



NEW ZEALAND: DEVELOPING AND SUSTAINING ECONOMIC LIBERALIZATION

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NEW ZEALAND UNTIL THE 1980s¹

In the early 1980s, New Zealand was sometimes seen through a romantic haze, and indeed it still is when nostalgia revives earlier romantic myths. New Zealand could be conceived from overseas as an idyllic rural pleasure park. It was overwhelmingly green, the climate varying from subtropical to temperate but never unpleasant for long. The snow was sufficiently well behaved to remain on top of mountains where it did not interfere with normal traffic and everyday life but was ideal for winter sports. Various attractions like geysers and volcanic wonderlands provided variety for tourists, largely Japanese, as they traveled from golf course to golf course, largely unimpeded by any local population.² The few local inhabitants were not all that enthusiastic about providing services, but there were too few of them to impede holiday-makers from abroad. They were surprisingly complacent despite a standard of living that remained static and therefore fell behind what was being experienced elsewhere.

New Zealand may still be seen like this, but there is another story also. It is a story of a country that developed as an agricultural supplier for Britain, suffered the problems of relying on agriculture and a single market as the driver of the economy, went through a period of strong governmental control of the economy and which has now developed as a diversified market economy.

¹ For relevant sources, see G.R. Hawke, 'New Zealand', Joel Mokyr, ed., *Oxford Encyclopaedia of Economic History* (Oxford: OUP, 2003); G.W. Rice (ed.), *Oxford History of New Zealand* (Auckland: Oxford University Press, 2nd ed., 1992).

² The image of New Zealand as a 'beautiful, empty golf course' was advanced by Japanese Prime Minister Kishi on a visit to New Zealand in 1957 when memories of World War II were still sufficiently fresh for it not to be entirely appreciated. Bruce Brown, 'Traders and Investors, 1960s to 1990s', in R. Peren ed., *Japan and New Zealand: 150 Years* (Palmerston North: NZ Centre for Japanese Studies, 1999), p.154

New Zealand is a society and economy built on international trade from its entry into the international economy in the nineteenth century. From the middle of the nineteenth century exports of wool, meat and dairy produce provided levels of real income per capita which were high by contemporary international standards. New Zealand skills and resources served international demand, choosing the market that provided the greatest economic return, which, for nearly a hundred years after about 1870, was mostly Britain. In line with conventional ideas of specialization, New Zealand used international trade to turn a small range of exports into a consumption pattern that was much like that of other relatively rich societies in the world. From the 1870s onwards, society demanded a range of goods and services, and many local activities were directed towards providing that range, often by transforming imported components and materials into products that satisfied the desires of local consumers. From early in its history, despite the composition of its exports, New Zealand was overwhelmingly an urban society, although dominated by towns that were small relative to the cities that existed overseas. New Zealand was a settler society in its dominant economic activities and social attitudes. It was informed by a belief in 'development', building a bigger society and economy while maintaining living standards that were higher than those being experienced in the United Kingdom, from where most of the settlers traced their ancestry. A bigger and better society meant that opportunities were created for a range of skills and aptitudes, and so tariffs and other devices were used to promote local industries and services.

Similarly, the social attitudes of New Zealanders were governed by rejection of some aspects of European societies. New Zealanders felt that prestige and position should go with achievement rather than with birth; that achievement should be measured in terms of utility to a developing society rather than by ancient ideas that some occupations carried more status than others. There was a kind of learning by experience that culminated in something very like the ideas of 'Equality' that were eventually articulated by English radicals such as Tawney:

It is possible to conceive a community in which the necessary diversity of economic functions existed side by side with a large measure of economic and social equality, and in which, therefore, while the occupations and incomes of individuals varied, they lived, nevertheless, in much the same environment, enjoyed similar standards of health and education, found different positions, according to their varying abilities, equally accessible to them, intermarried freely with each other, were equally immune from the

more degrading forms of poverty, and equally secure against economic oppression.³

These key characteristics of ‘development’ and ‘egalitarianism’ underwent change in the fifty years from the 1930s to the 1980s. The indigenous idea of equality was assimilated to the modern international concept of equality as measured by income distribution in terms of shares of total income according to placement in deciles of the population. It came to be widely believed, mostly erroneously, that New Zealand was characterized by an unusual degree of equality in that sense. And indigenous promotion of a range of activities so as to provide for the skills and aptitudes of New Zealanders was assimilated to the international endorsement of ‘import substitution industrialization’.⁴ There was uncertainty from the 1930s to the 1980s over whether industrial growth was sought as an instrument of economic growth and modernization or whether it was essentially an ‘employment sponge’.

