

The Politics of Successful Structural Reform

Roger Douglas

This is a shortened and edited version of a paper delivered by Roger Douglas, New Zealand's Minister of Finance 1984-88 and Minister for Immigration 1989-90, at the Pacific Regional Meeting of the Mont Pelerin Society in Christchurch on 28 November 1989.

OECD studies show that politicians tend, worldwide, to avoid structural reform until it is forced upon them by economic stagnation, a collapse of their currency, or some other economic and social disaster. Politicians tend to close their minds as long as they can to the need for structural reform, because they believe that decisive action must inevitably bring political calamity upon their governments.

As their countries' economies drift closer to crisis and structural problems are no longer deniable, they persuade themselves that action before the next election would give the advantage to their political opponents. They justify this stance to themselves by pretending that the opponents are deceitful and interested only in their own gain, not the country's well-being. As the economic situation worsens, both parties may seek to evade the issue by offering electoral bribes to distract voters from the real problems.

This article argues the contrary case: Political survival depends on making quality decisions; compromised policies lead to voter dissatisfaction; letting things drift is political suicide. My aim is to show that politicians can take practicable and politically successful action to benefit the nation, without waiting until economic or social disaster has forced their hand.

It is no part of my intention to argue that the government has got everything right in New Zealand since 1984. We need can learn from our own inadequacies, as well as from our considerable successes.

Quality Decisions and Political Consensus

Quality decisions are the key to structural reform and to political success in government.

The moral of New Zealand's story is plain. The politicians who sought success through ad hoc solutions that 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 upfront for larger medium-term gains, or focus on short-run satisfaction and be sandbagged later by the accumulated costs. 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 standards. Instant solutions do not have instant popular appeal.

Going for quality means choosing the actions that deliver most benefit to the nation in the medium term, instead of choosing more now, for supposedly 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 the available evidence.

From Day One, if a decision makes sense in the medium term, go the whole hog for quality decisions. Nothing else delivers an outcome that will satisfy the public at the end of the day.

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 we did not go the whole way for quality decisions during that period, we are now trailing behind the opposition, with approval ratings running sometimes as much as 3:1 against us.

Experience with quality decisions in tax reform, expenditure reform and financial deregulation 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 a reform before it is implemented: otherwise the actions taken will prove to be politically unsustainable at election

time. The tendency is to seek consensus in advance by compromising the quality of the decisions so as to bring the benefits up front, whether by ignoring the costs or by pushing them further down the track. But when the government compromises its decisions for immediate advantage at the expense of the medium-term outcome, public dissatisfaction will intensify over time.

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

To win elections, governments need the guts to implement quality decisions, to take the pain up-front instead of postponing it, and to be judged on the basis of the good outcomes they deliver. By taking that approach, New Zealand Labour won an increased majority in 1987.

Ten Principles of Politically Successful Structural Reform

1. For quality policies, you need quality people.

Policy starts with people. It emerges from the quality of their observation, knowledge, analysis, imagination, and ability to think laterally to develop a wider range of options.

The success of New Zealand's public sector reforms since 1984 depended on people as much as policy. Replacing people who cannot or will not adapt to the new environment is pivotally important. In the core public sector, we have abolished the old public service appeal system. Chief executives are contract appointments on merit, and are fully accountable for their performance. But the full potential of our reforms in this area cannot be achieved until Ministers learn to play their new role correctly, and let managers achieve the agreed outcomes efficiently.

By far the biggest quality problem in New Zealand, however, is the calibre of the people attracted to and selected as political candidates in both the Labour and the National Parties. In a two-party system, the public interest cannot be served well unless both parties adopt a broad-spectrum approach that is widely representative of the community. This can occur only if enough people with guts, education and vision are willing to accept the tasks involved in doing something for their country in the political arena. Politics is a mess because too many quality people are content to criticise from the sidelines. As long as that situation persists, we will wait in vain for good government in democratic countries. Improvement will occur only if quality people take the trouble to get themselves involved. They have to face up to their responsibility to ensure that good candidates are available, not just in one party but in both, and also to ensure that good candidates are selected by both parties.

By placing quality at the heart of all our endeav-

ours, we break the old moulds that have discredited politics and politicians, and led too many countries into avoidable economic calamity.

2. Implement reform in quantum leaps, using large packages.

Do not try to advance one 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.

Here and worldwide, the conventional wisdom is that genuine structural reform is the equivalent of wilful political suicide. That rule holds true if privileges are removed one at a time in a step-by-step program. 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 other groups in economy is removed from them. It is hard to complain about damage to your own group when everyone else is suffering at least as much — and you benefit from their loss, in the medium term. Whatever its own losses, each group has a vested interest in the success of the reforms being imposed on all the other groups. The economy operates as an organic whole, not a collection of unrelated bits and pieces. Structural reform aims to improve the quality of the interactions within the whole.

