ECONOMIES

REFORM SCHOOL

how New Zealand
taught the rest a lesson

The New Zealand economy is now growing at around 5 per cent a year. Inflation is low, the balance of payments is stable, public finances are rapidly improving and employment growth has been strong. Many countries could well be envious. New Zealand's Minister of Finance, Bill Birch, reviews more than a decade of comprehensive economic reform.

From 1950 to 1985 New Zealand's economic growth was well below the OECD average. Income per head grew just 1.4 per cent a year compared with 2.9 per cent for the OECD as a whole. A degree of inflexibility brought on by heavily protected manufacturing and agricultural sectors, highly regulated labour markets, high and variable effective tax rates, a high proportion of low value-added products and a narrow range of traded products left the economy vulnerable to shifts in world demand and shocks to commodity prices.

Successive governments tried to maintain and enhance New Zealand's living standards, relying largely on extensive overseas borrowing and increasingly restrictive regulatory economic policies. But changed external circumstances, including increases in oil prices in 1973 and 1979 and falling export prices, made the task increasingly difficult.

Although, as in many countries, policies in New Zealand through the 1970s were aimed at maintaining a high level of economic activity and employment in the short run, they did not promote the flexible private-sector responses needed to adjust to a changing world. These policies led to macro-economic imbalances, structural adjustment problems and a rapid rise in the government's domestic and external debt. After the next major shift in oil and commodity prices in 1979 and 1980, New Zealand's position deteriorated further. Unemployment rose steadily and inflation increased.

The response

A serious rethink of the government's role in the economy led to a comprehensive program of economic change. Reforms have aimed to maximise the extent to which government intervention, where it is considered necessary, works with, rather than against, the market process. This has involved macroeconomic stabilisation, regulatory reform, and the corporatisation or privatisation of state trading activities, and has affected almost every aspect of the economic system. The principal reforms have included:

- The Closer Economic Relations (CER) agreement with Australia.
- Removal of controls on prices, interest rates, rents and wages.
- Removal of virtually all agricultural subsidies and price supports.
- Floating of the exchange rate in 1985.
- A comprehensive opening up of the economy to world market influences. This included the elimination of almost all quantitative controls on imports and reduction in tariffs. By July 1990, all tariffs and quantitative controls had been eliminated on a bilateral basis with Australia.
- Sweeping deregulation of financial

The Rt Hon. W.F. Birch, the New Zealand Minister of Finance since March 1993, entered parliament in 1972 as MP for Franklin. He has held the portfolios of energy, national development, regional development, science and technology, labour, employment and state services. As Minister of Labour in 1990, he introduced far-reaching reforms of the New Zealand labour market.
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1991 to promote improved employ­
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Economic strategy
The current New Zealand government
has consolidated these reforms into a
comprehensive growth strategy with
four main elements:

Enhancing international linkages

- facilitating greater international
  competitiveness;
- enabling firms to benefit from
  international skills, ideas and capital;
- promoting better trade rules and
  assisting business to establish over-

seas contacts and obtain market
information.

A more competitive economy

- a competitive cost structure;
- more readiness to innovate (in
  product, process and market);
- better management and business
  performance.

A more skilled workforce and lower
unemployment

- a more efficient and flexible labour
  market;
- better performing education and
  training institutions;
- social policies which protect the
  disadvantaged while providing
  rewards for work and reducing
  dependency.

Results
The success of this strategy and reform
in general are now showing strongly.
The New Zealand economy is growing
at around 5 per cent a year and is wide-
ly forecast to slow only slightly.
Firm monetary policy and the com-
mitment to price stability has led to a
steady decline in the rate of inflation
from a peak of 19 per cent for the year
ended 30 June 1987 to around 1.1 per
cent currently.
Both the quantum and quality of
government spending in the past three
years have been strictly controlled. In
1990 government financial net expendi-
ture was projected to reach just over
44 per cent of gross domestic product
(GDP) in 1993/94. The estimated
actual result for 1993/94 was 34.8 per
cent. By 1995/96 it is forecast to have
dropped to 32.8 per cent.
The government's fiscal balance has
also improved dramatically. Financial
net expenditure exceeded revenue by
3.5 per cent of GDP in 1990/91. In
1993/94, the government is projected
to have a fiscal surplus of 0.6 per cent
of GDP. This is the first time revenue
has been in excess of expenditure since
the late 1970s. A surplus of 2.7 per
cent of GDP is forecast for 1995/96.
Growth in trade over the past decade
reflects strengthening international
linkages. Exports from the manufactur-
sector managers and the transparency
of government decision-making. This
has included the introduction of full
accrual accounting for the govern-
ment's accounts.

These structural reforms are intend-
ed to open individual sectors to inter-
nal and world market competitive pres-
sures and to allow decentralised market
mechanisms and the price system to
dominate as the principal signal for
investment, production and consump-
tion decisions.
The policies are consistent with two
fundamental changes in the basic
approach to economic policy-making.
Policy-making has shifted away from
a preoccupation with short-term results
to a focus on medium and long-term
objectives. The goal has been to pro-
vide a more stable and predictable poli-
environment for private-sector deci-
strategy-making.