By the 1980s, far from being an idyllic pleasure park, New Zealand faced major challenges. Its society and economy had been built on an expectation of incomes that were high in international terms, and indeed towards the top of the Organisation for Economic Co-operation and Development (OECD) league table. While different means of measurement give different results, and while the precise period under consideration can significantly affect the exact relative ranking of New Zealand, there could be no doubt by the 1980s that New Zealand’s position was deteriorating.⁵

Fundamentally, in the international economy, agricultural trade was not growing as fast as industrial trade. New Zealand was not well placed in relation to what had become the major engine of growth in the international economy: the exchange of manufactured goods among pairs of industrialized economies. This owed something to the way in which international trade policy evolved through the GATT, but it owed a great deal to the relative change of productivity in industry relative to agriculture.

Furthermore, among industrialized economies, Britain grew relatively slowly. For whatever reason, New Zealand’s major market did not facilitate economic growth at the level needed to maintain New Zealand’s OECD ranking. What is more, Britain was sharing a European predisposition to

³R.H. Tawney *Equality* (1931), p.87.

⁴Henry J. Bruton, ‘A Reconsideration of Import Substitution’. *Journal of Economic Literature* XXXVI (June 1998).

⁵Peter Mawson, ‘Measuring Economic Growth in New Zealand’. *New Zealand Treasury Working Paper* 02/14 (September 2002). www.treasury.govt.nz

preserve its national markets for agricultural products to its own domestic producers.

The elements of these challenges came together in Britain's entry into Europe in 1973. But while that event posed an enormous challenge to the assumptions and thinking of political life it merely brought into sharp relief the underlying economic challenge.⁶

Throughout the 1960s, and even earlier, while there were fluctuations in political and policy debates, the basic thrust of New Zealand's policy towards economic growth was for 'diversification'. The old idea of 'development,' while not dead, had given way to a search for higher average per capita incomes and the basic strategy was to seek higher growth through higher export growth, which was to be achieved by providing a greater variety of products to a bigger number of markets. The limitations imposed by Britain's relatively slow growth would thereby be evaded. Different products would at least moderate the constraining effect of agricultural protectionism. (Diversification of products did not necessarily mean a move away from agricultural products or at least from primary production. Diversification included forest products, dairy products other than butter and cheese, and meat products that served new markets). Promotion of industries and services in New Zealand, the argument went, should be directed towards support of this diversification rather than to the essentially social objective of the level and composition of employment.

The diversification strategy had considerable success despite the current tendency to look back on the 1960s as wasted time. However, the strategy encountered the oil crises of the 1970s. In the transfers of international income that resulted, there was a contraction of all of New Zealand's major markets, including those that had been newly developed, often with different products. Diversification is a good policy against concentrated risks; it is of little value when all markets contract together.

Diversification was persisted with—and adapted to a search for New Zealand markets in those areas where the economics of oil generated higher incomes. The Middle East became a significant market for sheepmeat and even for dairy technology. Furthermore, New Zealand had some hydrocarbon resources and in the changed international environment, they had enhanced value. Policies were developed to take advantage of them. However, these

⁶ And is only now starting to generate serious historical scholarship as distinct from informed participant commentary. See Stuart Ward, *Australia and the British Embrace: The Demise of the Imperial Ideal* (Carlton Sth: Melbourne University Press, 2002).

policies were not well managed. They were driven by ideas of self-sufficiency and technical efficiency rather than adaptation to international market trends. The ‘growth projects’ were not integrated into economic adjustment in general but were treated as though they were independent ventures. By 1984, it was fairly clear that the existing broad economic strategy had reached a dead end.

There were, however, some positives already in place. Realization that the economics of resource use could not be ignored in the interests of promoting employment had led to some practical effects. Transport delicensing had begun—and transport costs were significant in the topography and geographic position of New Zealand. Most important of all, the Australia New Zealand Closer Economic Relations agreement (CER) had been implemented in 1983. It resulted from the work of a few far-sighted officials and ministers who realized that generalized diversification was not going to be enough and that New Zealand activities would necessarily be more tightly integrated with the international economy. The importance of CER was not the ‘gains from trade’ of the classical economics textbooks but the political economy effect of building a constituency of support for economic adjustment whereby the use of New Zealand resources—human and natural—was guided by their value in international markets.

By the early 1980s New Zealand was ready for a significant transformation of its economy. The components for this were in place. New Zealand was a long-established trading economy; even, one could say, a globalized one. In pursuit of transformation there was no need to abandon the national concept of egalitarianism and the role of the individual in society and in the economy. There was no sudden change from a political entity intent on security to a new individualism, let alone selfishness; the nature of egalitarianism had been under debate for a long time, and the idea that industries should be turned from employment sponges to elements of diversified exports was at least as old. What was sought after 1984 included intensification of existing trends as well as dramatic change.

THE ‘REFORMS’

The content of the reforms is reasonably well known.⁷ A new government was elected in 1984, and at least partly because of the unexpected timing of a

⁷L. Evans, A. Grimes, and B. Wilkinson, with D. Teece, ‘Economic Reform in New Zealand 1984-95: The Pursuit of Efficiency’ *Journal of Economic Literature* 34 (4) (1996), pp.1856-1902; B. Silverstone, et al, *A Study of Economic Reform: The Case of New Zealand* (Amsterdam, etc: Elsevier, 1996); Graham Scott. *Public Management in New Zealand: Lessons and Challenges* (Wellington: NZ Business Roundtable, 2001).

