

New Zealand

– The Misguided Experiment

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LARGE SCALE experiments in economics are thought to be rare because we do not realise when they are taking place and do not draw the right conclusions from them.

Britain at the height of its empire practised capitalism and free trade both strongly biased by government in favour of Britain's investors and land owners and largely responsible for creating the working poor at home and abroad.

The second big economic experiment, in the USSR, generated a basic survival living standard for its people, destroyed private enterprise and squandered wealth on a space programme and nuclear weapons. The world is now on the throes of the global experiment where market forces and free trade are being encouraged to proliferate madly.

Dictatorships and corruption have had destructive effects on many countries; these are painful "experiments" for those who suffer the injustices of power and greed. One might be forgiven for deducing that democracy, freedom and absence of corruption heralds of a more equitable social and economic order. But let us examine one other experiment before jumping to conclusions.

New Zealand's experiment

A "Democracy Check" at worldaudit.org ranks New Zealand joint first with Denmark

in Democracy, second in Freedom of the Press and third in absence of Corruption out of 210 countries. In 1984 the New Zealand electorate decided that the country's economic progress over the previous 30 years had been unacceptably poor and that with the National Debt at 43% of GDP, Prime Minister Rob Muldoon should be replaced by a brand new Labour government led by Roger Douglas and Ruth Richardson and later by a National government under Jenny Shipley which would shake the country out of the doldrums.

Even without the pressure frequently applied to failing economies by the International Monetary Fund, a devastating monetarist regime was installed. It was decided that import controls, capital controls, strong trade unions, a redistributive welfare state and a large state sector had to go. They started by deregulating interest rates, removing international capital restrictions, devaluing the currency 20% and allowing it to float and removing agricultural subsidies in a root and branch monetarist restructuring.

Having savoured the taste for change they then scrapped regulations on business, abolished import quotas, enshrined price stability in law as the sole objective of monetary policy, forced workers into individual contracts, announced that budget deficits would eventually be banned,

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cut income taxes and slashed welfare benefits. Privatisation followed the removal of exchange controls and regulation. They even sold off the Bank of New Zealand, rail transport, electricity production and distribution, telecoms and radio bands. The huge capital gains of NZ\$16.6bn which resulted were not insufficient to compensate for the reduction in tax (for the rich) or run the Health Service Scheme which was not privatised.

To compensate for the tax reductions they discovered they needed to create what Donald Brash, the Governor of the Reserve Bank of New Zealand, described as a 'broad-based value-added tax' known as the Goods and Services Tax. This tax which hits rich and poor alike even includes food, medical services, books, and children's clothing. It started at 10% but soon went to 15%. Unbelievably the sole exception was financial services. The expectations were that there would be growth in GDP and productivity and as the economy rose everyone would rise with it and poverty would be abolished. They controlled wage increases and held prices and interest rates in order to artificially create what they assumed was the right environment for their experiment. Unfortunately they allowed land and consequently property and house prices to rise, the outcome being that wealth was siphoned off by the big land owners and the lower income groups not only had their wages held down but were faced with higher house purchase prices and mortgages.

Natural resources including water power, hot rocks, transport infrastructure, telecommunications, radio and television bands were given away with privatisation and the opportunity to reclaim for the community this wealth was denied.

Had they retrieved this value on an annual basis there would have been no need for the Goods and Services Tax which took from everyone the right to retain what they had created. This major defect destroyed whatever good there was in their efforts to release private initiative and allow people to retain the money they earned.

The privatised industries and services

were a failure on their own and contributed to the complete dissatisfaction of the local authorities and the electorate. The reasons for this will be explored but fundamentally the long-suffering New Zealanders decided they were being denied a say in the running of their local affairs. It remains to be seen whether the public will accept efficient services irrespective of who owns and provides them. Undoubtedly competition and the drive for profit should bring the best management and technology to bear. But giving away the rights to natural resources, ignoring the involvement of the community in its own affairs and the failure to balance short term gain with long term planning related to new technology and environmental issues has brought the New Zealand house of cards tumbling down.

