Economic Reform in New Zealand :

Radical Liberalisation in a Small Economy

Shaun Goldfinch
University of Otago

New Zealand provides a dramatic example of rapid and far–reaching economic liberalisation. A comparatively wealthy country for much of the 20 th century, New Zealand has a long history of Westminster–style democracy with developed systems of property rights and business law, reflecting British colonisation and settlement in the nineteenth century. Under an ostensibly social democratic Labour Government it comprehensively liberalized its economy in a process beginning in the early 1980s and extending into the 1990s. Changes included the floating of the exchange rate ; extensive liberalisation of financial, capital and other markets ; lowering of trade protection ; fiscal restraint and monetary deflation ; changes to the machinery of government ; corporatization and then sale of some government assets ; broadening of the tax base ; and changes to industrial relations frameworks including a radical liberalisation of the labour market. Change was extensive. New Zealand moved from being what the *Economist* claimed was one of the more 'hidebound' economies outside the former communist bloc, to amongst the most liberal in the OECD. From having some of the highest manufacturing tariffs in the world in 1970, New Zealand has now amongst the lowest levels of trade protection, particularly for agricultural products. One of the key initiators of this reform was the Labour Minister of Finance (1984 – 88) Roger Douglas, and consequently the period of the reform is often known as 'Rogernomics'.

Acknowledgements: Professor Paul Dalziel supplied much of the economic data for this study.

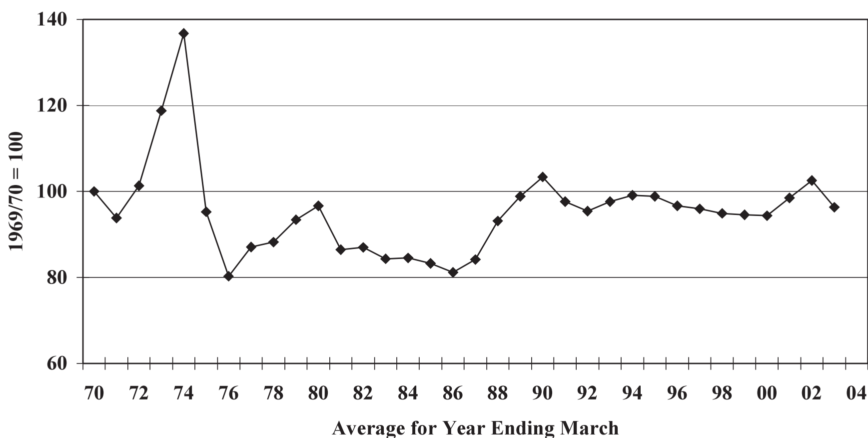
The Economic Policy Framework Before 1984

The economic liberalisation of New Zealand was particularly dramatic because, for much of the twentieth century, it had reasonably high levels of government involvement and regulation of the economy, and considerable state ownership of infrastructure and trading activities. In this former colony strongly tied to the British economy for much of its history, tariff protection of manufacturing was amongst the highest in the developed world by 1970 supporting a manufacturing industry focussed largely towards import substitution; exports were dominated by highly productive primary industries tied directly to British markets; and the government played an important part in regulating the labour market. New Zealand was an early developer of a welfare state under the Liberals from 1891－1911, then the first Labour government from 1935－49. New Zealand ceased being a welfare leader in the 1950s, although there was rapid growth after 1972 (Rudd 1997). After the Second World War New Zealand adopted a variant of Keynesian demand management, with an explicit commitment to full employment. Family income was delivered to a large extent through regulatory intervention in the wages system, based on this presumption of full employment (Castles 1985). New Zealand enjoyed high levels of prosperity throughout most of the twentieth century, vying with the United States, Australia and Canada to be the richest per capita country in the world at the turn of the twentieth century, and still in the top five in the 1950s. Unemployment was at extremely low levels — approaching zero — for the decades following the Second World War. Relative performance, at least in terms of economic growth, gradually declined against OECD averages from the early 1960s on. From 1971－81 New Zealand had an average annual real GDP per capita growth of 1.8 percent compared to the OECD average of 3.4 percent (OECD 1997). Ranked in terms of GDP per capita within the OECD, measured by purchasing power parities, New Zealand fell from tenth place in 1970 to nineteenth in 1980 (OECD 1997).

Economic Performance Before 1984

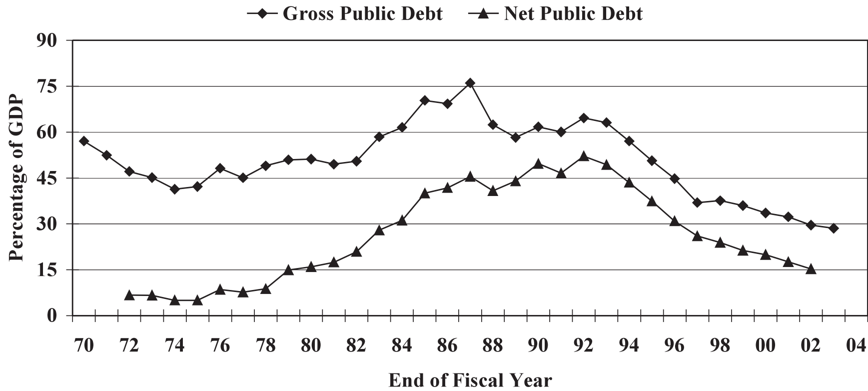
By the time of the 1984 election that introduced the reforming Labour government, there was a belief shared amongst economic policy elites that the New Zealand