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. 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. Obviously, fairness does not include compensation for those who are losing their past privileges, but even they make genuine fundamental gains after they have come through the adjustment.

3. Speed is essential: it is impossible to go too fast.

Even at maximum speed, the total program will take some years to implement, and the short-term trade-off costs start from Day One.

There are serious dangers in seeking to hold down the pace of change in order to satisfy groups that claim a slower pace would give the community more time to adjust with less pain. Policy cannot be fine-tuned with enough precision to ensure that, for example, inflation will be reduced successfully by a modest and targeted amount every year over an extended period. If an attempt is made to do so, it takes only a modest error or a miscalculation to move you backwards instead of forwards, thus destroying your credibility.

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

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

A great deal of technical debate has been aired worldwide about the optimum sequencing of structural reform, and the alleged sequencing errors of governments, both here and elsewhere. Armchair theorists postulate the desirability of tackling the labour market or the tradeable goods market before embarking, for example, on the deregulation of sectors such as finance. At a purely analytical level the debate is entertaining, but no clear-cut answers emerge. Moreover, from my point of view as a practitioner, the question is irrelevant. Before you can plan your perfect move in the perfect way at the perfect time, the situation has already changed. Instead of a perfect result, you wind up with a missed opportunity.

Some decisions take full effect the day they are made. Others take two to five years of hard work before they can be fully implemented. Perfect sequencing is just not 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.

4. Once you start the momentum rolling, never let it stop.

Don't stop until you have completed the program. Opponents' fire 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 is very important. **Before** you remove the privileges of a protected sector, it will tend to see structural change as a threat that 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. It becomes a supporter of reform.

The opposite process occurs wherever favoured groups are allowed to retain their privileges. Fearing that they may not be exempt for ever, they improve their organisation and become entrenched oppo-

nents of reform. Stop the rot before it begins. Remove privilege even-handedly across the board and give all groups a more constructive role in a better society.

5. Consistency + Credibility = Economic Confidence.

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

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. As the reform program 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 principle. People begin to understand that wherever a group manages to hold on to a privilege, an avoidable cost is imposed on those who are facing up to an adjustment process. But the battle for consistency and credibility is continuous, and never finally won. It remains permanently central to every decision that comes before the government for consideration.

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

6. Let the dog see the rabbit.

People cannot cooperate with the reform process unless they know where you are heading. Go as fast as you can, but, where practicable, give them notice by spelling out your objectives and intentions in advance. Where programs can or will be implemented in stages, publish the timetable up front. These strategies show that you know where you are going, commit the government to the action, let people know how fast they have to adjust, and reinforce the credibility of the total program.

Decision-makers must be able to see as much as possible of the total pattern of change affecting their businesses in the period ahead of them, in order to plan an effective adjustment. The release of information also places professional analysts throughout the community in a position to make their own independent evaluations of progress and government performance. They understand the importance of quality in decision-making, and the benefits avail-

able from consistent medium-term policies. They are often trusted advisers of the interest groups. Over time, their objectivity, combined with their increasing good will towards the reform program, becomes one of the major factors in creating a favourable climate of public opinion.

In 1987, after the most radical structural reforms in 50 years, New Zealand Labour fought the election on a platform that the job was only half-done: we alone had the guts and know-how to finish it. The government was returned with all the seats it won in the landslide 1984 election, and took two more seats away from the opposition. Voters wanted the job completed, and done right.

7. Never sell the public short.

Do not mistake the fears of politicians for ignorance, lack of guts or lack of realism on the part of the voting public.

Successful structural reform does not become possible until you trust, respect and inform the electors. You have to put them in a position to make sound judgements about what is going on. Ordinary people may not understand the situation in all its technical detail, but they know when key questions are being evaded. They can sense when they are being patronised or conned, and do not like it. They respect people who front up honestly to their questions. They listen with interest and attention if you tell the simple truths they are not used to hearing from politicians:

- There is no free lunch. The privilege of a favoured group is always paid for by the rest of the community. Privileged groups also have less need to perform, so the whole economy suffers.
- Subsidies always contain the seeds of the destruction of the very industries they were meant to help. You end up investing in uneconomic production that damages your own market future.
- A lower exchange rate is not the way to safeguard exporters. Not many years back, the New Zealand dollar was worth US\$1.35. Exporters then were more competitive than they are today.
- Inflation is what has ruined the competitiveness of exporters in this country over the last 20 years. Unless we tackle that, exporters in New Zealand do not have a long-term future.
- Interest rates will always be inflation plus a margin. If inflation is 15 per cent, interest rates will be 15 per cent plus a margin. If inflation is 2 per cent, interest rates will be 2 per cent plus a margin.
- Easing monetary policy will not solve the prob-

lem of high interest rates. Six months out, inflation, instead of falling, will take off again, and interest rates will rise with it.