The government stoutly defended its alleged success in achieving so much restructuring but in the end the statistics and the vote of the populace defeated them. We shall examine the economic results which have been thoroughly analysed by Paul Dalzeil of Lincoln University, Canterbury. We shall see that in a carefully controlled comparison with Australia, New Zealand has fared poorly in real terms as well as comparatively with a similar country in the same global environment.

NEW ZEALAND has many attractive natural resources. The beautiful, striking countryside was ideal for the filming of the Lord of the Rings and tourism has increased 20% as a result. Water resources and thermal energy from hot rocks had already been harnessed for electricity generation; would these monopolies fit into a privatised industry? They were largely retained in state ownership but managed by arm's length private companies. As far as the railways were concerned infrastructure, rolling stock and inter-island ferries were sold but the land on which they operated was leased for NZ\$1, thus denying a rightful return on the use of public land. This, however, did not prevent the privatised Tranz Rail from attempting to make the other utilities pay to cross "their" land! The

Government had given away to a private company monopoly rights to natural resources which were the birthright of the people and for which the new owners should have been paying an annual rent.

In the allegedly efficient capitalist system the new owners of banks, trains, energy generation, telecoms and radio waves had to make good returns for their shareholders and to maintain their share price. However, the railways could not obtain sufficient return from their widespread services to pay for the required capital investment. They floundered. They first tried to milk the company and then to sell it off.

Electricity came to grief because the need of the generating companies was the large scale use of the national grid whereas the need of local users was small scale generation avoiding the big energy losses of grid transmission. Unable to resolve the conflict, the grid supply to Auckland broke down causing months of serious reduction in supply. On ecological grounds the Government wanted to reduce electricity consumption but the suppliers naturally wanted to increase it; can regulation live with de-regulation?

Long term planning issues and the potential use of new technology caused confusion to the telecom companies. In 1995 they were accused of making excessive profits; by 2000 they had to admit that their lines were out of date and too slow for the internet. They are now undecided: should they update their antiquated lines, go for cable or try satellite?

In one way or another all the privatised industries failed to satisfy the consumer. The consumer as elector decided enough was enough and changed the Government again. In November 1999 Helen Clark brought in a new Labour Government. Interviewed by Jonathan Freedman she said the experiment in market fundamentalism "tax nothing, regulate nothing, do nothing" had failed.

RIGHT THROUGH their experiment the government of the day was claiming its results were outstanding. In the sense that they had implemented the 'reforms' that

they had promised they had, by 2000, transformed New Zealand from one of the most interventionist to one of the most open market-based economies in the OECD. The presumption was that this would be "a good thing" by leading to stability and growth. Undoubtedly the rich became richer and taking this as a measure of success and relying on the supposed 'trickle down' affect they were on the right track. But let us take a hard look at the results. For this we are indebted to Pal Dalzeil of the Commerce Division, Lincoln University, Canterbury, New Zealand who has made a detailed statistical analysis:

New Zealand's economic policy between 1984 and 1996 is often hailed as an example of comprehensive supply-side reform that successfully improved the performance of a weak economy. In contrast, this paper presents statistical evidence to show that (1) New Zealand sacrificed a large volume of per capita gross domestic product after 1987; (2) its average unemployment rate increased substantially after 1988; (3) labour productivity growth declined after 1992; and (4) the per capita real income of low-income households in 1996 was more than 3% lower in absolute terms than it had been in 1984. The paper concludes that the economic reform programme did not achieve the objectives expected at its launch.

Their fourth conclusion underlines the failure of the objective reiterated in the communiqué from the New Zealand Economic Summit Conference in September 1984 (page 302) as follows:

Participants were aware of two seemingly contradictory facts. New Zealand has abundant resources to realise the reasonable economic and social objectives of all its people. Despite that, these aspirations have not always been fulfilled. There is an unacceptable level of poverty. There are people in our community who have major difficulties with housing, health care, and meeting essential family needs. This failure to match resources and performance has not been a short term problem but rather a feature of the New Zealand economy for the last thirty years.

Dalziel was meticulous in his analysis in making allowances for the policies and trends experienced by Australia, which operates in a similar economic climate. Thus his assessment allows for the criticism that some reforms would have been implemented by any government, or that its final state would have been even worse without them.

