that nobody can be absolutely certain how New Zealand's economy would have evolved in the absence of the reforms, it is, of course, impossible to be too dogmatic on the question of whether they have 'worked'. But I have not the slightest doubt that the reforms 'worked' in comparison to a situation where we tried to continue with the policies of the late seventies and early eighties, with extensive protection, subsidies, price and wage controls, high inflation, large fiscal deficits and all the rest. It seems impossible to believe that using two people to do a job that one person could do would, in any sense, be an improvement. It seems impossible to believe that countries get better policies by hiding the full fiscal implications of what they are doing from the public. It seems impossible to believe that the well-being of the public at large is well served by protecting the vested interests of particular producers. To the extent that some countries are still trying to resist those elementary principles, the New Zealand reforms can well serve as a model for others.

And indeed there are policy areas where other countries appear to be following the New Zealand approach reasonably explicitly, including the way in which we have established the relationship between Government and central bank.

But nobody should imagine that sweeping reform of the kind implemented in New Zealand in recent years is painless, or politically easy. Many of those most directly involved paid with their political lives. There are many New Zealand observers who believe that the speed and scale of the reforms were only possible because of a rather unique coincidence – a serious run on the currency creating a widespread sense of crisis, dedicated officials (I was not one of them), and almost suicidally courageous politicians, all in the context of a unicameral, first-past-the-post electoral system, based on the Westminster relationship between Government and Parliament. Could it have been done differently?

From the point of view of economic theory, there is an argument that the *sequencing* of the reform process was a good deal less than ideal, and that as a consequence the economic and social costs of the reforms were greater than should have been the case. In this view, the complete liberalisation of financial markets early in the process, coupled with a monetary policy aimed at achieving a reasonably rapid reduction in inflation, initially large fiscal deficits, and a considerable delay in deregulating the labour market, was a recipe for trouble. Undertaking the reforms in that sequence meant, it is argued, that the real exchange rate was pushed up excessively, with the inevitable result that growth in industries which should have benefited by the reform process was much slower than would otherwise have been the case, and unemployment was far higher than should have been the case.

To me, this seems a plausible argument, although it may also be irrelevant. As several of those most closely involved in the reform process have pointed out in response, undertaking far-reaching economic reform is never easy in a political democracy, and reforms have to be undertaken when they are politically feasible, which is not always the same as when they are economically optimal. Moreover, it is misleading to imply that, had the sequencing been different, even in some theoretical sense optimal, there would have been no costs involved in the reforms. Inevitably, moving people from highly protected industries to unprotected industries involves some social and economic cost, just as reducing inflation from a high level to a low level involves cost. My judgement is that the *additional* costs imposed by the sequencing of the reforms were not great, although of course it is impossible to prove that contention one way or the other. It is probably also true that the early liberalisation of financial markets, seen by some observers as one of the sequencing mistakes, generated the economic pressures which made a number of the later reforms politically possible.

Could the reforms have been handled differently politically? There are certainly some who

believe that successive Governments bulldozed through the reforms against the wishes of the general public. Indeed, in significant part as a result of a perception that successive Governments lied to the electorate during the reform process, we have adopted an electoral system (a form of proportional representation closely modelled on the German electoral system) which many New Zealanders who voted for it now appear to regret, and which may well have reduced the scope for further reform. As somebody who is strongly committed to the democratic process, I certainly worry at the extent to which the reform process got well ahead of public opinion.

But, when I feel like criticising the reformers for not explaining their intentions in advance of making dramatic changes, I recall a conversation which I had with a group of elderly gentlemen in late 1984 shortly after the then-Labour Government introduced a tax surcharge on the taxpayer-funded retirement income scheme – which effectively means-tested that scheme, despite the Labour Party's strong commitment not to means-test the scheme prior to the 1984 election. My friends were indignant at the Government's deceit. I asked them whether they were confident that the original retirement scheme, without some form of means test, was economically sustainable in the long term. No, they thought it was probably not sustainable without some form of means test, and indeed its continuation without a means test would almost certainly, in their opinion, create major strains on the economy. I then asked whether they thought a political party could become Government if, before the election, they pledged to introduce a means test for the scheme. Not a chance, they agreed with alacrity. Then I asked them whether they were suggesting that the Labour Party had had a moral obligation to lie. They did not like that conclusion, and neither did I, but I am reminded of the conversation whenever it is suggested that Governments should not undertake reforms until a majority of the population support those reforms.

The reality is that Governments have a right, indeed a duty, to give a lead. Sometimes they face situations not contemplated when they are campaigning for office. Sometimes they are simply unaware of existing reality when they are formulating their campaign pledges. Clearly the cost of moving too far ahead of public opinion can be serious erosion of public confidence in government and in the political process itself. The cost of *not* undertaking necessary reform, however, is measured in entrenched unemployment and serious public sector debt problems of the kind common in many other OECD countries today, or even more serious problems of the kind which some of the countries of East Asia now face, with reform eventually having to be undertaken as the precondition of international support.