- For the last 100 years, Ministers have thought they were running government departments. We know now that they had no idea what was really going on, and no real control over it.
- For years, in New Zealand, politicians have been under the illusion that they could pick winners better than the private sector. They wasted billions, for zero or negative returns.
- You can have income tax at 20c with no incentives and a level playing field — or tax at 40c with incentives for favoured groups, in which case the government manages your investment. You choose!
- Import licensing did not create jobs. It gave rip-off profits guaranteed by the state to selected people, regardless of their performance, at the expense of consumers and economic growth.

8. Don't blink: public confidence rests on your composure.

Structural reform in New Zealand involved Ministers in making some of the most radical decisions announced to the public for 50 years or so. Relaxed, matter-of-fact composure is essential every time you face the public. Their confidence is always based on yours.

As the pressure of change comes on to the economy, the whole community starts watching every television appearance intently, looking for the least twitch of government nervousness. Their confidence in, and cooperation with, the reform program can be undermined by the least blink. Visible uncertainty among key Ministers spreads like a plague throughout the community.

Obviously, people are not going to be convinced by every golden word. To achieve a flexible economy, the government has to implement consistent policies over an extended period of time. Some people, who are not yet convinced about the direction of policy, will always leave the hall marvelling at your inflexibility rather than at the common sense of your answers. But it improves the confidence of the community as a whole to see the politicians responsible for structural adjustment face the music, and deal with public fears in a gentle, sensible, consistent way.

9. Incentives, choice, monopoly: get the fundamentals right.

A sick economy cannot be regulated back to health. Economic dynamism is the liberated energy of people at every level personally choosing and using

opportunities that benefit them. Government's role is to create a framework that widens their opportunities for choice, improves the incentives to productive activity and sees that their gain benefits society as a whole.

The ordinary consumer's only effective safeguard against exploitation is the ability to make free, personal choices among competing suppliers whose livelihood depends on satisfying the final consumer. Dedication to that principle from 1984 onwards is what places the present government squarely in the established Labour tradition of putting the needs of the common people first.

No one should be surprised that deregulation had to wait for a Labour government to gain office in New Zealand. The abolition of privilege is the essence of structural reform. Wherever possible, use your program to give power back to the people. That is central to both democracy and market socialism.

Labour supporters who value the goals of their party need to be consistently reminded that, wherever power exists, vested interests will cluster, trying to convert it into privilege for themselves. The inefficiency created by monopoly union privilege on the waterfront has exactly the same kind of adverse impact on the lives of other working people as the privilege of farmers or manufacturers.

10. When in doubt, ask yourself: 'Why am I in politics?'

Conventional politicians ignore the need for structural reform because they think they are in power to please people, and pleasing people does not involve making them face up to the hard questions. But genuine structural reform, carried right through fairly and without compromise, delivers larger gains in living standards and opportunity than those achiev-

able by any other political route.

Ask yourself: 'Why am I in politics?' Is it to get myself a high income, two cars and the maximum available number of perks? Or to do something that makes a real difference to the nation's future? At the end of the day, making that real difference matters more than anything else to the voting public. When they see, understand and believe what you are doing, they want it done.

The surest way for Labour to win again in 1990 is to decide where we want New Zealand to be by 1993 and beyond, then plan policies that lift our growth rate again, into the 4 to 6 per cent range. At 4 per cent a year, the economy would be growing by 50 per cent every decade. New Zealanders would have something worthwhile to do with their lives, and would receive a substantial reward for their effort. Moreover, when you set a goal like that, most of the social problems that are scaring politicians to death at the moment fall into perspective in a totally new context that changes their nature.

At present, the 1990 New Zealand election is in the balance. The past five years have produced lasting gains for all New Zealanders. But elections are about the future, not the past. For both our major parties, the risk of political failure in 1990 does not come from the dangers involved in adopting the principles I have set out in this article. It comes from the temptation to ignore them.

New Zealand's health, education, welfare, unemployment and racial problems will necessarily remain more or less insoluble in an economy that is still relatively low-growth by world standards. With growth at 50 per cent each decade, we could look at all those key issues as areas of opportunity, instead of being forced to view them as politically dangerous problems.

Policy

Notes for Contributors to *Policy*

1. Submissions should be about 2000-3000 words in length, but longer items will be considered. Manuscripts should be typed, double-spaced originals (not photocopies), and on an IBM PC or Apple Macintosh disk if possible.
2. Submissions should be written in a brisk, jargon-free style, and should avoid footnotes. References to publications should as far as possible be included in the text. Tables and graphs should be included only where necessary, and a clean, original copy included separate from the manuscript.
3. In case submissions need to be refereed, authors can ensure their anonymity is preserved by keeping personal details separate from the main manuscript.
4. Subheadings are encouraged both to improve the final appearance of the article and to provide a quick indication of its contents.
5. Unsolicited contributions are welcome, but should be accompanied by a stamped SAE.
6. If you have any enquiries, please call the Editor, Michael James, on (03) 458 3175.