Mr Brash comments on the economic reforms of the last 15 years in New Zealand

Comments on accepting the NZIER/Qantas Economics Award by Dr Donald T Brash, Governor of the Reserve Bank of New Zealand, held in Auckland on 18 August 1999.

*   *   *

Mr Chairman, ladies and gentlemen,

I was greatly flattered to be nominated for this NZIER/Qantas economics award, and feel deeply honoured to have been selected to receive it. I regard the earlier recipients of the award as among the giants of the economics profession, and I have been privileged to work with all of them in one way or another. I am also very much aware that, while my name is on the award, I owe that fact in large measure to the efforts of a great many other people, including my colleagues on the Monetary and Economic Council, on the Committee of Inquiry into Inflation Accounting, on the New Zealand Planning Council, on the Economic Monitoring Group, and on the various taxation advisory committees I was privileged to chair in the eighties; to the efforts of my colleagues and staff in the Reserve Bank; and of course to my teachers and family over a great many years. Thank you.

I was told I might speak briefly on accepting the award. What to talk about? It hardly seems the appropriate moment to speak about the Official Cash Rate, so I thought I might be allowed a little licence to add my contribution to the debate currently raging on all sides about the success or otherwise of the economic reforms of the last 15 years.

But before I do that I want to say that I sometimes wonder whether we New Zealanders are not congenitally prone to wild swings in mood: we are either riding high in self esteem, confident that we can take on the world and win, as we were in the mid-eighties and mid-nineties, or we are utterly gloomy, convinced that a cyclical downturn in net immigration represents the end of civilisation as we know it, with our only hope being to plead with Australia to take us on as a distant Tasmania. As Doug Myers mentioned in a speech a week ago, “we have developed a cottage industry of pessimism”.[1]

I do not propose to assess why we have this tendency to wild swings in mood, nor even to offer a comprehensive assessment of the economic reforms of the last 15 years. That can not be done in 15 minutes. But let me make just a few observations.

First, I believe that there are several aspects of those reforms where the results are measurable and clearly positive. For example, I believe we can now safely conclude that the monetary policy framework put in place as part of that overall reform process has been hugely successful. And I say that as someone who had only a small involvement in the original design of that framework. Am I saying that the framework guarantees against mistakes in the formulation and implementation of monetary policy? Of course not. No framework can do that. We have made mistakes in the past and, since we do not have (or claim to have) perfect foresight, we will certainly make mistakes in the future. But the monetary policy framework conceived when Roger Douglas was Minister of Finance as a way of depoliticising the operation of monetary policy, brought to Parliament by David Caygill, passed into law without a single dissentient vote, and now supported by most political parties is an outstandingly good one, and has already been emulated by a number of other countries. It has helped us to reduce inflation from well above the levels in other developed countries to a level closely consistent with those in Australia, the United States, and Europe. It has helped us to reduce long-term interest rates from 1000 basis points above US long-term interest rates in the mid-eighties to less than 100 basis points above US long-term rates in the recent past. That improvement in inflation

[1] “Wake up New Zealand”, speech to the Tauranga Chamber of Commerce, 11 August 1999.

performance has been of benefit to the New Zealand economy and of benefit to New Zealand society more generally.

Second, I believe that there are several aspects of the reforms where the results are not so easily measurable, at least in terms of conventional macroeconomic statistics, but where the results are again unambiguously positive. With banks now falling over themselves to lend money, who wants to go back to having to get down on bended knee to get a home mortgage loan? With new phone connections now available in most parts of the country within days of making a request and the cost of domestic toll calls down some 80 per cent in real terms in the last decade, who wants to go back to waiting 12 to 18 months for a residential phone connection? And who wants to go back to the old level of in-flight service on domestic airlines? Or to five-day-per-week shopping? Or to paying 60 cents for mailing a surface letter (the cost in 1986 in 1999 dollars), instead of today's 40 cents? None of these benefits show up very clearly in GDP statistics, but all of them have made a big, and a beneficial, impact on our lives. Few of us would want to lose them.