'snap' election, it had fewer commitments to pressure groups and vested interests than most governments. Furthermore, it marked a change of political generation and was led by people whose eye was on the future and on New Zealand's standing in the OECD league table, and who were not much concerned about preserving what had seemed to be the purely local achievements of reconciling social and economic aspirations. However, leading politicians had an unusual degree of interest in history. On several occasions they genuinely decided that they were less interested in the next election result than they were in their place in history along with the other great reforming governments of the past—those of the 1890s and the 1930s. The apparent tension between irreverence for the past and an eye on history was reconciled by an insistence on looking for what was really important—not the specific institution which could so easily become a vested interest but the gain in social well-being which was the ultimate objective. 'Equity and efficiency' could become a mere slogan, but it also drove a willingness to reassess policy from first principles, and to base decisions on policy analysis rather than political compromise.

Political influences were far from absent. There is near-consensus that the economic reforms of the 1980s were wrongly ordered, and there is a strong theoretical case that reforms should proceed such that responses to them are orderly. Participants in labor markets are slow to respond and therefore labor market reform should be early in a sequence. Financial market participants quickly exploit all opportunities, and consistency of social and private objectives will be facilitated if financial liberalization is late in the sequence of reform. The New Zealand reforms were in the inverse (and wrong) order.

This owed something to the political pressures against labor market reform—the Labour government retained ties to the trade-union movement—but it was in any case dictated by what was feasible. The traditional governmental controls on the financial sector were undermined by technical developments—credit cards and electronic funds transfers—and by the lack of credibility of governmental instructions to continue to subject payments to bureaucratic scrutiny. The theoretically ideal sequencing was simply not possible.

Political pressures were more significant in the choice of a balance of fiscal and monetary policy. It was apparent to informed officials that there would be pressures on the tradeables sector if the government relied on monetary policy to restrain inflation while adhering to an expansionary fiscal policy. However, the government felt that it could not restrain expenditure as much as

recommended because of the implications for beneficiaries of expenditure on education, health and social welfare.

Politics was also significant in the general pace of reform. Although Minister of Finance Roger Douglas, a leading architect of the reforms, may well have believed that the optimal strategy was ‘crash through or crash’, as he later argued, and although the government did maintain the momentum of change so as to build a consensus for change and to avoid frustrating delaying tactics, in practice more pragmatic decisions were made. The better characterization of the process was often the ‘marshmallow theory’ of David Caygill, that policy-making was like the chocolate selection of one who prefers soft centers—press and if it gives way, press further, and if it still gives, eat; if it resists, turn to another choice.

These accommodations of political pressures were probably much more important than any implicit compromise between different extremes of the political spectrum over domestic and external policy. It is sometimes suggested that the ‘left wing’ conceded an individualistic economic policy in turn for a ‘radical’ foreign policy and specifically for abandonment of the ANZUS Treaty. There is no doubt that in the political sphere, some people thought along those lines. But domestic policy was not a simple adoption of something different from traditional Labour Party values—the simplest statement is that it sought traditional objectives in modified ways that suited changed international circumstances, although there was always room for debate over whether unintended consequences were being properly evaluated. Foreign policy choices were not entirely dictated by specific political positions either; the ANZUS decisions, while controversial, had much cross-party support, especially by organizations such as International Physicians Against Nuclear War. The decision of the National Party to concede on ANZUS and nuclear issues generally before the 1990 election reflected its reading of the balance of opinion in the electorate and among its own supporters.

The important link between economic policy and the spheres of international relations and security strategy lay elsewhere. The dimensions of security most affected were ‘human security’—satisfying the material aspirations of New Zealanders, and giving a sense of confidence and assurance in looking outwards to the Asia-Pacific region and the world. The strongest implications in international relations were in creating links to the fastest-growing components of the world economy, most of which were in Asia, while taking care to provide buffers against adverse events in the international economy, buffers which were appropriate and sufficient for the circumstances of New Zealand.

The reforms were built on a wish to use market signals to facilitate the derivation of higher incomes in New Zealand through the use of New Zealand labor, skills, and materials to service international demands. The continuity with 'diversification' is obvious. But the change was also great. The basic idea was to abandon a strategy that could be characterized as identifying New Zealand resources, using them to generate products, and transporting those products to a grateful world (and then feeling betrayed because the world was not only far from grateful but seemed determined to erect additional barriers against those products). That strategy should be replaced by one that began by identifying markets, made sure that there were good communications of all kinds between the ultimate consumers and producers in New Zealand, ensured that New Zealand had the skills needed to service the market demand, and only then worried about the material and other resources which would be used in doing so. That drew on international thinking, especially on economic thinking, and it was a challenge to inherited and familiar ideas in New Zealand, especially ideas that were familiar to those whose specific knowledge was not in economics.