economy was in serious trouble. Growth rates had been less than the OECD average since 1960, and there had been considerable variability in terms of trade during the 1970s, as Fig. 1 shows. Traditional British markets were threatened after the United Kingdom joined the EEC in 1972. As in many other countries, the oil shock of 1973–74 had a severe impact on the New Zealand economy, but, according to a number of critics, New Zealand seemed slower to adjust and recover. Existing problems were compounded, argued these critics, by several factors. First, rather than adjusting to new realities of shrinking demand and prices for agricultural goods and seeking out new markets and developing new products, domestic agricultural prices were buoyed up by subsidies (Hawke 1992; Treasury 1984) Second, the protection of domestic industries allocated resources away from the more efficient export sectors. Third, considerable overseas borrowing was undertaken leading to an increase in public sector debt from 11 percent of GDP in March 1974 to 95 percent in June 1984 (Evans et al. 1996; Fig. 2). This was often undertaken to fund investments in large capital intensive 'Think Big' industries of questionable commercial value, or to maintain consumption at levels above that justified by production (Hawke 1992). Fourth, according to the Treasury and other critics, inconsistent macroeconomic policies and electoral budget cycles, labour market rigidities, an overly large public sector and excessive government regulation during the Muldoon Government contributed to this relative decline and lack of adjustment to changing realities (Bollard



Notes.
1. Source: Dalziel and Lattimore (2004) Graph 1. 2.

Figure 1 Terms of Trade Index 1



Notes.
1. Source : Dalziel and Lattimore (2004), Graph 6. 3.

Figure 2 Public Debt 1

1994 ; Roper 1997 ; Treasury 1984). The feeling of crisis grew when there was a run on the dollar before and immediately after the election, on the expectation of a devaluation. This belief was further compounded when the outgoing Prime Minister Robert Muldoon refused for a time to devalue the dollar on the advice of the incoming government, in direct contravention of constitutional conventions.

However, while much is made of the highly regulated New Zealand economy, particularly by protagonists of free–market reforms, New Zealand economic management in the postwar era largely reflected international trends and indeed New Zealand ranked in the middle of the OECD pack on various measures of economic freedom and on government and welfare spending (Hazledine 1998 ; Henderson 1996). The economic 'crisis' New Zealand faced, with the exception of the run on the currency, was also considerably overstated. During the 1970s there was some tentative liberalisation although this was applied inconsistently and sometimes reversed. In New Zealand the National Government of Prime Minister Robert Muldoon (1975 – 84) deregulated the economy in areas such as transport and meat processing, in allowing tendering for import licenses and in some liberalisation of the foreign exchange market. From 1976 – 1981 controls on interest rates were relaxed. There was also some movement towards the restructuring of farm subsidies and the removal of compulsory unionism. There was also considerable diversification in exports and a broadening of export markets, and the negotiation of the highly comprehensive free trade Closer Economic Relations treaty with Australia in 1983 (Easton 1997 ;

Hazeledine 1993 ; 1998 ; OECD 1994). However, this trend towards liberalisation was reversed somewhat with a wages and price freeze introduced in 1982. An expensive universal superannuation scheme was introduced after an election promise made in the 1975 election. The National Government also engaged in a number of major investments in energy and capital intensive industry (known as 'Think Big'), most of which did not meet with commercial success. Macroeconomic policy continued in an eclectic Keynesian tradition with 'stop-go' policies and pre-election fiscal boosts. Despite New Zealand's relatively poor performance during the 1970s, in the years before the 1984 election the New Zealand economy was exhibiting strength in some economic indicators. As Dalziel shows, between 1978 and 1984 the New Zealand's real GDP grew at 2.9 percent a year ; a rate that would have seen as highly desirable at the depths of recession of the late 1980s and early 1990s, and reasonably respectable now (Fig. 3). The wage and price freeze had had considerable impact in lowering the consumer price index to 3.5 percent by March 1984, the lowest since 1968. There was an increase in employment, and economic growth reached four percent in the March 1984 year. However, the fiscal deficit reached record levels in 1984 at 6.5 percent, up from 4.6 percent in 1982/3.

Notes.
1. Source : Dalziel and Lattimore (2004), Graph 3. 1.

Figure 3 Real GDP Per Capita 1

Economic Liberalisation After 1984

The New Zealand snap election of July 1984 saw Labour Governments sweep to power, marking the beginning of a rapid and far-reaching program of economic liberalization. The Labour Government under Prime Minister David Lange was elected without settled economic policies. There had been debate in the years before the election between two sections within the (mainly parliamentary) Labour party: one broadly supported economic liberalisation; the other a more corporatist model of economic management. These disagreements were not resolved by the time of the 'snap' election in July 1984 and the two policy strands were 'patched up' in the party manifesto, albeit in such a way that little information was given to the prospective voter (NZ Labour 1984; Oliver 1989). As economic policy subsequently unfolded, it was clear that those promoting economic liberalisation had gained control of policy formation. There were two major sources for these policies: a reform package developed while in opposition by future finance minister Roger Douglas and his office (which included a seconded Treasury official); and a similar set of policies developed by the Treasury (1984) and outlined in the post-election briefing paper *Economic Management* presented to the newly elected government. The Reserve Bank also was also in favour of economic liberalisation. In the next few months, and in the following years, New Zealand introduced a series of economic liberalisation measures that showed a degree of comprehensiveness, theoretical purity and speed of introduction possibly unparalleled elsewhere in the world. Indeed, many major reforms were introduced in the first few months of the Labour Government and in the comprehensive 1984 budget package. The election of a conservative National Government in 1990 saw liberalisation accelerate again, with major reforms introduced in the first few months of the new Government and in the highly comprehensive 1991 Budget, including large cuts to welfare benefits.

Reform under the Labour (1984-90) and National Government (1990-99) was remarkably comprehensive covering nearly all aspects of economic management and the state sector. It can be seen as having the following characteristics: first, the New Zealand dollar was floated and capital and financial markets were deregulated within the first few months of the Labour Government and over the following years. The financial markets became amongst the freest in the world.

