The Politics of Successful Structural Reform

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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 costly 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 the government. As their country's economy drifts closer to crisis and structural problems are no longer deniable, they persuade themselves that action within a relatively short time of an election would give the advantage to their political opponents. They convince themselves that this stance is justified by pretending that the opponents are deceitful and interested only in their own gain, not the country's well-being. When the economic situation is serious enough to arouse public concern, both parties may, in many cases, seek to evade the issue by offering electoral bribes to distract voters from the real problems.

This paper 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 New Zealand government has got everything right since 1984. We need to learn from our own inadequacies, as well as from our considerable successes. Where we implemented quality policies in that period, the polls show on-going voter approval. Wherever we stopped short of quality, the polls show rising disapproval from the public.

BACKGROUND INFORMATION

This section very briefly summarises New Zealand's economic situation in 1984, and the progress made since then to achieve better structural balance.

In the decade to 1984:

- New Zealand's economic growth rate averaged 0.9 per cent a year — half the OECD average.
- Our inflation averaged 13.3 per cent, including a two-year wage-price freeze — 1½ times the OECD rate.
- Government expenditure rose from 28 per cent of GDP to 39 per cent, with substantial additional sums kept off the balance sheet.
- Net public debt multiplied six times over, and debt servicing mushroomed from 6.5 per cent to 19.5 per cent of total government spending.
- Unemployment rose from 5,000 to 132,000, with no sign of stopping there.

In the twenty-five years to 1984:

- New Zealand's average annual increase in productivity was the lowest in the OECD, at 1.2 per cent a year, compared with Japan's average of 5.8 per cent and the EC's at 3.3 per cent.
- New Zealand's relative standard of living fell from third highest in the world to a mid-20s ranking. Without a change of direction, it could have reached 50th place or worse by the year 2000.

Those adverse trends culminated in a run on the New Zealand dollar during the July 1984 election campaign. Labour took office with the doors of the banks closed to foreign exchange dealings.

How New Zealand drifted into structural imbalance

After the 1930s depression, New Zealand aimed to insulate itself from international economic shocks and boost urban employment by raising substantial barriers against international competition. Manufacturing subsequently developed a high cost structure which precluded it, in large degree, from export activity. The costs thus imposed on the economy, over time, reduced the competitiveness of our agricultural exporters. Those problems were intensified by British entry into the EC and the oil shocks of the 1970s. Balance of payments problems became endemic.

Instead of facing the real problems, the government began to subsidise farmers to compensate for those costs, and to subsidise uncompetitive manufacturers into the export business. Public money was used to underwrite multi-billion-dollar energy projects which the private sector had correctly rejected as bad commercial risks. Returns proved to be zero or negative. In 1982, as the imbalances worsened, prices, wages, interest rates and rents were all subjected to direct controls by a conservative government, in a vain attempt to tell the tide to turn back. The distortions in New Zealand's resource allocation, which had caused our problems in the first place, were thus compounded. By 1984, the situation was no longer sustainable, and a run on the New Zealand dollar brought it to crisis point.

Labour's approach for structural change

The new Labour government set aside traditional myths and went back to fundamentals.

New Zealand is a trading nation. We earn our living standard by selling for commercial profit against competition on the world market. To achieve that, our producers had to be just as efficient and innovative as their competitors. New Zealand needed economy-wide reforms designed to:

- take short-term adjustment costs on the chin for the sake of medium-term benefits for all New Zealanders;
- institute a firm anti-inflationary monetary policy;
- deregulate the finance sector;
- open over-protected industries to international competition;
- improve the quality of government spending, thereby reducing the cost burden placed on private sector initiative;

- increase the transparency of government decisions so that the real costs were available to the community;
- remove subsidies, incentives and concessions so that exporters were forced to live or die in the market-place;
- make our labour market more responsive to market opportunity;
- lower marginal tax rates across the board to provide all our citizens with more effective incentives;
- improve resource allocation by creating a level playing-field for everyone, so that resources would flow into the areas offering the best returns to investors and the nation.

After three years of intensive reform, Labour was re-elected in 1987 with an increased majority.

- Agriculture, still New Zealand's biggest export industry, is no longer dependent on the state. It is once again developing in response to world market opportunities and conditions.
- Quantitative import controls have been virtually abolished.
- Average tariff levels have been notably reduced, and above-average rates brought much closer to average levels.
- New Zealand's finance sector is now one of the most deregulated in the world. It has deepened considerably, become more efficient and a great deal more innovative in its services.
- Internal product markets have also been significantly deregulated, including, for example, full deregulation of Telecom from April 1989 — a world first.
- The monopoly rights of government departments to supply goods and services to other government departments have been removed, placing them on an equal footing with other suppliers.
- The tax system has been totally overhauled. The OECD has since described it as one of the least distorted systems in the OECD area.
- State business enterprises have been put on a sound commercial basis, with efficiency gains in the 30-100 per cent range.

- The core public sector departments are now fully accountable, on a basis of outputs, for the resources they use.
- Inflation for the year to June 1989 was 4.4 per cent. The government is committed to an inflation target in the 0-2 per cent range by the end of 1992. Given consistent policies, that should be achievable.
- Our balance of payments deficit, about $4.1 billion in March 1986, had improved by $3 billion to around $1.4 billion by March 1989, and the improving trend is being maintained.
- Official overseas debt has fallen from a peak of 41 per cent of GDP to 27 per cent of GDP. The 9 per cent fiscal deficit has been turned into a small surplus. The financial deficit is below 1.5 per cent of GDP.
- The economy is now emerging from the mild recession which accompanied the structural adjustment, with a sustainable growth rate on current policy settings in the $2\frac{1}{2}$ to 3 per cent range.
- A potential now exists to boost that growth rate — given the political will to undertake further significant reforms — into the 4-6 per cent range occupied by our Asian trading partners.

THE KEY TO STRUCTURAL REFORM AND POLITICAL SUCCESS

The evidence of New Zealand's story is plain. The politicians who sought success through ad hoc solutions which evaded the real problems damaged the nation and destroyed their own reputations. Voters ultimately place a higher value on enhancing their medium-term prospects than on action that looks successful short-term, but which sacrifices larger and more enduring future gains. A fundamental choice is always there: you can take the costs up-front for larger medium-term gains; or focus on short-run satisfaction and be sandbagged later by the accumulated costs.

