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**Social democracy and market reform in Australia and  
New Zealand**

**John Quiggin**

**Department of Economics**

**James Cook University**

Communications to John Quiggin at

**EMAIL [John.Quiggin@jcu.edu.au](mailto:John.Quiggin@jcu.edu.au)**

**FAX + 61 77 814149**

**Phone + 61 77 81 4798**

**+ 61 77 251269**

**Abstract**

Social democratic governments in Australia and New Zealand adopted policies of radical free market reform, including financial deregulation, privatisation and public sector reform in the 1980s. Because of the absence of institutional obstacles to government action, reform was faster and more comprehensive in New Zealand than in Australia. The New Zealand reforms were associated with increasing inequality and generally poor economic outcomes. There is nothing in the New Zealand experience to support the view that radical free-market economic policies are consistent with social democratic welfare policies or with social democratic values of concern for the disadvantaged. The Australian reforms were less radical, and were accompanied by some refurbishment of the welfare state. Economic performance did not improve, as anticipated by advocates of reform, but was considerably better than that of New Zealand.

JEL Codes H1, H5, N4

## **Social democracy and market reform in Australia and New Zealand**

The political and economic history of Australia and New Zealand over the past twenty-five years displays remarkable parallels. In 1972, both countries elected social democratic governments led by charismatic reformers, Gough Whitlam and Norman Kirk. Both governments seemed set to achieve long-held goals of the labour movement including the provision of free university education and medical care, more generous social welfare benefits and public support for the arts and sciences. Labour (or, in the Australian spelling, Labor) appeared as the party of the future.

Twenty-five years later, these hopes are in ruins. Conservative governments pledged to radical free market reforms hold office in both countries, and in all but one of the Australian states. Worse still, from the perspective of social democracy, the shift to the right is simply an extension of policies initiated by labour governments in the 1980s. The key components of the Thatcher revolution, including deregulation, privatisation, competitive tendering and contracting for public services, were implemented in Australia and New Zealand by labour governments. The only major task they left to their successors was that of breaking the (already greatly reduced) power of the union movement through labour market reform.

### **The Fraser & Muldoon governments**

By 1975, the collapse of the long postwar boom had led to the downfall of labour governments in Australia and New Zealand. Particularly in Australia, reaction against the failures of the governments of 1972–75 was a major factor in Labor's subsequent shift to the right. The expansion of public spending and the rapid growth in real wages that took place under Whitlam were seen as major contributors to the recession of 1974 and to the emergence of sustained high unemployment. Subsequent Labor leaders were at pains to present themselves as responsible economic managers and to distance themselves, as much as possible, from Whitlam. There was also a reaction against Whitlam's style of government. The system of Caucus democracy, in which Cabinet decisions were frequently rejected by the parliamentary party as a whole, was seen as symbolic of misgovernment. Whitlam's determination to implement the program on which he had been elected, regardless of deteriorating economic circumstances, was seen as dogmatism.

The governments that replaced those of Whitlam and Kirk were led by conservative strongmen: Malcolm Fraser in Australia and Robert Muldoon in New Zealand. When they took office both men were seen as radical rightwingers, but from the vantage point of the 1990s, they are usually regarded as highly interventionist. This view is anachronistic, in that it projects policy concerns of the 1980s on to earlier periods (Kelly 1992) and misleading, in that the trend of policy under the Fraser and Muldoon governments was towards deregulation, even if hesitantly and with frequent reversals. For example, the Fraser government laid the groundwork for much subsequent free market reform, most notably through the establishment of the Campbell Committee of inquiry into the financial system, which recommended deregulation of financial markets and a freely floating exchange rate. Similarly, the Muldoon government liberalised foreign exchange regulations, deregulated parts of the transport sector and removed barriers to trade with Australia through the Closer Economic Relations agreement (Bollard and Buckle 1987).

The conservatives initially assumed that the economic crisis of the early 1970s would be resolved by a combination of monetarist macroeconomic policies and a cut in real wages. The second oil shock of 1979 made it clear that these assumptions were invalid, but provided a new hope, that of an export-led recovery based on minerals and energy. The most notable expression of this hope was Muldoon's 'Think Big' program, a set of projects based on the exploitation of natural gas and other resources.

By the early 1980s, it was clear that hopes for an export-led recovery were misplaced. The booms never eventuated and the projects designed to exploit them resulted in growth in international debt, particularly in New Zealand. The contrast between apparently boundless resources and poor economic performance created a widespread sense of disillusionment with the economic policies of the past. Rising unemployment and slow growth were seen as the outcome of national economic failings rather than as a part of an economic crisis common to all developed countries. This view was supported by the assumption that international problems were primarily due to higher energy prices and should therefore not affect energy-rich countries.

In Australia, concern about poor economic performance was expressed in the growth of a literature focusing on the alleged decline of Australian living standards relative to that of other developed countries. Work in this literature began with the claim that, in 1870, Australians had enjoyed the highest standard of living in the world but that slow relative growth had led to Australia being overtaken by a dozen or more countries. Projecting this trend forward, it was suggested that Australians would soon be 'following the Argentinian path' (Duncan and

Fogarty 1985) or would become the 'poor white trash of the Pacific' (Scutt ed 1985). Most Australian writers in the 'white trash' tradition blamed the 'Federation trifecta' of policies centred on tariff protection, the Arbitration system of wage determination and the White Australia policy for creating a backward-looking and inward-looking culture (Henderson 1983).

A less dramatic version of the argument focused on below average growth in income per capita in the period after 1950. The statistical basis of the literature on relative decline is weak (Quiggin 1987), and most econometric studies conclude that, after taking account of convergence effects and differences in population growth rates, Australia's economic performance for the period 1950-80 was about average for the OECD (Dowrick and Nguyen 1986, Gruen 1986). Nevertheless, the steady decline in the terms of trade for exporters of primary products presented both countries with economic problems. Particular difficulties were created for New Zealand, which remained heavily reliant on British export markets over the postwar period and suffered economic losses when Britain entered the European Community in 1971. The extent to which New Zealand's poor economic performance over the 1970s can be explained by adverse trade shocks is open to debate. In any case, by the end of the decade, per capita income in New Zealand was between 5 and 10 per cent lower than in Australia.

The claim that past policies have yielded poor outcomes implies support for radical change, but gives little guidance as to the appropriate direction of change. In the early 1980s, however, the debate in both countries was dominated by advocates of the ideas referred to in Australia as 'economic rationalism'. The term originated under the Whitlam government where it had the positive connotation of policy formulation on the basis of reasoned analysis, as opposed to tradition, emotion and self-interest, but, with the exception of support for free trade, did not imply a presumption in favour of particular policy positions. Over time, however, most 'economic rationalists' came to assume that reasoned analysis would always lead to support for free-market policies. Hence, the analytical process could be dispensed with, and replaced by advocacy of a predetermined set of policies, those of market reform.

The example of the Industries Assistance Commission, set up by Whitlam to make recommendations on tariffs and agricultural support policies was highly influential. After receiving a reference from the government to inquire into a policy area, the Committee held public hearings before producing a report, which almost invariably advocated a reduction in government intervention. The best of these reports achieved high standards in presenting a detailed consideration of the evidence and a tightly argued policy analysis, and even the worst were usually more impressive than the arguments put up by the Commission's opponents.