Second, fiscal policy was largely aimed at reducing the fiscal deficit and activist demand management was abandoned. New Zealand's commitment to fiscal disinflation was such that large pro-cyclical cuts to the fiscal deficit were made during the severe recession of 1991. A broadening of the tax base was also carried out with the introduction of a Goods and Services tax (a VAT) and the lowering of marginal income and company taxes. In 1994 the *Fiscal Responsibly Act* was passed which cemented in the focus on balanced budgets and increased the apparent transparency of the budget process (discussed below).

Third, New Zealand monetary policy was aimed at deflation, with the independence of the bank and the focus of monetary policy on inflation only confirmed in the *Reserve Bank Act* 1989. Previous Reserve Bank Acts had also required the Bank to take into account output and unemployment. The Reserve Bank Act requires a contract to be signed between the Governor of the Reserve Bank and the Minister of Finance, requiring the Governor to maintain inflation, initially in the 0–2 percent range. How this was to be achieved was left largely for the Governor to decide.

Fourth, there was labour market deregulation. There were some tentative moves towards deregulation of labour markets in New Zealand with the *Labour Relations Act* 1987 and in 1991 the National Government introduced the *Employment Contracts Act* which radically deregulated the labour market and adopted individual contracts in employment, undoing a century of state intervention in the labour market and sponsorship of the union movement.

Fifth, New Zealand undertook an extensive program of microeconomic liberalization with the intention of increasing efficiency in the economy, introduced a wide range of deregulatory measures and made large cuts in trade protection. Subsidies to agriculture and export incentives were removed. New Zealand agricultural industries became amongst the least protected in the world, and possibly the least protected. Controls on foreign investment were considerably relaxed.

Sixth, the New Zealand government corporatized and then sold a number of government assets, with the privatisation programme being the largest in the OECD in terms of revenue raised as percentage of GDP. Disinvestment included transport and energy infrastructure, including the railways and airlines, banking and insurance, tourism and various government services and agencies.

Seventh, massive cuts were made to some welfare benefits in the 1991 budget,

with some reduced by one quarter. New Zealand moved away from positive 'cradle-to-the-grave' notions of the welfare state to embrace neoliberal views of the welfare state as a 'minimal safety net.'

Eighth, the state sector was comprehensively restructured alone new public management lines. As well as corporatizing and privatising a number of government agencies as already noted, changes included introducing performance related individual contracts for senior staff; increasing departmental management autonomy; changing financial management and reporting requirements for government agencies including moving from input-based to output based reporting; and departmental decoupling and decentralisation including promoting policy-operations and funder-provider splits. Contracting-out of government service became the norm. Large numbers of state servants were made redundant (Goldfinch 1998).

The Role of Ideas

Economic policy change in New Zealand was highly derivative of neoclassical economics and related schools of economics such as Public Choice and New Institutional Economics. Neoclassical economics focuses on the actions of (assumed) highly atomized, instrumentally rational and selfish individuals and firms. These are the building blocks that go up to make the model of the economy held by many neoclassical economists: that of a self regulating mechanism tending towards a state, where all resources, including labour, are employed. Some of the assumptions and methods of neoclassical economics have been extended to apply to the design of institutions, and to the study of politics and the public sector, in Public Choice and New Institutional economics. These provided guides to the redesign of the public sector and the design of legislation. The different components provided a more-or-less coherent policy paradigm in economic policy in New Zealand. This had the following characteristics.

First, a strong belief in the efficacy of the market in delivering the greater sum of welfare, efficiency and freedom, and hence a scepticism of attempts to regulate or replace it by government or other types of provision.

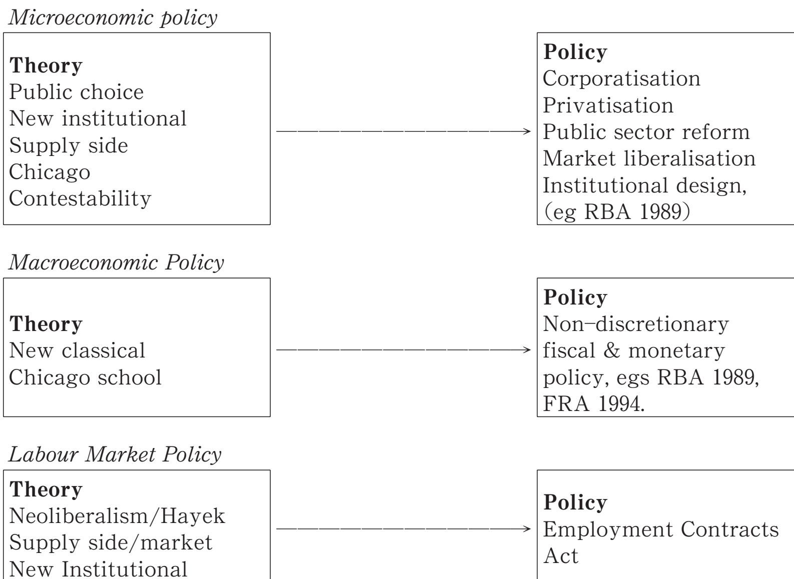
Second, doubt regarding the effectiveness of the government in macroeconomic policy, which shows itself in the avoidance of activist macroeconomic policy, including such measures as rule based monetary policy focused only on inflation (the

Reserve Bank Act) and legislative limits on fiscal spending (the *Fiscal Responsibility Act*).

Third, the concentration on optimising individuals within organisations and the public sphere saw management structures developed to focus on financial incentive driven performance (within the public service) and on limits on bureaucratic, political 'opportunism' and interest group rent–seeking, such as rule based macroeconomic policy and contractual arrangements (such as the *Reserve Bank Act* and the *Fiscal Responsibility Act*, and employment contracts in the public sector and in the *Employment Contracts Act*). The characterisation of interest groups in Public Choice as illegitimate vested interests gave cause to exclude them from policy formation.

