A Model Strategy for Small States to Cope and Survive in a Globalised World Economy? An Analysis of the “New Zealand Way”

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1. Introduction
A major issue of concern to contemporary social scientists is the relative decline of the autonomy of the nation-state. Traditionally, the nation-state served as a useful unit of analysis for scholars in international political economy. It may no longer be a useful starting point. Advocates of the globalisation thesis argue that the nation-state is losing much of its room for maneuver in public policy decision-making\(^1\). This is a result of trade liberalisation and deregulation, particularly of the financial sector; rapid technological advances in telecommunications and data processing, and the exponential growth of international trade and foreign direct investment (FDI).

As I will argue below, two opposite arguments about the impact of globalisation on small states might be put forward.

First, it would appear that small states are particularly affected by a loss of autonomy as a result of globalisation. Smaller states face a constrained choice of responses to the impact of the world economy on their own national markets. By virtue of their economic and political power, size and strength, smaller states dispose of a relatively smaller array of policy responses than larger states. They cannot hope to set the parameters of the global economy given their relatively small economies and limited political and military clout. Small states are usually host to only a small number of transnational corporations and,

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owing to the size of their own domestic market, they are commonly not only dependent on exporting their own products, but also on importing raw materials from abroad. Alternatively, the opposite argument might be made. Small states are particularly well prepared to deal with open markets because of their economic structure. For many European small states, a protectionist trade policy was never a viable option. Katzenstein (1985)\textsuperscript{2}, who is often credited for his pioneering work on “small states”, points out that these states, due to their dependence on both imports and exports, are committed to the cause of international free trade. Foreign trade typically makes up a large proportion of small state Gross Domestic Product (GDP)\textsuperscript{3}. Small states also depend on occupying market niches with relatively highly developed technology in sections of the economy where they enjoy a comparative advantage in production or a technological lead over their competitors\textsuperscript{4}.

In this study, I seek to analyse how one small state has responded to the challenges of globalisation. Using New Zealand (NZ) as a case study, I will examine New Zealand’s remarkable reform process as one possible policy response to dealing with a globalised world economy. “Model New Zealand” has been heralded as a successful model of structural adjustment by international observers. Regardless of whether one accepts the normative component of this judgement, New Zealand presents a paradigmatic case of complete market liberalisation and the embrace of neo-liberal doctrines. Can New Zealand indeed serve as a model for other small states? I seek to critically examine the


\textsuperscript{3} In 1987, total trade (imports and exports) constituted more than 60 per cent of GDP in Switzerland, Austria, and Norway and more than 100 per cent in the Netherlands, Ireland, and Belgium.
reform process and shed light on its intellectual sources, employing some of the insights generated by the constructivist approach in international relations. Can New Zealand be properly considered a success story from which other small states can learn? The country went from being one of the most regulated countries in the OECD to being one of the most deregulated\(^5\). I argue that it underwent a very painful period of transition and adjustment during the reforms. Even now the beneficial effects are far from obvious.

Market liberalisation has come at a very high social cost. Poverty and social inequality are rising. The economic data reveals an equally mixed picture. In 1995, commentators admired the “turn-around economy” and observed that the initial hardship seemed to be finally paying off. After the devastating impact of the Asian crisis in New Zealand, this assessment seems questionable and premature. New Zealand has been able to successfully fill some market niches in cutting edge agricultural engineering. At the same time, however, extreme liberalisation also means strong dependency on foreign capital, as is especially true for New Zealand with its large current account deficit and high level of foreign direct investment. Dependency on highly volatile foreign capital can become problematic rather quickly, as New Zealand’s current recession in the wake of the Asian crisis vividly demonstrates.

\(^4\) An example for this is the leading market position of mobile telephony companies from Scandinavia, such as Nokia.
2. Small States and Globalisation

How should we conceptualise globalisation? And how is it affecting the policy choices of small states? The purpose of this section is to arrive at a working definition of globalisation and to analyse its impact on small states.

Since academic discourse on this subject is of a relatively recent nature, it is perhaps unsurprising that no single coherent definition of the phenomenon has yet emerged. However, from the writings of those authors who are willing to acknowledge globalisation as a genuinely new phenomenon a common thread can be extracted. These authors argue that the nation-state is losing its autonomy, or posit, as Susan Strange has done, the “retreat of the state”. The state’s sphere of control is decreasing, as an array of new actors moves in to undermine the state’s formerly comfortable command of territorially based authority. Among those actors are international institutions, networks and, most importantly, private transnational and multinational corporations.

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8 Ricardo Petrella succinctly summarizes this argument about the waning power of the nation-state vis-à-vis the market, which is a very central proposition of the literature on globalization in general. He posits that “Global markets are putting an end to the national economy and national capitalism as the most pertinent and effective basis for the organization and management of the production and distribution of wealth.” (Ricardo Petrella (1996) Globalization and Internationalization: The Dynamics of the Emerging World Order, in: Boyer and Drache, ibid, 1996, pp. 62-84. Gerald Epstein points out that “short-term capital mobility undermines a country’s ability to undertake policies that threaten investor confidence in its economy.” (Gerald Epstein (1996), International Capital Mobility and the Scope for National Economic Management, in: Boyer and Drache, ibid, 1996, pp. 211-227.
While the nation-state no longer seems able to command the same array of macroeconomic tools, obvious winners are international markets. Global financial flows of gigantic proportions\(^9\) play an important role in shaping and curtailing governments’ choices.

Following the wave of deregulation and market liberalisation, which commenced in the late 1970s, particularly in the financial sector, the state’s macroeconomic weaponry chest looks considerably less well-stocked today. No longer can a government simply rely on monetary policy to set its economy’s parameters: If it tries to increase the interest rate so as to curtail inflationary growth, this move will simply attract mobile foreign capital. National fiscal policy is also affected by the increased mobility of global capital. Nation-states cannot freely determine corporate tax levels, because what the market deems to be an excessive rate will only cause companies to invest in regions or state more amiable to their interests. Some analysts have gone as far as positing a global “race to the bottom” in which regions and indeed nations have to compete for corporate investment by lowering their environmental, safety, health and social standards and offering tax breaks and other incentives\(^10\). Regardless of state incentives, due to the decrease in strict regulation of the financial sector\(^11\), global capital is much more uninhibited to move into and out of new locales at relative ease. Large volumes of money are on the move, “free to roam the globe looking for the brightest investment opportunities”\(^12\).

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There are two factors contributing to the relative ease with which large-scale global financial flows are occurring today at an unprecedented rate.

Firstly, deregulation of the financial markets made short-term foreign investment and portfolio investment\(^{13}\) much easier than before. Secondly, technological innovation, another important factor mentioned by Strange\(^{14}\) and Drache\(^{15}\), has meant that such transfers of financial capital can take place at an ever accelerating pace. Rapid advances in modern computer-based technology allow for rapid and easy data processing and manipulation. The progress of telecommunications technology enables global dissemination of information at unprecedented levels of speed. In fact, I would argue that innovations in technology as such undermine the feasibility of the nation-state’s regulatory capacity.

The dramatic increase in foreign direct investment (FDI) should also be mentioned, which is a relatively recent development as well. Investment of a given company abroad in means of production (factories, plants, refineries, etc.) is a phenomenon unparalleled in previous economic history and ought to be distinguished from colonial patterns of raw material extraction through subsidiary companies within colonies. Foreign direct investment in production facilities either seeks to elude protectionist measures by the host country or endeavours to exploit different levels of wages or social standards for production. Thus, global trade is to some extent no longer the exchange of goods among companies from different nation-states (taking advantage of Adam Smith’s comparative

\(^{13}\) Petrella in Boyer and Drache, *ibid*, 1996.

\(^{14}\) Strange, *ibid*, 1996.

\(^{15}\) Drache in Boyer and Drache, *ibid*, 1996, pp. 31-62.
advantage in the production of goods), but instead has to be re-conceptualised as the intra-company exchange of goods in various stages of the production cycle\textsuperscript{16}.

Closely related to the issue of establishing a concisely specified definition of globalisation are questions of distinctiveness and uniqueness. Is the current degree of global economic interdependence and growth of trade dependency\textsuperscript{17} indeed a genuinely new phenomenon\textsuperscript{18}? Is there something that distinguishes the global exchange of money, goods and services today from exchange routes and networks in the age of Cecil Rhodes’ Imperialism, Marco Polo’s Asian expeditions, trans-Saharan trade routes, or Roman trade with its neighbours? Perhaps so, some authors might concede, but they are less convinced that the level of current global interdependence and international trade is more than just a return to the pre-1914 levels of global interchange\textsuperscript{19}.

\textsuperscript{16} Strange claims that a full quarter of so-called global trade is really of this nature (Strange, \textit{ibid}, 1996). The same figure is quoted in Winifred Ruigrok ‘\textit{Paradigm Crisis in International Trade Theory’}. Paper prepared for the Forum on Applied Science and Technology, Commission of European Community, Brussels, 1991.