But what about economic growth? Surely growth in GDP has been disappointingly slow since 1984, and this proves beyond reasonable doubt that the reforms have failed? Certainly, taking the whole 15 year period growth has been disappointing. I am not at all sure, however, that it is legitimate to conclude that therefore the reforms have made no difference to our potential growth rate. In the first several years of the period, the New Zealand economy was going through huge changes made inevitable by the decision to abolish quantitative import controls, to reduce tariffs, to abolish export subsidies, to corporatise and then privatise many state-owned enterprises, to deregulate the banking sector, and to reduce inflation from levels well above the developed country average. A lot of the capital built up in the period before 1984 was destroyed when the subsidies and protection on which that capital was totally dependent were eliminated. While there is some debate about the speed with which subsidies were eliminated, there is little or no debate that abolishing those subsidies was in the interests of the long-term health of the New Zealand economy. But inevitably the short-term result of these moves was to leave the overall level of GDP looking pretty flat. It was, on a small scale, similar to the kind of trauma which the former Soviet bloc countries have gone through in recent years, with whole industries wiped out and, in their case, overall GDP shrinking substantially. New Zealand's GDP did not shrink to any significant extent, but for six or seven years it barely grew at all. From the early nineties, however, the picture is much more encouraging. In the six years from 1992 to 1997, growth in GDP averaged 3 per cent per annum – not the 4 or 5 per cent per annum which we achieved when we were first emerging from the recession but better over those six years than the growth in Japan, in continental Europe, and in the United Kingdom, and almost identical to the growth in Australia, on average over those six years. We would of course like to be growing faster, and unless we do we will not regain any of the ground lost relative to Australia during the sixties, seventies and eighties, when we were growing quite a bit more slowly than Australia and other developed countries. But we still did very much better in the six years to 1997 than we did in the previous three decades.

But what about 1998? I suspect the fact that Australia grew at more than 4 per cent in 1998 while we grew not at all in that year is at the root of a lot of our current gloom. How could we bomb out so badly, when both countries had a very similar exposure to the Asian crisis? This isn't the place to provide a comprehensive answer to this question, and indeed I don't think anybody yet has a comprehensive answer to this question. Some blame poor monetary policy decisions by the Reserve Bank for the difference. I don't share that view and see the impact of New Zealand's severe drought as being a much more relevant factor, but then I am clearly not an objective observer. But even if, for the sake of the argument, monetary policy caused all of the difference between Australian growth and New Zealand growth in 1998, that was at most a temporary impact, and monetary policy in New Zealand was eased very substantially over the course of 1997 and 1998. Official forecasts suggest that growth in New Zealand over the next two years will be closely similar to that in Australia, as it was for the six years prior to 1998. So it is hard to see strong grounds for pessimism there.

But what about productivity? Now we are getting to the heart of the matter, and there has been some pessimism, even among professional economists, that New Zealand's productivity performance has not improved discernibly as a result of 15 years of reform. To shed some light on this issue, the Reserve Bank, the Treasury, and the Department of Labour commissioned some work on productivity by Denis Lawrence, director of the Tasman Asia Pacific economic consultancy, and Erwin Diewert, professor of economics at the University of British Columbia, and their conclusion, as summarised by them in the New Zealand Herald exactly one week ago, was that “to the extent we can make like-with-like comparisons between New Zealand and Australia (another country that has had a sizeable but more gradual reform programme over a similar period) New Zealand’s performance (in multi-factor productivity) appears to be at least comparable”.[22] Indeed, they suggested that if sectors where productivity is very hard to measure (such as banking and community services) are excluded from the numbers on both sides of the Tasman, New Zealand productivity seems to have been as good as, or even a little higher than, in Australia in recent years.

So we have plenty of reasons for being optimistic. We have more natural resources per capita than a great many other countries, but not so many that we are tempted into ignoring the real source of our future prosperity, which is the skills and education of our people. We have a framework for both monetary and fiscal policy which is the envy of a great many other countries, and that framework has already delivered us consistently low inflation for nearly a decade and a huge reduction in net public sector debt. Despite important differences of opinion on a whole range of issues, we have a substantial measure of consensus about some of the really important policy questions. Remarkably for a country which, until the mid-eighties, had a long history of controls on almost everything, we have a public service which is almost totally free of corruption. Similarly, we have a judiciary which has never been suspected of corruption. New technologies which were not even dreamt of when Britain entered the European Union substantially reduce the tyranny of distance by reducing the cost of finding and servicing distant markets. New technologies create new business opportunities by making us less dependent on the economies of large scale production, thereby reducing the relevance of our small local market.