Second, fiscal and monetary policies
have been coordinated to provide a sta-
ble environment conducive to sus-
tained economic growth. This has
meant macroeconomic policies aimed
at achieving low inflation and disci-
plined government spending.

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countries has declined from 54 per cent to 19 per cent.

Inflows of direct foreign investment have risen substantially in recent years. In 1990 and 1991, direct foreign investment was around 4 per cent of GDP — compared with an average of 0.9 per cent of GDP in the 1980s.

International competitiveness, as measured by relative unit labour costs, has improved by about 15 per cent since 1988. This change is partly a reflection of the success of macroeconomic policies in reducing inflation. This has made possible less restrictive monetary conditions, thus encouraging investment and the expansion of the externally oriented sector. The fall in relative unit labour costs also reflects improvements in labour productivity flowing from better-functioning product, capital and labour markets and increased realism in wage-setting, particularly in the period since 1990. For example, individual businesses have used reformed employment regulations to generate flexible and efficient employment conditions.

Structural and macroeconomic adjustment brought large job losses. Reforms substantially reduced "subsidised" employment that existed in highly protected import-substitution industries and in the public sector. But growth is beginning to translate into greater job opportunities. Employment has been growing strongly and the level of unemployment has declined, recently falling from around 11 per cent to 9.1 per cent. Further falls in the unemployment rate are projected.

Educational qualifications of those entering the workforce are also improving. Participation rates in upper-secondary education have increased rapidly since the mid-1980s and are now approaching the OECD average. In parallel with the increase in education participation rates, there has been a significant decline in the proportion who leave school without qualifications.

**Building on progress**

Since becoming Minister of Finance I have identified five basic building-blocks of policy:

- the Reserve Bank Act and the 0–2 per cent inflation target;
- the Employment Contracts Act and a flexible labour market;
- balanced budgets and the continued reduction of public debt as a percentage of GDP;
- a broad-based, low-rate tax regime with no increases in income, company or GST tax rates; and
- becoming increasingly internationally competitive.

In recognition of the role played by fiscal policy in achieving the government’s wider economic and social objectives, the Fiscal Responsibility Act became effective from July 1, 1994. The Act aims to improve the conduct of fiscal policy by specifying principles of responsible fiscal management and by strengthening the reporting requirements of the Crown.

**Responsible fiscal management**

The principles are simply a guide to good fiscal housekeeping. They establish a set of benchmarks against which the public can assess fiscal policy.

They include the need to run fiscal surpluses to achieve prudent levels of public debt. The subsequent maintenance of debt at prudent levels will require fiscal balance over the economic cycle.

As a small, open economy subject to many uncertainties, a reduction in net public debt from around 42 per cent of GDP to between 20 per cent and 30 per cent of GDP is considered appropriate.

**Reporting and publishing requirements**

The Act requires the Minister of Finance to publish a budget policy statement outlining the government’s long-term (10-year) fiscal objectives, short-term (three-year) fiscal intentions and broad strategic priorities for the coming budget. The statement must demonstrate the consistency of the government’s fiscal objectives and intentions with the principles outlined in the Act, or explain why they are not consistent.

There is a legislative requirement to publish monthly fiscal out-turn reports and six-monthly economic and fiscal updates. The latter must also be published before each general election.

The Act requires fiscal reporting to follow generally accepted accounting practice (GAAP), a set of reliable and consistent accounting rules established independently by the Accounting Standards Review Board.

This will enhance the credibility of the government’s budget and other fiscal reporting. The 1994 budget was the first to be prepared in line with GAAP.

In 1993 the government published a comprehensive strategic policy document entitled *Path to 2010*, which set out its medium-term economic and social goals. *Path to 2010* has been followed in June this year by *Towards 2010: the next three years*, which reiterates the objectives of maintaining and accelerating economic growth and building strong communities and a cohesive society.

While economic growth is beginning to translate into more jobs, the government is nonetheless directing effort at creating opportunities for particular groups such as the long-term unemployed and those with few qualifications. A Prime Ministerial Task Force on employment was established in February in consultation with other political parties. The task force is expected to report later this year.

Progress on further enhancing openness and a competitive enterprise economy is also a key priority. Tariffs need to be set in a manner which encourages innovation and productivity. The level of protection of industry in New Zealand is still higher than in many other countries and is unevenly spread between industries. A review of post-1996 tariffs is under way.

**Conclusions**

Economic reform in New Zealand has been comprehensive, involving macroeconomic stabilisation, regulatory reform and the corporatisation and privatisation of state-trading activities. Fiscal and monetary policy have been coordinated to provide a stable macroeconomic environment for sustainable growth.

The reorientation of the economy away from the inward-looking strategies that had held sway for half a century has been a key factor behind the current success. While there have been adjustment costs, these cannot be ascribed entirely to the reform process. Rather, they are in part the result of past policies. Reform was inevitable. The previous policy mix had become unsustainable.

Our country has turned around and recovered from an untenable position and achieved relatively high levels of growth in adverse international circumstances. Priorities for the future are to deliver on the government’s fiscal objectives, to keep inflation low, to keep the policy environment consistent so that businesses can have confidence, to follow policies that promote opportunity and discourage dependency, and to enhance openness and a competitive enterprise economy.