

*published  
1-11-85*

ON THE DRY SIDE 152      LANGE'S ECONOMY      John Hyde

David Lange and his Minister for Finance Mr. R.O. Douglas make Mr. Hawke and Mr. Keating, and even Mrs. Thatcher, look like wets. Their policies are only those which most Western Nations claim to follow now, but the strength of their response to New Zealand's economic plight is exceptional.

I don't wish to depreciate their efforts, but it is easier for Lange and Douglas to be economic rationalists than it is for most leaders. Because New Zealand is an open society who's economic problems are greater than those of other white English speaking countries many New Zealanders know that without tough measures their beloved country is headed for Queer Street. Although most of these are National voters they offer Lange critical support. New Zealand does not suffer serious ingrained class or racial antipathies. Its trade unions are powerful but less so than those which confront either Hawke or Thatcher.

These relative advantages do not mean that Mr. Lange's task is easy. People in protected industries and the public sector are being hurt by his changes. They do not all admit that their privileges are a national cancer let alone admit the consequences of allowing the cancer to develop to Argentinian proportions. The economy will probably take about fifteen years (half the time it took to get into the mess) to show that the pain of lost privilege and consequent adjustment was worth it. In the meantime Lange has only theory and experience elsewhere on his side.

It is important to appreciate the depth of New Zealand's troubles; these make Lange's strong action necessary and provide the public opinion which makes it possible. Thirty years ago New Zealand was the third wealthiest country after the United States and Canada; by 1978 it had slipped to 22nd. In 1983 it suffered growing current account deficits and growing external debt, widening fiscal deficit, high inflation on the heels of undisciplined money management, deteriorating unemployment, protected manufactures, regulated tertiary industries and agricultural subsidies. Australians should recognise the list. The National Party had governed for 29 of the past 36 years but economic mismanagement had been by consensus. Now the new economic rationalism also enjoys the official support of both parties.

The old policies plainly could not have been sustained; even so, in November 1983, Sir Robert Muldoon introduced rigid price and income controls which kept the lid on the pressure cooker a little longer but did nothing to turn down the heat. The fixed exchange rate became overvalued. When Muldoon called the election the lid blew off as currency fled in anticipation of devaluation.

Immediately after the election Lange devalued by 20% and removed all interest rate controls. He then applied his dry sponge to the foreign exchange markets, the financial markets, and the goods

and services markets; and adopted only half damp labour market policies. In only nine months he increased foreign exchange dealers' limits, then effectively abolished all exchange controls, removed the restriction on foreign ownership of dealerships, removed term and interest rate restrictions on private overseas borrowings, allowed overseas owned companies to borrow in NZ and allowed NZ financial institutions to finance daily balances overseas. In March this year the NZ dollar was floated. Since then it has risen about 13% against major currencies, and since the New Zealand devaluation, has risen about 35% against the Australian dollar. Some manufacturers are now complaining about foreign competition as they did in similar circumstances in Thatcher's Britain.

The NZ Reserve Bank's annual report says deregulation of the financial sector is "taking it, in short order, from the most regulated of the OECD countries to probably the least regulated".

New Zealand was the one country which quite clearly had more damaging levels of protection than Australia. Import licensing is to be phased out by the end of the 1980s. The highest tariffs are to be reduced to 25% within four years. Direct subsidies are being reduced or eliminated. Export incentives are being phased out. Farmers have lost input subsidies and their price guarantees are on the way out.

To keep an unfortunate pledge made in Opposition, Lange has restored compulsory unionism. That is a step backwards. He has taken some semi-corporatist measures, not unlike those recently adopted in Australia, to encourage better recognition of national priorities by unions and employers. Conciliation procedures have been changed so that unions can no longer force unwilling employers to go to arbitration. This change will reduce the influence of historical relativities. The government knocked back a union request for a general wage order. Most importantly Ministers have made it as clear as possible that demand will not be expanded to accommodate wage settlements. If they are believed NZ should avoid the worst of the problems which accompanied Thatcher's disinflation.

The fiscal deficit, 8.9% of GDP in 1983/84, is forecast to be down to 2.8% in 1985/86. Government expenditure is down from 41% of GDP to 38%. Unemployment has fallen from 5.8% to 2.8%, but the mix of an inflexible labour market, product market deregulation and a strong currency will probably cause some further unemployment, as occurred in serious proportions in the United Kingdom where the labour market is particularly rigid. Inflation exploded to 16.6% with the unbottling of the price/wage freeze and the devaluation, but is now turning down.

In political terms Lange's policies have been very risky. Although his foreign policy stance is to their liking, he is offending his traditional constituency and there is no way that the full benefit of his rational economics can be felt by the next election. But unlike Thatcher, he is unlikely to be faced

with truly militant unions or racial riots and New Zealand has the advantage of a repentant and much reformed National Party which seems to be resolved not to get cheap political mileage by allying itself with those who are disadvantaged by the economic reforms. Win or lose the next election, unless his courage fails him, Lange should be remembered as the man who put the New Zealand economy on the free market course which made eventual recovery possible. So much for party labels.