\textsuperscript{17} Drache argues that industrialised nation states are growing increasingly dependent on foreign export of their products (Drache in Boyer and Drache, \textit{ibid}, 1996, p. 52). This implies that a self-imposed “de-coupling” from the world market does not any longer constitute a viable policy option.


\textsuperscript{19} For prominent proponents of this argument see Paul Hirst and Graham Thompson, \textit{Globalization in Question: The International Economy and the Possibilities of Governance}, Cambridge, MA: Blackwell Publishers, 1996. See also Paul Bairoch, \textit{Globalization Myths and Realities – One Century of External Trade and Foreign Investment}, in: Boyer and Drache, \textit{ibid}, 1996, pp. 173-193. I do not subscribe to this point of view. For one, I do not think that the current unregulated flow of finances across borders was in any way paralleled by pre-war circumstances. But even if globalisation is nothing new \textit{per se}, it does present a major new challenge for small states to adopt to and thus warrant analysis in the framework of this study.
Different scholars emphasize different policy areas, which vary in the degree to which they are affected by a globalised world economy. Obviously, there are also different normative points of view arguing about whether or not globalisation is a phenomenon worthy of appraisal or condemnation, usually depending on the author’s political persuasion.

Based on this discussion, I propose to define and conceptualise globalisation in terms of the speed and regulatory ease of worldwide flow of capital. While it is important to consider the rapid growth of international trade in recent years as well, the latter component does not constitute a genuinely new phenomenon and therefore does not really deserve a new label. At this juncture, it is important to distinguish between globalisation – as defined above – and internationalisation, that is, the increasing global interdependence based on growth of international trade.

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20 Cable, ibid, 1995.
21 Both (neo-)Liberals and (neo-) Marxists are usually convinced of the new character of globalisation, but their normative assessment naturally falls within polar opposites. For a critical approach see Gill, ibid, 1995, Broad, ibid, 1995. For a more enthusiastic account see Kobrin, ibid, 1997.
22 Global trade per se does not constitute a truly new or distinct occurrence in the global economy. It may be true that the automobile we drive today is just as likely to be produced in Osaka, Wolfsburg or Seoul as in Detroit. But the Romans also imported goods from outside of their Empire, not all of which were “exotic” enough to make the decision to import inevitable. Yet today’s Wall Street stock broker who decides to transfer portfolio investment from Djakarta to Singapore and from Hong Kong to Los Angeles, all within minutes and by pressing a few buttons, does not have any historical precedent.
How and in what way is globalisation affecting small states? While Katzenstein contributed significantly to research on small states, his work and that of others exploring small states in the literature dates back to the mid-1980s or earlier. At that point, the imminent pressures of globalisation had not yet received the same amount of scholarly attention as is true of today, since they were not as readily apparent.

As briefly alluded to in the beginning, two arguments could be advanced here. Based on Katzenstein’s research, one might argue that small states are actually particularly well prepared for a world of deregulated financial and trade flow. Since they have always been dependent on the international marketplace for the raw materials they imported and the export of the manufactured goods they exported, they had to be able to navigate the treacherous tides of the international marketplace from very early on. In fact, because of their status they had no choice other than to open up their economy. At the same time, they found ways to specialise in niche products.

On the other hand, the argument could be made that small states are but pawns in a game they cannot control nor even manipulate. The globalised economy finds small states in a particularly vulnerable position. If we accept the premise that nation-state lose some of their ability to manipulate their macroeconomic parameters, this must apply with particular vengeance to small states. They are even more vulnerable to the consequences of the rapid inflow and outflow of foreign short-term investment. If governments of large countries can no longer counteract the speculative movement of the markets, this must be

an even more unsurpassable challenge for small states. Companies from small states
cannot enjoy the advantages of the economies of scale, which a large domestic market
offers. Small states are typically host to only a small number of transnational companies
(TNCs), which are in a position to take advantage of deregulated international trade and
investment opportunities. Their economies are made up by small and medium-sized
businesses, which run the risk of being taken over or run off the road by large foreign
TNCs. The best these small and medium-sized businesses can hope for is to diversify
their customer base by gaining new markets abroad. However, they will certainly be hard
pressed to find products they can effectively and competitively market abroad owing to
their limited resource basis for international advertising, marketing, and distribution.

New Zealand is a case study of small country moving from strong isolationism to full-
fledged market liberalism. New Zealand policy-makers concluded in the mid-1980s that
isolationism was no longer a viable policy option. Instead, they turned their country into a
laboratory of free trade and Chicago-style neo-liberalism. Does this model have insights
to offer to other small states?

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3. **Introducing the New Zealand way**

In 1984, the small South Pacific island nation of New Zealand gained worldwide attention by implementing the most comprehensive economic reform program of any OECD country to date. Within only a few years, New Zealand experienced a paradigmatic shift from neo-Keynesiasism to New Right monetarism. It went from being one of the most regulated countries in the OECD to being the most liberalised and deregulated. In fact, neo-liberalism found a much more zealous disciple in New Zealand’s Labour Party than is true for any other New Right leader. New Zealand “out-Thatchered Mrs. Thatcher”

A small remote island nation, over a thousand miles from its nearest neighbour Australia, it had previously been known for pre-empting its European cousins with progressive policies such as female suffrage in 1893, a comprehensive welfare system and a fervent environmental and anti-nuclear policy. Now New Zealand stood at the forefront once again. This time, though, it overtook Western Europe on the right. It made headlines for a radical move away from Keynesian economics and the welfare state. Perhaps surprisingly, it was a Labour government, which under the stewardship of Prime Minister Lange and Minister of Treasury Roger Douglas jump-started a radical programme of deregulation, market liberalisation and privatisation of state-owned enterprises. The OECD, *The Economist*, and other like-minded apostles of the neo-liberal New Right

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outdid themselves in praises for the blitzkrieg style economic reform programme\textsuperscript{25} which radically re-defined the role and scope of government in New Zealand within a few years.

The reform programme included the deregulation of the financial sector, the removal of subsidies to producers, both in the manufacturing and the agricultural sector; the removal of tariffs on imports, a fundamental tax reform, a comprehensive restructuring of the public sector, a radical cut in the generous system of welfare provisions, a total remodelling of labour relations, and the corporatisation and privatisation of formerly government-owned enterprises. Tables 1 and 2 provide an outline of the reform program enacted in New Zealand between 1984 and 1994.

\textsuperscript{25} The Economist deemed New Zealand “an international model for economic reform” (13 November 1993, p. 155) and was impressed by its “exhilarating dash for economic freedom” (\textit{The Economist}, 1 June
### International Trade:

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>8 November 1984</td>
<td>Export-oriented subsidies and incentives removed completely or to be phased out – affected areas included manufacturing, agriculture, fishing, forestry, and tourism</td>
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<tr>
<td>21 November 1984</td>
<td>Package of measures resulting in an effective liberalisation of the financial sector</td>
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<tr>
<td>6 March 1985</td>
<td>Limits on foreign ownership of New Zealand financial institutions removed</td>
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<tr>
<td>1985</td>
<td>Deregulation of foreign direct investment; very liberal regime for portfolio investment and repatriation of profits</td>
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<td>9 September 1985</td>
<td>Treasury announces schedule to phase out import licensing by 1992 and reduce tariff protection</td>
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<td>18 August 1988</td>
<td>Prime Minister signs protocol for free trade agreements with Australia, breaking most trade barriers by 1 July 1990</td>
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<tr>
<td>18 April 1989</td>
<td>Manufacturing trade barriers between NZ and Australia to be removed as of July 1989</td>
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<tr>
<td>December 1991</td>
<td>Government announces further streamlining for approval of foreign direct investment</td>
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### Monetary Policy:

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<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>18 July 1984</td>
<td>New Zealand dollar devalued by 20 percent</td>
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<td>30 August 1984</td>
<td>Interest rate control removed</td>
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<tr>
<td>21 December 1984</td>
<td>Reserve Bank effectively abolishes restrictions on foreign currency exchange</td>
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<tr>
<td>14 February 1985</td>
<td>Minimum public sector security and reserve asset ratios removed</td>
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<tr>
<td>4 March 1985</td>
<td>New Zealand dollar floated – abandonment of “crawling peg” and fixed exchange rates since 1987</td>
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<td>15 December 1989</td>
<td>Reserve Bank of NZ Bank Bill passed. Bank is now more independent from government, but overall more accountable: government defines objectives, while Bank designs policies. The sole aim for monetary policy is now defined as “achieving and maintaining stability in the general level of prices”. Target of 0%-25 price increase by 1992-93.</td>
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### Fiscal Policy:

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<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>8 November 1984</td>
<td>As part of 84-85 budget, government announces first tax reform: Removal of some tax exemptions, fringe benefits tax, lower marginal income tax rate, announcement of the introduction of a general goods and services tax (GST) as of 1 April 1986; government makes vow not to cut welfare state expenditures in the first wave of reforms</td>
</tr>
<tr>
<td>20 August 1985</td>
<td>Government announces details of further tax reforms, effective as of 1 October 1986: GST tax is to replace most other indirect taxes, its level is set at 10 percent; a simplified income tax which entails huge cuts at the top end from 66 percent to 48 percent and much smaller cuts at the bottom end from 20 to 15 percent; small adjustments to Social Welfare payments to compensate for the effects of the GST</td>
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<tr>
<td>18 June 1987</td>
<td>Two months before general elections, the Minister of Finance announces $379 million government surplus and repayment of $600 million overseas debt. This was calculated on a cash flow basis, thus incorporating the gains from the first wave of privatisation and the revenue from state-owned enterprises (SOEs) which were now under an obligation to make profit</td>
</tr>
<tr>
<td>17 December 1987</td>
<td>Government announces increase of GST to 12.5 percent as of 1 October 1988 (later postponed to 1 July 1989), an increase in the company tax rate from 28 to 33 percent as of 1 April 1989, and a flat personal income tax (later withdrawn; instead, income tax at top end reduced to 33 percent as of 1 October 1988)</td>
</tr>
<tr>
<td>10 February 1988</td>
<td>Company tax rate reduced to 28 percent, personal income tax brackets reduced to three: 33 percent for income over $30,875 and 24 percent below, this amounts to another tax cut at the top and a tax increase at the bottom. An exception was made for income below $9,500, which was now taxed at 15 percent. Both changes are effective as of 1 October 1988.</td>
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<tr>
<td>19 December 1990</td>
<td>Government announces Economic and Social Initiative, marking the beginning of the end of the welfare state in NZ. Government cuts income support entitlements by between 2.9 and 24.7 percent as of 1 April 1991. It tightens the benefit eligibility criteria. It establishes reviews to reduce expenditure in housing, education and health.</td>
</tr>
<tr>
<td>June 1994</td>
<td>Fiscal Responsibility Act is passed, safeguarding the reforms and curtailing the room for maneuver for future governments. Section 4 mandates that total debt must be reduced to prudent levels, operating expenses must not exceed operating revenue on average, over a reasonable amount of time, a positive value for government net worth must be maintained, fiscal risks must be managed prudently, and the level and stability of tax rates should be reasonably predictable for future years.</td>
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### Industrial Policy:

**December 1985**  
Government announces new guidelines for its commercial activities sector, essentially turning it into profit-making corporations, imposing performance objectives on their managers, non-commercial functions (e.g. employment policy) are cast off

**20 May 1986**  
The Electricity Division, State Coal Mines, Post Office and Civil Aviation are removed from their respective departments and turned into corporate structures which are now subject to taxes and dividends and stripped off any special privileges

**1986**  
Commerce Act is passed, stating in its preamble that it is “an Act to promote competition in markets within New Zealand”, including such fields as banking, air travel and taxi cabs

**1 April 1987**  
The State-Owned Enterprises Act goes into effect, providing a legislative framework to these aims. This mandates the newly created state-owned enterprises (SOEs) to operate “as profitable and efficient as comparable businesses that are not owned by the Crown”. Government corporatises its trading sector, by turning it into SOEs. 24 SOEs are established, among them the Government Property Services, the Airways Corporation, Forestcorp, Landcorp, NZ Post, Post Office Bank, Electricorp, Telecom, Railways Corporation and Coalcorp.

**3 March 1988**  
Government sells 70 percent of shares of Petrocorp to Fletcher Challenge

**27 July 1988**  
Government announces its intention to sell Government Property Services

**28 July 1988**  
As part of the 1988 budget, government announces its intention to sell off $2000 million worth in assets that year

**18 August 1989**  
Government sells Rural Banking and Finance Corporation to Fletcher Challenge

**12 December 1989**  
Government sells Government Printing Office to Rank Group

**3 May 1990**  
Government sells State Insurance Office to Norwich Insurance

**14 June 1990**  
Government sells Telecom to Ameritech and Bell Atlantic and NZ companies Fay Richwhite and Freightways

**15 June 1990**  
Government sells Tourist Hotel Corporation of NZ to Southern Pacific Hotel Corporation Ltd.

**May 1992**  
Government announces studies for further privatisation programmes

**July 1992**  
Government sells 57.3 percent share in Bank of NZ to National Australia Bank

### Labour Policy:

**1987**  
Labour Relations Act: regulates size of unions, abolishes practice of using agreements in second-tier bargaining as yardsticks for next round of wage bargaining, Arbitration Court is abolished and replaced by Mediation Service, Arbitration Commission, and a Labour Court

**1 April 1988**  
State Sector Act extends provisions of Labour Relations Act to the state sector

**3 December 1988**  
In light of high unemployment, government announces job-subsidy scheme, paying employers for hiring long-term unemployed to perform community work scheme

**19 December 1990**  
Government abandons tripartitism. Employment Contracts Bill is introduced as part of the government’s Economic and Social Initiative. It becomes effective as of 15 May 1991. It repeals the Labour Relations Act of 1987 and combines the Mediation Service and the Arbitration Court into an Employment Tribunal and renames the Labour Court into Employment Court. It liberalises the labour market, by abolishing mandatory union membership and allows employees and employers to choose between collective and individual employment contracts. Since employment contracts can be negotiated with or without the aid of an intervening agent, union power is severely undermined.

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Tables 1 and 2: The New Zealand reform programme in terms of international trade, fiscal, monetary, industrial, and labour policy. Source: See fn. 26
As can be seen from Tables 1 and 2, the liberalisation programme occurred in two major waves. Under Labour Party guidance, from 1984 to 1990, the first wave of reforms was implemented. As Minister of Finance Roger Douglas played such a pivotal role in the process, the label “Rogernomics” is often applied to the reforms. These included industry deregulation, trade reform and capital market reform. Startling to many voters and academic observers, the National Party continued the reform programme, after it took over power from Labour in 1990. The second wave of reforms entailed macroeconomic stabilisation, corporatisation of state-owned enterprises (SOEs), privatisation of SOEs, a comprehensive labour reform, and a fundamental restructuring of the welfare state.

As can be seen, the reform programme bears a striking resemblance with structural adjustment programmes commonly recommended for Third World countries. The first steps of deregulation affected the financial sector, and included the removal of exchange rates and a floating of the New Zealand dollar. The government committed itself to a monetarist anti-inflationary regime, by means of sustaining high interest rates and exchange rates. Price stability was enshrined as the overarching goal in the Reserve Bank

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27 In fact, one author uses New Zealand as a “critical case study” to test the practical feasibility of IMF structural adjustment programmes. His findings are that these programmes take a very long time indeed to show any beneficial results and even then, it is far from certain whether these effects can be sustained in the long-term. See: Herman Schwartz, “Can orthodox stabilization and adjustment work? Lessons from New Zealand, 1984-1990”, International Organization, 45, 2, Spring 1991, p. 221-256. See also: Ralph Lattimore, “Economic Adjustment in New Zealand: A Developed Country Case Study of policies and
Act of 1989, leading to what can be described as the “Bundesbank-sation” of the institution. Labour drastically cut down subsidies, abolished import licences, and began to phase out tariffs. It also opened up the economy to foreign direct investment. In fiscal policy, personal income tax for top earners was reduced significantly and a goods and services tax was introduced. Government activity and the public sector as a whole were fundamentally restructured. Government departments were re-organised along corporate lines. In many cases, this meant transformation into SOEs and subsequent privatisation, in most cases to Australian or American companies. This corporatisation included government research facilities, hospitals, public housing, and universities.

As part of the second wave, the labour market was liberalised and the welfare state underwent severe cutbacks in scope and size. This translated into a full-blown attack on the structural power of unions with the abandonment of collective bargaining imbedded in the 1991 Employment Contracts Act. At the same time, welfare benefits and eligibility were drastically curtailed\(^28\).

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This “big bang” reform program marked a revolutionary departure from the past. New Zealand has a long history of heavy state interventionism and government regulation. Barry Gustafson notes that:

Manufacturers and wage-earners were protected by import controls, and farmers were encouraged to produce and were protected from fluctuations in overseas markets by subsidies, tax incentives, and producer boards [responsible for the coordination of marketing of products]. The banking system and value of the currency were tightly controlled. [Gustafson, 1997, my addition in brackets]

In fact, some of the economic measures pursued by its government were commonly associated with the State Socialist countries of the former Warsaw Pact - such as tight controls on the circulation of currency, high tariffs, import quotas, and a central government agency co-ordinating export policy. Government intervention has traditionally been regarded as beneficial and a cautiously modernising force.