These new ideas provided a ready explanation of New Zealand's apparently poor economic performance, and a set of simple and ideologically attractive policy solutions and responses. The method of transmission into policy making was often through domestically based policy makers, especially public servants from the strategically located Treasury and the Reserve Bank, as well the key ministers. These key 'policy entrepreneurs', sometimes educated in graduate programs in American

Table 1 Theoretical Influences on Policy Decisions 1984 – 94



Notes:
RBA is Reserve Bank Act which committed the Bank to combating inflation only and contracted the Governor to achieve an inflation rate (originally 0–2%). FRA is FinancialResponsibility Act, which tied the government into a 'fiscally responsible' path. Employment contracts Act introduced individual contracting in the labour market

economics departments in the late 1970s, were important in convincing their respective institutions and other policy makers to support the new policy directions (Goldfinch 1997; 2000a). They took these often cutting-edge theoretical ideas and applied them to the New Zealand situation in the years before the 1984 election and after. Table 1 shows the important ideas and the policies they influenced. As examined below, the simple policy making structures in New Zealand and culture of policy making allowed this small group of individuals from key policy organizations to dominate policy making and put their ideas into policy practice.

Economic policy Making 1984 – 1999

In New Zealand's simple unitary state, economic policy making structures can be simple and influence highly centralized and personalized. Under the first-past-the-post electoral system, Cabinet controlled the legislature, while the Treasury was by far by the most powerful public sector policy body, with the Reserve Bank in control of monetary policy after 1984. At a time when most interest groups were excluded from policy development, the Business Roundtable, with ties to both the Labour and National Governments and to the Treasury, and with the resources to produce a wide variety of policy submissions and reports on myriad policy issues, was able to wield important influence over some policy directions. Groups that would be expected to be influential during a Labour Government, such as the trade union movement and the extra-parliamentary Labour party, found themselves often excluded from economic policy making. As such, during the height of the reform process during 1984 – 94, economic policy making was highly centralized around a small group of policy elites sharing similar views on the benefits of economic reform along neoliberal lines. Policies were often developed in secret outside formal channels, and were delivered in large packages, and in some cases in the face of explicit election promises to the contrary.

In New Zealand's Westminster system, the Cabinet is responsible for policy decisions. Members of the Cabinet, along with ministers outside Cabinet, deputy and associate Ministers, parliamentary undersecretaries and the parliamentary whips, can sometimes be as much as half of the ruling party in what was a two party system until the mid- 1990s. Along with strict party discipline, this gave the executive decisive power in determining policy directions and legislation, so much so that the

New Zealand system has previously been described as an elective dictatorship (Mulgan 1992). The convention of collective responsibility of Cabinet also means that once a position is decided within Cabinet, this position will be presented to the House. This could give a small clique of ministers (or even a single dominating personality) within Cabinet immense power to set policy and drive through legislation. This was the case both under the Fourth Labour Government (particularly with Douglas as Finance Minister) and its National successor. Since the introduction of the proportional representation system, Mixed Member Proportional (MMP) in 1996 and the coalition and minority governments that can arise as a result, it is likely that this executive dominance has been reduced somewhat and parliament and coalition parties have become more important in economic policy making, although Boston and Church (2002) argue this should not be overstated.

The Treasury

The economic reforms are largely spelled out in two post-election briefing papers developed by the Treasury — *Economic Management* (1984) and *Government Management* (1987). Since before the Second World War Treasury has been the most powerful department in New Zealand with influence over almost all aspects of public policy. This power derives from a number of sources. Most importantly, the Treasury's role as the Government's principal economic and financial adviser and controller of Government finances gives it the function of overseeing general economic policy and of the policy directions of the department. It reports on all departmental submissions that have financial implications and has a key role in the budget process, including preparing forecasts and budget documents. The Treasury is also able to establish for itself a reputation for high quality advice, expertise and analytical strength, partly due to its comparatively large number of qualified policy and financial analysts and its comparatively greater control of policy resources and funding. This, along with a socialisation and training process, gives Treasury analysts a confidence and ability to press the well-established Treasury view in policy-making against competing perspectives (although on many economic policy issues there are no competing departmental views presented). The Treasury view is also permeated through the public service by the appointment of Treasury officials to top posts in other departments (around half of public sector chief executive have a Treasury background), and to senior positions in the private sector (especially in

the financial and consultancy sectors). Treasury has sometimes had strong backing in Cabinet because of the high ranking of the finance minister in Cabinet, as well as the support of the additional finance ministers. This support can be extremely important if there are close ties between Treasury and the Minister of Finance, which was the case during Douglas' and Ruth Richardson's (Finance Minister 1990-93) tenures. Treasury has also seconded officials to the leader of the opposition since 1975, with Treasury officials sometimes being an important influence on the formation policy preferences of opposition parties (Goldfinch 1997). An official was not seconded to the Labour opposition before their election in 1999.

Under the Labour coalitions elected after 1999, the Treasury has seen its power challenged to a limited extent by the conversion of the Ministry of Commerce to the Ministry of Economic Development, with an explicit brief to examine economic policy. There was some limited softening of the Treasury line under a Treasury secretary appointed from outside the organisation, but after his departure, the Treasury line has again hardened along stronger neoclassical lines. In the first term of the Labour Government (1999-2001), the Minister of Finance did not have a Treasury official seconded to his office - but did so in his second term (after 2001).

The Reserve Bank

The Reserve Bank is in charge of monetary policy and oversees the operation of the financial sector, but also provides general economic policy advice, especially on macroeconomic policy. The Reserve Bank sees its role as:

operating monetary policy so as to maintain price stability,
promoting the maintenance of a sound and efficient financial system,
meeting the currency needs of the public (Reserve Bank 1997).

While not as important as Treasury in driving economic changes of the 1980s and early 1990s, in a number of areas such as financial liberalisation and the float of the dollar, as well as the broad focus of monetary policy aimed towards disinflation, the Bank provided key influential advice. At the same time, the Bank was recommending macroeconomic policies that were not significantly different to the Treasury line, providing broad support for the changes.