The conclusion of this experiment are devastating, but the road to recovery will have to be carefully prepared. As a start, the new Government has taken a hard look at education where only 11% go to university compared with over 50% in Britain.

AN ASSESSMENT OF THE POLICIES

Free Trade With New Zealander Mike Moore the Director General of the World Trade Organisation, it was inevitable that one of the "reforms" would be the wholehearted introduction of free trade (although all import tariffs would not go until 2006). Free Trade is always advocated by the wealthier countries like Britain in the 19th century because they have the most to gain. By removing subsidies and tariffs New Zealand hit its agricultural and import-substitute industries hard. This was intended to improve efficiency and to raise the standard of living by allowing cheaper imports. Unfortunately, all countries cheat in order to appease their agricultural and industrial lobbies – in France/Europe with agriculture, Britain/Europe with textiles, in USA with steel. South Korea shielded itself behind a tariff barrier until it was ready to face the rest of the industrialised world; Japan invented technology barriers which only they could clear. New Zealand exposed itself to a greedy world before everyone was prepared to obey the rules.

Mistake number one.

Free Ownership of Monopoly Rights The one thing a country can claim as its own is its land and natural resources. We are not sufficiently globally advanced to declare natural resources a *world resource*; would Saudi Arabia or Russia share their oil? Would Indonesia share their timber? Would

the USA share the minerals of the ocean bed? In the meanwhile land and natural resources can be shared *nationally* – as long as they are not allowed to fall into private hands without recompense to the community. Whether they belong to home or foreign nationals they are not shared. Mistake number two.

Private ownership of natural resources and land without annual recompense takes a huge chunk of the national wealth away from the people who have a right to share it. New Zealand quite rightly reduced Income Tax, allowing people to keep the fruits of their labours. Had it collected the annual value of the land and natural resources it would have more than made up the loss to the Chancellor and avoided the need for a "broad-based" Goods and Services Tax.

Free Movement of Capital On the face of it this seems like an obvious reform. All activities need capital and with loads of investment capital available world-wide interest rates should trend downwards. However, money tends to accumulate in the hands of a small percentage of the world population; 20% own more than 85% of the wealth. This gives them power over the rest to set the rules of the game.

The big accumulators are the investment companies, often part of the banks who through mergers and acquisitions are becoming fewer in number but more powerful in size and the Insurance and Pension companies. Through their involvement by investment in more and more world-wide companies they create an elite who can award themselves very high incomes either as salary or as shares. New Zealand exposed themselves to this mountain of money. The story of Tranz Rail typifies this (*see Box 1*).

It is reported that in the year ended March 2000, overseas investors earned NZ\$ 8bn in New Zealand; they returned 87% home and reinvested 13%. If the investors had been New Zealand companies would it have been otherwise? Many workers like the Philipinos go abroad to work and send the money home; is it any different?

It seems to me that people should be allowed to keep what they genuinely earn through skill and hard work in a meritocratic world but that it is the out-flow to top company controllers and financiers which is disproportionate. This is obviously so where it is dependent on land and natural resources. It is not obviously so where it is beyond national and international surveillance of financial flows. New Zealand exposed itself to this world accumulation of money. Mistake number three.

prime exponent of small government and the claim to return power to the people and yet in reality it is one of the most regulated. And the regulations favour the most powerful who are allowed to make high profits, award themselves high incomes and have the most favourable tax positions. The wealth does not trickle down; financial dealing and political lobbying make sure of that. In emulating these 'freedoms' New Zealand has discovered that Government cannot sit on the sidelines and do nothing.

Reducing Government The USA is the

Government has become involved in sorting out the problems in the privatised

Box 1 The History of Rail Transport in New Zealand

Established in 1870 the New Zealand rail system had become hopelessly inefficient and overstaffed a century later. In 1982 it was converted into a government organisation, the New Zealand Railway Corporation. In anticipation of impending privatisation it was restructured in 1990 into New Zealand Rail, a limited liability company with NZ\$ 1.2bn of debt written off and NZ\$ 360m of new equity created. It was sold to Tranz Rail in 1993 for NZ\$ 328m.