Those concepts are not foreign to the public. People accept low incomes as students to earn more later. They save for their old age, and willingly invest in a better future for their children. There is a deep well of realism and common sense among the ordinary people of the community. They want politicians to have the guts and the vision to deliver sustainable gains in living standards. Inadequate politicians see instant popularity as the key to power. If their rating slips, they feel threatened. They look for policies with instant appeal to create continuous public bliss. That approach flies in the face of reality. There is no free lunch. Every decision involves trade-offs which do not vanish, just because some politician chooses to ignore them. The sordid fact is: instant solutions do not have instant popular appeal. Notoriously, they are peddled by politicians who actively blind themselves and others to the facts about the situation.

The problem with compromise policies is simple. They do not produce the right outcome for the public at the end of the day, so they come back to haunt the politicians responsible for them. As costs and distortions accumulate, such governments resort to misrepresenting and suppressing vital information about future economic prospects, to warp the judgement of the voting public. Too often, they end up locking themselves and the public into their own nonsense. No one escapes until a crash has liberated the suppressed information, and consigned them to oblivion. Going for quality means choosing the actions that deliver most benefit to the nation in the medium term, instead of choosing more now, for supposed political gain, at the cost of less later.

Objectives set on that basis, and the means most likely to achieve them, must both be tested against the best available economic analysis and against all of the available evidence. Traditional preconceptions or prejudices about means should not be allowed to prevent a thorough review of all options, and the selection of the means most likely to achieve the chosen goals. From Day One, if a decision makes sense in the medium term, go the whole hog for quality solutions. Nothing else delivers an outcome that will satisfy the public at the end of the day.

LESSONS OF THE NEW ZEALAND EXPERIENCE

Wherever the New Zealand government has 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.

The experience of New Zealand provides an important insight into the nature of political consensus, which is widely misunderstood by politicians. The conventional view is that consensus support must exist for reform before you start, otherwise the actions taken will not be politically sustainable at election time. The tendency is to seek consensus in advance by compromising the quality of the decisions in order to bring the benefits up front, and either to ignore any costs, or to push them further down the track. But when the government compromises its decisions for immediate advantage at the expense of the medium-term outcome, the dissatisfaction of the public will intensify over time.

The fact of the matter is that the interests of the various groups in society are complex and diverse. None of them welcomes the idea that their traditional privileges may be removed. Consensus for quality decisions does not arise before they are made and implemented. It develops progressively after they are taken, as they deliver satisfactory outcomes to the public. To win elections, 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, Labour won an increased majority in 1987. On the other hand, to the extent that such a government loses the nerve required to take a consistent, medium-term approach to quality, the result of the next election will become doubtful.

PRINCIPLES FOR SUCCESSFUL STRUCTURAL REFORM

The New Zealand government's recipe for using quality policies to combine successful structural reform with electoral success can be summed up in ten key principles:

1 Quality decisions start with quality people. Moving quality people into strategic positions is a prerequisite for success.

2 Implement reform by quantum leaps. Moving step by

step lets vested interests mobilise; big packages can neutralise them.

3 Speed is essential. It is impossible to move too fast. Delay will drag you down before you can achieve your success.

4 Once you start the momentum rolling, never let it stop. Set your own goals and deadlines. Within that framework, consult widely in the community to improve detailed implementation.

5 Credibility is crucial, is hard to win, and can be lost overnight. Winning it depends on consistency and openness.

6 The dog must see the rabbit. Adjustment is impossible if people don't know where you are going; you have to light their path.

7 Stop selling the public short. Voters need and want politicians with the vision and guts to create a better future.

8 Don't blink or wobble. Get the decisions right, and face up to them. Confidence often rests on your own visibly relaxed composure.

9 Opportunity, incentive and choice mobilise the energy of people in order to achieve successful change. Protection suppresses it. Get the framework right to help everyone act more effectively.

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

My paper is structured around these ten principles, illustrated by examples drawn from the events of the five years since 1984.

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 quality of the present government's policies was made possible only by the fact that Labour was lucky enough to attract capable new candidates in the 1978, 1981 and 1984 elections. They shared Labour's traditional goals, were able to get their minds round complex issues, cared about getting the outcomes right, and had the guts to adopt means that would achieve them. The success of our 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.

Getting the incentives and the structure right can also transform the performance of many dynamic and capable people who were not able to achieve the right results under the old system. The head of one of our old trading departments, for example, was told he would not be needed in the new corporation because, under him, the outfit had been spending millions more than its income. 'So what!' he retorted. 'Them was the rules then — these are the rules now. I have no problem with that!' The stunned chairman saw the point, gave him the job, and he did it very well indeed.

In the private sector, management quality has improved dramatically since deregulation. Far more companies are run now by highly motivated individuals with their own money on the line. The changes in Business Roundtable membership are typical — thirty-one of the forty people who were members in 1986 have changed. The average age of Roundtable members has dropped by ten years since then.

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, based on performance. So far, however, those jobs have not attracted people of quite the same quality. Top managers are not yet convinced that politicians have learned the limits of their role in the system. They continue to fear that detailed political interference in the running of departments could prejudice their ability to achieve the goals set for them with the efficiency the new system needs. 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.

The biggest quality problem in New Zealand by far, however, is the calibre of the people attracted to and selected for political candidacy in both the Labour and National Parties. Labour's capacity to make quality reforms arose from the good candidates recruited in 1978-84. The main risk of a U-turn arises from both parties' inability to recruit good people now.

In a two-party system, the public interest cannot be served well unless each of the parties adopts a broad-spectrum approach that is widely representative of the community. Our Labour Party tends to draw many of its most active members from the trade unions, teaching, academics and lawyers. National draws mainly on farmers, lawyers and small-business people. This relatively narrow active membership base can create problems for both parties. They tend to select people representative of their own membership — not the wider community. Both parties become, in a sense, closed societies. The people in the community with the capacity to break down that closed-shop system find the parties too inward-looking to bother doing so. Candidate selection comes to represent an increasingly narrow range of interests, and the quality of policy then suffers for many years to come.