The change in strategy was effected in practical steps whose connections and rationale were not always apparent. Protection was removed in order that the allocation of resources within New Zealand should be guided by international market signals. It was more comfortable for New Zealand trade negotiators who would no longer have to justify New Zealand protection; but that was a minor motivation. Domestic interests found it hard to comprehend that the end objective of activity was not the promotion of exports but the efficient use of New Zealand resources; they thought they were being asked for something new and at the same time required to be more self-reliant and genuinely private-sector in nature; but that was not the motivation either.

The strategy generated public-sector reforms, initially in the corporatization and privatization of state trading activities, and then in the management of core public-service departments as well. Again, discussion often revolved around 'reliance on the market', the relative performance of public and private sectors, and even the sale of public assets to reduce fiscal imbalances, but the key strategy was that enhanced efficiency of resource use could not be achieved if large proportions of total land and capital were tied up in an inefficient state trading area, or if regulatory policy did not create incentives in line with international market signals.

And the signals would not be read properly if relative price changes were buried in general inflation. While the Reserve Bank Act (1989) had political intentions in ensuring that information could not be concealed from the

electorate, its fundamental rationale was clarification of market signals—that is, of what international consumers valued most highly among the potential outputs of New Zealand activities.

One of the issues about the reforms was always their duration. Throughout the 1980s, there were many who accepted that change was necessary but who wanted it to be finite. The reforms should be expedited, and then terminated so that life could return to normal. The world did not stand still, however. Nevertheless, nostalgia soon substituted for reality in looking back to the 1960s.

The 1990s were in part a continuation of the 1980s but also saw moves into new directions, sometimes influenced by the swing of the political pendulum, and sometimes responding to changes in the international economy. The Fiscal Responsibility Act (1994) clearly continued the public sector reforms of the 1980s, joining the Reserve Bank Act in ensuring that key economic and fiscal activities had to be communicated to the electorate.

As in any democracy, government determines the goals, but the legislation now provides for regular public statements (by officials rather than politicians) commenting on them. The Secretary of the Treasury and the Governor of the Reserve Bank are both required to tell the electorate whether current policy stances can indeed be expected to further the government's goals.

The National Government, elected in 1990, tried to move forward with strategic policy development built around 'economic opportunity' and 'social cohesion'.⁸ The choice of these objectives is interesting in that each of the key objectives has both economic and social elements. This proved to be too difficult for popular understanding and could not be preserved against the attractions of the familiar 'economic' and 'social' simplified dichotomy. Integration of 'economic' and 'social' had long loomed large in policy debate and practice—within the idea of 'development', in the discussion of 'equality', in the objectives of industrialization, in the Task Force on Economic and Social Planning in 1976 which led to the foundation of the New Zealand Planning Council (1977-91), in the 'equity and efficiency' focus of the 1980s, and in the strategic planning of the 1990s. It still looms large in the 'transformation' strategy of the current government. No stable equilibrium has

⁸ 'National' is the name of a political party and 'National Government' is not a coalition government such as is often found in periods of national crisis in many countries. From 1936 to 1996, the National and Labour parties were the two dominant contestants for political office. Since 1996, a changed electoral system has seen them joined by other contestants.

been reached—that is, in no case has there been a widespread consensus that social and economic integration has been achieved.

‘ECONOMIC LIBERALIZATION’?

I have written about the New Zealand experience as a major change of direction with economic and non-economic implications. Is it correctly characterized as ‘economic liberalization’? It involved a great deal of economic thinking and can be regarded as including giant steps toward economic orthodoxy. I have not had space for all of them in this chapter; the switch from heavy reliance on direct taxation to a mix of direct and indirect tax and the choice of a ‘value-added tax’ being perhaps the most obvious adoption of economic orthodoxy which has not been discussed here. (The name ‘goods and services tax’ was the only concession to political correctness, ‘value-added tax’ sounding like a tax on something which the Labour Party had long related to the ‘development’ objective in that it wanted to add value to primary products before they were exported. The New Zealand tax was exemplary in its maintenance of the purity of the best international economic thinking.)

I emphasize that the orthodoxy I have in mind is the orthodoxy of theoretical economics, not the predominant fashion in economic policy-making. There were some parallels between the New Zealand reforms of the 1980s and ‘Reaganism’ or ‘Thatcherism’ but so there were with the Accord of the Hawke and Keating governments in Australia or with the ‘quality of life’ strategic policy of the Japanese governments of the 1980s influenced by the Miyazawa plan. All those governments were responding to economic and social trends of the time and it would have been extraordinary if all responses had been entirely different. Equally, a few elements in common do not establish a number of derivatives from a common source. American and British commentators who see the world as copying Reaganism or Thatcherism are simply wrong.

The New Zealand reforms were ‘economic’ in that they gave a new importance to incentives, and towards the achievement of social goals by creating social structures within which individuals pursuing their interests would incidentally create social optima. My language is chosen to echo Adam Smith, but also modern thinking about the roles of government in creating conditions in which markets can work effectively.⁹ All of this is far removed

⁹ John McMillan, *Reinventing the Bazaar: A Natural History of Markets* (New York & London: Norton, 2002).

from ‘minimalist government’, ‘leave it to the market’, or ‘the private sector knows best’.