Due to almost unlimited access for its agricultural products to its former motherland Britain, “England’s Garden” prospered throughout the 1950s and 1960s, boasting the third-highest standard of living in the 1950s. New Zealand was able to provide its citizens a generous set of cradle to grave welfare provisions, universal health care and free access to education. Until the mid-1970s, unemployment was virtually unheard of. Wage

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levels were set so as to guarantee a living wage “for a man, his wife and three children”\(^{31}\). The National Party government provided generous agricultural subsidies and managed the worldwide marketing of New Zealand’s agricultural products. Meanwhile, domestic manufacturing was protected from competition from abroad through high tariff barriers\(^{32}\). The government willingly underwrote New Zealand’s continuing current account deficit by accumulating foreign debt. As delightful as life at the other end of the planet seemed, some troubling structural problems were already evident, such as the excessive dependence on the export of commodities.

In the 1970s these problems were brought to light as the global economy experienced meagre growth and high inflation. New Zealand was hard hit, exhibiting one of the lowest growth rates of any country within the OECD during the 1960s and 70s\(^{33}\). There were a number of external shocks which New Zealand faced. Firstly, main customer Great Britain joined the European Community, thereby becoming part of the Common Market for agricultural products. Though exceptional provisions were made to buffer some of the shocks for the New Zealand economy, this meant a sudden loss of New Zealand's agricultural market in Great Britain.

\(^{31}\) This was the threshold officially used by the NZ Arbitration Court at least until 1954. See Dalziel and Lattimore, *ibid*, 1996, p. 72

\(^{32}\) NZ used to rely on import licensing and import tariffs. Import licensing was originally established to “restrict the values of imports…” but the “value of licenses for goods for which there was a NZ-made equivalent was kept particularly low”. (Dalziel and Lattimore, *ibid*, 1996, p. 31). Protected domestic industries included automobile assembly, electrical products, textiles and footwear industries. The level of protection afforded to manufacturing was estimated at 70 per cent in the mid-1970s (Gary Richards Hawke, *The Making of New Zealand*, Cambridge, UK: Cambridge University Press, 1985.)

\(^{33}\) Growth in GDP per capita in NZ was the lowest of all OECD member countries between 1960 and 1985; it was only at 1.4 per cent, compared to an OECD average of 2.7 per cent. Average GDP growth in this period was the third lowest of all 24 member countries. NZ ranked third in GNP per capita in 1955, but 16\(^{1}\)th in 1982 (OECD, *Economic Survey: New Zealand*, Paris: OECD, various issues and Massey, *ibid*, 1995, p.. 10-21).
Zealand’s main market. Secondly, in the wake of the oil crises of 1973 and 1979, New Zealand’s terms of trade deteriorated dramatically. Not only did oil prices rise exponentially, demand for commodities slipped. This hurt New Zealand’s economy badly, since its exports were still largely composed of wool, meat and dairy products. Notwithstanding a temporary boom in commodity prices between 1971 and 74, terms of trade deteriorated further throughout the 1970s and early 1980s. New Zealand’s unsophisticated reliance on agricultural products and its failure to diversify its export basis in time was beginning to backfire. Thirdly, and related to this, in the wake of global stagflation, the Europeans were not alone in their hesitance to accept agricultural imports. A worldwide shift towards more protectionism occurred in the agricultural sector. This development is continuing to bedevil the New Zealand economy and only gradually coming to an end.

Robert Muldoon, Prime Minister and Finance Minister between 1975 and 1984, attempted to address the economy’s sour performance by pseudo-Keynesian methods. As part of the so-called “Think Big projects”, he led an ambitious campaign to reduce New Zealand’s reliance on agricultural products and its failure to diversify its export basis in time was beginning to backfire. Thirdly, and related to this, in the wake of global stagflation, the Europeans were not alone in their hesitance to accept agricultural imports. A worldwide shift towards more protectionism occurred in the agricultural sector. This development is continuing to bedevil the New Zealand economy and only gradually coming to an end.

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35 World prices for wool had already slipped previously. They fell by over 20 per cent in both 1967 and 1968. The price for oil increased both in 1973 and 1979, leading to a 30 per cent decline in NZ’s terms of trade in 1974-75. The price for wool sank again in the early 1980s (Dalziel and Lattimore, *ibid*, 1991, p. 30-46). In fact, “…in eight out of nine years between 1975 and 1983 inclusive the terms of trade were at a lower level than in any year from 1950 to 1974, and the average for 1975 to 1983 was more than 23 per cent below the average for 1950 to 1974 (J. Gould, *The Muldoon Years*, Auckland: Hodder and Stoughton, 1985, p. 43).
36 In 1981, these three products made up 40 percent of all exports. In the early 1980s, 9 to 10 per cent of GDP was comprised of agricultural activities. Food processing constituted 27 per cent of the manufacturing sector (Schwartz, *ibid*, 1991, p. 235).
37 The reliance on agricultural products proved problematic because of the US and the EU pursuing a protectionist policy in agricultural trade throughout the 1970s and 80s. Moreover, the EU practice of dumping agricultural surplus on the world market also hurt NZ exports. Finally, both the US and the EU
Zealand’s dependence on foreign oil imports and increase the domestic heavy manufacturing industry such as the steel industry in Northland. His macroeconomic policy was unfortunately poorly designed and inconsistent. Though Keynes had called for state intervention to stimulate demand, this did not imply gross misallocation of funds to poorly planned projects.\footnote{One of the projects included the expansion of the NZ Steel Plant. The plant’s size was planned on the assumption that NZ steel demand would somehow double. Internationally, there was already a drop in world steel prices and a move towards protectionism discernible.}

Muldoon’s short-sighted and ill-advised course maneuvered unsteadily between heavy state interventionism, including the 1982 wage and price freeze, and cautious flirts with reforms. Essentially, this misguided lingering highlighted his lack of any real vision.

In 1984, the country underwent a severe economic crisis. Muldoon and his National Party had failed to offer anything more sophisticated then a simple wage and price freeze, while clinging on to an overvalued New Zealand dollar. Foreign debt had accumulated to a level of 40 percent of Gross Domestic Product (GDP), well in excess of what crisis-ridden countries such as Mexico and Argentina had taken on.\footnote{Muldoon had essentially financed his attempts to shelter NZ from the effects of world recession by borrowing abroad. While Reagan employed the same strategy in financing his crypto-Keynesian Star Wars programme it was clear that what the US could get away with, New Zealand could not (\textit{Quod licet Iovi, non licet bovi}). By 1983/84 the fiscal deficit had accumulated to 9 per cent of GDP, current account deficit stood at 6 per cent, public overseas debt was 35.4 per cent and total overseas debt at 46.7 per cent (OECD: \textit{Economic Survey New Zealand 1988-89}). By ways of comparison, Mexico’s total foreign debt stood at 34 per cent of GDP during the 1982 Debt Crisis (Schwartz, \textit{ibid}, 1991).} In this situation, the National Party called a snap election on 14 July. Labour scored an overwhelming victory (see appendix 1).
4. Why did it happen and why in New Zealand? Analysing the intellectual sources

Notwithstanding the economic malaise the country faced in 1983 and 1984, the dogmatic zealousness with which economic reforms were implemented by Labour Minister of Finance Roger Douglas and his small group of cohorts in the Treasury Department presents somewhat of a puzzle to the outside observer. How did a country known for its progressive policies, its welfare state and its anti-nuclear and environmental policies so quickly and emphatically embrace the tenets of neo-liberalism and the New Right ⁴⁰?

The simplest answer is usually provided by the defenders of New Zealand’s neo-liberal experience. They are quick to point out that New Zealand – faced with tremendous economic structural problems and facing a severe crisis and government bankruptcy – had little choice ⁴¹. A small country cannot continue down a path of isolationism, but must accept to navigate the tides and the ups and downs of the global market.

This is, of course, hardly a satisfactory answer. The country still had other policy options, such as moving towards a more neo-corporatist direction, as in Western Europe, or a much more gradual and cautious reform programme such as that in Australia ⁴².


⁴² In Australia, the Labor Party consulted with unions in the restructuring of major businesses. Unions agreed to labor quiescence in exchange for being included in tripartite economic decision-making. For a more detailed discussion see Tom Bramble with Sarah Heal, “Trade Unions” in: Rudd and Roper, ibid,
A more satisfactory answer can be provided if we follow some of the insights generated by the constructivist literature in international relations. Scholars in this tradition have questioned the static structure-agent relation embedded in the neo-realist paradigm and posit a more dynamic interrelation between the two. Since our environment is socially constructed and interpreted, actors respond to their perception of the environment. Constructivist scholars emphasise the importance of what states make of their situation. In this process of forming one’s perception, it is of obvious importance what types of intellectual frameworks inform the actor and to what extent these parameters can be manipulated as a result of the inflow and acceptance of ideas. There is now a burgeoning body of literature on the influence of ideas on policy-makers. Scholars basing their work on these premises emphasise the diffusion of ideas through network channels. The results of a cognitive evolution might thus disseminate worldwide.