A solution can occur only if enough people with guts, education and vision are willing to accept the tasks involved in doing something worthwhile for their country in the political arena. The pay, conditions and general status of MPs in the country are all major deterrents to people with the knowledge, skill and experience to do a good job for New Zealand in politics. Their pay needs to be at least doubled, not to reward existing MPs but to create enough competition from quality people to get rid of those who are incapable of giving adequate performance. The low status of MPs in the community is a chicken-and-egg problem. It results from the short-sighted, excessively partisan approach so many of them take to their responsibilities.

Implement reform in large packages

Do not try to advance a step at a time. Define your objectives clearly and move towards them by quantum leaps. Otherwise the interest groups will have time to mobilise and drag you down. The political problems involved in making a conventional attack on protection are well understood. The benefits of protection are substantial in the hands of the favoured few who receive them. Such groups are usually well-organised, and are capable of mobilising quite powerful opposition against reform. The cost of protection, however large in aggregate, is relatively small per person per item, widely dispersed across the rest of the economy, and often invisible to the people paying the bill. At best, they are weak and disorganised allies of reform. At worst, the campaigns of the interest groups may exploit their ignorance to persuade them that reform will damage the nation.

Here and worldwide, the conventional perception is that reformers are playing against a stacked deck of cards. Genuine structural reform is portrayed as equivalent to wilful political suicide. That rule holds good where privileges are removed one at a time in a step-by-step programme. Paradoxically, it ceases to apply when the privileges of many groups are removed in one package. In that case, individual groups lose their own privileges, but simultaneously, the aggregate cost of paying for the privileges of all of the other groups in the economy is removed from them. That opens up a totally new ballgame, which can be illustrated by describing the first Budget presented by the new Labour government in November 1984, and the public response to it.

Within days of the election, we had devalued by 20 per cent, removed interest rate controls, and started funding the government deficit in a non-inflationary way, by borrowing in the market. A month later, justified by the devaluation, we announced the phasing out of quantitative import controls and export incentives to manufacturers, and gave notice of moves to reduce high tariffs. Three months after that, the Budget announced a block-buster series of decisions scheduled to impact progressively over an extended period with virtually unstoppable momentum, including:

- the phasing out of a vast number of subsidies to a wide range of producers in farming, manufacturing, forestry, fishing and transport;
- a progressive increase in government interest charges on rural lending, to normal market levels;
- phased price rises to full cost recovery for many government-supplied goods and services, including coal and electricity;
- moves making fringe benefits subject to income tax, and a surcharge on the tax of wealthy superannuitants;

- the abolition of certain tax privileges on life insurance and superannuation contributions;
- a new support package for low and middle income families, to protect our most vulnerable groups from the new costs imposed.

The 1984 Budget then concluded with a broadbrush announcement that the government would, from 1986, impose a new flat 10 per cent tax on all goods and services, across the board, without exceptions. Simultaneously with its introduction, we announced that we would dramatically reduce both average and marginal rates of income tax across the total income range, to improve everyone's incentives. At that stage, further major improvements would be made in support programmes for low and middle income families to ensure that they would emerge from the tax changes as net winners.

Nothing like that had happened in living memory. You could hear the jaws dropping open right across the nation as the Budget speech was broadcast, hitting one vested interest after another. Paradoxically, however, it is harder 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. The major interest groups gathered in Parliament Buildings the following Monday. Road transport operators complained that road user charges on them had been increased by an appalling 48 per cent. They were not supported — they were howled down — by the other groups present. It was seen as selfish and insensitive, with so many hurting at once, for any one group to push its own barrow. The underlying fact is that, whatever their own losses, each individual group also had a vested interest in the success of the reforms being imposed on all of the other groups in the room.

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

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

- When reform is packaged in large bundles, the linkages in the system can be used to see that each action effectively enhances every other action — and also improves its selling potential.
- Winning public acceptance depends crucially on demonstrating that you are improving the opportunities for people as a whole, while protecting the most vulnerable groups in the community.
- Large packages provide the flexibility needed to demonstrate that the losses suffered by a group of people are offset by fundamental gains for the same group in some other area.

The public will take short-term pain on the chin, if the gains are spelt out convincingly, and the costs and benefits have been shared with visible fairness across the community as a whole. Obviously, fairness does not include compensation for those who are losing their past privilege, but even they make genuine fundamental gains after they have come through the adjustment. If insufficient consideration is given to these balances, the reactions of aggrieved people forced to take more than their share of the costs will end up tearing the reform process apart.

In my view, the principle of quantum leaps and big packages provides the answer for countries like Canada and Ireland, where opposition to reform has created problems recently.

Speed is essential

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

When reform has been delayed for many years, the trade-off costs are inevitably considerable. Tangible benefits take time to become visible, because of the lags built into the system. If action is not taken fast enough, the consensus that supports reform can collapse before the results become evident, while the government is still only part-way through its reform programme. There are serious inherent 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 of external circumstances to end up going backwards instead of forwards, and destroying your credibility.

Vested interests seeking to preserve past privileges will always argue strongly for a slower pace of change. It gives them more time to mobilise public opinion against the reforms. On the other hand, vested interests cannot obtain the pay-off from change until the government has moved far enough to reduce the costs imposed on them by the privileges of other interests. The vested interests continuously underestimate their own ability to adjust successfully in an environment where the government is rapidly removing privilege across a wide front.

In 1984, the chairman of the New Zealand Dairy Board told me that farmers could not survive an exchange rate above 44c to the US dollar without going broke. At that time, the rate stood at 50c. When the New Zealand dollar had risen to 55c, farmers argued that anything higher than 50c would put farming out of business, and said that 55c was driving the whole industry into bankruptcy. When the exchange rate reached 70c to the US dollar, they started telling me that at 62c or 63c they would probably be all right. They were focused on symptoms, not fundamentals, at every stage.

Many apparent demands for a slower pace, on closer analysis, express a powerful resentment that the government is not moving fast enough to abolish privileges enjoyed by rival groups. In New Zealand, farmers demanding a reduction in the pace of change regularly said they needed it because of the costs still imposed on them by excessive protection elsewhere in the economy. They cheered up whenever the government responded by announcing further and faster changes in the sectors where protection was still prejudicing their ability to respond competitively. Properly understood, complaints of that kind are reasonable. Farmers asked to operate without subsidy cannot afford, for example, to pay the excessive costs of a monopoly ports system. Nor can they be fairly asked to face up to their own adjustment costs if manufacturers supplying their inputs continue to enjoy the privilege of high protective tariffs.