The difference is best illustrated by the corporatization and privatization processes in which a great deal of effort was devoted to ensuring that regulatory regimes were designed to generate competitive business rather than rent exploitation. The degree of success remains controversial but the profits achieved by some private buyers do not necessarily imply that the original decisions were wrong—they may reveal that the potential for growth was greater than recognized. (This was undoubtedly at least in part the case with telecommunications, where it is hard to believe that new possibilities would have been exploited with anything like the pace achieved had the industry not been privatized.) Certainly, however, learning proceeded with experience. Initially, the biggest source of gain was expected to be the monitoring of asset allocation and management by capital markets once enterprises were privatized, but in practice the main gains came from having shareholders who were less risk-averse than governments. The argument that economic thinking was more important than fashions in economic policy applies less to experience than to the design of the reform policies. The corporatization and privatization policies are reasonably concrete; those familiar with economic reasoning would recognize the centrality of the point about prices as transmissions of information.

Even at the level of policy formation, the ‘economic liberalization’ character of the reforms was distant from the usual political rhetoric. New Zealand policy had long been conceived in terms of foreign-exchange constraints—exports were not sufficient to finance the imports which were desired at full employment. The ‘foreign exchange constraint’ idea was developed within New Zealand, but it was also a framework of analysis much used internationally—especially in the form of the ‘Scandinavian model’ but also in relation to the United Kingdom.¹⁰ The ideas of externally constrained export growth and the theoretical construct of the income elasticity of demand for imports is a fruitful starting point for analyses of various kinds.

It can of course be misused. Economic analysts can take too mechanical an approach to the given nature of export growth or to the constancy of the income elasticity of demand for imports. It is even more possible for policy analysts to confine their attention too readily to the immediate applications of the theoretical construct. New Zealand analysts were right to emphasize

¹⁰ A.P. Thirlwall, *Balance of Payments Theory and the United Kingdom Experience*. (London: Macmillan, 1980).

barriers to agricultural trade relative to barriers to manufactured exports; indeed, we might think that the New Zealand policy machine was slow to recognize the way that trade in manufactured goods had reversed the pattern of the interwar years and become an engine of growth in the 1950s and 1960s.¹¹ However, it did not follow that export growth rates were entirely beyond the reach of policy influence, or that policy influence must necessarily be through a simple idea of market or product diversification rather than looking more closely at how New Zealand activities could service international consumer demand. Similarly, one might have thought that given the history of ‘great constants of economics’ which proved to move almost as soon as their constancy was postulated—the wage-income ratio, the incremental capital-output ratio—there might have been more attention to the determinants of the income elasticity of demand for imports, going somewhat beyond the idea of import substitution.

The foreign-exchange constraint was a tool for analysis and exposition, not a direct source of policy recommendations. Quick fixes are attractive, and not only in New Zealand,¹² and it was all too easy for analysis of how New Zealand had developed up to any particular date to be used for inappropriate advocacy of policy stances from that date onwards. Furthermore, the line of thinking could easily be extended into a ‘public administration’ notion of management from the center. The foreign-exchange constraint approach diverted attention from incentives and indirect effects. When the foreign-exchange constraint was discarded in favor of satisfying international consumer demand—first by Treasury analysts, and then by government policy—incentives and indirect effects moved back to central focus. This was the core of the revival of economics. Treasury analysts did not dictate government policy—the balance of fiscal and monetary policy would have been different and many other policy choices would have been decided differently if they had—but they did bring a new primacy to economic thinking by their impact on the central strategy of policy. It could have come from elsewhere. In Australia, emphasis on foreign exchange constraints had

¹¹ It was even slower to recognize that the international environment had moved from the initial IMF design of exchange rates which were fixed except in the case of fundamental disequilibrium to one where exchange rates floated and traders across international boundaries gained assurance from market instruments rather than from government commitments about exchange rates.

¹² The Cairncross diaries are fascinating for showing how similar rules of thumb dominated the formulation of much policy advice in Britain in the 1960s. Alec Cairncross, *The Wilson Years: A Treasury Diary, 1964-69* (London: The Historians’ Press, 1997).

subsided earlier, being replaced by emphasis on the consistency of labor market settlements with the trend of inflation-adjusted real output which brought into focus the internal consistency of decentralized decisions. However, in New Zealand, the change came in 1984. And not surprisingly, while non-economists did not quite know why their standing had been reduced, they soon knew it had been, and resisted.¹³

My analysis so far starts from ‘liberalization’ in the sense of ‘individual freedom within defined social constraints’. ‘Liberalization’ also has specific connotations for external economic policy, reflecting the deep interconnections in economic thinking and in nineteenth century British policy development between free trade and laissez faire (in its scholarly rather than debased sense). We have already noted the related significance in New Zealand in the 1980s between the reforms in general and the switch to an ‘outward-looking economic stance’. It had a head start in CER, and removal of protection was important in several ways—using international price signals to guide resource allocation, concentrating attention on markets rather than disposal of produce, and demonstrating that government intervention would be guided by efficiency and equity and not by what was customary. It also meant that New Zealand was well placed to respond to changes that became general in the Asia-Pacific Region.