Especially in its heyday in the 1970s and early 1980s, the Commission was seen as a model of rational policy-making by many economists. Critics who suggested that the Commission's conclusions were predetermined and that the inquiry procedures were little more than elaborate window-dressing (Quiggin 1993, Toohey 1994) had little influence before the 1990s.

Apart from the Commission's Reports, the most important policy document produced by the economic rationalists was *Australia at the Crossroads* by Kasper et al. (1980), who proposed a radical free market program which, they predicted, would raise per capita income by more than 70 per cent, relative to a no-change baseline. By the time of its defeat in 1996, the Hawke-Keating Labor government had implemented most of the program proposed by Kasper et al. (1980), going well beyond it in many cases. However, growth in per capital income was no higher than in the baseline scenario presented by Kasper et al.

In New Zealand, the future Finance Minister, Roger Douglas, had expressed his discontent with existing policies in his book *There's got to be a better way*, (Douglas 1980). As the title suggests, Douglas was looking for a radically new policy agenda. However, Douglas (1980) was still open to interventionist as well as free-market options. By 1983, drawing on advice from businessmen and Treasury officials, Douglas had developed a radical free-market program (Easton 1997).

Parallel developments in the policy debate were unsurprising in view of the close linkage between the economies of Australia and New Zealand. Migration between Australia and New Zealand has always been unrestricted and the Closer Economic Relations agreement signed in 1983 removed most barriers to the flow of goods. The parallel economic performance of the two countries is therefore not surprising. The modest divergence in performance over the 1970s could reasonably be explained as a temporary shock, arising from New Zealand's greater reliance on the United Kingdom as an export market, and Australia's greater endowment of mineral resources, particularly coal and oil.

The surprise was the divergence that took place during the 1980s, when GDP per capita in New Zealand fell to a level 20 percent below that prevailing in Australia, and remained there (Easton and Gerritsen 1996). Even more surprisingly, most international commentary is based on the assumption that New Zealand's reforms have been highly successful, while Australia is seen to have suffered because of its less whole-hearted approach to free-market reform. In fact, as is shown in Section 8, whereas Australia's economic performance has been very similar to the OECD average since 1983, New Zealand's has been considerably worse.

### **The adoption of free-market reform**

The term 'reform' is normally interpreted to mean 'change for the better'. This usage makes sense in a context where everyone agrees about the desirable direction of change, although there may be disagreements about the pace of change and the feasibility of particular reform strategies. For most of the present century, 'reform' has been broadly synonymous with 'social democratic reform'. The free market policies introduced in Australia and New Zealand are described as reforms but involve repealing the reforms of the past. Rather than adopt a tendentious description of this process, such as 'reaction', I will use the term 'reform' to refer to policies promoting structural change, without any presumption that reforms are desirable. The Australian and New Zealand labour governments entered office as advocates of social democratic reforms, but implemented policies of free-market reform.

In Australia, the Hawke Labor government was elected on the basis of a social democratic program, embodied in its 1982 platform. This platform was the product of a thoroughgoing reassessment of the party's procedures and policies following the defeat of the Whitlam government. Although in some respects the platform marked a retreat from the ambitious goals of the Whitlam period, it maintained both a long-run commitment to social democratic ideals and a belief in the necessity for extensive intervention in the economy through active industry policy, public ownership of natural monopolies, and so on.

The platform also included innovative elements, of which the most important was the idea of a Prices and Incomes Accord. Shortly after its election, the government held a national economic summit conference in an attempt to extend the Accord relationship between the government and the unions to a tripartite process incorporating business. The summit, which reflected Hawke's personal commitment to consensus politics was a great political success. In the long term its greatest significance was that it served as a model for the Tax Summit of 1986, which prevented the introduction of a goods and service tax.

As well as establishing the Accord, the Hawke government took a number of steps towards implementing its social democratic program, including raising social welfare benefits, introducing a national health insurance scheme (Medibank), and maintaining the stimulatory fiscal policy inherited from the outgoing Fraser government.

Nevertheless, the pressures for movement in a different direction were strong. The defining event for the Hawke government's economic policy came in December 1983. The dollar came under speculative pressure as foreign exchange markets anticipated an appreciation. Instead of tightening controls on capital flows, as the Whitlam Labor government had done in similar circumstances, the government decided to float the currency and abolish exchange controls.

The float and, even more, the abolition of exchange controls, were significant steps in themselves. The effect of the float was to give financial markets greatly increased power over the government's economic policy, or, in the jargon of the day, to expose the government to 'market discipline'. On the other hand, the discipline on private sector borrowings implicit in a fixed exchange rate was lost. Australia has always been a capital-importing country, but in the 1980s the inflow of capital, and the corresponding current account deficits grew rapidly, exceeding 5 per cent of GDP in the late 1980s. At the same time, debt and portfolio holdings of equity replaced direct foreign investment. The results included an explosive growth in private overseas debt and an overvaluation of the currency leading to sustained current account deficits. Concern about debt and the current account deficit eventually forced the government into the contractionary policies that precipitated the recession of 1989-91.

More fundamentally, the float marked the willingness of leading members of government to abandon traditional social democratic views in favour of free-market economic views. Rather than being seen as a regrettable necessity, the float was presented as a break with the dogmas of the past. For the first few years after 1983, the government prided itself on maintaining a 'clean' float, with minimal intervention from the Reserve Bank, though a more pragmatic stance emerged over time.

The enthusiastic reaction of the financial markets reinforced the government's change of direction. Keating was named Finance Minister of the Year by *Euromoney* magazine, and for a decade afterwards bore the (frequently ironic) nickname 'The World's Greatest Treasurer'. Roger Douglas won the same award the following year.

Although the business establishment maintained its historic links with the Liberal Party, Labor was closely linked with the rising 'entrepreneurs' of whom the archetypal example was Alan Bond.<sup>1</sup> Despite the name, the entrepreneurs were not noted for significant new undertakings, but focused on property speculation and takeover deals. They were initially embraced by the labour governments as proof of the dynamism generated by financial deregulation. However, the entrepreneurs were quickly disowned as their financial empires unravelled after the stock-market crash of 1987.

The enthusiastic reception of the float by financial markets, and the acquiescence of the Labor movement, emboldened the leaders of the government to move further away from traditional Labor views and further towards a thoroughgoing economic rationalism. Acceptance of more wide-ranging financial deregulation and the desirability of cutting back the public

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<sup>1</sup> As well as controlling assets worth billions of dollars, Bond was famous for owning the yacht which won the America's Cup, and for paying a world-record price for a Van Gogh painting, through a complex transaction which ended in a prison sentence.

sector followed rapidly. The abandonment of Labor's belief in the public sector was formalised in the 'Trilogy' commitments of 1984. The commitments were:

- Federal government tax revenue would not be permitted to grow as a proportion of GDP;
- Federal government spending would not grow faster than the economy as a whole; and
- the Federal deficit would be reduced in money terms in 1985—6 and would not be permitted to grow as a proportion of GDP in the following two years.

The government was initially fairly successful in meeting these objectives, but the deficit and public expenditure grew rapidly after the economy went into recession in 1989. Nevertheless, after the Trilogy commitments, the direction of Labor's economic policy was set.