It is uncertainty, not speed, that endangers the success of structural reform programmes. Speed is an essential ingredient in keeping uncertainty down to the lowest achievable level. When state trading departments were being transformed into commercial corporations, it became obvious that large-scale redundancies would occur in the coal and forestry areas. Because some of those activities were located in depressed areas, the government took its time to make the final decision, leaving thousands of employees in limbo for about six months. Staff knew that some of them had no future in the industry, but did not know which of them. They could not leave before the government made up its mind, because they might lose their redundancy pay-out. The result was deep and intense bitterness, which the government interpreted as being directed primarily against the policies themselves, and this further eroded the willingness to take action. Once firm decisions were announced, the feeling in those regions improved rapidly. A lot of those people always knew change was inevitable. The public often shows more realism than politicians. What those people really wanted was an end to the uncertainty, so that they could decide how to get on with their own lives.

A great deal of technical debate has been aired worldwide about the optimum sequencing of structural reform, and the alleged sequencing errors of governments, both here and elsewhere. Those 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 analytic level, that debate is entertaining, but no clear-cut answers emerge. Moreover, from my point of view as a practitioner, the question is fundamentally irrelevant. Before you can plan your perfect move in the perfect way at the perfect time, the situation has already changed anyway. Instead of a perfect result, you wind up with a missed opportunity. Some decisions take full ettect the day they are made. Others take two to five years of hard work before they can be fully implemented. Perfect sequencing, even if it existed, would not be achievable.

Keep the momentum rolling

Once you start the momentum rolling, never let it stop until you have completed the total programme. The fire of opponents is much less accurate if they have to shoot at a rapidly moving target. If you take your next decision while they are still struggling to mobilise against the last one, you will continually capture the high ground of national interest and force them to fight uphill. The government can develop public awareness of the key issues by structuring the content and sequence of its packages to dramatise the relevance of the fundamental economic linkages.

By the end of 1985, for example, the adjustment costs were biting quite deeply into pastoral farming, which had lost some large subsidies and was also facing low international commodity prices. Land values were tumbling back from the inflated levels stimulated by the previous government's assistance measures, and equity problems of considerable magnitude had begun to emerge. Nevertheless, resource allocation in farming and forestry was still being distorted by large concessions that allowed people to write off livestock and development costs against other taxable income. People buying livestock were happy to bid prices up to two or three times the value justified by market returns, because they knew that the taxpayer was covering two-thirds of their costs. Tax write-offs had led the wine industry to plant twice the acreage needed to satisfy the market, and boosted wine stocks to three years' supply, against an international norm of half that.

The government decided that, despite the adverse climate and the increased cost for those concerned, all such concessions had to be removed to promote the medium-term health of their industries. To combat the inevitable outraged reaction, we moved the whole reform programme into a higher gear. In the same package, we announced an unprecedented onslaught on public sector waste. State-owned businesses accounting for \2y_2 per cent of GDP and 20 per cent of the nation's investment became corporations with commercial objectives under quality directors drawn from the private sector. They would now pay normal tax dividends, and raise their capital in the market, without the aid of government guarantees. The changes dwarfed any made before in our past public sector history. Through corporatisation, Electricorp has cut costs a real 25 per cent. Telecom will do better than that. Rail freights are down 45 per cent in real terms. Coal prices to some major customers have been halved.

Farmers here have traditionally loathed the Labour Party, but moves on that scale convinced them that we meant business about getting their costs down, as well as removing their subsidies. Federated Farmers became one of the first major interest groups to endorse the principles behind our reforms. From then on, their aim was to ensure that the government lived up to its promises. The New Zealand Business Roundtable, representing large corporations forced to undergo massive and costly restructuring, also rapidly recognised the medium-term benefits to the nation. 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 which has to be opposed at all costs. After you remove its privileges and demonstrate that the clock cannot be turned back, the group starts to focus on removing the privileges of other groups that still boost its own costs.

On the other hand, exactly the opposite process occurs wherever some favoured group is allowed to retain its privileges and is given on-going protection from the broad thrust of the reforms. Anxiety levels in protected groups rise steadily as reform progresses in the rest of the economy. They fear their turn may come next. Their internal organisation improves dramatically. They boost their public profile. They entrench their opposition. To conceal their vested interest in exemption from reform, they will aim to dictate the rhetoric that governs all public debate.

In New Zealand, for example, reforms designed to reduce waste and inefficiency across the widest possible front were consistently painted as adherence to the nastiest form of hardline monetarism. Corporatisation, designed to achieve more jobs and better living standards for everyone, was said to be driven by an uncaring New Right obsession with profit at the expense of people and service. Efforts to improve the quality and quantity of health services for ordinary New Zealanders were portrayed as replacing public care with private profit at the expense of the ill and the elderly. The strategy of this rhetoric is to obliterate public awareness of all medium-term benefits, exaggerate the short-term costs, and portray those costs as the objective and sole outcome of reform. Those groups end up making strenuous efforts to gain control of the political process in the reforming party, to stalemate any threat to themselves by terminating the total reform programme. The answer is: Stop the rot before it begins. Remove privilege even-handedly across the board and give such groups, along with everyone else, a more constructive role in a better society.

Consistency plus credibility equals economic confidence

Continuous credibility is essential to maintain public confidence in structural reform and minimise the costs. The key to credibilty is consistency of policy and communications. The voting public has seen governments come and go, all of them promising low inflation, more jobs and higher living standards. But for years, life has gone on, exactly as it always used to. Take the first step early, and make it a big one. You have to break the pattern of the past dramatically enough to convince the community that, this time, somebody really does mean business.

When the government lacks credibility, people refuse to change until the clash between their old behaviour and the new policy imperatives has imposed large, avoidable costs on the economy. As the reform programme rolls forward, a lot of people start hurting. Their confidence depends on maintaining the conviction that the government will drive reform to a successful conclusion. Speed, momentum, the avoidance of ad hoc decisions, and an unwavering consistency in serving medium-term objectives are the crucial ingredients in establishing the government's credibility. Resolution is particularly important when, notwithstanding the best of intentions on the government's part, the community remains sceptical and refuses to learn before it gets hurt.