The Reserve Bank estimates that our sustainable rate of growth is currently around 3 per cent per annum. I am convinced that, with the right policies and the right attitudes, we can do even better.

Where do professional economists fit into all this? Having devoted the first half of my speech to arguing that the current mood of pessimism about the fruits of the last 15 years of reform is considerably overdone, I want to use the second half of my address to talk about where I think professional economists have let the side down. I am not talking about all of my colleagues of course. Some have done a superb job of explaining how the world works. But too often you, I, we have remained silent in the face of very considerable public and political confusion and uncertainty.

Take, for example, the rather limited public comprehension of what has been happening to the New Zealand economy over the last 30 or 40 years. It seems, to me at least, that for several decades prior to the early seventies New Zealand enjoyed a standard of living which was high by international standards because we had unfettered access to the British market for everything which our very efficient farming sector could produce. We taxed our farming sector by providing protection to our inefficient manufacturing sector, and used the revenue to build a generous system of state-funded health, education, and welfare. This may not have been sustainable indefinitely in any event, because the real price of our commodity exports was steadily declining (although improving productivity in the farming sector was doing a pretty good job of offsetting this decline in price). But the viability of the whole approach was jeopardised when Britain entered what was then referred to as the Common Market in the early seventies. All of a sudden, our farming sector was under severe pressure. For more than a decade, we tried to pretend we could box on regardless. We made no serious attempt to help the farming sector by reducing the protection given to inefficient sectors. We made no serious attempt to tailor our social welfare system to the cloth available. Indeed, in 1975 we introduced a Domestic Purposes Benefit which would, over 20 years, grow to involve a fiscal cost almost as big as the Unemployment Benefit. In the same year, we killed off an embryonic contributory superannuation scheme and replaced it with a very generous taxpayer-funded scheme.

[2] New Zealand Herald, 11 August 1999.

What successive Governments have been grappling with over the last 15 years is finding ways to make more of the economy internationally competitive, to take up some of the load which the farming sector can no longer carry, while trying to explain to a sceptical public why the erstwhile generosity of the state may not be able to continue. Alas, they have got precious little help from professional economists in explaining this story to the public, and in some respects we economists have actually encouraged the public's reluctance to change.

Or take another example. Tariffs. To the best of my recollection, I have only ever met two economists in my life who believed that tariff protection was a desirable long-term feature of economic policy (a few more have accepted the infant industry argument in favour of temporary protection). Economists are probably more united against tariffs and import controls than they are on any other single issue. And yet we allow to go unchallenged statement after statement, on talk-back radio and in the print media, suggesting that New Zealand has been daft to reduce its tariffs ahead of our trading partners, and that the only reason we are doing so is because politicians, or Treasury officials, are driven by some mad theory. Or perhaps just by a desire to look holier-than-thou in international trade negotiations. The idea that we should reduce tariffs in New Zealand no matter how stupid other countries are about raising theirs is incomprehensible to most of the public, and yet is an idea which would be accepted by almost all economists. Of course we would be better off if other countries did not raise tariffs against our lamb, or our kiwifruit, or our butter, or our cheese, or our beef, or our fish. But even when they do raise such tariffs, it is not in our own interests to reciprocate in kind. Economists know that, but have not done a terribly good job of helping the public to understand that.