Under Hawke's prime ministership (1983-91) and then Keating's (1992-6), the government's commitment to free market policies became steadily stronger, and was embodied in a comprehensive program of microeconomic reform.<sup>2</sup> In 1988, the government committed itself to a general reduction in tariffs, and to privatisation of enterprises such as the Commonwealth Bank. In 1990 the two-airlines agreement came to an end and the basis was laid for competition in telecommunications. During the early 1990s, policies of competitive tendering and contracting out and private provision of infrastructure led to a further contraction of the role of government.

In this respect, Labor's most significant legacy was the National Competition Policy Act, frequently referred to as the 'Hilmer reforms' after the report of Hilmer et al () on which the policy was based. This act bound both state and federal governments to implement comprehensive pro-market reforms, to be overseen by the unelected and unaccountable National Competition Council. The most noteworthy examples are the corporatisation of government business enterprises and a comprehensive program of competitive tendering and contracting for publicly provided services. As a result, although electors, and even the Howard Liberal government, have shown considerable 'reform fatigue', the policies of the free-market reformers who dominated the Labor government are still being implemented.

### *Explaining Australian Labor's shift to the right*

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<sup>2</sup> More extensive discussion of microeconomic reform policies is given by Forsyth (1992), Gruen and Grattan (1992) and Quiggin (1996).

Throughout its shift to the right, the Australian Labor government followed, rather than led, the climate of opinion among the economic policy élite.<sup>3</sup> At least until the recession that commenced in 1990, this climate was one of increasingly unqualified economic rationalism.<sup>4</sup> It is, then, unsurprising that the Australian Labor party moved to the right. In all of this, the experience of Australian Labor was broadly similar to that of European social democrats who, with greater or smaller degrees of reluctance, followed the prevailing trend towards free-market policies.

The fact that Australian Labor showed much less reluctance may be explained, in large measure, by the factional structure of the party. The dominant Right group, and to a lesser extent its Centre-Left allies, had a tradition of 'pragmatic' contempt for ideology, priding itself on its single-minded focus on obtaining and retaining office. This did not, of course, mean that the faction was free of ideology. Rather, the lack of any socialist ideological ballast left the Right open to capture by the newly dominant ideology of economic rationalism. Defence of traditional Labor policies was confined to the minority Left faction, which was largely ineffectual. After a few years in which the Left was successfully marginalised within the government, the main leaders of the Left, such as Brian Howe, were willing to accept the general policy of free-market reform in exchange for greater influence in areas such as social security policy.

Hence, no serious attempt was made, within or outside the government, to put forward an alternative economic program, except in some isolated areas of policy. During the period of Opposition from 1975 to 1983, Labor's attention had been focused on macroeconomic issues and the development of an expansionary program centred on the Accord. There had also been a vigorous debate on tariffs and industry policy, which led to support for a number of 'Industry Plans' adopted in the early years of the government.<sup>5</sup> With these exceptions, however, the

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<sup>3</sup> The meaning and relevance of the term 'policy-making élite' has been debated. The policy-making élite included the Reserve Bank and the 'central' departments of the Federal government (Treasury, Finance and Prime Minister's), and the Industry Commission. The economic rationalism of these institutions was supported and amplified by the majority of economic commentators, the Opposition Liberal Party, business organisations such as the Business Council of Australia and the National Farmers Federation, and a proliferation of private sector think-tanks, which recruited many of their staff from institutions such as the Treasury. Some of these groups had little direct access to the government, but led opinion from outside.

<sup>4</sup> The pejorative use of the term 'economic rationalism' was first popularised in the early 1990s by a study of decision-making elites in the Commonwealth public service (Pusey 1991).

<sup>5</sup> The steel plan was generally viewed as highly successful, and adjustment plans for the motor vehicle and heavy engineering industry were qualified successes (Castles and Stewart 1993). Attempts to smooth the contraction of the textile industry were less successful and policies aimed at stimulating 'sunrise' industries such as biotechnology had little impact. However, the abandonment of active industry

terms of the policy debate were set by the economic rationalists. The question for the government was not which way to turn, but how fast to move in the free-market direction.

### *New Zealand*

The New Zealand Labour Party won office in 1984 on the basis of a fairly traditional, if vague, social democratic platform. However, the incoming Finance Minister Roger Douglas had already developed the policy program that would be followed by the Labour government. As in Australia, the Labour government came to office as the result of a snap election, which was accompanied by a foreign exchange crisis. The crisis atmosphere ensured that Douglas and his supporters could implement their policy program without regard to community concerns or opposition within the Labour party. The Prime Minister, David Lange initially left economic matters to Douglas, focusing attention on foreign policy issues such as the ban on nuclear ship visits.

Whereas Hawke's approach to politics was based on negotiation and consensus, Douglas favored rapid implementation of reforms on a broad front, on the assumption that when the benefits of reform were evident, popular support would follow (Douglas 1993). Douglas regarded consultative processes (New Zealand held its own economic summit in 1985) as little more than a device to confuse and neutralise opponents. Douglas' authoritarian approach was made easier by the fact that New Zealand is a unitary state with a unicameral Parliament. As Evans et al. (1996, pp. 1856-7) observe:

The early pace of the reforms reflects in good part the deep-seated nature of the initial crisis, widespread recognition, particularly in the business community, of the need for change, strong intellectual and administrative support from key public sector advisers and New Zealand's constitutional arrangements. In New Zealand a governing party with a clear parliamentary majority can legislate its program with few constitutional impediments. The major nonconstitutional constraints on the executive are internal party unity, electoral support, and the disciplines imposed by external financial flows.

The electoral system until 1996 was one of single member constituencies elected to a unicameral parliament on a plurality basis, which permitted a government to achieve a substantial majority of seats while receiving a minority of votes cast. In Australia, by contrast, national governments have normally had the support of a reliable majority in the House of Representatives, elected by constituencies, but not in the Senate, which is elected by a system

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policy was due far more to the advance of free market ideology than to any empirical evaluation of its successes and failures.

of proportional representation. In addition, power is divided between national and state governments and all governments are constrained by the constitutional limitations associated with a federal system. Finally, the links between the New Zealand Labour party and the trade union movement were weak, whereas those in Australia were strong and were made even stronger by the Accord.

It is important to consider whether the fact that reform was more radical in New Zealand than in Australia (or for that matter, anywhere else in the world) reflected broader discontent with the existing economic policy framework or whether it was simply the result of a set of institutions and personalities which made radical reform easier to implement. New Zealand's economic situation was objectively worse on most measures, though not with respect to unemployment. However, there was no shortage of discontent with Australia's economic performance, and the prophets of doom in the early 1980s were at least as prominent in Australia as in New Zealand (Duncan and Fogarty 1985). The critical factor is that the New Zealand political system was open to the 'blitzkrieg' approach required to impose free market reforms on an initially sceptical, and later actively hostile, public (Easton 1997b).