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 grasp the idea that wherever a group manages to hold on to privilege and protection, an avoidable cost is imposed on those who are facing up to the adjustment process. Public opinion was outraged in New Zealand when the government granted a quite minor subsidy to railways to keep the Westland-Canterbury railway line open. The local political advantage involved in the action was buried by nationwide criticism of the government for appearing to set aside the principles which it had promoted as fundamental to its reforms. The message from the voting public changes. It now reads: 'Keep the reform process going — drive it to a successful conclusion, or you are dead in the water at the next election.'

Structural reform has its own internal logic, based on the linkages within the economy. One step inevitably requires and leads to another, to extract benefit for the nation as a whole. Abolishing export assistance is fruitless unless the costs of exporters are also reduced by lowering tariffs, deregulating internal transport and reforming ports and shipping services. The fiscal gains from corporatisation or privatisation will vanish without trace if expenditure in an unreformed social services sector is left to rise without regard for efficiency. The redundancies created, as production is rationalised to improve efficiency, may turn into more or less permanent unemployment if an inflexible labour market protects insiders against outsiders. Where the logic of reform is not followed closely enough, the confidence of investors will be impaired, and the ultimate sustainable growth rate achieved may be less than optimal.

Credibility takes a long time to win, but it can be lost almost overnight. Confidence then collapses. The costs of the adjustment rise. The time required expands. The political risk increases. In the wake of the sharemarket crash, for example, many countries sought to soften the political and financial impact on the community by easing back on their monetary policies. The dragon of inflation leapt back to life. Those countries are now faced with the costs involved in slaying for the second time. Electors do not thank you for that.

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

Let the dog see the rabbit

People cannot co-operate 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 programmes can or will be implemented in stages over time, publish the timetable up front. Those 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 programme. Such an approach is particularly important in areas such as the removal of import licensing and reductions in tariffs, which impose major changes in the way firms go about their business.

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 government indicated in November 1984 that, roughly two years later, wholesale sales tax would be abolished, GST would be introduced, and income tax rates would be cut across the board. By early 1988 the top marginal rate of income tax, which we inherited at 66 per cent, had been reduced in two stages to 33 per cent, and company tax had also been cut from 45 per cent in 1983-84 to 33 per cent. The December 1987 Economic Statement extended corporatisation of state trading enterprises into a large privatisation programme designed to cut public debt by $14 billion by late 1992.

Finance Minister David Caygill adopted a similar strategy in 1989 by formalising the government's inflation target at 0-2 per cent by 1992. This had several very substantial advantages. Firstly, the government was committed to perform in line with that target or lose valuable credibility. Secondly, the community's awareness of that factor was helpful to confidence. The release of such information also places professional analysts throughout the community in a position to make their own independent evaluation of progress and government performance. They understand the importance of quality in decision-making, and the benefits available via consistent medium-term policies. They are often trusted advisors of the interest groups. Over time, their objectivity, combined with their increasing good-will towards the reform programme, becomes one of the major factors in creating a favourable climate of public opinion.

The confidence of the community is further increased if private sector people respected for their experience and capability are involved in helping to fine-tune policies and improve management. Expert panels appointed from the private sector, for example, received the public submissions on our major tax initiatives, to help to remove any administrative bugs from the new systems. Note, however, that our policy objectives were never opened up to review by those consultative bodies. Their role was to get maximum efficiency in the implementation and administration. The success of state-owned trading organisations since corporatisation has been largely due to the huge input of expertise provided by their private sector boards of directors.

Conventional political wisdom says that structural reform, because it imposes short-term costs which are unwelcome to the public, is a recipe for political suicide at the next election. In 1987, after the most radical structural reforms in fifty years, Labour fought the election on a platform that the job was only half-done and that we alone had the guts and know-how to finish it.

The government was returned with all the seats it had won in the landslide 1984 election, and took two more seats away from the opposition. Voters wanted the job completed, and done right.

Credibility and consistency can be maintained only in the context of a disciplined Cabinet which works right through the issues, and stands four-square behind every decision collectively taken. In my view, there is one force which is always capable of undermining the process of structural reform: the government itself, when it loses sight of its own fundamental objectives. If the discipline of collective Cabinet decision-making and collective Cabinet responsibility breaks down, the way is open for interest groups to seek to regain control of the ballgame.

Never sell the public short

Do not mistake the fears of the politicians for ignorance, lack of guts or lack of realism on the part of the voting public. The people out there in the community fight wars when they have to. They trade off short-term costs for long-term benefits every day of their lives. They take out mortgages and bring up children. Faced with the need for structural reform, normally responsible politicians will confide privately: T know it's needed, but people out there don't! Politics is the art of the possible!' Middle-of-the-road MPs maintain their personal security by making sure that their grip on reality is fuzzy round the edges: 'Ups and downs are normal. Things will come right. They always do.'

As the problems worsen, the demagogues and opportunists move in: 'We have just one problem — our political opponents are nuts! I can fix the lot with applied common sense and some No. 8 wire.' For years at a time, while the economy drifts on towards crisis or collapse, the public is offered nothing better than that by way of information or diagnosis. So they give the demagogue a go. Nobody stops to think that people may really want politicians with the vision and the guts to help them to create a better country for their children in the year 2000 and beyond it. 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.

Tell the public, and never stop telling them, right up-front:

- what the problem is and how it arose
- what damage it is doing to their own personal interests
- what your own objectives are in tackling it
- how you intend to achieve those objectives
- what the costs and the benefits of that action will be
- why your approach will work better than the other options.

Ordinary people may not understand the situation in all its technical detail, but they have a lifetime of experience at work and at home to help them sift the wheat from the chaff. 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 face up honestly to their questions. At the height of the rural crisis in 1986, for example, I walked on to the platform in South Otago without a speech-note in my hand, talked for forty minutes, and answered questions for two hours. The chairman wound up the meeting by saying that it took courage to do that, and invited me to return in twelve months' time. The local headline was: 'Minister Puts Head Into Lion's Den'. Such audiences listen with interest and attention if you tell the simple truths they are not used to hearing from politicians.