45 Emanuel Adler, “Cognitive Evolution: A Dynamic Approach for the Study of International Relations” in Emanuel Adler and Beverly Crawford (eds.), Progress in Postwar International Relations, pp. 43-88
Especially interesting is the suggestion that while ideas might be out on the open, they have to find channels of access to policy-makers and are then usually adapted to circumstances and institutional configuration of individual countries.\footnote{Jeffrey Checkel used this framework to account for the change in Soviet foreign policy (see Checkel, \textit{ibid}, 1997). In a similar vein, Risse-Kappen point out that “ideas do not float freely” because… access to the political system as well as the ability to build winning coalitions are determined by the domestic structure of the target state, that is, the nature of its political institutions, state-society relations, and the values and norms embedded in its political culture. “ (Thomas Risse-Kappen, “Ideas do not float freely: transnational coalitions, domestic structures, and the end of the cold war", \textit{International Organization} 48, 2, Spring 1994, p. 187}

However, we should remind ourselves, that the influence of ideas on actual policy-makers, particularly those originated by academics, has been pointed out quite some time ago. Keynes himself asserted in 1936:

“Indeed the world is ruled by little else [than ideas]. Practical men, who believe themselves quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.” \footnote{John Maynard Keynes, \textit{The General Theory of Employment, Interest, and Money}, New York: Harcourt Brace, 1936.} [Keynes 1936, my addition in brackets]

In the case of New Zealand, it seems fairly evident that the type of ideas and intellectual constructs embraced by Douglas and his associates at Treasury were imported from abroad, seeing that they constituted a revolutionary break with New Zealand’s state interventionist and later Keynesian tradition. Since the ideas behind the reform programmes were so alien to the New Zealand context, how can we account for this policy turn? Where, then, did these ideas originate?
In this context, the two major documents released by Treasury following the 1984 elections *Economic Management* and the 1987 elections *Government Management* are informative to study. *Economic Management* was prepared by Treasury in a mere six weeks and provided the outline for the economic policies for the following six years. The spirit and at times even the letter of these documents betray their heavy indebtedness to the ideology of the New Right\(^48\). Most centrally, the neoclassical ideology of the Chicago School, the Public Choice writings and Austrian economics left their heavy imprints on the guidelines which were to dominate the New Zealand reform process\(^49\). A thorough summary of these intellectual sources would be well beyond the scope of this paper. However, one can adequately summarise these intellectual sources by pointing out the common themes stressed by these writers, namely a fundamental distrust in the state and a reliance on the market for the efficient allocation of resources and the greater good. Or, to put it into slightly more acerbic terms, just as George Orwell’s pigs had chanted “Four legs good! Two legs bad!”\(^50\), so Friedman, von Hayek, Buchanan and their cohorts were chanting “Government bad! Market good!”


\(^{50}\) George Orwell, *Animal Farm*, New York: Harcourt and Brace, 1946.
While New Zealanders profited over the decades from a benevolent state interventionism, Friedrich von Hayek, epitomising the Austrian school, portrayed the state as an inevitably power-maximising leviathan, eager to clutch its paws around individual citizen’s liberties. Thus, the state was virtually guaranteed to intervene into an ever increasing array of individual liberties, thereby perpetuating a journey down a “road to serfdom”\textsuperscript{51}. The market, on the other hand, provides innovation and allows for creative discovery. Chicago School economist Milton Friedman also strongly criticised government’s tendency to curtail an individual’s liberty. He postulated a minimalist role for the state. Only the unregulated market would provide for the most efficient price-setting, send out the “right” signals, and thereby foster and encourage the activities of the utility-maximising individual. Consequently, Friedman rallied against the welfare state and against any state intervention beyond a closely circumscribed array of public goods. The sum of actions of rational, utility-maximising individuals, on the other hand, would provide benefits for everyone as the economy would move towards an equilibrium\textsuperscript{52}. This semi-religious belief in the invisible hand of the market in efficiently allocating resources and a general distrust in government was complimented by some of the Public Choice


theorists, also originating at the University of Chicago as well as Virginia. Public choice applies some of the basic tenets of economics to political activity, arguing that bureaucrats, far from being benevolent altruistic and high-spirited individuals, working in the interest of the greater public good, are really just as pettily minded profit-maximising as anybody else. Thus, they attempt to maximise their department’s budget, size and scope.

How did Chicago influence New Zealand? What were the channels of influence along which these ideas travelled? And what characteristics of the domestic structure, emphasised by constructivists like Risse-Kappen, nourished the implementation of the reform programme? In this context, it is important to recognise the importance of channels of intellectual exchange with the United States. A number of Treasury officials had received their graduate training in the United States. To some extent, this mirrored the development in Latin American countries, particularly Chile and Mexico, where students trained in the US (the “Chicago Boys” in the Chilean example), applied with almost religious zealot the theories they had been indoctrinated with to restructuring the domestic structures of their home countries. Similarly, many NZ Treasury officials had

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54 “Some prominent change agents were graduate students in the US in the 1960s and 1970s. … Some US experts were imported by Treasury to act as consultants and Treasury recruits were sponsored to study at leading North American universities.” (Kelsey, *ibid*, 1997, p. 54).
spent time at academic institutions in the US or had previous experience at such free-
market bastions as the World Bank or the International Monetary Fund (IMF)\textsuperscript{55}.

We should mention in passing that many New Zealanders began to develop a negative
self-image of their own country as a sleepy backwater prone to old-fashioned ‘boring’
Keynesian state interventionism. They were fed up with Muldoon’s heavy-handed and
fairly authoritarian paternalism.

In addition, we can point to at least two other intellectual sources.

First, there is the IMF. Schwartz points out that New Zealand’s reform programme bears
striking similarity to the recommendations of the IMF for structural adjustment\textsuperscript{56}. New
Zealand removed its wage, price and interest controls, deregulated financial transactions
and phased out subsidies for manufacturing and agriculture. As mentioned previously,
some NZ Treasury officials had professional experience at the IMF.

Secondly, it is certainly no coincidence that New Zealand launched its reform programme
a mere five years after a similarly minded individual had ascended to power at 10
Downing Street\textsuperscript{57}. The former colonial power Great Britain still exerted an intellectual

\textsuperscript{55} Examples include Bryce Wilkinson and Rob Cameron, two of the authors of \textit{Economic Management} who
had spent stints at Harvard, and Graham Scott who served as Secretary to the Treasury between 1986 and
1993 and who had obtained his PhD from Duke University and additional training at Harvard Business
School in 1985. Meanwhile, Grant Spencer spent time at the IMF between 1981 and 1984. The current
governor of the Reserve Bank worked for the World Bank between 1966 and 71. Rod Deane had worked for
the World Bank for four years before becoming chief economist and then deputy governor at the Reserve
was Richard Manning, professor of economics at the University of Canterbury which many Treasury
120).

\textsuperscript{56} Schwartz, \textit{ibid}, 1991

\textsuperscript{57} For an explicit comparison between the reform programmes in Britain and NZ, see: Jonathan Boston,
Science} 39, 2, 1987, pp. 129-152
hegemony over New Zealand\textsuperscript{58}. Thatcher exhibited distrust towards the state and its role in the economy, initiating an expansive programme of privatisation and an extensive restructuring of the public sector. She also significantly curtailed the role of unions. Meanwhile, in the United States, supply-side economics and market liberalisation also carried the day after the election of Ronald Reagan in 1980. Reagan’s policies included measures such as deregulation, prominently in the field of telecommunications and airlines, “rolling back the state”, cutting down welfare expenditures, and enacting tax cuts, particularly at the top end of the income scale.

Following the constructivist research agenda, the particular domestic structures of a host nation also ought to deserve attention in an analysis of the impact of ideas on a given polity. In the case of New Zealand there are indeed particularities, in fact peculiarities which fostered the swift and rapid enactment of a comprehensive package of economic reforms. Two central factors merit our attention here. First, as part of its colonial heritage, New Zealand had up until 1993 a Westminster-style “first past the pole” system and only two major political parties. In fact, New Zealand constituted a more perfect example of the Westminster model than the British motherland\textsuperscript{59}. Thus, once Labour had got hold of power in 1984, it commanded a comfortable absolute majority of seats. Political opposition thus had practically no way of manipulating the course of events. The same

\textsuperscript{58} Examples for this include the predominantly British origin of radio and television programmes. A large proportion of NZ academics had completed graduate training in the UK. Up until the early 1980s, the immigration quotas were heavily biased towards immigrants from the British Isles. The educational and government systems were modelled along British terms. In fact, Lijphart insists that NZ represented the most perfect example for a Westminster-type system (Arend Lijphart, Democracies: Patterns of Majoritarian and Consensus Democracies in 21 Countries, New Haven, CT: Yale University Press, 1984).

applies for the situation of the National Party after 1990. Because of the amount of power the executive could wield in this system, no checks and balances were in place to act as a dam against the blitzkrieg-style policy-making approach of Mr Douglas. Thus he and his intellectual companion in the Treasury Department were able to quickly enact their programme. There was no second chamber of parliament, no effective opposition and no presidential veto to impede the onslaught of reforms.