There was, and is, substance as well as PR hype in notions like ‘Pacific century’. New Zealand’s first interest in the mid-1980s was in deepening relationships with any and all of the world’s fastest-growing economies, and many of them were in the Asia-Pacific Region. CER had shown that it was possible to use international agreements to promote liberalization even if the agreement was with an economy that was not itself especially noted for a liberal economic policy. CER was widened and deepened on an accelerating timetable, and it continued to throw up an agenda of new liberalization issues. New Zealand policymakers were ready to listen to ideas like the ‘open regionalism’ propounded by the Pacific Economic Co-operation Council even if there were many skeptics, some intelligently so and some unwilling to contemplate any departure from standard Anglo-Saxon analysis of trade diversion and trade promotion. At the end of the 1980s New Zealand policymakers were receptive to the development of the regional organization among governments, the Asia Pacific Economic Co-operation community (APEC), and the government of the 1990s participated enthusiastically in its development. It resisted misunderstanding, genuine and deliberate, of the

¹³ G.R. Hawke, ‘After the world had changed’, *New Zealand Books* 6(1) (March 1996), pp.19-21

meaning of Asia-Pacific, and it was well placed as further apparently oxymoronic concepts were developed. In particular, ‘concerted unilateralism’ posed no problems for New Zealand given its acceptance of the argument that dismantling of protectionism was justified in its own interest. ‘Concerted unilateralism’ was no more than the mutual support of governments taking actions in their individual interests, and it made very good sense politically even if it puzzled the literally minded. New Zealand could enthusiastically participate in APEC as it took attention away from the legalistic processes of exchanging preferential entry rights to national markets and focused on something more like the economic integration that was at the center of theoretical economics.

Enthusiasm for the reduction of protection fluctuated during the 1990s, and so did commitment to APEC processes, as they did among the membership of APEC generally.¹⁴ New Zealand society registered many debates about its own nature and about its place in regional and international affairs. They overlapped with the ANZUS issue; an especially valuable project led from the East-West Center in Hawaii explored how social, political and economic trends in the US, Australia and New Zealand had diverged in ways that were often not well-understood and which were related to the position of each of those societies relative to the wider Asia-Pacific Region.¹⁵

New Zealand had its resident puritans and political activists, such as those who challenged the Multilateral Agreement on Investment and disrupted the Seattle conference of the WTO. But their effect was merely to promote reconsideration of some of the implications of a policy switch that had indeed entrenched ‘economic liberalization’ in any of its established meanings.

¹⁴ See also John Ravenhill, *APEC and the Construction of Pacific Rim Regionalism* (Cambridge: CUP, 2001), although his expectations of APEC are too demanding. Had he evaluated GATT after ten years, he would have concluded that it would never amount to much, let alone develop into the WTO.

¹⁵ Richard W. Baker, *Australia, New Zealand, and the United States: Fifty Years of Alliance Relations. Report of a Study Project* (Honolulu, Hawaii: East-West Center, 1991); Richard W. Baker ed., *Australia, New Zealand, and the United States: Internal Change and Alliance Relations in the ANZUS States* (New York, Westport, Conn. & London: Praeger, 1991); Richard W. Baker and Gary R. Hawke eds., *ANZUS Economics: Economic Trends and Relations among Australia, New Zealand and the United States* (Westport, Conn. & London: Praeger, 1992); Richard W. Baker ed., *The ANZUS States and Their Region: Regional Policies of Australia, New Zealand, and the United States* (Westport, Conn: Praeger, 1994).

THE ECONOMIC TRANSITION

'Economic liberalization' is entrenched, but it is sometimes questioned. Key elements such as the Fiscal Responsibility Act and the Reserve Bank Act have not been overturned, although there has been some fine-tuning in respect of the latter, as there has been of the State Sector Act. Sometimes, what has been presented as a major step in a new direction is no more than a clarification returning to the original intent of a reform which was obscured in the course of implementation—as with the supposed emphasis on policy outcomes in relation to departmental 'outputs' in the 'new public management'; the high-level objective was always to articulate what departments did to promote the objectives of the elected government through dialogue between ministers and officials, and to make that consistent with defining what was expected from departments so that their performance could be monitored and appraised. But those who were deflected into sterile debates of 'outcomes' and 'outputs' thought they were reversing reforms in returning emphasis to the former. Similarly, economic liberalization in relation to trade policy had to be repackaged as 'closer economic partnerships' rather than bilateral trade agreements, and as 'fair trade' rather than 'free trade'. But the core liberalization, while slowed down, has not been reversed.

Nevertheless, there has been apparently serious political debate and public discussion over the question, 'have the reforms failed?' Some parts of the media even continue to answer in the affirmative.