Looking forward, some ongoing worries

Looking forward, what are the things which worry me? There are three in particular.

First, despite the widespread consensus among policy-makers about the benefits of recent reforms, a great many of the general public are much less convinced of their merits, even now that they have been implemented. There is a widespread perception, for example, that privatisation has done nothing but alienate New Zealand control of important assets, even though, when pressed, very few people would want to return to the levels of service provided by the pre-privatisation Telecom or Air New Zealand. There is a widespread perception that the reforms ‘have made the rich richer and the poor poorer’ and, while it is probably true that the reforms have widened the distribution of *incomes* somewhat,⁹ it is a good deal less obvious that the distribution of *wealth* has become more uneven as a result of the reforms. Thus, for example, it is clear on a moment’s reflection that those groups who were ‘wealthy’ in pre-reform New Zealand – large-scale land-owners, large-scale commercial property owners, highly protected manufacturers, those with inherited import licences – have been materially *disadvantaged* by the reforms. So,

while the data do not exist to comment on the current distribution of wealth, it is at least clear that many of those who were rich prior to the reforms were not made richer by the reforms themselves.¹⁰

Unfortunately, too many New Zealanders still believe that economic reform was driven by the desire to test some abstract theory, not to improve the social and economic outcomes for all New Zealanders. Successive Governments have been unable to persuade a significant number of New Zealanders that continuing on the pre-1984 track was simply not a viable option. This failure constitutes a risk to the continuation of rational policy in the years ahead, even though, as indicated, policy-makers in almost all political parties support most of the reforms which have been undertaken.

Secondly, I myself feel quite uneasy about New Zealand’s continuing heavy dependence on the savings of others, or in other words, about the continuing size of the current account deficit. The last year in which New Zealand ran a current account surplus was 1973 and, while the deficit has been quite small in some of the intervening years, it is currently around 8 percent of GDP. As a consequence of this long succession of deficits, the ratio of the country’s net external liabilities to GDP is almost certainly over 80 percent and rising (the data are not terribly reliable), the highest of any developed country.

⁹ Available data is not totally conclusive about what happened to income distribution as a result of the reforms. Using Census data, the National Bank of New Zealand concluded that “what we can unambiguously say is that the distribution of gross incomes is more equal in both 1986 and 1991 than in 1981.” (National Bank of New Zealand, *National Business Outlook*, April 1993.) George Barker found that “incomes became less equally distributed’ over the period 1987 to 1991, largely as a result of the rise in unemployment over that period.” (*Income Distribution in New Zealand*, 1996.) But there are some indications that this trend has been reversed as unemployment has fallen from its 1991 peak.

¹⁰ Interestingly, of the 11 wealthiest individuals in New Zealand listed by the *National Business Review* in August 1987, five saw their wealth substantially or completely eliminated during the ensuing decade, two saw their wealth very substantially reduced (from an aggregate of some \$900 million to an estimated \$320 million), and the other four saw an increase in their combined wealth from \$750 million to \$1,015 million, an increase almost exactly in line with that of the CPI over the same period.

Does that actually matter? There is a respectable school of thought that argues that it does not. Milton Friedman, for example, has suggested that the world would be a much happier place if governments did not calculate or publish balance of payments data. Certainly, in a situation where the Government is running a budget surplus, the existence of a balance of payments deficit necessarily means that it is the private sector of the economy which is spending more than it is earning. And it is not self-evident that that should be a concern of the Government. Nor is it a situation that will continue indefinitely – either private *New Zealand borrowers* will decide that they have taken on enough liabilities, and so reduce their borrowing; or *foreign creditors* will decide New Zealanders have taken on enough liabilities, and will reduce their lending. Either way, the balance of payments deficit will tend to cure itself. Indeed, to the extent that the recent strong rise in the balance of payments deficit represents an adjustment by the household sector to the improved outlook for incomes and the very much greater availability of credit than in the years prior to reform, with a resultant step increase in the ratio of debt to household sector income, it may well cure itself quite quickly.

But I have two concerns. One is that our continuing propensity to spend more than we earn will, in time, result in an ever-increasing proportion of New Zealand assets being owned overseas. Nothing much wrong with that economically if that is what we collectively want, but it runs the risk of provoking a political backlash at some stage by those who, having spent beyond their means for decades, suddenly resent foreign savers who have been more prudent. Clearly, foreign savers who provide us with the capital which we are reluctant to provide for ourselves require a return on that capital, and the interest and profits accruing to foreign savers are already a significant debit item in the balance of payments.