After the change of Government in 1984, the major purpose of monetary policy became inflationary control in the medium term and was largely left to the control of the Reserve Bank. The *Reserve Bank Act* 1989 gave the Bank greater independ-

ence in determining monetary policy with a 0–2 percent inflation target to be achieved within an agreed time frame (originally December 1992, but actually reached before that). The inflation target was broadened out December 1996 as part of the new coalition agreement between the National Party and New Zealand First. Price stability was now defined as annual average price increases between 0 and 3 percent. This 0–3 percent target was maintained by the Labour–Alliance coalition elected in 1999. In September 2002, price stability was redefined and somewhat softened to annual increases in the Consumers Price Index (CPI) of between 1 and 3 per cent on average over the medium term.

The Fiscal Responsibility Act 1994

Since the passing of the *Fiscal Responsibility Act* in 1994, there has been an improvement in the transparency of the budget process. The Act, as its name suggests, requires the government to be 'fiscally responsible'.[1)] This involves formulating and reporting its fiscal policy objectives to Parliament. The Government must report to Parliament how it is to comply with these fiscal principles, any departure from them must be justified, and an explanation must be given to when they will be complied with in the future. The Act also requires disclosure of the fiscal consequences of economic policy decisions, which includes publishing three year forecasts every half year, and four to six weeks prior to a general election. Forecasts include the usual financial statements, as well as a statement of fiscal risks and contingent liabilities, which describe and (if possible) quantify the fiscal risks associated with the forecasts. The Minister of Finance and the Secretary to the Treasury sign statements of responsibility declaring that all policy decisions have been included in accordance with the Act, and that the Treasury has used its best professional judgement in preparing the fiscal impacts of the policy decisions.

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1) Responsible fiscal management is defined as the following:
- Debt should be reduced to prudent levels;
- Operating expenses should not exceed operating revenues over a reasonable period (i.e. budget deficits should not be maintained);
- Crown net worth should be maintained at sufficient levels to counter adverse events;
- The fiscal risks facing the Government should be managed prudently, and;
- Fiscal policies should be consistent with predictable stable tax rates.

Changing Policy Styles after 1984

New Zealand's simple political and policy-making structures have always left the possibility that a tiny elite could dominate policy making. However, before 1984 policy making in New Zealand was generally participatory. Interests groups and elites were formally and informally included in the policy-making processes, and policy making structures were set up during the post-war era to facilitate this. In contrast, after 1984, interest groups, with the notable exception of the business interest group, the Business Roundtable, were often excluded from policy-making processes. Policies were developed by a small group of elites, sometimes in secret, and sometimes introduced contrary to promises otherwise. This change of style in policy making can be seen as due to the following: First, the perception of poor economic performance supported a belief that usual methods of policy making were not appropriate and that radical change needed to be introduced quickly. This feeling of crisis was intensified by the run on the currency during the 1984 election campaign. This allowed policy initiatives already developed by Douglas and the Treasury before the election to be quickly rolled out, with little opposition expressed from other policy makers and politicians. As Prime Minister (1984-88) David Lange noted in an interview:

> If we had been elected in the normal course of events in 1984 we would have had a victory session of Parliament, and come back in February. We would have been a reforming government at a very slow pace and we would have made no huge difference to New Zealand. But we came in, we hit the deck running, and it is a remarkable credit to our cohesion and ability to work together, and I suppose our basic intelligence and youth, that we went through a period of extraordinary crisis and persuaded the country.
>
> The [currency] crisis was absolutely critical to what we did. On the Saturday night [after the election result] I heard [defeated Prime Minister] Muldoon say congratulations, but I've got bad news for them. Sunday, when I heard the bad news, I actually considered calling in the World Bank because I didn't see how we could get away doing the radical things that we would have to do and still remain clean from charges of being politically duplicitous and having abandoned all our promises. Then Muldoon put on an absolutely virtuoso performance destroying the economy that we

> inherited — scorched earth television performances — and the whole of New Zealand knew we were in crisis. He wanted a revolt against us so he could take control in three weeks but all that happened was we took control of it. He convinced them there was a crisis, and we made a response.

Second, Public Choice theory was influential in developing a belief that interest groups were vested interests that should be excluded from policy making, and that, in fact, interest group influence had previously contributed to New Zealand's relative decline. Public Choice views of policy making accorded with the elitist and technocratic views of leading policy makers and politicians. As Finance Minister from 1984－88 Roger Douglas (1993, 220－221) noted in his book *Unfinished Business* :

> Do not try and advance a step at a time. Define your objectives clearly and move towards them in quantum leaps. Otherwise the interest groups will have time to mobilise and drag you down.

Third, leading policy makers formed a close (and often relatively closed) trust and reciprocity policy community in the Wellington as they were educated and worked together. The influence of members of this network increased as they were appointed (and appointed each other) to key positions within the public and private sector. Links were further cemented through shared memberships of international organisations such as the OECD, the World Bank and the IMF and with neoliberal think tanks and associations such as the Australian Tasman Institute, the Centre for Independent Studies and the Mont Pelerine Society (Goldfinch 2002). A former departmental chief executive described this process in an interview as follows :