Don't blink

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 begins to bear on the economy, the whole community starts watching every television appearance like a hawk, looking for the least twitch of government nervousness. Their confidence in, and co-operation with, the reform programme can be undermined by the least blink. Visible uncertainty among key ministers spreads like a plague throughout the community.

Structural reform demands a major change in the ideas and attitudes which ordinary people grew up with. Such demands inevitably cause discomfort and uncertainty in many people. Our qualitative research showed that, in the process, people become hypersensitive to any signs of similar anxiety in the politicians who are responsible for the reform programme. They attend meetings and watch the TV news not just to find out what is happening and to understand the ideas behind it, but also to probe the feelings and emotions of the people at the helm. When they cannot understand the technical detail of the argument, they rely on their own assessment of the speaker's mental and emotional condition to provide them with a basis for judgement.

That is another reason why it pays to make decisions of the finest quality. When you know you have got it right, and know the policies are on course, that comes out through their TV sets. TVNZ told me they searched their film library for a clip of Roger Douglas looking nervous or uncertain, and were disgusted to find that I had looked 'cheerful and relaxed the whole bloody time'. Knowing or believing that you have got it right provides a firm foundation for dealing with people in a relaxed, confident way when you are face to face with them, even at large meetings of quite angry people. These remarks are not a recipe for arrogance. Listening to argument from sources of every kind is fundamentally important to policy-making, as well as to selling policies successfully. But all of that advice has to be measured against the government's medium-term goals. It is not arrogance to hold a sound course towards objectives that benefit the country.

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. 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 way.

Get the fundamentals right

A sick economy cannot be regulated back into 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. In other words, remember whose side you are on. Interest groups, whether of farmers, manufacturers, teachers or health workers, exist to serve the interests and improve the lives of consumers. The purpose of economic activity is to satisfy the needs of consumers. Government is not there to protect vested interests at the expense of the consuming public. Its role is to ensure that vested interests cannot thrive except by serving the general public effectively.

In command economies, the theory was that such problems would disappear if governments took the power to make all the important decisions on behalf of the general public, to protect people. Since 1917, that theory has been tested to extinction. The power they used was taken away from the people themselves. Government became the most oppressive vested interest of all. In New Zealand the government, by its past domination of areas like coal-mining, electricity, education, health and welfare, has often gone quite a long way in that direction. Our attention was focused on the benefits of regulation, without regard for the wider costs imposed. On that false accounting, regulation will seem automatically to improve the public good.

The only effective safeguard for ordinary people is the ability to make a free personal choice among competing suppliers whose livelihoods depend on satisfying the final consumer. Dedication to that principle from 1984 onwards is what placed the government squarely in the established Labour tradition of putting the needs of the common people first. The abolition of privilege is the essence of structural reform. Wherever possible, use your programme to give power back to the people. That is central to both democracy and market socialism.

Improving incentives in the taxation system

Privilege was a central feature in the taxation system which Labour inherited in 1984. Two-thirds of all goods and services carried no indirect tax. The other third carried arbitrary rates ranging from 10 per cent to 60 per cent. A top personal income tax rate of 66 per cent cut in at only $2\frac{1}{2}$ times the average income. For investors, tax avoidance was more rewarding than productive investment to earn market incomes. Loopholes usually let the wealthy avoid some or all of their obligations. Most wage and salary earners paid full nominal rates, eroding their incentive to improve productive effort. Tax avoidance often offered a better return than productive investment for market income, so tax distortions frequently had more impact on resource allocation than market opportunities. Company tax was 45 per cent, but the primary business objective in many enterprises was to avoid tax. The system was so leaky that some of our most successful companies paid little or no tax at all. But a huge number of beneficiaries and low-income families faced effective marginal tax rates of 80-100 per cent and more if they tried to improve their own position by productive personal effort.

By contrast, the ideal system would minimise distortion and damage to incentives by using low, flat rates on personal and company incomes and consumption, with no concessions whatever. In my view, many modern economies could successfully operate on a system of flat rates in the 15-20 per cent range across both the income and consumption bases, given the political will to do so. Low-income people would be safeguarded by forms of assistance designed to widen their opportunities for choice and to increase their incentives to improve themselves by productive effort.

A fundamental choice has to be made in designing tax systems. You can have high rates with perks and concessions for favoured groups — or low tax rates, more choice, and no concessions. Taxpayers, given those options, overwhelmingly favour the latter approach. They trust themselves more than governments to make choices that extract optimum value from their own money. The track-record leaves no doubt that politicians are inadequate investment managers. Over the years in New Zealand, they have wasted billions on projects that gave zero or negative returns.

Since 1984, in New Zealand, the government has halved the top personal rate to 33 per cent, and cut company tax from 45 per cent to 33 per cent. We now have a flat 12.5 per cent on consumption, virtually without exceptions. We aimed for a broad base, lower rates, flatter scaling, and minimal exemptions — a near-level playing field where resources would flow freely to areas offering the best return. The lower rates, in themselves, have made avoidance much less rewarding. Simultaneously, we have been very aggressive in eliminating concessions, perks, loopholes and tax incentives. Far more people now pay tax at or close to the nominal rates. The disincentive impact of the system has been vastly reduced, and it is no longer a major factor distorting our resource allocation.

Improving incentives via the regulatory environment

The biggest and most heavily protected monopoly in New Zealand when Labour took office in 1984 was not any of the country's large private business corporations; it was the public sector. The Government Printing Office had a monopoly on all government printing, for example. The construction of hydro dams was timed to give continuity of employment to Ministry of Works staff. State Coal not only mined most of the coal in the country, it also had first claim on all coal reserves, and it set the regulatory regime applied to its own private sector competitors.

As corporatisation has moved on towards privatisation, the government has put great emphasis on regulatory issues. Turning a public monopoly into a private one does not produce full economic efficiency. State businesses have been placed on a level playing field with private sector competitors. Departments' monopoly rights to supply goods and services to other departments have been removed.