The reform process began with a decision that a change of direction was required and that the direction of change was undoubtedly in the direction of liberalization. There was no need and no time to define explicitly the objectives sought or the milestones expected. What are now the standard processes of public sector management came after the reform process was begun. There was, therefore, no statement of expectations to establish a framework within which the success or failure of the 'reforms' could sensibly be discussed.

Furthermore, as we observed, the idea of a discrete reform process was always nonsensical. The world moved on. Economic experience depended on many factors of which policy was only one, and policy was a sequence of decisions rather than a single package. There were responses to every policy initiative, and after a while, experience owed as much to varied responses to subsequent reforms as they did to the initial reform.

The overall performance of the New Zealand economy in relation to economic growth and in relation to comparative income growth rates and

levels within the OECD depends critically on the period within which comparison is made, and assessment of the relative force of various determinants requires care. The most persuasive recent study argues that in explaining disappointing outcomes, international variables and even climate are more important than failed policy influences. And the level of disappointment that is justified is less than is often alleged.¹⁶

My own view is that the best single summary statistic is that from the Reforms of the 1980s, the long-run average annual growth rate of total factor productivity of the New Zealand economy has increased from about one per cent per annum to about 1.5 per cent per annum. Had we been told in 1984 that we were engaging in both the pain and the excitement of the 1980s and 1990s in order to achieve a fifty percent increase in our fundamental growth rate, I have little doubt that we would have proceeded. It is difficult to take seriously any simple notion that the reforms failed.

We now find an emphasis on ‘transformation’. The idea has become prominent in papers written in an effort to give strategic direction to government thinking and from there it has migrated to political discussion. It feeds on analogy with successful economic ‘transformations’ in the past—the Industrial Revolution, the rise of the ‘newly industrializing economies’ of Asia—and it might have been linked to ‘structural adjustment’ if that term had not been pre-empted by the IMF and developing economies and thereby been associated with the rhetoric of failure. In the literature of New Zealand history, the term ‘transformation’ has been associated with technological progress, and especially with the impact of refrigeration, on society as well as on the economy.¹⁷ The only link between that and the current idea is wishful thinking about the ‘new economy’—one could even regret that there is no understanding that just as refrigeration added to the wool-growing industry and did not displace it, so the impact of information and communication technologies on New Zealand is likely to be through agriculture rather than substituting something in its place.

We could quickly come to think that ‘transformation’ is currently a solution in search of a problem, empty political rhetoric rather than a policy-relevant idea. However it pays to remember that rhetoric about development

¹⁶ Robert A. Buckle, Kunhong Kim, Heather Kirkham, Nathan McLellan, and Jared Sharma, ‘Towards an Understanding of the New Zealand Business Cycle: Analysis Using a SVAR Model of the New Zealand economy’, *New Zealand Treasury Working Paper* (December 2002) www.treasury.govt.nz

¹⁷ Tom Brooking, ‘Economic Transformation’, in Geoffrey W. Rice *Oxford History of New Zealand* (Auckland: Oxford University Press, 2nd edition, 1992), chapter 9.

in the nineteenth century also incurred incredulity and ridicule, and that the rhetoric of the First Labour Government in the 1930s was little developed before it was implemented. The clarity of even ‘diversification’ owes a lot not only to hindsight but also to historical perspective. We cannot yet do more than make disciplined conjectures about how transformation will appear in the future. My guess is that just as the changes of the 1980s were motivated above all by recognition that New Zealand had fallen behind other countries in average living standards, so ‘transformation’ will be seen as a response to similar pressures. The relevant concept of living standards in the 1980s was wider-than-average real per capita income, and the current pressures are wider still—they include average real per capital income but extend into the employment and social experiences available to New Zealanders in a much more interdependent international economy, continuing our history of integrating economic and social objectives, and they include realization that valued aspects of New Zealand society are under threat. The notion of equality, which was already an uneasy combination of equality as expounded by Tawney and similar thinkers and half-knowledge of European social insurance ideas, can no longer provide guidance to policy development. ‘Transformation’ is a step in a process towards evolving—by experience as well as by thinking—a new understanding of the balance of collective and individual as we search again for higher economic growth rates.

THE SOCIAL AND POLITICAL TRANSITION

The ‘transition posed challenges to political and social attitudes and institutions. The political challenge is clearest in the replacement of a first-past-the-post (FPP) political system with a mixed member-proportional representation system (MMP), which makes vastly more difficult the kind of dramatic change in policy direction experienced in the 1980s. It is often said that the electorate delivered its verdict on ‘economic liberalization’ by ensuring that it could not happen again. There is no doubt that dissatisfaction with the state of the world, with politicians, and with government policies contributed to the referendum results that led to the introduction of MMP. ‘Economic liberalization’ was certainly within the mix of influences that generated that dissatisfaction, but just how important it was is far from clear. Furthermore, it tends to be forgotten that the adoption of MMP resulted from an intellectual study of democratic government from first principles and that the choice between MMP and FPP was between continual monitoring of the executive by

a representative legislature and occasional direct popular judgment on the executive in an election.¹⁸