### **Financial deregulation**

The case for financial market deregulation in Australia had been put forward in the report of the Campbell Committee of Inquiry, appointed by the Fraser government. In Opposition, Labor had criticised the report, correctly predicting that 'Total deregulation of financial markets, as advocated by the report, would bring about higher interest rates, increased government taxes and charges, less finance for housing, a more volatile exchange rate, greater foreign ownership and less control by government over the form or pace of development of the Australian economy'. (quoted in Langmore 1992)

However, as the Labor government moved towards acceptance of a freely floating exchange rate, commitment to a policy of regulation of domestic financial institutions became untenable. The Government commissioned a new report which recommended the removal of all interest rate controls and of restrictions on maturities on trading and savings bank interest bearing, and, most controversially, the admission of foreign banks. In the first major trial of strength with the Left of the party, the recommendation for the admission of foreign banks was pushed through the 1984 Annual Conference of the Australian Labor Party (Gruen and Grattan 1993).

Financial deregulation in New Zealand commenced almost immediately after the government's election, and was even more rapid than in Australia. All controls on capital flows

and on the asset portfolios of financial institutions were abolished. The abolition of exchange controls removed the main effective barrier to foreign investment and the majority of large companies became either partially or completely foreign-owned.

In both countries deregulation produced an explosion in financial speculation but did little to improve either the availability or the allocation of long-term investment capital. The most noticeable result was the rise and fall of paper financial empires of the 'entrepreneurs', such as Bond and Skase in Australia and Judge in New Zealand. However, the entrepreneurs merely the most visible symbol of a boom in speculative lending and investment in which the major banks and well-established businesses were heavily involved.

The failure of deregulation may be traced to its one-sided nature. Although controls on banks and other financial institutions were removed, the government remained committed to maintaining the stability of the financial system, and therefore to protecting financial institutions from collapse. The advocates of deregulation accepted that prudential supervision of the banks aimed at controlling the risk of bank failures and financial panics, was required even in a deregulated setting, but failed to recognise that the effectiveness of prudential controls would be seriously compromised by the removal of the majority of existing regulations. Although some new controls, such as the prime asset ratio and capital adequacy controls were introduced, they proved inadequate to the task.

Deregulation put the banks in a no-lose situation. They could and did adopt much more risky lending strategies. If their loans turned out well, the banks pocketed the profits. If they turned out badly, the government was there to pick up the tab. Examples abound, but the experience of Bond and Skase clearly demonstrate the inability or unwillingness of the banks to rigorously monitor their credit risks. A major outcome of deregulation was an increase in lending to marginal customers, many of whom borrowed to speculate. In the last five years of the eighties, while personal credit grew at around ten per cent a year and credit for housing by fifteen per cent, business debt increased by twenty-five per cent a year. The boom in speculative lending was reflected in poor investment decisions. The Industry Commission (1997) estimates that capital productivity growth over the 1980s was negative.

In practice, the banks did not need to call on the Reserve Bank to act as lender of last resort. Publicly guaranteed banks are 'too big to fail'. That is, the cost of letting such banks become insolvent, and paying out the depositors, is greater than the cost of assisting them to carry on as going concerns. In addition, the effects of a major bank failure on international and domestic business confidence have been too serious to contemplate. As soon as it became apparent that banks were in serious difficulty, government began to tilt the 'level playing field'

in their favour. Foreign ownership rules were bent to enable the banks to realise a better return on the assets in the media and other industries that they acquired as a result of the failure of the entrepreneurs to whom they had lent. The tax treatment of bank losses was made more favourable. This pattern of rescuing failed institutions has been followed in other countries that have experienced a deregulation-led boom and slump.

The New Zealand experience was slightly different. Most institutions were owned either by government or by foreign (largely Australian) financial institutions and were bailed out by their owners when they ran into trouble. New Zealand has continued to maintain a laissez-faire approach to financial regulation, effectively relying on the overseas owners of its financial institutions, and their central banks, to maintain the stability of the financial system.

It would have been difficult for any government to resist the pressure for deregulation. The effectiveness of the controls which existed at the beginning of the eighties were being gradually eroded. Financial institutions outside the controls had grown in influence and the regulated financial institutions had created debt instruments that were close substitutes for those which were controlled. However, there were choices. Some countries such as the Scandinavian countries, the United Kingdom, New Zealand and Australia chose policies of radical deregulation, while other European countries made only moderate changes to their regulation policies. The results of radical deregulation have been uniformly damaging and have followed a remarkably similar pattern: an asset price boom followed by collapse and severe recession.

## **Tax policy**

The first major difference between Australia and New Zealand in the process of free market reform arose with respect to tax policy. The advocates of free-market reform, led by Treasurer Paul Keating in Australia and Finance Minister Roger Douglas in New Zealand were committed to the idea of a Goods and Services Tax (GST), that is, a broad-based consumption tax using the value-added tax (VAT) mechanism. Based on the experience of the introduction of a VAT in Canada, the reformers favored a flat-rate tax with no exemptions, arguing that an exemption for say, food, would 'open the floodgates' to demands for other exemptions and therefore defeat the purpose of reform.

However, the inclusion of food in the tax base for the first time ensured that the move to a GST would be regressive, especially when combined with cuts in top marginal tax rates. This made the task of securing a consensus in favour of such a tax reform package virtually impossible. Although a good deal of intellectual effort was expended in attempts at squaring the circle, it was impossible to design a package which compensated low-income earners and

recipients of social security benefits for the regressive impact of the GST while leaving enough net revenue to finance significant cuts in top marginal rates of income taxation.

In Australia, the co-operation of the unions was essential to the success of the government's wages policy, based on the Prices and Incomes Accord. Moreover, Hawke was philosophically committed to the idea of consensus. The government therefore organised a Tax Summit, at which it proposed a set of three tax options. The idea was that both the mildly radical Option A and the do-nothing Option B would prove unacceptable, leading to the formation of a consensus behind Option C, based on a GST. It was hoped that the unions and business groups would be attracted by the prospect of low marginal income tax rates and that the 'welfare lobby' would welcome the expansion of social welfare expenditure designed to offset the regressive impact of the GST.

In the event, however, the unions were sceptical about Option C, and welfare groups strongly opposed it. When business leaders, still hostile to Labor, refused to back the package, Hawke abandoned it, leading to the first major breach in his relationship with Keating. In the end, the government adopted tax reforms based on Option A, including taxes on fringe benefits and capital gains, offset by full dividend imputation and cuts in top marginal rates. As a result, the net impact of tax changes under Labor was broadly neutral, with the tax burden faced by different income groups changing very little over the period 1983-96.

In New Zealand, the lack of popular support for a GST was not an obstacle to its implementation. The Labour government, with an outright majority in a unicameral Parliament, saw no need to seek national consensus before adopting a tax policy that had not been mentioned in its election campaign or to worry about compensating low income earners. The GST was introduced at a uniform rate of 10 per cent, later increased to 12.5 per cent, with food being taxed at the full rate, while the top marginal rate of income tax was reduced to 48 per cent and then to 33 per cent.

The case for cuts in the top marginal tax rate was based on the supposed disincentive effects of high marginal tax rates. This argument ignored the fact that in a tax-welfare system with targeted or means-tested welfare benefits, the highest effective marginal tax rates are usually those faced by low-income earners, many of whom are also likely to have more elastic labour supply than high-income earners.

The additional revenue from the GST was insufficient to fund the income tax cuts on a sustainable basis, and the resulting growth in the budget deficit put government spending under pressure. Hence, the limited measures introduced to compensate low income earners were quickly eroded. The net impact of the tax policy changes was highly regressive.