Secondly, Treasury played a central role in the reform process. In fact, it “became the principal initiator” and formed a “consistent, cohesive, intellectually convicted group” as Prime Minister Lange later recalled. It was able to do so owing to its “near-monopoly position…with respect to economic policy advice” within the “unitary, centralized structure” of the political system in New Zealand.

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60 Some New Zealand analysts have therefore interpreted the referendum of 1993, in which a majority voted for the implementation of a German-style mixed member proportional system (MMP) as a vote against the feeling of alienation and the sense of powerlessness during the reforms (Kelsey, ibid, 1997, pp.44-45). During the late 1980s the phrase elected dictatorship was coined because “die allseits bewunderte neoliberale Wende nach 1984 hatte dem Volk die „ungezügelte Macht“ der Mehrheitsparteien im Westminster-System vor Augen geführt.” (Rouven Schellenberger, “Neuseelands neues Wahlsystem gerät unter Druck”, Berliner Zeitung, 5 October 1998).

61 Brian Easton has employed the term “blitzkrieg approach” to characterise “In each case the lightning strike involved a policy goal radically different from the existing configuration, to be implemented in a short period, following a surprise announcement and a very rapid implementation.” (Brian Easton, “How did the Health Reforms Blitzkrieg Fail?”, Political Science, 4, 2, 1994, p. 215). Douglas was notorious for keeping both the public and the Cabinet uninformed of his next steps. In fact, he later summarised his strategy by offering the following advice: “Once the programme begins to be implemented, don’t stop until you have completed it. The fire of opponents is much less accurate if they have to shoot at a rapidly moving target.” (my emphasis, Douglas, ibid, 1993). The disdain for democratic decision-making processes, which leaks from these lines is quite revealing. In some ways, Douglas and his cohorts enjoyed the benefits of being able to exploit a “window of opportunity” which the 1984 financial crisis offered to them. They also acted as policy entrepreneurs. Prime Minister David Lange later conceded an interview: “When the crisis hit in July 1984 it was Roger Douglas who, above all, had thought through the economic issues – so when the Cabinet needed to fall back on an economic philosophy, it was Douglas who had one” (National Business Review, 11 July 1986).


63 see Nagel, ibid, 1998
Because the reforms constituted such a radical break with the intellectual tradition hitherto pursued we must look abroad for some of the intellectual sources of the New Zealand sources. In this context it is enlightening to accept the premise of the constructivist turn in international relations and consider how ideas and norms can influence policy-makers. The Treasury documents outlining the economic reform programme bear the heavy imprint of the Chicago school, the Austrian school and to some extent the insights of Public Choice. Based on the premise of a distrust of the state and placing faith in the invisible hand of the market, these theories shared in common their advocacy of relying on an unregulated market and a minimised state. They made their way to New Zealand by ways of intellectual interchange with the United States. A feeling of disdain towards Muldoon’s heavy-handed authoritarianism, commonly yet falsely associated with Keynesianism helped usher in a paradigmatic intellectual change in New Zealand and a shift towards the free-market ideas of Chicago. Domestic structures, such as a Westminster-style political system, ensuring an absolute majority for one party, and the strong influence, which Treasury could exert, both contributed to the implementation of these ideas in practice.

5. A Model Strategy? Analysing the implementation of the “New Zealand Way”

In 1984, economic crisis mandated immediate action. Defenders of the reform programme argued that there was little choice to a comprehensive restructuring in light of the apparent failures of Muldoon’s pseudo-Keynesianism. In any case, in the early 1990s, “Model New Zealand” was touted in the international press as a success story and not
only by the OECD\textsuperscript{65}. A never ending stream of international journalists, academics, and politicians descended perennially upon Wellington\textsuperscript{66} to explore what it was that had turned this small South Pacific nation into a “job creation machine”. Commonly, New Zealand’s relatively low unemployment rate was mentioned along with its economic growth rate as measured by GDP. In 1993, GDP grew by 4.8 per cent, by 6.1 per cent in 1994 and by 3.3 per cent in 1995. Employment grew by 2 per cent in 1993, 4.3 per cent in 1994, and 4.7 per cent in 1995. Meanwhile, unemployment declined from 9.5 per cent in 1993 to 8.2 per cent in 1994 and again to 6.3 per cent in 1995 (see also appendix). Government was able to record a surplus in its budget balance\textsuperscript{67}, allowing it to enact a tax cut in 1997\textsuperscript{68}. The implication was, of course, that both developing countries and the advanced industrial countries could stand to learn a lesson or two from this powerhouse in the South Pacific. Slavish adoption of an IMF-style structural adjustment programme seemed to have paid off for the Kiwis. An economy, which up until the 1980s had exhibited sluggish growth and still bore uncanny resemblance to a developing country owing to its heavy reliance on a large commodity sector, was now showing signs of remarkable growth.


\textsuperscript{66} Halimi, \textit{ibid}, April 1997

\textsuperscript{67} This was particularly impressive to American observers. See “Political and Social Change in New Zealand – Hearing before the Subcommittee on Asia and the Pacific of the Committee on International Relations”, House of Representatives, 104\textsuperscript{th} Congress, 31 July 1995, Washington, D.C.: GPO, 1995.

Meanwhile, the advanced industrial countries of Europe were suffering no or slow growth while facing a pressing structural unemployment problem. There was considerable debate about liberalising the labour market and restructuring the public sector in order to be able to successfully compete in a global economy\(^69\). New Zealand had enacted all these changes and seemed to be harvesting the fruits the reform programme bore. It had gone from being extremely regulated and protectionist to being the most ardent supporter of an unregulated market environment. New Zealand’s remarkable reform programme seemed to translate into impressive economic benefits. Thus, the country seemed well-suited to serve as a model for coping with the challenges of globalisation.

However, a closer look reveals a much more mixed record. Upon closer inspection, it becomes evident rather quickly that the 1993-95 economic boom constituted little more than a temporary recovery from almost a decade of recession. Throughout the 1980s, the payoffs from the reforms appeared far from evident. New Zealand went through a drawn-out period of extremely painful adjustments. On many indicators, such as employment, the economy is returning to pre-1984 levels only now. In the following section we shall examine the economic performance in more detail. As I will point out, the country paid a very high price for its “success”. Both the social cost is chilling and the issue of loss of national autonomy is far from a purely academic concern for many Kiwis. Privatisation and economic liberalisation has meant that many economic decisions are no longer being made in Wellington, but in corporate headquarters in Australia, Britain and the US. Due
to its reliance on foreign capital – both in the form of portfolio investment and FDI - the country has made itself vulnerable to the whims of the international financial markets, as became painfully obvious during the Asian crisis. A genuine success is New Zealand’s cutting edge technology in the field of agricultural engineering. But overall, a sober analysis of the costs and benefits of the reform programme cannot lead to the same enthusiastic conclusions of the international financial media.

Let us consider the economic side first. Throughout the 1980s, New Zealand’s macroeconomic indicators were anything but impressive. In fact, between 1985 and 1992 total growth across OECD economies averaged 20 percent, while New Zealand’s economy shrank by one percent\(^\text{70}\). In both 1989 and 1991 GDP growth was negative. Between 1987 and 1991, the unemployment rate more than doubled from 4.1 to 10.7 percent, reaching unprecedented levels and exceeding the OECD small member countries’ average (see appendix 2 for further details). While labour productivity did begin to increase in 1986, this was mainly due to massive labour cutbacks and not even a consistent trend\(^\text{71}\). In fact, between 1984 and 1993 productivity growth averaged only 0.9 percent\(^\text{72}\).

While Muldoon’s practice of heavy borrowing from overseas was severely criticised, Labour actually continued this practice without passing down the benefits to NZ citizens.

\(^{69}\) In Germany, this took the from of the debate about “Standort Deutschland”
\(^{70}\) Kelsey, \textit{ibid}, 1997, p. 9
\(^{71}\) Dalziel and Lattimore, \textit{ibid}, 1991, p. 23
\(^{72}\) Kelsey, \textit{ibid}, 1997, p. 9
Both total public debt and public overseas debt continued to increase, the former reaching a record 80 per cent of GDP in 1987\textsuperscript{73}.

Inflation continued to vex the economy until 1993, averaging 9 per cent\textsuperscript{74}.

In the short to medium term the reforms brought about the worst recession in New Zealand since the 1930s. The “reinvention” of government and the public sector translated into a massive rise of unemployment. A country in which unemployment was virtually unheard of now saw workers laid off by the thousands. Unemployment peaked up to record levels.