The challenge to social institutions is often presented as a loss of egalitarianism, illustrated by the standard distribution of incomes according to deciles. It is often asserted that New Zealand started from an unusual degree of equality in such terms rather than from an income distribution not much different from average OECD experience, albeit with a compressed wage distribution, but the case is far from made. Furthermore, experience in the 1980s and 1990s cannot be expressed simply, and comparisons of deciles at specific points of time can be misleading. The distribution of lifetime incomes probably moved much less than the standard snapshots. The widening of income differentials was an international phenomenon rather than one unique to New Zealand and probably owed most to changes in technology which made cognitive skills and educational capabilities much more important than they had been. To the extent that New Zealand policy decisions were significant, the most important element was probably the unemployment that resulted from economic adjustment. Policy decisions about border protection, labor market regulation, and tax and benefit obligations and entitlements probably came well down the queue of influences.

In any case, this discussion probably focuses on the wrong sense of 'equality'. Discomfort with the social transition owes much more to displacement of the established. Those who had standing no longer have it. We heard and hear a great deal about 'cuts' in government support, and when we explore we find that existing providers have lost ground to new entrants—often Maori or women. Established NGOs welcomed the support to new groups but claimed that their share of government expenditure should not be reduced. We might think of various kinds of impossible dreams as described by Swift:

These unhappy people were proposing schemes for persuading monarchs to chose favourites upon the score of their wisdom, capacity and virtue; of teaching ministers to consult the public good; of rewarding merit, great abilities and eminent services; of instructing princes to know their true interest by placing it upon the same foundation with that of their people: of choosing for employment persons qualified to exercise them; with many other wild impossible chimeras, that never before entered into the heart of man to conceive, and confirmed in me the old observation that there is

¹⁸ G.R. Hawke (ed.), *Changing Politics? The Electoral Referendum, 1993* (Wellington: IPS, 1993).

nothing so extravagant and irrational which some philosophers have not maintained for truth.¹⁹

‘Displacement of the established’ also has an aggregate aspect. There had been at least some aspects of Tawney’s notion of equality. Differences existed but within a common range of experiences. To give a concrete example, most New Zealanders experienced the same conditions of public transport and were not divided into those who belonged to airline frequent flyer clubs and those who did not. The greater comfort of those with assets was less visible. But changes were occurring. Those with assets were less exclusively those who had gained them through their own achievements; smaller family size meant that inheritance was more important than it had been. From the 1980s, change accelerated, because of trends in consumption copied from overseas, because of continuing changes in demography, because of the impact of international trends in technology, and because of local policy decisions. Public understanding did not keep pace with change, and while economic analysis was more influential on public policy, financial rewards to individuals looked to owe more to luck.

After this relatively dramatic economic liberalization we now have several important dimensions of consistency vying for their place in a coherent conceptual framework. There are significant elements in place—the inflation regime of monetary policy and the fiscal framework of the Fiscal Responsibility Act being the most important. But the integration of economic and social objectives is far from obvious to much of the community interested in policy debates. I would conjecture that a key element will prove to be transforming the concern with ‘equality’ away from distribution at a point of time to managing distribution through time, especially where this interacts with a choice between collective and individual actions. Key issues will be the environment and superannuation, and we will be driven by both experience and international thinking.²⁰ The ability of the new MMP political system to develop consensus will be well tested.

The New Zealand experience therefore has implications for the regional understanding of transitions. Every economic transition will have international experiences and local peculiarities. Economic change poses challenges to social and political stability, but is as likely to promote regional integration as to engender international rivalries.

¹⁹ Jonathan Swift ‘A Voyage to Laputa, etc.’ *Gulliver’s Travels* (1726) ch. 6.

²⁰ But see also N. Barr, *The Welfare State as a Piggy Bank: Information, Risk, Uncertainty and the Role of the State* (Oxford: OUP, 2001).

The clearest lesson of all is the desirability of managing expectations. The governments of the 1980s and the 1990s put their faith in policy analysis rather than political management. The current government is not making that mistake. Nevertheless, the challenge of managing change has not diminished—not since the time of Machiavelli's Italy:

And it ought to be remembered that there is nothing more difficult to take in hand, more perilous to conduct, or more uncertain in its success, than to take the lead in the introduction of a new order of things. Because the innovator has for enemies all those who have done well under the old conditions, and lukewarm defenders in those who may do well under the new. This coolness arises partly from fear of the opponents, who have the laws on their side, and partly from the incredulity of men, who do not really believe in new things until they have had a long experience of them. Thus it happens that whenever those who are hostile have the opportunity to attack they do it like partisans, whilst the others defend lukewarmly, in such wise that the prince is endangered along with them.²¹

²¹ N. Machiavelli, translated by W.K. Marriott, *The Prince* (London: Dent & New York: Dutton, 1908), pp.47-8.