From this point on, the development of economic policy in Australian and New Zealand diverged. Although the two countries followed much the same path towards free market reforms, the Australian government was more cautious. It claimed to follow a pragmatic and realistic policy, a middle way between the irrelevance of adherence to traditional Labor shibboleths and the free market dogmatism of the conservative parties.

The divergence is clearly apparent in the subsequent careers of Douglas and Keating. Douglas left the New Zealand Labour Party after the government fell in 1990, and became one of the founders of a new party, the Association of Consumers and Taxpayers, committed to an extreme free market position including the ultimate elimination of virtually all forms of government activity. By contrast, Keating, having replaced Hawke as Prime Minister at the end of 1991, won a seemingly impossible election victory in 1993 with an effective campaign against a package of free market reforms centred on a GST. Although Keating left Parliament after the electoral disaster of 1996, he remains an influential figure in the Labor party.

## **Health and welfare**

From a social democratic viewpoint, the Hawke-Keating government's greatest successes were in the area of health and welfare policy. The government reintroduced the national health insurance scheme, Medicare, which had been designed and introduced by the Whitlam government, but dismantled in a series of *ad hoc* steps by the Fraser government. Although subject to increasing stress as a result of the conflict between the government's desire to cut spending and growing demands for health services, Medicare provided universal access to high quality hospital and medical services at relatively low cost.

The conflict between the desire to constrain spending and growing demand for services was even more evident in the area of social welfare. The combination of an ageing population and unemployment well above the levels prevailing in the 1970s implied a rapid growth in the number of welfare beneficiaries. At the same time, it was evident that important welfare needs were not being met. Furthermore, the welfare system was characterised by 'poverty traps', that is, high effective marginal tax rates arising from the fact that benefits were reduced as the beneficiaries' income increased.

The government responded by targeting benefits more tightly and increasing benefits for the worst off groups in the community, notably including welfare beneficiaries living in privately rented accommodation. Old age pensions were subjected to means tests, and the government sought to make the payment of superannuation a standard condition of

employment rather than one confined to managerial and professional employees. A further notable initiative was the Family Allowance Supplement which was a payment made to low income families, including those where parents were employed on low wages. The supplement reduced the problem of poverty traps which arises when family can derive a larger income from benefits than from employment. The net effect of policy changes in social welfare was progressive and at least partially offset the increase in inequality of pretax income associated with the government's free market reforms.

The record of the Labor government on social welfare may be subject to two types of criticism. The first, expressed mainly by advocates of European-style universalist social welfare, is that targeting *per se* is undesirable. This view has had relatively little currency in Australia, where most participants in the policy debate agree that welfare benefits and taxes should be viewed as part of an integrated tax-welfare system. In such an integrated system, an income-tested welfare payment is logically equivalent to a progressive income tax. For any given amount of welfare spending, targeting achieves the maximum redistribution (Castles and Mitchell 1994). Redistribution is constrained by the need to avoid excessive effective marginal tax rates, which in extreme cases lead to poverty traps.

The primary focus of the debate is therefore concerned with the aggregate volume of welfare spending, which is largely determined by standard benefit rates, most of which move in line with age pensions. The Hawke government raised the single age pension rate from 22.7 per cent of average weekly earnings when it took office to 25 per cent in 1991 (Gruen and Grattan 1992), a task which was admittedly made easier by restraint in real wages under the Accord. This achievement, which has survived the government's loss of office must be viewed as a positive one in the economic circumstances.

In New Zealand, by contrast, the Labour government had few, if any, significant achievements in the area of social welfare. After initially raising some benefits, the government was faced with the problem of increasing demands for social welfare expenditure associated with rising unemployment and the aging of the population. A variety of *ad hoc* restrictions on benefits were introduced. An attempt at comprehensive reform was made in 1990, but Labour lost office before it could be implemented. The incoming National government cut welfare benefits in nominal terms, by more than 20 per cent in some cases, stopped inflation adjustments and severely restricted eligibility.

The story in health care was similar. The free market advocates within the government commissioned a report which recommended radical reforms based on the concept of a 'purchaser-provider' split. The government rejected this approach, but the general thrust

towards commercialisation undercut any movement in an alternative direction, such as the establishment of Area Health Boards. The incoming National government implemented the free-market reform proposals, replacing existing health services with Regional Health Authorities, which were supposed to purchase health services from hospitals, renamed as 'Crown Health Enterprises' and run by managers (named chief executive officers) on private sector business lines. Health care was one of the biggest disaster areas of the New Zealand reforms, with most of the Crown Health Enterprises suffering heavy losses and the majority of chief executive officers resigning (Easton 1997b, Kelsey 1997).

The widely accepted view of the New Zealand Labour government as the 'gravediggers' of social policy in contrast to the 'refurbishment' achieved in Australia is challenged by Castles and Shirley (1996), who suggest that the outcomes might have looked very different if the Australian Labor government had lost office in 1990 or 1993. Yet even Castles and Shirley observe that, '

in New Zealand, the record of the government was sufficiently lacking in purpose as to invite the question: 'social policy: has there been one'

and state that policy developments such as targeting were part of 'a downward trajectory of welfare development'. It is hard to avoid the conclusion that the New Zealand Labour government dug the grave of social policy, even if the burial was left to its National successors.

## **Privatisation**

For a number of years, it appeared likely that privatisation would represent the point at which the Australian Labor government would refuse to follow Thatcher's lead. The Labor party's stated objective, reaffirmed after considerable debate in the late 1970s was 'the socialisation of the means of production, distribution and exchange'. Labor won several state elections on the basis of energetic scare campaigns against conservative proposals for privatisation.

By 1987, however, the situation had changed sufficiently to permit asset sales totalling \$1 billion in the May Statement of that year. As Hawke (1994, p. 391) observes:

Many of these were uncontentious — for example a partial sale of our embassy site in Tokyo and other land sales — but they presaged the broader privatisation debate ahead.

Hawke assumed, like Thatcher, that the proceeds of asset sales could be treated like current income and used to finance current expenditure or reductions in taxes. Hawke (1994, p. 391) says:

When it came to privatisation, Brian [Howe] was able to argue that one dollar simply could not do two jobs. Putting a dollar of equity into the running of an airline was paid at the expense of programs for the unemployed or the single mother.

A more sophisticated, though still ultimately fallacious, argument was that public sector companies like Qantas were starved of investment due to constraints on public sector borrowing (Walsh 1993). The critical problem here is that the constraints themselves are determined by irrational objectives such as the elimination of public sector net financial debt. The relevant policy objective is to achieve an appropriate level of public sector net worth, and net worth is increased when government business enterprises undertake profitable enterprises. It might be argued that reductions in net debt were 'demanded' by financial markets, and were therefore necessary regardless of the lack of any economic rationale. However, there is little evidence of this. In the period when Labor commenced privatisation, the budget was in surplus even without privatisation proceeds, so that the attitudes of financial markets had little direct significance for governments.

The commitment of the leading figures in the government to privatisation was evident by late 1987, but it took some years before the opposition of the Labor party membership and the public could be overcome, and large scale privatisation could be implemented. The Labor leadership attacked conservative proposals to privatise the Commonwealth Bank of Australia in the election campaign of early 1990, but made a decision in favour of partial privatisation later the same year.