Yet after eight painful years of transition, the reforms finally seemed to pay off. In December 1991, inflation dropped to below two per cent. In 1993, balance of payment deficit moved below two per cent of GDP and the government budget showed a surplus for the first time in fiscal year 1993/94. Real GDP began to grow again in 1992 and unemployment began to sink in 1994-95\textsuperscript{75}. However, unemployment was still well above pre-1984 levels and so was public debt. According to the OECD, real GDP in 1992 was still 5 per cent below the 1985/86 level. The GDP growth in 1993-5 seemed to have brought NZ merely back into a general trend of worldwide economic recovery\textsuperscript{76}.

In the meantime, New Zealand had become a dramatically different society. Before analysing the more recent development and the impact of the Asian crisis, it is worth shedding some light on the social costs of “Model New Zealand”.

\textsuperscript{73} Dalziel and Lattimore, \textit{ibid}, 1991, p. 29  
\textsuperscript{74} Dalziel and Lattimore, \textit{ibid}, 1996, p. 87  
\textsuperscript{75} Dalziel and Lattimore, \textit{ibid}, 1996, p. 93  
\textsuperscript{76} \textit{OECD Economic Surveys 1994: New Zealand}, Paris: OECD, 1994, p. 11 and Figure 1.
New Zealand has always been proud of its social cohesion. A quasi-social democratic commitment to social equality, equal wages and a welfare state had meant a stable, peaceful and socially cohesive society. Now, as the commitment to “sleepy backward” Keynesianism went flying out of the window, so, too, did the commitment to social equality. The income gap rose and as unemployment grew, so did social inequality. Despite a slight increase in productivity, real wages have slightly decreased since 1985/86. A lot of the growth in employment can actually be traced back to the growth of part-time jobs which doubled from 200,000 to 400,000 between 1984 and 1995, while the number of full-time positions decreased. These part-time positions typically do not entail the same amount of benefits as full-time jobs.

Following the first wave of corporatisation and privatisation, which lead to massive growths in unemployment, the National party, adding insult to injury, enacted a combined programme of welfare cuts and labour market deregulation in 1990/91. Subsequently, poverty increased markedly. By 1991, 17.8 per cent of all New Zealanders lived below the poverty line, while the median income had declined by 19.2 per cent between 1982 and 1991.

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77 According to Infometrics data, the top 20 percent of incomes received 45 percent of all income in September 1993 (up from 35 percent in the late 1970s and an estimated 50 percent in 1997/98. Meanwhile, the bottom 20 percent earned 13 percent of total income. (Infometrics Economic forecasts, September 1993, p.3) A number of similar studies show that income re-distribution is occurring, making the rich even more well-off, while the poor are getting poorer (see, for instance: P. Saunders, “Rising on the Tasman Tide: Income Inequality in New Zealand and Australia in the 1980s”, Social Policy Journal of New Zealand 2, 1994, p. 97; Brian Easton, “Income Distribution”, in: Silverstone et al., ibid, 1996, pp. 101-138 and Brian Roper, “The Changing Class Structure” in: Rudd and Roper, ibid, 1997, pp. 79-99).

78 Dalziel and Lattimore, ibid, 1996.

Perhaps unsurprisingly, crime rates rocketed, violent crime increasing by 50 percent between 1982 and 1991, endowing New Zealand with the dubious distinction of having the third-highest violent crime rate in the world. New Zealand today has the highest youth suicide rate in the western world. For a country which is trying to portray itself as one of the few success stories in creating a bicultural society Aotearoa New Zealand, the disproportionate rise in poverty and unemployment among its Maori and Pacific Island population presents at the very least a severe embarrassment. Of serious concern is the emergence a two-tier social stratification of society, which parallels racial lines and mirrors the unfortunate American experience. Symptoms of this development are the growth of urban ghettos in South Auckland and the growth of criminal youth gangs among Maori and Pacific Island youths.

Following the cuts in the welfare system enacted by National in 1990, real poverty emerged in New Zealand to a degree previously unprecedented. There was a rapid growth in the number of people reliant on soup kitchens and private welfare organisations. Furthermore, corporatisation and privatisation of the Housing Corporation has obliged this former component of the welfare state to raise profits. A

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82 Jardine, ibid, 1998
83 Maori were hit hardest by the wave of labour cuts. In December 1994, unemployment rates among young Maori stood at 30 percent. The gap in scholastic achievement between non-Maori and Maori continued to grow. Because Maori were disproportionally dependent on welfare benefits (49 per cent of Maori men and 58 per cent of Maori women in 1990, before the reforms), they were severely affected by the cuts in social welfare spending (data is from Kelsey, ibid, 1997, p. 284-285).
84 Kelsey reports that Salvation Army food parcel assistance increased tenfold (or 1117 per cent) between 1990 and 1993 (Kelsey, ibid, p. 292).
85 Housing New Zealand’s 1994 annual report demonstrated that rents had increased by an average of 54 percent between 1993 and 94 (Kelsey, ibid, p.227).
logical result has been the steady increase in rents and sales of a number of flats. This policy accepted the eviction of the most needy, precisely those for whose purpose the system was created for\textsuperscript{86}. This has lead to the emergence of homelessness for the first time in the history of the country.

At the same time, the corporatisation of higher education has meant the introduction of steep fees for tertiary education. Government drastically cut its spending on the education sector. While New Zealand students previously were obliged to a nominal fee of approximately NZ$100 per academic year, rates increased to between NZ$3000 and NZ$20,000 by 1999. Student loans are available, but at market level interest rates only. At the same time, student allowances were cut both in size and scope. This has contributed further to social stratification and inequality\textsuperscript{87}. Meanwhile, the policy of privatisation and corporatisation was extended to cover the health sector with the better-off being offered the option of buying into private health insurance scheme. Meanwhile, the quality and scope of public health provision is deteriorating\textsuperscript{88}.

\textsuperscript{86} For a comprehensive treatment of the reform of the housing sector, see: Elizabeth McLeay, “Housing Policy”, in Boston and Dalziel, \textit{ibid}, 1992, p. 169-185
\textsuperscript{88} New Zealand has sunk from being the OECD country with the fourth-highest level on government spending in the to rank 18. This is beginning to translate into inferior health care provision (Urs Welterlin, “Neuseeländer sind die Reformen leid – Gesundheitswesen in der Krise”, \textit{Der Standard}, 28 October 1997, p. 3).
In the medium to long term, the radical privatisation programme and liberalisation of the economy has made New Zealand extremely dependent on the volatile international financial markets. Such dependency became readily apparent during the Asian crisis.

As speculators withdrew their money from the overvalued Asian currencies they did not stop and discriminate thereby excluding New Zealand. The Asian flu rapidly spread to the country, plunging it into recession and causing a fall of the NZ dollar to below 50 US cents for the first time in eleven years. New Zealand’s Top40 share index followed the dramatic decline of its Asian cousins in late 1997 and again in June 1998. In a sense this was not surprising, seeing that New Zealand suffered from similar problem as Thailand did, namely a large current account deficit, caused by the large inflow of foreign capital. While superficially speaking, the situation might be seen as different from Thailand because a large proportion of the deficit was due to large-sale FDI, foreign investors in East Asia had thought exactly that to be true of countries there.

It is clear that the negative impact of the Asian crisis also had to do with the extent to which Asian countries, such as Japan and Korea, have begun to replace Britain and Europe as main outlets for New Zealand products. Owing to the persistence of trade

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90 Part of the 1998 recession was also homemade. This has to do with the deflationary bias which strict adherence to monetarism entails. NZ abandoned its system of setting broad targets for monetary conditions in early 1999 as a result of its disastrous experiences with it in 1998 (“New Zealand switches monetary control system”, Financial Times, 9 February 1999, p. 4). However, this measure does not properly address this underlying bias.

barriers to agricultural sectors, New Zealand farmers were glad to find customers in resource-poor commodity importers such as Hong Kong, Singapore and Taiwan\textsuperscript{92}. The rise of the New Zealand dollar versus the currencies of most of its Asian trade partners inevitably made its products more expensive and thus less attractive. This also translated into losses in revenues from the tourism sector. Furthermore, since Australia takes 20.3 percent of NZ exports\textsuperscript{93}, some indirect effects also came to play a role.