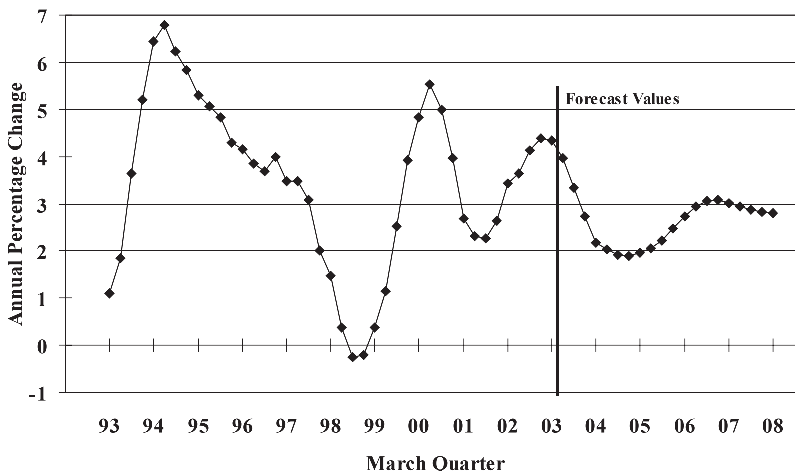
> There was a cadre of us . . . a couple of dozen people and they exercised influence in a mighty way. We had been at university together, sometimes taught each other and were very compatible. Scott, Kerr, Cameron and Wilkinson in the Treasury, and one or two others in the Reserve Bank.
>
> It was only when [businessman] Ron Trotter decided that the business community had to support the Government reforms that he got Roger Kerr to head the Roundtable and used him to persuade all the other [business people]. So people like Trotter who originally used to be a real rent seeker . . . gradually became a convert . . . and Ron was fantastic. Elworthy led the Federated Farmers. [Roderick Deane, a

> Deputy Governor of the Reserve Bank] asked [Finance Minister] Roger Douglas to ask Elworthy to come on the Reserve Bank board. Then we got Ron Trotter on the Reserve Bank Board.
>
> And then [Deane] knew people like [businessmen] Allan Gibbs and John Fernyhough ... and persuaded them to give a hand in running these new [state owned] corporations and persuaded the government to appoint them as chairmen of these new corporations.
>
> So it was all a network of twenty people who had been talking about these ideas for a long time. In opposition was [future finance minister] Ruth [Richardson]. So through that period people like Roger Kerr and [Deane] would interact with [future National ministers] Simon Upton and Ruth [Richardson].

The Effects of the Reforms

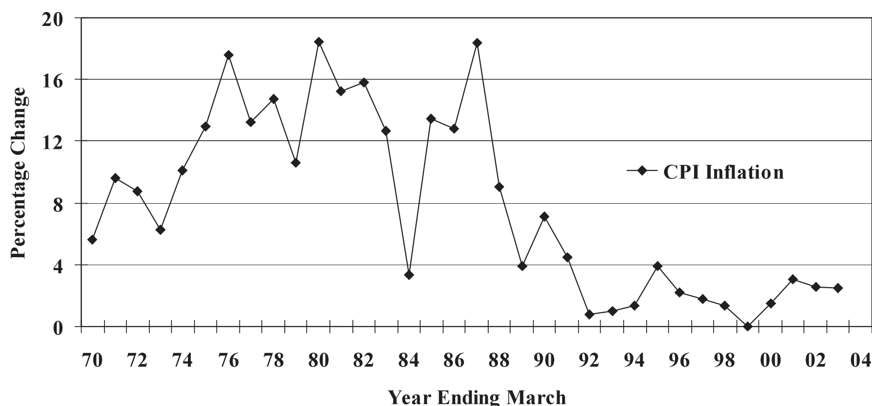
Economic Indicators

Change was extensive, comprehensive and rapid. While policy reformers were able to achieve their policy aims to a remarkable extent, and notwithstanding claims that New Zealand provides an exemplar of economic policy reform, there is considerable debate as to whether the changes has been entirely positive. To some extent, it depends where one looks. Poor economic growth performance was particularly marked in the post-stock crash era of 1987－92 when New Zealand real GDP per capita declined markedly against the OECD, despite strong terms of trade and the booming world economy of the late 1980s (Fig. 3). From 1984 to 1994 GDP per capita declined 10 percent against the OECD average (OECD 1996, 3). In general since 1993 New Zealand's economic growth has been similar to OECD averages, albeit with a recession during 1998. Since 1999 economic growth has been steady, assisted by strong export commodity prices (Fig. 4). Compared to Australia however, a country with a similar growth performance until 1987, New Zealand has performed comparatively badly (Fig. 3). In 2002 GDP per capita measured on a purchase power parity basis was 85 percent of the OECD average, compared to 94 percent in 1984 and close to the OECD average in 1970. The OECD ranking on a per capita GDP (PPPs) in 2002 was twentieth, compared to nineteenth in 1980 and ninth in 1970. In general, it can be said that New Zealand's relative GDP per capita decline against rest of the OECD, a factor since the 1960s, seems now to have ceased, although no



Notes.
1. Source : Dalziel and Lattimore (2004), Graph 10. 1. The data from March 1993 to March 2003 are actual data. The data from June 2003 to March 2008 are forecast data made in September 2003

Figure 4 Economic Growth and Forecast Growth. Real GDP

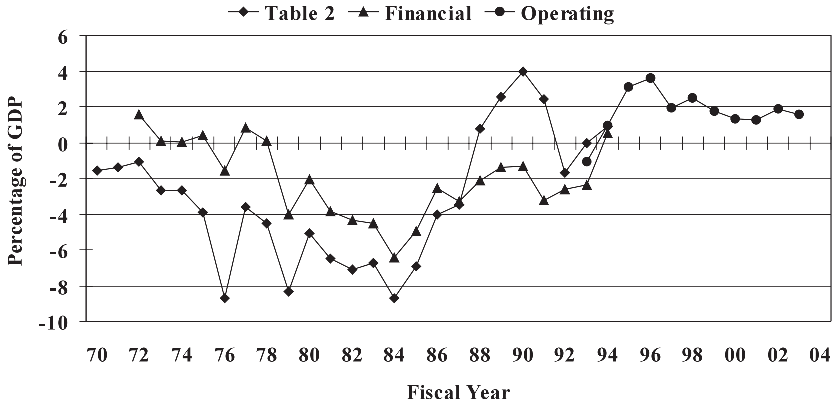


Notes.
1. Source : Dalziel and Lattimore (2004), Graph 5. 2.