Ray Richwhite (a NZ company) who had been the main advisors to the Government from 1990 to 1993 took 31.8% of the shares; the other share holders were:

Winsconsin Central (a US company)	27.3%
Berkshire Fund (a US investment Company)	27.3%
Alex van Heeren (private investor)	9.1%
Richwhite family interests	4.5%
NZ\$ 220.9m was borrowed and NZ\$ 107.4m contributed by the shareholders.	

In 1995 Tranz Rail made a capital repayment of NZ\$ 100m, NZ\$ 90.6m of which went to the original shareholders, reducing their contribution to NZ\$ 16.8m (16 cents per share).

In mid 1996 the company issued 31 million new shares to the public at NZ\$ 6.19; they were eagerly sought after and reached NZ\$ 9 by mid 1997.

In 1998 the Berkshire Fund sold 16.3 million shares at more than NZ\$ 8 each. Alex van Heeren sold 7.4 million shares at NZ\$ 5.99 profiting NZ\$ 42m and no capital gains tax!

With huge capital expenditure and poor performance the shares fell to a low NZ\$ 2.6; Dr Small the Managing Director till May 2000 was rewarded with a big salary increase, taking NZ\$ 1.8m in his last year.

Michael Beard, the new MD had big restructuring ideas like selling the local Auckland lines back to the Government for NZ\$ 81m, closing down passenger services and concentrating on freight and the Cook Straight Ferries. In December 2001, the big shareholders considered setting up a joint venture with Australian West Coast Railway (in which the French Connex has a significant stake). Tranz Rail would receive NZ\$ 28m in the deal. What will New Zealand get for a railway?

corporations. They have discovered they have responsibilities to the people who elected them in ensuring that services are provided, that the environment is preserved, that new technologies have to be introduced for the benefit of all. They have to balance the benefit to the consumer against the profit of the corporation if there is a conflict of interest.

This is illustrated by the mess which electricity privatisation has created. Firstly, natural resources are not paying back a fair return to the community. Secondly, the national grid is a form of monopoly and there is conflict over who should extend and/or maintain it. Thirdly, this conflicts with the preference by local districts to manage their own electricity distribution through mutual trusts. Fourthly, where does the responsibility for providing adequate future supplies by environmentally acceptable means rest? Decisions between hydroelectricity, thermal energy, wind power, nuclear power and other potential options have to be a matter for public concern.

Less government can be achieved by sharing responsibilities with local government but strategic decisions cannot be avoided.

Corporate Business Structures Perhaps the right-wing privatisers had not realised how corporate management has changed. We no longer have single objective, self-contained companies which handle all their affairs in-house and whose finances are transparent. A world-renowned company can be a marketing function only, doing none of its own manufacturing. It can outsource all its management to different parts of the world. It can be bought and sold as a commodity itself. Where is it and to whom is it responsible? It needs to be regulated if the government wants to ensure it provides the service required. Was this mistake number five?

There may be a way in which privatisation can play a part in running

utilities but clearly it has not worked in New Zealand and doesn't seem likely to. It seems sad that the New Zealand lambs have been thrown to the financial wolves.

THE PRINCIPLES of private enterprise and freedom for the individual within a democratic system are worth striving for but the lesson from New Zealand's experiment is that they have to be operated within a carefully designed set of rules.

There is no argument about the need for the rule of law and the presence of financial institutions. The inadequate state of these in Russia when she attempted to enter the world of market forces was plain to see and has led to a state of near social and financial anarchy. But in addition there is a need for regulations to curb the uncontrolled forces of accumulated wealth and money in order to safe-guard the interests of people and the environment.

It is reported that Singapore has studied the versions of economic management practised around the world and has selected New Zealand as the example to follow. Here is another exciting experiment in the making. Singapore under Lee Kwan Yew has one of the most successful forms of capitalism already which it has built on an island without any natural resources; will it be able to control the tiger which New Zealand has unleashed?

Besides adequate regulation there is one key part of legislation which New Zealand omitted and which Singapore would be very strongly advised to implement. The one thing which Singapore will understand is the value of land for which there is and will be an ever increasing demand. By allowing the freedom to use land in return for the payment to the community for its annual use, Singapore will be able to release a huge encouragement to the hard working population by replacing practically all other taxes. This in itself will release a flood of new enterprise which will even surprise one of the already most successful countries in the world.