Or take a third example. Health care. I am certainly not going to step into the political maelstrom which is the health care debate, at least in part because I simply do not know what to suggest or recommend. But every economist knows from the days of Economics 101 that if you offer to supply something for free, the demand for it will be enormous, and that if you don't use price to limit that demand, you will soon be unable to meet the demand – whether you devote 6 per cent, 8 per cent, or 10 per cent of GDP to health care – and will be faced with long queues. In recent years, and contrary, I suspect, to public perception, government spending on health care has risen somewhat faster than GDP. (In the year to March 1984, government spending on health care took 5.6 per cent of GDP, while in the June 1999 year government spending on health care is estimated to have absorbed 6.4 per cent of GDP.) I simply do not know what proportion of GDP New Zealand should be spending on health care. But I do know that, no matter how much is spent on health, there will always be queues unless price or some arbitrary political decision is part of the rationing process. Of course queues may be an optimal way of dealing with the situation. As I said, I don't want to enter the substance of this debate. All I am saying is that economists would do a service to rational discussion of health care if they made the nature of the issues clear.

At the end of the day, what I am seeking from my professional colleagues is a greater commitment to assist in the formulation of economically sound policy. At the moment, politicians of all of the major political parties are hugely constrained by the fact that, while more economically literate than people in many other countries, the general public do not have a good understanding of some of these crucial issues. How, for example, do political leaders grapple with the gradually growing fiscal cost of National Superannuation, or encourage rational public discussion of the issue, when a news item in one of our largest daily newspapers could say, about the present Government's decision to maintain the real value of National Superannuation by indexing it to the CPI rather than to wages, "up to half the superannuitants in New Zealand could be pushed below the poverty line when their pensions are reduced tomorrow".[33] I suspect it is true that the great majority of superannuitants today believe that their National Superannuation payments have been reduced or are about to be reduced, and yet of course economists know that that is not true, either in nominal terms or in real terms. It is true in relative terms of course, but a reduction in relative terms is assuredly not what most people think of

[3] "Elderly pushed into poverty", The Dominion, 31 March 1999.

when they talk about a reduction in a benefit. To the best of my knowledge, no economist challenged that newspaper claim, or similar statements made on the electronic media.

Let me make it clear that I am not, here, arguing for any particular “solution” to the growing fiscal cost of National Superannuation. There are obviously a range of possible solutions, including an increase in income tax. All I am saying, and saying as strongly as I know how, is that we will not improve our economic performance, nor get the sound policy decisions on which that improved economic performance depends, without a better public understanding of the nature of the issues. Economists can not of course achieve that on their own. It requires leadership from political leaders, from business organisations, and from community leaders also. But as those with a professional understanding of tariffs, budgets, monetary policy, taxes, and all the rest, economists surely have a major responsibility to help in building public understanding of the choices and the dilemmas.

As an aside, the Reserve Bank decided to sponsor the production of a textbook on economic policy for the Journalists Training Organisation a year or so back. This textbook will be launched next week. It does not attempt to promote a single view of economic policy, and contains chapters written by a wide range of New Zealand economists and financial journalists. It is the Bank’s attempt to ensure that journalists, at least, have access to information on some of these important issues.

Perhaps it is appropriate to end with a quotation from a speech given just last week by Mr Kerry McDonald, managing director of Comalco New Zealand and of course for a number of years Director of the New Zealand Institute of Economic Research. In that speech[4] he observed:

“It seems that there simply isn’t a decisive constituency in New Zealand for increased growth and living standards. No one is demonstrating for it, and few are fussed by the lack of it. Many want the fruits; they want the cargo to arrive, but not the hard effort of creating the economic wealth in the first place.”

As a fifth generation New Zealander, I badly want Kerry McDonald to be wrong. I suspect he wants to be wrong himself. I know that, when I threw my hat into the political arena in 1980, what motivated me was a fear that, unless we could arrest our relative economic decline, my kids would leave New Zealand as soon as they were old enough to choose, and the country which I love would gradually sink into the sand.

I think that we have as a country made some real progress in recent years at arresting that decline. The last 15 years have certainly not been in vain. But in part because of the failure of the economics profession, the public seem to imagine that half a century of relative decline can be arrested by just a few years of reform. It can’t be. There is still much to be done. Economists can assist sensible public discussion of the issues, and if we fail to do that, we may yet, like the good people of Hamlyn, see our children disappearing over the horizon.[4]

---

4 “Is a high performance business environment possible in New Zealand?”, speech to the NZ Institute of Management, Canterbury Division, 9 August 1999.