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Change is only possible when a country undertakes comprehensive reform

There is little point in tinkering with some areas while leaving others untouched e.g. a change to border protection may be useful in reducing the costs exporters face, but this is largely wasted if infrastructure costs remain high.

This illustrates the key theme that underlies this speech, that it is the interaction between policies that matter rather than any particular policy.

The central strategic considerations when undertaking structural reform are **quality decisions**. These also lead to political success in government.

The evidence of New Zealand's story is plain. The politicians who sought success through ad hoc solutions, which evaded the real problems, damaged the nation and destroyed their own reputations.

Voters ultimately place a higher value on enhancing their medium-term prospects than on action that looks successful short-term, but only by sacrificing larger and more enduring future gains.

A fundamental choice is always there: You can take the costs up-front for larger medium-term gains; or focus on short-run satisfaction and be sandbagged later by the accumulated costs. Those concepts are not foreign to the public. People accept low incomes as students to earn more later. They save for their old age, and willingly invest in a better future for their children.

There is a deep well of realism and common sense among the ordinary people of the community. They want politicians to have guts and vision to deliver sustainable gains in living standard.

Inadequate politicians see instant popularity as the key to power. If their rating slips, they feel threatened. They look for policies with instant appeal to create continuous public bliss.

That approach flies in the face of reality. There is no free lunch. Every decision involves trade-offs, which do not vanish just because some politician chooses to ignore them.

The sordid fact is: instant solutions do not have instant popular appeal. Notoriously, they are peddled by politicians who actively blind themselves and others to the facts about the situation.

The problem with compromise policies is simple. They do not produce the right outcome for the public at the end of the day. So they come back to haunt the politicians responsible for them.

As costs and distortions accumulate, such Governments resort to misrepresenting and suppressing vital information about future economic prospects, to warp the judgement of the voting public.

Too often, they end up locking themselves and the public into their own nonsense. No one escapes until a crash has liberated the suppressed information, and consigned them to oblivion.

Going for quality means choosing the actions that deliver most benefit to the nation in the medium term, instead of choosing more now, for supposed political gain, at the cost of less later.

Objectives set on that basis, and the means most likely to achieve them, must both be tested against the best available economic analysis and against all of the available evidence.

Traditional preconceptions or prejudices about means should not be allowed to prevent a thorough review of all options, and the selection of the means most likely to achieve the chosen goals.

From my view point, it makes political sense to act from day one on the following basis –

If a decision makes sense in the medium-term, go the whole hog for quality solutions. Nothing else delivers an outcome that will satisfy the public at the end of the day.

What then was New Zealand's response to quality politicians?

Wherever the New Zealand Government implemented uncompromised quality policies since 1984, the opinion polls show that voters today give a satisfactory rating to the Government's performance.

Wherever the New Zealand Government did not or has not gone the whole way for quality decisions since 1984, government approval rating is always low.

LESSONS OF NEW ZEALAND EXPERIENCE

New Zealand's experience provides an important insight into the nature of political consensus, which is widely misunderstood by politicians here and around the world.

The conventional view is that consensus support must exist for reform before you start otherwise the actions taken will not prove to be politically sustainable at election time.

The tendency is to seek consensus in advance by compromising the quality of the decisions to bring the benefits up front and either ignore any costs or push them further down the track.

But when the Government compromises its decisions for immediate advantage at the expense of the medium-term outcome, the dissatisfaction of the public will intensify over time.

The fact of the matter is that the interests of the various groups in society are complex and diverse. None of them welcome the idea that their traditional privileges may be removed.

Consensus then for quality decisions does not arise before they are made and implemented. It develops progressively after they are taken, as they deliver satisfactory outcomes to the public.

To win elections consistently, governments need the guts to implement quality decisions, take the pain up-front instead of postponing it, and be judged on the basis of the good outcomes they deliver.

By taking that approach, Labour won an increased majority in 1987. To the extent that we have continued to take it since then, we kept open an opportunity to win again in 1990.

On the other hand, to the extent such a government loses the nerve required to take a consistent, medium-term approach to quality, the result of the next election will become doubtful.

What then is the required recipe for using quality policies to combine successful structural reform with electoral success?

Ten key principles should underlay any strategy.