The second concern is the costs of the transition which *could* be involved in moving from deficit to balance or surplus, for if it is *creditors* who decide that enough is enough, the

likely symptoms of the decision would be a sharply lower exchange rate and sharply higher interest rates, as the inflow of foreign funds is curtailed or reversed. These moves would abruptly shift resources back into the export- and import-competing sectors of the economy, and shake them out of other parts of the economy. (Indeed, to some extent this has been happening over the last 12 months, with a fall in the New Zealand dollar and a rise in interest rates over that period.) Economists talk about ‘shifting resources’ as if this can always be achieved smoothly and painlessly. In reality, however, an abrupt fall in the exchange rate and commensurately sharp increase in interest rates would be accompanied by considerable social and economic cost, as businesses in the domestic sectors of the economy, such as construction, retailing, and restaurants, face financial difficulties and, in some cases, fail. Unfortunately, no economist I have met has any easy solutions to this awkward dilemma, other than to have the public sector continue to run budget surpluses as a contribution to total national savings. Certainly we know that the old remedies – attempts to restrain imports, or artificially-engineered reductions in the real exchange rate – always end up doing more harm than good.

Finally, there appears to be considerable unfinished business in the education, health, and social welfare areas. Until these areas have been effectively addressed, it is hard to argue that New Zealand can be regarded as a completely satisfactory model for anybody.

In education, it seems to me a cause for serious concern that so many of our high school graduates (indeed, so many of our university graduates) have only the most rudimentary idea of how to write grammatical English; and that while Singapore, South Korea, Japan and Hong Kong occupied the top four places in the Third International Maths and Science Study, New Zealand ranked only 24th (out of the 41 countries in the study). It cannot be good for our economic growth, or for the employment prospects of many of our young people, that, according to an OECD report released in April,

nearly half the workforce in New Zealand cannot read well enough to work effectively in a modern economy.¹¹ While this is, in aggregate, a similar situation to that in Australia, the United Kingdom and the United States, it is a matter for particular concern that 70 percent of Maori New Zealanders, and about three-quarters of Pacific Island New Zealanders, are functioning “below the level of competence in literacy required to effectively meet the demands of everyday life.”¹² We all have our own favoured solution for these educational deficiencies. But whatever policies are followed, the one thing that is obvious is that future prosperity will depend heavily on the pace at which New Zealanders develop their ‘human capital’. And this is true both for the obvious reason that unskilled people will be increasingly less needed in the modern economy and for the perhaps less obvious reason that, unless New Zealanders have a proper education, the ability of Governments to make sensible policy choices will be severely restricted.

In health, I frankly have no idea whether policy is now on the right track or not. To me, it seems entirely sensible to separate the funding from the provision of hospital services, but successive Governments have so far failed to explain the nature of the policy dilemma to the general public, who often seem to imagine that Governments can continue to fund an ever-increasing level of ever-more-expensive medical procedures, for a steadily ageing population, without using either price or queuing as a rationing device. If Government continues to provide hospital care without charging users for that care, it seems to me inevitable that we will have either waiting lists of some kind or arbitrary rules defining the services which the taxpayer will fund.

In social welfare, the widespread perception is that the Government has effectively walked away from its obligation to provide income support to those in need, despite the fact that

expenditure on social welfare will consume 36 percent of total government expenditure in 1997/98 (nearly 13 percent of GDP), *above* the 30 percent of total government expenditure in 1984/85 (about 11 percent of GDP), and that those dependent on the Domestic Purposes Benefit, for example, have increased from 53,000 in 1984 to 115,000 in 1997/98.¹³ New Zealand spends rather more of its GDP on government transfer payments than does Australia, notwithstanding the higher unemployment in Australia. And yet, despite that – perhaps because of that? – New Zealand sees high levels of family breakdown, very high levels of ex-nuptial births (41.8 percent of all live births in the year to March 1998), very high numbers of children being brought up in single-parent families (especially among the Maori and Pacific Island communities), and all of the poverty, educational problems and crime often associated with these conditions.

Conclusion

Yes, the economic reforms of the last 14 years have accomplished a great deal. While there may well have been other policy options which might have been followed in 1984, continuing with the policies which had been followed prior to that time was clearly not one of them. Some of the things that have been accomplished may be a model for others, and indeed have already been copied by others. At a time when a great many countries are grappling with how to make retirement income schemes fiscally sustainable, how to make their public sectors more transparent and more accountable, how to reform their taxation systems, and how to dismantle the subsidisation of special interest groups, we can take considerable satisfaction at the progress made in New Zealand.

But there are no grounds for complacency. Like most other countries, New Zealand still needs

¹¹ *Human Capital Investment: an International Comparison*, OECD, 1998.

¹² *Adult Literacy in New Zealand*, Ministry of Education, 1998.

¹³ Taking expenditure on National Superannuation out of total social welfare expenditure gives a ratio of social welfare expenditure to GDP of 4.1 percent in 1984/85 and 7.4 percent in 1997/98, showing an even more rapid increase than for social welfare expenditure inclusive of expenditure on National Superannuation.

to continue seeking ways to improve productivity, to improve the quality of education, to increase private sector savings, and to reduce dependency. Indeed, one of the lessons of recent years is that continuous incremental policy improvements may well be the only way of avoiding the need for periodic dramatic and far-reaching change. Even those who strongly support the reforms of the post-1984 period would see that as an advantage.