Research on international competitiveness shows that the key factor in its development is a highly competitive home market, to provide the right discipline and incentives for producers. Telecom, for example, has the potential to become one of our biggest new exporters of services in the next ten years, if it has to face the prospect of open-ended competition at home, after privatisation. But given a continued monopoly or a market shared out among purely nominal competitors, it is a safe bet that Telecom would remain incapable of achieving much of its theoretical export potential. State sector reform has been good politics for the government. Our 1987 vote, even in Wellington, which has more public servants than any other city, demonstrated that beyond any doubt.

Improving incentives in the core public sector

The problems of waste in the core public sector departments were less easy to solve because, in many cases, there was no equivalent of a commercial bottom-line to define efficiency. Where they sold goods and services, we required them to move on to a full cost-recovery basis. Those activities were then freed to expand or contract in response to genuine market demand. Mainstream departmental activity had always been controlled by managing their inputs — staff numbers, capital expenditure programmes, travel, EDP spending, and so on. Under the traditional system, budgets were based on historical cost plus an adjustment for inflation, plus additional allowances to cover activity resulting from new policy decisions. Pay, personnel and industrial relations were managed through a totally centralised system that included comprehensive appeals, outside the control of the people trying to run the department. Ministers thought they had been running their departments for the past one hundred years, but genuine accountability was non-existent. Waste could not be identified. Expenditure creep was continuous.

We went back to fundamentals. Outputs, not inputs, are the real measure of value. Ministers should fix the outputs required, and hold departments accountable for efficient delivery. The centralised system was demolished. Chief executives in each department were appointed by merit on contracts which made them personally accountable for the performance of the department. The minister spells out, in a formal document, the outputs and priorities for the coming year, based on an agreed budget. The CEO's job is to deliver those outputs on time and to price.

As Finance Minister, for example, I discussed with the Treasury all the issues we wanted to raise in the coming year, and those we expected other people to raise for consideration. In each case, we worked out a broad strategy in the interests of the nation, agreed how long the work would take Treasury staff, and established in rough dollar values the benefit to the nation. After that, we made judgements about the political prospects for obtaining Cabinet agreement and the likely public reaction. Then we set the work priorities for each Treasury section for the year.

CEOs now hire and fire for the department, strictly on merit. They manage the industrial relations of their enterprise, under exactly the same legal framework as private sector employers. Not the least benefit of these reforms is that they clarify the true role of ministers, who have traditionally immersed themselves in the day-to-day running of their departments. Ministerial attention is now firmly focused, through the contract mechanism, on objectives, goals and strategy. Management has been moved into the hands of accountable professional managers. The new system forces ministers to decide, in a strategic way, what they want their department to contribute to society, and to relate their priorities realistically to the available funding. Ministers have found it a salutary experience to be faced so directly with their true political responsibility. They are still learning how to come to grips with their real task.

Monopoly versus choice in the social sector

Opinion polls leave no doubt, in all the areas so far described, that the voting public endorses the extensive action taken to reform and restructure those huge areas of the economy. On the other hand, wherever our policies have gone only part of the way towards reforms of uncompromising medium-term quality, the government is equally clearly in trouble with the public. Public discontent with the government's performance is most intense in social policy areas such as health, education, welfare and race where a Labour government might have hoped to do best.

The government was, in fact, very determined to achieve major improvements in the quantity and quality of health and education services, and they were given special status and top priority. By deliberate decision, the social services sector was exempted from the pressures of restructuring which the government imposed on most of the rest of the economy in the four years from 1984. While many other departments were facing expenditure cuts, health and education budgets were boosted 20 per cent in real terms in that period — a very large increase indeed. In the event, demand for funds in both areas has increased at an even faster rate, with little evidence that the extra money improved either the quality or quantity of service. An increase of 20 per cent in real terms, measuring by the Consumer Price Index, actually delivered only 1.8 per cent in real terms, on the basis of the public hospitals' own industry price index. This resulted primarily from large increases achieved by means of compulsory arbitration, a feature of previous legislation which has since been abolished in that particular form.

When state businesses were reformed, the evidence showed that perverse incentives and inadequate accountability in a totally protected system had wasted 30-50 per cent of the total funds provided. Evidence is not available to be definitive about the levels of waste and inefficiency in the social services sector as a result of perverse incentives and inadequate accountability; nothing, however, suggests that it is likely to be any lower than the levels we found in state trading enterprises.

In New Zealand, the government has traditionally been, and continues to remain, by far the dominant supplier of health and education services. Contestability is relatively minimal. The government view, as expounded by then Prime Minister David Lange, was that access to health and education could be guaranteed only if the state continued to provide the service. In his view, providing low-income consumers with the money to buy such services from competing suppliers was not an option because a right-wing government could alter that at the stroke of a pen.

Given the basic policy stance adopted, the key problem facing the government in these areas in the last five years has been:

- How do you subject providers to the discipline of consumer choice in a system dominated by one monopoly state supplier?
- How do you attack waste effectively when contestability and competition are outlawed by the rules of a monopoly ballgame?

The government faces exactly the difficulty involved in trying to achieve competitive export performance by regulating a private-sector system based on monopolies with total protection.

In Education, the government has sought to deal with that dilemma by abolishing the old system of centralised direction. A much smaller ministry now establishes guidelines and funds schools. Boards elected by parents manage each school, based on national guidelines and perceived local needs. They allocate the available funds as best they can, among competing uses. To that extent, the system is now more responsive to users, but some boards will undoubtedly conclude that demanding more money from the government is the best way to solve management problems.

In the health area, elected boards have traditionally managed public hospitals as the local element in a highly centralised bureaucratic system. Nobody has been satisfied with the outcome. An independent task force established by the Labour government concluded that output could be expanded 30-50 per cent without extra money, by eliminating the waste from the present system. It recommended that internal prices and contestability, in a government-funded system, would provide the improved incentives and management information needed to achieve gains of that order. A very similar approach was subsequently developed in the United Kingdom, and is now being implemented there, but the reaction of the New Zealand establishment was overwhelmingly conservative.

More importantly, Prime Minister Lange and the Labour Party Council shared a view that such proposals could become a stalking horse for privatisation. So reform here took a different track. Elected boards were reduced in number, rationalised on a regional basis, and their responsibilities were widened to include primary care and prevention, as well as public hospital care. A comprehensive bureaucratic effort is under way to develop national guidelines and performance standards as a surrogate for consumer choice and the discipline of contestable markets.