Privatisation commenced on a large scale in 1991 with the sale of a tranche of shares in the Commonwealth Bank, the sale of Aussat to form the basis of Optus, preparations to merge and privatise Qantas and Australian Airlines, and the sale of Commonwealth Serum Laboratories which was responsible for the preparation of blood products. In all of these cases, privatisation reduced public sector net worth, in that the interest savings attainable by using sale proceeds to repay public debt were less than the value of the earnings foregone (Quiggin 1995, Hamilton and Quiggin 1995)

As usual, New Zealand Labour moved earlier and faster on privatisation, though, as in Australia, the government lied about its intentions until the last possible moment. Assets sold by the Labour government between 1984 and 1990 included New Zealand Telecom, Air New

Zealand, and the Government Printing Office. As in Australia, the government treated the revenue from asset sales as current income.

The National government went much further selling not only government business enterprises but cutting rights over state forests, mortgages held by the Housing Corporation and so on. The loss of public wealth from privatisation is illustrated by the case of New Zealand Telecom, which was sold for \$4.25 billion to the American firms Ameritech and Bell Atlantic under conditions which guaranteed an effective monopoly. By 1996, the buyers had sold shares worth \$3.1 billion, repatriated around \$1 billion in dividends, and retained a majority shareholding valued at \$7 billion (Kelsey 1997).

### **Labour markets and the Accord**

The divergence between the Australian and New Zealand labour governments was most evident in the area of labour market policy, although even here, the Australian Labor government drifted towards a free market position over the course of its thirteen year term. At least from 1983 to 1989, however, a highly interventionist labour market policy played a central role in the Australian government's policy framework.

The Accord between the government and the Australian Council of Trade Unions was the most important policy innovation adopted by the Hawke government, and was conceived as part of a Keynesian expansionary strategy. The experience of the 1970s and early 1980s was seen as showing that the main constraint on expansion was the danger of rapid growth in nominal wages leading to an inflationary spiral. Under the Accord, it was intended that nominal wage increases should be agreed centrally in such a way as to allow modest growth in real wages and a gradual decline in the rate of inflation. Although no general program of price controls was proposed, firms with substantial market power were subject to price surveillance.

The Keynesian analysis put forward by the designers of the Accord was criticised by those who argued that the primary economic problem was the 'real wage overhang', that is, the excessive level of real unit labor costs arising from the wages explosion of the mid-1970s and the resources boom of the early 1980s. Most advocates of the 'real wage overhang' model were sceptical of the value of incomes policies, but their views had a significant influence on the development of the Accord, beginning with the Labor Party's 1982 Conference at which the Accord's stated objective of 'maintaining and increasing real wages' was amended to read 'maintaining and increasing real wages over time.'

The 1982 amendment was the first step towards a reinterpretation of the Accord focusing on real wages and real unit labor costs. On this interpretation, the union movement accepted a

sustained reduction in the labor share of national income (reversing the increase that took place in the 1970s) in return for government policies oriented towards employment growth and progressive social reforms. This version of the Accord was implemented as a series of special deals resulting in real wage reductions.

The first and most important was associated with the introduction of Medicare in early 1984, a health insurance system that involved indirect payment for services via an income tax surcharge. The consequent artificial reduction in the consumer price index was passed on to wages. The union movement's acceptance of such trade-offs indicated a willingness to make sacrifices in order to restore full employment. In return, the theory underlying the Accord proposed an expansion of the 'social wage' in the form of progressive expenditure on the provision of community services and welfare.

The first few years of the Accord were generally viewed as highly successful. The strong economic recovery which commenced in 1983 was accompanied by declining real wages and a gradual decline in the rate of inflation. Industrial disputes, which had previously been regarded as a major social and economic problem, became rare. Employment growth was strong, and the rate of unemployment declined steadily, reaching a minimum of 5.9 per cent in mid-1989. It has been argued that most of these developments would have taken place anyway, reflecting the worldwide decline in the power of unions (Moore 1989). However, most analysts conclude that the Accord made a difference and was successful in achieving its main objectives (Beggs and Chapman 1987, Chapman 1997).

Over time, however, the Accord began to fall from favour. Concern with the aggregate level of real wages declined somewhat, and there was a widespread desire to achieve greater flexibility. Individual unions were concerned that a policy framework that delivered regular centralised wage increases rendered them irrelevant to their members, many of whom were discontented by the contrast between general wage constraint and the conspicuous consumption of upper-income earners, especially the 'entrepreneurs'. Employers were particularly concerned to secure higher levels of work intensity, greater control over work practices and in the end, the Industrial Relations Court (the body responsible for making decisions on wage increases under the centralised arbitration system) was left isolated as the sole defender of the system. The main disagreement was whether labour market reform should be pursued through enterprise-level bargaining (the approach favoured by unions) or individual contracts (the approach favored by advocates of microeconomic reform).

The recession of 1989 undermined the primary basis on which the Accord was premised, namely that it would deliver strong employment growth. The recession itself was induced by

restrictive monetary policy based, in large measure, on the belief that the Accord would not be sufficient to control pressures for wage increases flowing from booming asset markets.

Although the Accord was formally renewed on seven occasions during the term of the Hawke-Keating government, it ceased to be a major factor in economic policy after 1989. The tightening of that monetary policy in that year, partly in response to a fear that the Accord was in danger of breaking down, induced a severe recession. The rate of unemployment rose to 11 per cent and has remained above 8 per cent ever since.

The attention of the government was briefly captured by the unemployment problem, as exemplified in the December 1993 Green Paper, *Restoring Full Employment*, and the May 1994 White Paper, *Working Nation*, both of which argued that a growth rate of 4.5 per cent, complemented by job subsidies, training and individual case management, was needed to bring long-term unemployment down. Evaluation of *Working Nation* is difficult in view of the fact that the programs were only in operation for two years. Chapman and Piggott (1995) give an *ex ante* evaluation suggesting that the net budgetary cost per job created would be low, a view broadly supported by the *ex post* studies of Junankar, and Kapuscinski (1997) and Stromback, Dockery and Ying (1997). Official evaluations have varied from glowing (Crean 1995) to circumspect (DEETYA 1996) to damning (unpublished research cited by the present conservative government) according to the political demands of the occasion.

With the election of the conservative Howard government in 1996, the Accord was abandoned in favor of labour market reform aimed at pushing unions out of the bargaining process, rather than attempting to use the union movement as a force for wage restraint. Labour market programs were cut drastically, along with public sector employment. Despite continued economic growth, the unemployment rose from around 8 per cent, to 8.7 per cent.

Labour market policy in New Zealand was largely one of drift. Although Douglas and others advocated radical labour market reform, only modest changes were introduced. The Labour Relations Act of 1987 liberalised the private sector labour market to some extent and sought to modernise the trade union movement through mergers and enterprise bargaining. The 1988 State Sector Act extended these reforms to the public sector.

The real impact of the Labour government arose from the fact that it accepted rising unemployment as a necessary cost of reform. The weakened economic position of the unions, and their associated with a generally discredited Labour Party, left them with little capacity to resist the radical labour market reforms introduced by the Bolger National Party government in 1991, under which individual contracts became the primary basis for employment. These

reforms were implemented through the Employment Contracts Act, which provides no union rights of any kind.