- 1 Quality decisions start with quality people
- 2 Implement reform by way of quantum leaps
- 3 Speed is essential
- 4 Once you start the momentum rolling, never let it stop
- 5 Credibility is crucial
- 6 The dog must see the rabbit
- 7 Stop selling the public short
- 8 Don't blink or wobble
- 9 Use opportunity, incentive and choice to mobilise the energy of the people
- 10 Elect politicians who have the guts to undertake structural reform

Principle

Implement reform by way of quantum leaps using large packages.

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

In New Zealand and world-wide, the conventional perception is that reformers are playing against a stacked deck of cards. Genuine structural reform is portrayed as equivalent to political suicide.

That rule holds good where privileges are removed one at a time in a step-by-step programme. Paradoxically, it ceases to apply when the privileges of many groups are removed in one package.

In that case, individual groups lose their own privileges, but simultaneously, the aggregate cost of paying for the privileges of all of the other groups in the economy is removed from them.

Paradoxically, it is harder to complain about damages to your own group when everyone else is suffering at least as much and you benefit from their loss, in the medium-term.

The underlying fact is that, whatever their own losses, each individual group also had a vested interest in the success of the reforms being imposed on all of the other groups.

Packaging reforms up into large bundles is not just a gimmick. Its political and economic efficiency rests on fundamental considerations, which are the essence of good structural reform:

The economy operates as an organic whole, not an unrelated collection of bits and pieces. Structural reform aims to improve the quality of the inter-actions within the whole.

When reform is packaged in large bundles, the linkages in the system can be used to see that each action effectively enhances every action and also improves its selling potential.

Winning public acceptance depends crucially on demonstrating that you are improving the opportunities for people as a whole, while protecting the most vulnerable groups in the community.

Large packages provide the flexibility needed to demonstrate that the losses suffered by a group of people are offset by fundamental gains for the same group in some other area.

The public will take short-term pain on the chin, if the gains are spelt out convincingly, and the costs and benefits have been shared with visible fairness across the community as a whole.

Principle

Speed is essential – it is impossible to go too fast

Speed is essential and it is impossible to go too fast. Even at maximum speed, the total programme will take some years to implement. The short-term trade-off costs start from day one.

When reform has been delayed for many years, the trade-off costs are inevitably considerable. Tangible benefits take time to become visible, because of the lags built into the system.

If action is not taken fast enough, the consensus that supports reform can collapse before the results become evident, while the Government is still only part-way through its reform programme.

Vested interests seeking to preserve past privileges will always argue strongly for a slower pace of change. It gives them more time to mobilise public opinion against the reforms.

On the other hand, vested interests cannot obtain the pay-off from change until the government has moved far enough to reduce the costs imposed on them by the privileges of other interests.

The vested interests continuously underestimate their own ability to adjust successfully in an environment where the Government is rapidly removing privilege across a wide front.

They focused on symptoms, not fundamentals at every stage.

Many apparent demands for a slower pace, on closer analysis, express a powerful resentment that the Government is not moving fast enough to abolish privileges enjoyed by rival groups.

Farmers in New Zealand who lost direct subsidies equivalent to 35c in every dollar they earned and because of a strengthening New Zealand dollar, received less New Zealand dollars for what they sold, survived because action was taken in New Zealand to reduce excessive protection elsewhere.

- e.g. Tariff reduced
- Railways restructured
- Ports etc.

It is uncertainty, not speed that endangers the success of structural reform programmes. Speed is an essential ingredient in keeping uncertainty down to the lowest achievable level.

When state trading departments were being transformed into commercial corporations, it became obvious that large-scale redundancies would occur in the coal and forestry areas.

Because some of those activities were located in depressed areas, the Government took its time to make the final decision, leaving thousands of employees in limbo for about six months.

Staff knew that some of them had no future in the industry, but did not know who. They could not leave before the Government made up its mind, because they might lose their redundancy payout.

The result was deep and intense bitterness which the Government interpreted as being directed primarily against the policies themselves. It further eroded the willingness to take action.

Once firm decisions were announced, the feeling in those regions improved rapidly. A lot of those people always knew change was inevitable. The public often shows more realism than politicians.

What those people really wanted was an end to the uncertainty, so that they could decide how to get on with their own lives.

A great deal of technical debate has been aired world-wide about the optimum sequencing of structural reform, and the alleged sequencing errors of governments, both here and elsewhere.

My view is that these debates are largely irrelevant in practice.

Before you can plan your perfect move in the perfect way at the perfect time, the situation has already changed anyway. Instead of a perfect result, you wind up with a missed opportunity.

Some decisions take full effect the day they are made. Others take years of hard work before they can be fully implemented. Perfect sequencing, even if it existed, would not be achievable.