Simultaneously, the government in 1989 reached the end of its ability to make real on-going increases in funding, and getting their priorities right became a more acute problem for boards. The boards, under heavy pressure from vested interests which have often succeeded in having their own representatives elected, have not always managed the task to the satisfaction of the community. Moreover, a variety of intense controversies have broken out over the alleged failure of boards and the system to pay sufficient regard to the health priorities of large numbers of consumers. In Auckland, our largest city, the minister was forced to sack the whole board and appoint a commissioner. She has taken power to appoint good managers to elected boards where necessary. As with education, the situation is still evolving. It will be some time before anyone can assess objectively how many of the problems have been solved, and how many will remain unsolved. Meantime, opinion poll approval ratings for government management in both health and education have fallen. In some polls, the ratio was 3:1 against the government in 1989.

Incentive, choice and monopoly in the labour market

Within the public sector, the labour market reforms implemented in New Zealand have been wide-ranging and effective. In my view, they are among the best of their kind anywhere in the world. In the private sector, by contrast, the system remains fundamentally based on national occupational awards. Personal choice has been given improved but still limited application. Most international authorities such as the OECD believe that New Zealand pays a considerable price in avoidable unemployment for the relative inflexibility of its labour market.

The areas of greatest progress were the government's decision to step aside from negotiations, leaving industrial relations to the parties; and its abolition of compulsory arbitration. Since then, elements of both have returned in a different form to a degree, in recent government proposals for comparable worth legislation, and for the regulation of equal opportunities. Some movement has occurred away from national awards, which ignore ability to pay, in the direction of industry and enterprise bargaining, but independent observers see it as patchy and slow. New legislation has undoubtedly played a role in achieving it, but so have the pressures of the adjustment-induced recession. The situation will be more fully tested as the economy recovers. If the reforms are inadequate to that strain, the risk is that the system may begin to generate unwarranted inflationary pressures which will undermine the benefits of our other reforms. To the extent that the system benefits workers in secure jobs at the expense of those in insecure jobs and those on the dole, it complicates the task of reducing our unemployment levels. In combination with the substantially improved but still modest sustainable growth rate achieved by reform in the past five years, this suggests quite high unemployment for a considerable period.

'Why am I in politics?'

Conventional politicians ignore 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. They use the latest polls to fine-tune their image and their policies, in order to achieve better results in the next poll. In other words, their aim is really to be in perpetual power. It becomes increasingly clear to people that the problems have not been solved, and the opportunities have been thrown away. So such governments end up being thrown out, neck and crop.

Genuine structural reform, carried right through fairly and without compromise, delivers larger gains in living standards and opportunity than those achievable by any other political route. Because Labour implemented such a programme in its first three years, we were re-elected, notwithstanding significant adjustment costs, with a majority larger than our landslide 1984 win. After the 1987 election, the government lost some of the momentum which had sustained the reform programme in its first three years. The vested interests were able to marshal a counter-attack. The then Prime Minister sought to re-establish a consensus by calling for a 'breather' in the reform process — an announcement made without consulting either the Cabinet or the Caucus. Mr Lange felt that some people needed time to catch up with the changes already made. He also feared that on-going reform would inevitably change some traditional social-sector policies.

Protected groups within the community, looking for ways to arrest the process of change before it affected their interests and, if possible, to turn back the clock, seized their opportunity. The government became polarised internally between those who wanted to advance the process of reform a stage further to achieve improved outcomes, and those who wanted to call a halt. A stalemate developed, dramatised in the news media around a conflict of objectives and personality between David Lange, as Prime Minister, and myself as Minister of Finance.

The government lost its ability to take consistent account of the ten principles described in this paper. Confidence was dissipated by public uncertainty about the future directions of policy. In September 1988, the Prime Minister tried to solve the deadlock by attempting to remove me from the Finance portfolio. The Cabinet, however, rejected that approach as ill-advised. By December, all conceivable steps had been taken to resolve the conflict, and had failed. In my view, the conflict was damaging the nation's economic prospects. The situation was intolerable. I therefore opted to force a choice of direction on the Caucus by announcing that, from January, I would not be available to serve as Finance Minister if Mr Lange remained Prime Minister. He immediately dismissed me from the Cabinet. He was re-elected Prime Minister by the Caucus, but proved unable to maintain a consensus within the Caucus for his own preferred directions. That situation persisted until August, when the Caucus re-elected me to the Cabinet. Within days, David Lange had tendered his resignation as Prime Minister, and Geoffrey Palmer replaced him.

Throughout that period, the government continued to make good headway in many areas where existing policy was well-established. That was regarded as crucial to the government's credibility.

- Corporatisation progressed further, and advanced into privatisation.
- Monetary policy remained sound. The Reserve Bank Amendment Bill was introduced as scheduled.
- Problems on the waterfront and important areas of transport were tackled.
- The reform of the core public sector moved forward on sound lines.

On the other hand, the government's ability to make quality medium-term decisions in areas where policy had not already been clearly established was undoubtedly impaired. But above all, the public lost confidence in the consistency of the government's track record, and no longer felt able to predict how the task of policy development would be approached in future. In March 1989, David Caygill tackled that problem head-on by announcing that the government was targeting inflation at 0-2 per cent and interest rates of 7-10 per cent by the end of 1992. Those announcements, and the evidence that a gradual economic recovery was on the way as a result of the previous four years' work, have played key roles in settling public opinion somewhat.

Within the new government team under Geoffrey Palmer, a serious effort is being made to preserve the government's achievements without necessarily undertaking new initiatives which might be controversial. The current concentration is more on ameliorating perceived current political problems than on initiating any new round of fundamental structural reform to improve growth prospects. The risk involved in this approach is that the government is less focused on medium-term opportunities capable of further improving its capacity to deliver satisfactory outcomes in 1993 and beyond. It is no longer setting the agenda as it did during its first three-year term, and has therefore less fundamental capacity to modify the changing winds in the climate of public opinion. Compared with its first three years, it is coasting on the expectation of good achievement as a result of its past efforts, rather than laying a foundation for new future achievements.