### **Economic outcomes**

Although free market economists have contrasted the policy processes in Australia and New Zealand, rather less attention has been paid to differences in outcomes. New Zealand was consistently seen as the model of correct policy economic outcomes in New Zealand have been consistently poorer than those in Australia. Table 1 presents information on a variety of economic indicators for Australia and New Zealand for the periods 1973-83, 1983-90 and 1990-96. The latter two periods cover the term of office of the Labor government in Australia and correspond fairly closely to the terms of the Labor and National governments in New Zealand. Although the cyclical experience of the two countries has not been identical, in both cases there was a cyclical peak just before 1990, followed by a severe recession and a recovery phase that is still under way.

The greatest divergence in economic performance took place while the Lange-Douglas government held office. The period from 1984 to 1990 was one of stagnation in New Zealand, whereas Australia enjoyed steady economic growth until the recession that commenced in 1989. As a result, the gap in per capita incomes went from between 5 and 10 per cent in 1983 to around 20 per cent in 1991. As New Zealand's poor aggregate performance was accompanied by growing inequality in earnings and a more regressive tax system, whereas Australia experienced some wage compression due to the Accord and tax reforms that were broadly neutral in their effect on income distribution, the divergence in outcomes for those on low incomes was even more dramatic.

As in most OECD countries, inflation rates in Australia and New Zealand generally declined from the early 1980s onwards. In Australia, the decline in the rate of inflation as measured by the GDP deflator was fairly uniform from the mid-1980s onwards. In New Zealand, the once-off effects of the introduction of the GST led to a temporary increase in inflation rates, but otherwise the process was similar. Nevertheless, fears of an inflationary upsurge were among the macroeconomic misjudgements that led to severe tightening of Australian monetary policy in late 1989 and the subsequent deep recession.

From 1984 to 1989, labour market outcomes in Australia were clearly superior to those in New Zealand, and very good in absolute terms. Employment grew at an annual rate of 3.2 per cent from 1984-90, with unemployment falling to a low point of 5.9 per cent. However, employment contracted sharply during the recession, and strong employment growth in the

initial stages of the subsequent recovery was not sustained. As a result, the rate of unemployment in Australia rose to 11 per cent during the 1989-91 recession then fell back to 8 per cent, where it has remained. Average employment growth over the period 1990-96 was 0.8 per cent.

In New Zealand, Labour lost office in 1990 after a period during which labour market performance deteriorated steadily. A detailed analysis of movements in unemployment is difficult as there are no official New Zealand unemployment figures, for the period before 1986. The OECD estimates the unemployment rate in 1983 at 5.6 per cent, but this is not a standardised measure and other estimates are lower (Easton, personal communication). Unemployment rose steadily, reaching a peak of 11 per cent during the recession. Employment growth was close to zero, and labour force participation rates declined. Large-scale labour-shedding resulted in relatively strong labour productivity growth over this period, a point which was emphasised by advocates of the New Zealand 'miracle'.

The incoming National Party government introduced both radical labour market reforms and cuts of around 20 per cent in welfare benefits, with unemployment benefits being affected more than others. These changes, introduced just before the trough of the recession, had little immediate effect. However, the recovery produced fairly strong employment growth, a reduction in the unemployment rate, which fell to 5.9 per cent before rising to 6.7 per cent in 1997, and two years of very strong output growth in 1994 and 1995. From the viewpoint of advocates of the New Zealand 'miracle', these outcomes show that the only problem with the Labour government's approach was the failure to tackle labour market reform.

The evidence presented in Table 1 suggests a far less optimistic account. In terms of GDP per capita, New Zealand did not regain any lost ground over the period 1990-96 and currently appears to be falling even further behind. Estimates produced by the New Zealand and Australian Reserve Banks suggest that, although the two countries have similar population growth rates, the sustainable growth rate for New Zealand is around 3 per cent (Brash 1997), while the sustainable growth rate for Australia is around 3.5 per cent. The gap is generated primarily by weaker trend growth in employment in New Zealand and by slightly lower trend productivity growth. Even the achievement of the sustainable growth rate appears doubtful in view of the chronic current account deficit, currently above 5 per cent of GDP. It does not appear that the radical reforms undertaken by the Lange government had any long-term payoff in terms of income growth, compared to the more cautious approach adopted in Australia.

A somewhat more favorable view of the outcome of the New Zealand reforms may be obtained from a comparison of performance over the reform period since 1984 with relatively

poor performance prior to 1984. Evans et al. (1996) examine GDP per working age adult, and conclude that growth since 1984 has been superior to that prevailing in the previous seventeen years. The selection of this unusual performance measure, which happens to make the period before 1984 look particularly bad, entails the need to make arbitrary imputations, all of which are chosen in a way which yields low estimates of the pre-1984 growth rate. More generally, an analysis based on the hypothesis of convergence suggests that a low starting level of income resulting from prior weak growth makes the achievement of high growth easier, not harder. It is difficult to avoid the conclusion that the statistical evidence presented by Evans et al. was selected on the basis that it was the only available measure that gave any support to their highly favorable account of the reforms.

Growth in employment was somewhat more impressive, but only partially made up the ground lost over the period from 1984-1990. Over the entire period since 1993, Australia had stronger growth in employment than New Zealand. Strong employment growth over the period 1990-96 was matched by weak labour productivity growth, more than wiping out New Zealand's slightly superior performance over the period 1984-90.<sup>6</sup> As with GDP, recent evidence suggests the gap in favour of Australia is widening further.

Finally, New Zealand's reduction in measured unemployment rates is overstated. As in other countries where income from unemployment benefit is less than that available from alternatives such as sickness and supporting parents benefit, the result was a shift from unemployment benefits to other benefits. Since eligibility for unemployment benefits is typically conditional on job search, while eligibility for other benefits is based on incapacity for work, such a shift in benefit category is typically reflected in a reduction in survey-based measures of the proportion of the population unemployed and actively seeking work.

### **The erosion of political support**

In both Australia and New Zealand, the adoption of free market policies was associated with a steady erosion of political support, particularly among working class voters. Over the period since World War II, the Australian Labor Party had never received less than 40 per cent of the vote. Labor's strategists took this core of support for granted, and concentrated on the need to win 'swinging voters'. The standard logic supporting 'middle of the road' policies was reinforced by features of the Australian electoral institutions including compulsory voting and

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<sup>6</sup> In public discussion, many advocates of the New Zealand miracle cite both the strong productivity growth achieved in 1984-90 and the strong employment growth of 1990-96 to produce an impression of superior performance on both counts that is the exact opposite of the truth.

the preferential system, which required all voters to give a complete ranking of the alternatives. Under this system, it was suggested, disaffected Labor voters had 'nowhere else to go'. They could not abstain and, even if they cast a first preference vote for a third party or independent candidate, it was the relative ranking of the major party candidates that was decisive.

The abandonment of traditional social democratic policies led to a steady decline in the number of committed Labor voters. As Labor moved steadily to the right, the Australian Democrats, originally a centrist group of former Liberals, became, by default, the main left-wing opposition party, along with a variety of green and antinuclear groups. Many former Labor supporters switched to these groups.