If a window of opportunity opens up for a decision or action that makes sense in the medium term, use it before the window closes.

When an economy has been driven down a blind alley and ends up facing a brick wall, what matters is to back it out as soon as possible and get it back on the high road to a better future.

Principle

Once you start the momentum rolling, never let it stop

Once you start the momentum rolling, never let it stop until you have completed the total programme. The fire of opponents is much less accurate if they have to shoot at a rapidly moving target.

If you take your next decision while they are still struggling to mobilise against the last one, you will continually capture the high ground of national interest and force them to fight uphill.

The Government can develop public awareness of the key issues by structuring the content and sequence of its packages to dramatise the relevance of the fundamental economic linkages.

The underlying process of structural change is very important.

Before you remove the privileges of a protected sector it will tend to see structural changes as a threat which has to be opposed at all costs.

After you remove its privileges and demonstrate that the clock cannot be turned back, the group starts to focus on removing the privileges of other groups that still boost its own costs.

On the other hand, exactly the opposite process occurs wherever some favoured group is allowed to retain its privileges, and given ongoing protection from the broad thrust of the reforms.

Anxiety levels in protected groups rise steadily as reform progresses in the rest of the economy. They fear their turn may come next. Their internal organisation improves dramatically.

They boost their public profile. They entrench their opposition to conceal their vested interest in exemption from reform. They will aim to dictate the rhetoric that governs all public debate.

In New Zealand, for example, reforms designed to reduce waste and inefficiency across the widest possible front were consistently painted as adherence to the nastiest form of hard-line monetarism.

Commercialisation, designed to achieve more jobs and better living standards for everyone, was said to be driven by an uncaring New Right obsession with profit at the expense of people or service.

Efforts to improve the quality or quantity of health services for ordinary New Zealanders were portrayed as replacing public care with private profit at the expense of the ill and the elderly.

The strategy of this rhetoric is to obliterate public awareness of all medium-term benefits, exaggerate the short-term costs and portray these costs as the objective or sole outcome of reforms.

These groups end up making strenuous efforts to gain control of the political process in the reforming party to stymie any threat to themselves by terminating the total reform programme.

The answer is: Stop the rot before it begins. Remove privilege even-handedly across the board and give such groups, along with everyone else, a more constructive role in a better society.

Principle **Credibility is crucial**

Continuous credibility is essential to maintain public confidence in structural reform and minimise the costs. The key to credibility is consistency of policy and communications.

The voting public has seen governments come and go, all of them promising low inflation, more jobs and higher living standards. But for years life has gone on exactly as it always used to.

Take the first step early and make it a big one. You have to break the pattern of the past dramatically enough to convince the community that, this time, somebody really does mean business.

When the government lacks credibility, people refuse to change until the clash between their old behaviour and the new policy imperatives has imposed large, avoidable costs on the economy.

As the reform programme rolls forward, a lot of people start hurting. Their confidence depends on maintaining the conviction that the government will drive reform to a successful conclusion.

Speed, momentum, the avoidance of ad hoc decisions and an unwavering consistency in serving medium-term objectives are the crucial ingredients in establishing the government's credibility.

You know when you start to win the credibility battle. The media begin to put every government statement under a microscope, looking for inconsistent decisions and lapses of principles.

People begin to grasp the idea that wherever a group manages to hold on to privilege and protection, an avoidable cost is imposed on those who are facing up to the adjustment process.

At this point – the message from the voting public changes. It now reads:

Keep the reform process going – drive it to a successful conclusion or you are dead in the water at the next election.

Structural reform has its own internal logic, based on the linkages within the economy. One step inevitably requires and leads to another, to extract benefit for the nation as a whole.

Abolishing export assistance is fruitless, unless the costs of exporters are also reduced by lowering tariffs, deregulating internal transport and reforming ports and shipping services.

The fiscal gains from corporatisation or privatisation will vanish without trace of expenditure if an unreformed social services sector is left to rise without regards for efficiency.

The redundancies created as production is rationalised to improve efficiency may turn into more or less permanent unemployment if an inflexible labour market protects insiders against outsiders.

Where the logic of reform is not followed closely enough, the confidence of investors will be impaired and the ultimate sustainable growth rate achieved may be less than optimal.

Credibility takes a long time to win but it can be lost almost overnight. Confidence then collapses. The costs of the adjustment rise. The time required expands. The political risk increases.