Figure 5 CPI Inflation 1

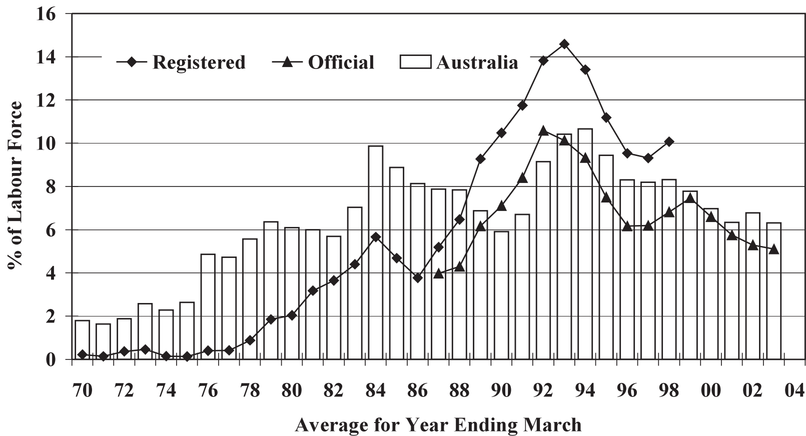
improvement in the relative OECD ranking has been achieved.

On consumer price inflation New Zealand has performed well and better than many of its trading partners (Fig. 5). On fiscal balances, New Zealand has been in surplus since the early 1990 (Fig. 6). Public debt has declined since its height in the mid- 1980s, with net public decline declining to 15 percent of GDP by 2003 (Fig. 2). Unemployment was at 4.3 percent in the March 2004 quarter, the fourth lowest



Notes.
1. Source : Dalziel and Lattimore (2004), Graph 6. 1.

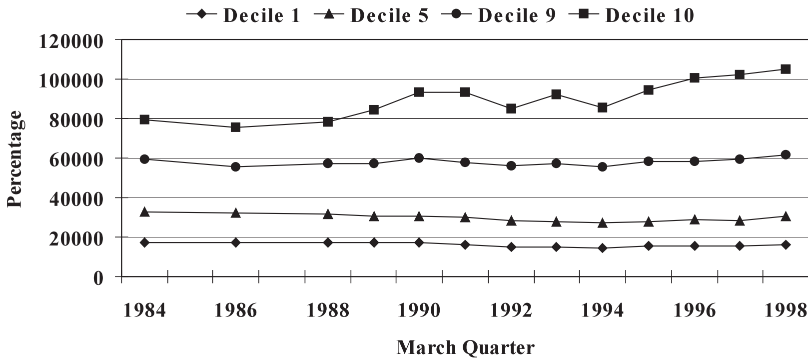
Figure 6 Fiscal Balance 1



Notes.
1. Source : Dalziel and Lattimore (2004), Graph 2. 3.

Figure 7 Unemployment 1

in the OECD, and approaching the low levels of unemployment existing before the reform process (Fig. 7). Income disparity has increased markedly and probably at the fastest rate in the OECD during the 1980s and 1990s, and New Zealand is not now the egalitarian society once enshrined in its political myths. Those in the top deciles have seen their relative incomes improve considerably (Fig. 8). The *Employment Contracts Act* of 1991 achieved one of its unstated aims — the reduction of the power of the trade unions — with union coverage declining catastrophically from 42.5 per-



Notes.
1. Source : Dalziel and Lattimore (2004), Graph 3. 2.

Figure 8 Income Distribution 1

cent of the employed workforce in 1991 to 17 percent by the end of 1999 (May et al 2001). The International Labour Organization noted the Act was in violation of conventions to which New Zealand was a signatory. With the enactment of the *Employment Relations Act* in 2000, union membership has shown some recovery with coverage being 21.7 percent of the workforce in 2002. Labour productivity growth has been well below the OECD average since the early 1990s. Some problematic aspects of the privatisation process, particularly its haste and the low prices achieved in some asset sales, have been noted (Goldfinch 2000b). Sale of some state agencies, particularly in information technology, considerably undermined skills and capacity in the public sector, which contributed to a number of serious policy failures. In some cases, failure of key privatized industries such as the airlines and the railways forced the fifth Labour Government (elected 1999) into recovering ownership.

Political Impact of the Reforms

While policy makers in New Zealand were effective in achieving many of their aims of policy makers, economic reform led to significant opposition, electoral instability and the undermining of the legitimacy of the political system. While opponents were largely ineffective in modifying the new policy directions, the volatility of the electorate in the late 1980s suggests that opposition to the new policies and politics of Rogernomics became widespread and intense, especially following the 1987 election. Factional disputes inside the Labour Cabinet led to a number of resignations and sackings of ministers, culminating in the resignation and replace-

ment of Prime Minister David Lange by Geoffrey Palmer in 1989. Palmer himself was replaced by Mike Moore just a short time before the 1990 election. Rapid change in prime ministers is highly unusual in New Zealand politics.

In 1990 the Labour Government lost the election in a landslide to a National Party that seemed to promise a move away from the economic liberalization agenda. However, after the National Government intensified the reform programme and broke a number of its election promises, it too found its support evaporate and its large majority slip to just one seat after the 1993 election. The two party system that had dominated since the 1930s also suffered stress, with some of the left of the Labour party led splitting in 1989 to form the New Labour Party (later part of the Alliance, then the Progressive Coalition), some of the right (including former Labour finance ministers) later forming the market liberal Association of Consumers and Taxpayers (ACT), while a former National Minister Winston Peters formed the populist New Zealand First party in 1993. These small parties (or their descendents) continue to play a significant role in the New Zealand parliament, with all gaining representation under the proportional electoral system introduced in 1996.