Nevertheless, the 'swinging voter' strategy was successful for a long time. Labor received 49.5 per cent of the first preference vote in 1983, 47.5 per cent in 1984, 45.8 per cent in 1987 and 39.4 per cent in 1990, but retained office on the basis of second preferences and astute targeting of marginal seats. The adoption by the Liberals of doctrinaire program of free-market reforms, called *Fightback*, drove some traditional supporters back to the Labor party in 1993, but the many commentators who interpreted this as evidence of solid support for Labor were mistaken.

The damaging long-term consequences of the swinging voter strategy were felt in 1996, when Labor's primary vote fell to 38.8 per cent, the lowest since World War II, and one of the lowest since the Federation of Australia in 1901. At the State level, Labor is office only in New South Wales, and the Carr government, in its enthusiastic pursuit of microeconomic reform, including privatisation of the electricity industry, seems to have learned little from the disasters encountered by the Federal Labor party.

In view of voter discontent with both major parties, it would be a mistake to write off Labor's electoral chances. Despite the crushing defeat of 1996, some recent opinion polls have shown Labor in the lead. The fundamental problem, however, is that it is difficult to identify either a policy program that distinguishes the Labor party from its opponents or a substantial social group for which the Labor party speaks. By contrast, the small business sector forms a solid core of support for the conservative parties. The lack of distinctive policies is less damaging for the conservatives, since it reflects bipartisan support for a program based on their own official ideology. The conservative parties may therefore be seen as the natural party of government and Labor as the 'B team', to be called upon when the electorate wearies of conservative governments that have become complacent and dogmatic after too long in office.

In New Zealand, the Lange Labour government was re-elected in 1987, in large measure because of the popularity of its antinuclear foreign policy, and related policy on human rights.

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The loss of traditional supporters was offset by Labour's capture of the votes (12.3 per cent of the total in 1984) that had formerly flowed to the New Zealand Party, which supported both free-market economics and an antinuclear foreign policy, with the result that Labor's share of the vote rose from 43 per cent in 1984 to 48 per cent in 1987. However severe divisions over economic policy, both within the government and within the labour movement led to a crushing defeat in 1990 from which the New Zealand Labour Party has never fully recovered. Labour received only 35 per cent of the vote. The party broke into fragments, with Douglas forming a radical free-market party and left activists combining with environmentalists to form the Alliance party.

Many more Labour supporters, particularly Maori, were attracted to the New Zealand First Party, essentially a vehicle for its demagogic leader Winston Peters, after he walked out of the National Party government. Labour received a little over 34.7 per cent of the vote in the 1993 and 28.2 per cent in the 1996 elections, falling at times to 20 per cent support in opinion polls. The party continues to represent an uneasy coalition of free-market reformers, Labour traditionalists and those for whom Labour is the best of a bad lot.

The 1996 election in New Zealand was the first held under a system of multi-member proportional representation created as a response to discontent over the way the Lange and Bolger governments had used the disciplined majorities created by a constituency system to push unpopular reforms through Parliament. It left the balance of power with Peters, who eventually agreed to go into coalition with the National Party. However, the coalition government is so unpopular that Labour's support in opinion polls is now around 50 per cent.

As in Australia, then, it is not impossible to imagine Labour regaining office, but it is hard to see what purpose the election of a Labour government would serve, except to remind the conservatives that the electorate still has the capacity to punish them for poor performance.

## **An assessment**

Despite its abandonment of many traditional social democratic policies, the Australian Labor government continued to defend its claim to represent the values of the labour movement, and the current Labor Opposition has continued, at least until recently, to defend the record of the Hawke-Keating government. Until the recession that commenced in 1989, the government's claims were supported by strong employment growth and reductions in the rate of unemployment. A more durable claim is that, although total spending on social welfare was constrained, the government improved targeting through means tests and introduced other innovative welfare programs such as family allowance supplements for low-income earners.

This increased the redistributive impact of welfare spending and offset the rise in inequality in market incomes associated with policies of deregulation and privatisation.

Arguably, the Australian Labor government may be seen as having done relatively well in an unfavourable environment. Given the breakdown of Keynesian macroeconomic policy, the increasing irrelevance of economic development strategies based on tariff protection, the rising influence of financial markets and the fiscal demands created by increases in the demand for age pensions, unemployment benefits and publicly provided services such as health and education, any social democratic government would have faced a difficult task.

However, Labor's rhetoric did not convey this message. Rather than presenting itself as adapting to undeniable realities while doing its best to protect its core constituency against the worst impacts of globalisation and competition, these two themes were embraced as the way of the future. In policy terms, the Labor government celebrated its successes in 'opening up' the Australian economy, and derided the policies of the 1950s and 1960s, a period remembered by most Australians as one of full employment and prosperity. At a personal level, the identification of leading Labor ministers with the wealthy beneficiaries of globalisation was too obvious to be ignored. By both opponents and supporters, Hawke and Keating are remembered primarily for 'opening up the economy', and not for innovations in social policy.

It is hard to offer even a qualified defence of the New Zealand Labour government. In the few areas where the government did not follow anti-labour policies, it prepared the way for its National Party successors to do so. The government's leading figures, Douglas and Prebble, revealed themselves as extreme free-market ideologues after finally leaving the party. The abandonment of traditional policies was not rewarded by electoral or economic success. In seven years out of office, Labour has not succeeded in producing a coherent set of economic and social policies incorporating progressive elements of reform policies. Rather its current stance is one of accepting that previous governments have 'gone too far' without proposing a concrete alternative.

In summary, the experience of the Australian and New Zealand labour governments does not support the view that a combination of free market economic policies and social democratic values represents a hopeful option for the labour movement. The tension between the two is evident, and tends to increase the longer a labour government remains in office. The tension would be reduced if free market policies delivered the promised improvements in economic performance, but, so far, this has not been the case.

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**Table 1 Economic Performance in Australia and New Zealand**

average annual % change	1973-83	1983-90	1990-96
<b>GDP per capita</b>			
Australia	1.1	2.5	1.7
New Zealand	0.6	0.8 (84-90=-0.2)	1.8
OECD	1.4	2.6	1.0
<b>Excess of High (D9) over Low (D1) Pay</b>		1983-90	1990-95
Australia		-0.2	1.5
New Zealand		2.1 (84-90)	0.7 (90-94_
US		1.6	1.9
UK		1.9	1.2
<b>Consumer Prices</b>			
Australia	11.9	5.7	2.5
New Zealand	13.7	9.8	1.9
OECD	8.6	3.9	2.8

<b>Employment</b>			
Australia		3.2	0.8
New Zealand		0.2	2.2
OECD		1.6	0.6
<b>Consumer Prices</b>			
Australia	11.9	5.7	2.5
New Zealand	13.7	9.8	1.9
OECD	8.6	3.9	2.8
<b>Unemployment</b>	1983	% point change 83-90	% point change 90-96
Australia	9.9	-3.0	1.6
New Zealand	5.6	+2.1	-1.6
OECD	8.5	-2.4	1.5
<b>Labour Productivity</b>			
Australia		0.9	2.1
New Zealand		1.2	0.8
OECD		1.8	1.3

Note: unemployment is standardised measure except for NZ.

Sources: OECD *Historical Statistics*, *Economic Outlook*, *Employment Outlook*