The battle for consistency and credibility is always ongoing and never finally won. It remains permanently central to every decision that comes before the government for consideration.

In the wake of the sharemarket crash of 1987, for example, many countries sought to soften the political and financial impact on the community by easing back on their monetary policies.

The dragon of inflation leapt back to life. Those countries were then faced with the costs involved in slaying it for the second time. Electors do not thank you for that.

Winning back lost credibility can take longer than winning it in the first place. If confidence starts to waver, push the reform programme forward a big new step – and take it quickly.

Let us now look at how these principles of political change might apply in general terms to the reform of government management and then apply those lessons to social policy.

Reform of Government Management

It is impossible to construct an efficient economic process if the largest player in the economy is inefficient. It is fundamental that the government continues to review its spending to ensure that unnecessary programmes are removed. That is a well understood policy approach worldwide.

In New Zealand we went further, believing it was critically important that the processes of management and accountability were as clear and straightforward as possible.

The Main Reforms

- ◆ Corporatisation and privatisation
- ◆ Public sector employment
- ◆ Government financial management

New Zealand shifted in the late 1980s from a cash based, input focused system to an accruals based and output oriented system. This represented a dramatic change in accounting and accountability of all aspects of government.

Its symbolic representation in New Zealand Government's balance sheet is well known but that is only an outward indication of a wider change.

Because this is an area where New Zealand is still ahead of most countries, I focus my comments on these accounting changes.

Accounting changes

The main reason for change is to allow us to have better information on the use and management of assets and the production of goods and services.

Basic management questions

- ◆ What are we buying?
- ◆ What does it cost?
- ◆ What capital is being used?

Who is responsible?

- ◆ For controlling different aspects of activity
- ◆ We need a clear accountability system.

So what changes did we make?

- ◆ Contracts for outputs
- ◆ Accrual accounting
- ◆ Government Balance Sheet
- ◆ Accountability and responsibility

Conclusion

There is no room for claiming that accountability is unclear.

The Civil Servant in 1980

The Civil Servant in 2000

Social Policy (Health, Education, Welfare and Retirement Provision)

While most countries in the developed world have undertaken a certain amount of economic reforms, few if any have undertaken any quality social policy reform.

- ◆ Why is this?
- ◆ What do governments need to do?
 - Destroy present policies
 - Put forward comprehensive policies in a packaged form.

The current system

****NB ILLUSTRATIVE FIGURES****

Family of 6 (2 adults, 4 children)	
	Current system
Income	\$800
Tax	\$150
In the hand	\$650
Education	Free but lousy
Health	Free but you die on the waiting list
Welfare (sickness, accident, unemployment)	Free but they lock you into dependency on the whim of politicians
Retirement	Free but survival level income only for majority of retired
In the hand	\$650
For the voter:	<ul style="list-style-type: none"> - No power - Monopoly - No choice - Low productivity - Poor quality - Poor outcomes - Low staff morale - Low status - Administrative decision making - Dependency - Low income families treated scandalously - Higher taxes arising from inefficiency - Bureaucracy - Sameness

The reform deal

NB ILLUSTRATIVE FIGURES

Family of 6 (2 adults, 4 children)		
	Current system	The reform deal
Income	\$800	\$800
Tax	\$150	\$150
In the hand	\$650	\$650
Education	Free but lousy	\$400
Health	Free but you die on the waiting list	\$200
Welfare (sickness, accident, unemployment)	Free but they lock you into dependency on the whim of politicians	\$100
Retirement	Free but survival level income only for majority of retired	\$800
In the hand	\$650	\$2,150
For the voter:	<ul style="list-style-type: none"> - No power - Monopoly - No choice - Low productivity - Poor quality - Poor outcomes - Low staff morale - Low status - Administrative decision making - Dependency - Low income families treated scandalously - Higher taxes arising from inefficiency - Bureaucracy - Sameness 	<ul style="list-style-type: none"> - Power - Competition - Choice - High productivity - High quality - High performance - High staff morale - High status - Prices - Freedom - Equality of treatment - Lower taxes arising out of improved efficiency - Small regulatory team - Diversity

The outcomes flowing from such changes would be dramatic.

- ◆ Quality of health and education services would improve dramatically as a result of competition and choice.
- ◆ Changes in welfare incentives would result in less dependency on government.
- ◆ Retirement incomes would rise dramatically over time.
- ◆ Taxation would fall as yearly increase in:
 - Cost to government of health welfare, education and retirement provision fall.
 - Other measures become possible.