The 1993 election saw the endorsement in a referendum by the electorate of a shift from plurality (first-past-the-post) voting to a proportional system based on the German Mixed Member Proportional system. This was despite the change being opposed both by leading politicians and a well-resourced advertising campaign funded by big business. As Mulgan (1997) points out, such radical constitutional change is usually found only after severe stress such as that experienced after a loss of a war or following a revolution, and is normally evidence of a breakdown of political legitimacy, suggesting the reform process induced considerable political stress. It is unlikely that without the simple political structures that existed in New Zealand, and particularly the first-past-the-post majoritarian electoral system that normally delivered a majority government and a dominant executive, that the reform process could have been maintained in the face of such opposition.

Change Under the Labour Government Elected in 1999

The Labour-Alliance coalition was elected in 1999 on a rhetoric that rejected the hard-line economic liberalisation followed by the previous two governments, and questioned the wisdom of aspects of the reform process. While it has maintained the

stable macroeconomic policy focussed on inflation control (albeit in a considerably less doctrinaire manner), the Labour Government has moved away from the rhetoric of free markets and increased government support for regional and industry development and research and development, made some increases in the welfare state, reversed some privatisations and repealed the anti-union *Employment Contracts Act* 1991. Marginal income tax rates for 'high income' earners were slightly increased. This modest change of direction exited some opposition from champions of neo-liberal theories, such as the Business Roundtable. However, rather than these changes causing economic collapse as suggested by the some of the more hysterical opponents of the Labour Government, the economy has been generally been performing well since 1999.

One of the more significant changes under the Labour Government is the rejection of the 'hand-off' approach to industry policy and a focus on assisting identified key sectors within the economy; what was termed, largely pejoratively, as 'picking winners' in the rhetoric of the 1980s and 1990s. However, rhetoric has often out-stripped action, and government assistance to industry remains modest. On 12 February 2002 Prime Minister Helen Clark released the Government's policy framework, *Growing an Innovative New Zealand*. The three key elements of 'strengthening the economic foundations,' 'investment in innovation, talent and global connectedness' and 'sectoral policies focussing on the bio-technology, ICT and creative sectors,' are somewhat short on specifics, but led to a further group of initiatives. Four taskforces were established in May 2002 in biotechnology, ICT, screen production, and design, to report in response to this new strategy. Provision was been made for $NZ 110 million in 2003/4 over four years to fund initiatives developed in response to the Taskforce reports. The Budget 2003 boosted funding for R&D, including private R&D and industry-led collaborative research ventures. The government also made available $NZ 100 million for the venture capital market while the 2002 budget included a modest fund of $NZ 6.5 million in 2002/03, increasing to around $NZ 8 million by 2004/05, to attract more domestic and foreign investment. The 2004 Budget included $NZ 500 million to fund a series of 'Growth Innovation Framework' initiatives in the areas of 'international connection', 'innovation', 'skills and talents', and 'infrastructure'. There were also a number of other industry assitance packages offered by various government agencies.

The *Employment Relations Act* enacted in 2000 repealed the *Employment Contracts*

Act and provided procedures for collective bargaining for employees who were union members. Unions are allowed access to workplaces to recruit members and deal with employment matters, and a new free and 'proactive' mediation service was established. The new act has encouraged a small growth in the number of unions and of union membership, reversing a decline trend that had lasted since the mid–1980s.

There has been a modest reversal of the presumption towards privatization. The most significant was the government approval of the establishment of the state–owned savings bank, KiwiBank, in February 2001, with its first branch opening a year later. Somewhat ironically, KiwiBank is under the aegis of the State Owned Enterprize, New Zealand Post, which had previously operated the post office savings bank privatized in 1989. After the impending collapse of the one–time government owned airline Air New Zealand in 2001, the New Zealand government made a significant capital injection into the business, some of which it later sold at a profit. It still maintains a significant ownership. The poor performance of the privatized railways and considerable under–investment in rolling stock and infrastructure, saw the government purchase the rail network for a nominal sum of ＄NZ 1 in a deal with the new private owners of the railways. The government now faces the prospect of investment of ＄200 million to rebuild the rail system after a decade of neglect. However, despite the rhetoric against the sale of state assets, there has been the sale of the State Owned Enterprise mapping organization Terralink in 2001, after it went into receivership. Others argue there is still a presumption towards privatization, particularly from the Treasury, although now couched in the technical and rather impenetrable language of accounting rather than economics (Newberry and Pallot 2004).

Conclusion

New Zealand provides a dramatic example of economic liberalisation. In little more than a decade, a comprehensive series of measures were introduced that turned New Zealand into the freest English–speaking economy and one consistently ranked third in the world by various measures of economic freedom. New Zealand was meticulous in following the policy prescriptions of neoclassical and public choice economists, in some cases lifting policies more–or–less from theoretical treatises.

Consequently, for a time New Zealand became the darling of the assorted champions of neoliberal theories, including the IMF, the World Bank, the OECD and various right-wing think tanks.

The economic success of New Zealand is, however, modest. On some economic indicators it has performed well. However, despite doing nearly all asked of it by economists, after 15 years of reform New Zealand has only recently ceased its decline against the rest the OECD average in terms of GDP per capita (PPPs). It suffered a long period of stagnation in the late 1980s and early 1990s. It has also been somewhat lucky — the periods of strong economic growth in the mid-1990s and early 2000s coincided with high prices for its agricultural export commodities, upon which its export receipts still mainly depend, as they did before 1984. Compared to its near neighbour Australia, which liberalized its economy in a more gradual and less doctrinaire manner and explained and brought its population along with the changes, New Zealand has performed relatively badly in terms of economic growth. There are also a number of countries that have not acted entirely in accord with the theories of neoclassical economists — Ireland and the Netherlands being two dramatic examples — but have far outperformed New Zealand. The Labour-Alliance coalition elected in 1999 has questioned aspects of the reforms and made modest adjustments to some policy settings. Critics, sometimes of a nostalgic bent, have regretted some of the social changes introduced by the reforms — the growth of a US-type individualism, the undermining of norms of egalitarianism, and the increase in income inequality. The reform experience of New Zealand at least calls into question the often over-blown claims made by the champions of free-market reforms.

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