The exposure of New Zealand’s economy to the international financial markets is so high because of a perpetual current account deficit. The external deficit to GDP ratio hovers between 6 and 7 percent, while the foreign liabilities amount to 80 percent of GDP in 1998\textsuperscript{94}. This level of foreign debt is a record high for any OECD country. It makes New Zealand dependent on the volatility of the market. To some degree, this is a result of the policy of the private sector to accrue high levels of foreign debt, in order to finance investment so as to stay internationally competitive. Another large causal factor of the problem of a current account deficit is New Zealand’s radical privatisation programme, enticing overseas investors to invest in a country with a very business-friendly environment and causing profits to be repatriated\textsuperscript{95}. The stock of foreign direct investment more than tripled between 1989 and 1994, now making up one quarter of the GDP\textsuperscript{96}. Whether this level of foreign direct investment can be sustained over a long-term

\begin{footnotesize}
\textsuperscript{92} In 1998/99 Thailand, Malaysia, Hong Kong, South Korea, the Philippines and Indonesia make up 14.2 percent of NZ exports (\textit{Pacific Economic Outlook}, Singapore: Pacific Economic Cooperation Council, 1998, p. 47)
\textsuperscript{93} Pacific Economic Cooperation Council, \textit{ibid}, 1998, p. 47
\textsuperscript{94} OECD, \textit{ibid}, 1998, p. 3
\textsuperscript{95} This is reflected in the fact that the net investment income has decreased consistently. In 1994, it stood at –5,737 NZ$ million, in 1995 at –6,383 NZ$ million and in 1996 at –6,777 NZ$ million (OECD, \textit{ibid}, 1998).
\end{footnotesize}
period now that key assets of the New Zealand economy have been sold off into private hands is, however, far from certain\(^97\).

Regardless of whether or not one accepts the neo-liberal premise that privatisation of public enterprises results in overall efficiency gains for the economy\(^98\), for a small country such policy raises the non-trivial concern over real loss of sovereignty. Foreign control over New Zealand is anything but a purely academic subject. In 1995, foreign investors owned half the stock market, 40 per cent of government bonds, while foreign ownership of companies amounted to 33.6 NZ$ billion as compared to government assets of 30 NZ$ billion\(^99\). Around 90 percent of the banking sector is foreign owned, primarily by Australian companies\(^100\). US, British and Australian companies profited from the wave of privatisations, buying up companies at relatively low prices, though NZ taxpayers’ money helped create the bulk of the infrastructure of these companies in the first place. Major examples of privatisation include the sale of Telecom, Air New Zealand, Bank of New Zealand, New Zealand Rail, and the cutting rights for the states’ forests (see also appendix)\(^101\). At the same time, Asian investors bought up large shares of NZ real estate, both commercial property and forestry land. These developments led one NZ politician to comment that “we risk being transformed into sharecroppers on our

\(^{97}\) Between 1991 and 1995, the level of direct investment from Asian countries, the US, Australia and Canada increased consistently to a level of 3,130 US$ million. In 1996, it tumbled to 280 US$ million (Pacific Economic Cooperation Council, \textit{ibid}, 1998, p. 75).

\(^{98}\) Williams points out that the “effect of ownership on allocative efficiency are indeterminate” based on a number of studies. (Michael Williams, “The Political Economy of Privatization”, in: Holland and Boston, \textit{ibid}, 1990, pp. 140-164.

\(^{99}\) Kelsey, \textit{ibid}, 197, p. 109

\(^{100}\) OECD, \textit{ibid}, 1998, p. 139
land”.102 With telecommunication, transportation, the financial sector, the energy sector103 and increasingly the natural resource base and urban real estate being turned over to foreign owners, constraints on the array of policy measures a NZ government can undertake are quite severe. In a small country, privatisation programmes run the risk of attracting predominantly foreign investors due to the small domestic capital basis. As the case of New Zealand demonstrates this can leave the “independence … as a nation substantially undermined”104 with decisions affecting the economic and political life of the polity being made in boardrooms in New York, London and Sydney and no longer in Wellington. This also implies that for the sake of marginally reducing its debt level105, the NZ government has terminally abandoned its control levers over a large section of the economy, now no longer controlled by a democratically elected government, but rather by purely profit-oriented private businesses. It has also given away valuable sources of revenue which are now used to maximise private sector profits. These profits, in turn, are being quickly repatriated to overseas locales. For a small country, following the New Zealand Way there is a very real danger of turning into a banana republic106.

101 For a complete list of sold government assets up to 31 December 1995, see OECD, *ibid*, 1996, p. 98. I have included some of the central privatisations of formerly SOEs in the appendix.
103 This includes the privatisation of regional utility companies. As a result of minimal investment into infrastructure and drastic cuts in personnel, Mercury Energy which took over the Auckland utility company was unable to keep up with demand leading to the 1998 power outage which lasted 12 weeks (Jürgen Corleis, “Eine Stadt ohne Strom – Neuseeland: Erst in zehn Wochen wird sich die Situation in Auckland wieder normalisieren”, *Berliner Zeitung*, 6 March 1998 and Christoph Keese, „Privatisierungen: was der Stromausfall von Auckland lehrt“, *Berliner Zeitung*, 19 March 1998
105 However, as I have pointed out earlier, though government debt level has decreased since the onslaught of privatisations, the overall foreign debt level is still precariously high. In fact, “the government’s efforts to reduce overseas debt after 1987 (principally through sale of state-owned assets) did not succeed in reducing the country’s total OND, but only transferred debt from the official to the market sector” (Paul Dalziel, National’s Economic Strategy”, in Boston and Dalziel, *ibid*, 1992, p.31).
106 Meanwhile, the Financial Times is encouraging the country not to stray from the path of the “purist free market approach” (“All Black Mood”, *Financial Times*, 10 February 1999).
However, while large-scale enterprises where sold off to foreign buyers, New Zealand has been fairly successful in developing cutting-edge products in a number of agriculture related technologies, thereby occupying specialised market niches. Companies specialise in high-tech agricultural products and services, particularly geared towards the dairy and sheep farm industries. These range from technical equipment for livestock feeding to livestock genetics services. Companies have the advantage of profiting from high-quality research and development conducted at the Department of Technology at Waikato University in Hamilton\textsuperscript{107} and the Department of Agricultural Engineering at Massey University in Palmerston North\textsuperscript{108}. High-quality research in agricultural sciences is also being carried out on the South Island at the Animal Division and Food Sciences Department at Lincoln University in Christchurch. There are early signs of the development of a “cluster economy” in Hamilton where the university promotes the cooperation with the regional Crown Research Institute (CRI) and the emergence of spin-off companies commercialising in some of the fruits of the research activity. These are encouraging signs and indicators of New Zealand taking advantage of its experience, expertise, and technical know-how to develop unique globally competitive leading products. This is an indication of acknowledging and profiting from niche markets which other, larger countries are either unaware of or incapable of penetrating. However, we

\textsuperscript{107} Research at Waikato focuses particularly on Environmental Technology and the exploration of method limiting the negative environmental impact of commercial agriculture.

\textsuperscript{108} Research at Massey explores agricultural machinery, building technology, post-harvest engineering, sustainable and renewable energies, water resources and waste management engineering.
might voice some concern about the fact that these products are still related to agriculture. Thus, the economy’s reliance on this sector is sustained.\(^{109}\)

6. Conclusion: A Mixed Picture

New Zealand has launched an ambitious and comprehensive series of reforms, commencing in 1984. The country chose to respond to the challenges implied by a globalising world economy in a fairly radical fashion, moving from being one of the most regulated economies in the OECD to the opposite extreme.

This paper has analysed the New Zealand reform programme in a quest to explore its feasibility as a model for other small state in coping with the pressures of globalisation. It is commonly argued that increasing interdependence, exponentially growing trade flows and expanding foreign direct investment are undermining the nation-state’s level of autonomy. More precisely, the nation-state loses its capability to manipulate key macroeconomic tools and thereby effectively to control key parameters of public policy-making. As my analysis has shown, the New Zealand way presents a mixed track record. The – fairly limited - successes of the much-heralded “Model New Zealand” have come at a significant cost. Unemployment, poverty, and social inequality all stand at unprecedented levels today in New Zealand. While some macroeconomic indicators have been stabilised, the short to medium-term impact of the reforms has been devastating. The short-term recovery of the mid-1990s already seems to be fading in the wake of the Asian crisis. New Zealand’s high level of foreign debt combined with an extraordinary

\(^{109}\) Commodity or raw material exports still make up 50 per cent of New Zealand’s total exports. This is a problem, not least because commodity prices are currently at their lowest since 1990 (Brian Fallow, “City
level of foreign direct investment means that the country is highly exposed to the whims of the international financial market.

Owing to large-scale privatisations, initiated in the mid-1980s as a measure to reduce foreign debt and in line with the neo-liberal anti-statist dogma, substantial sections of the New Zealand economy are now controlled by Australian, American and British companies. This leads to the repatriation of profits from NZ operations and a huge current account deficit. It also means that the NZ government has voluntarily abandoned its capability of controlling large sectors of the economy and has given away revenue-generating resources. The NZ government thus finds the range and effectiveness of its public policy options severely curtailed, not least due to the Fiscal Responsibility Act, the Public Finance Act and the Reserve Bank Act, all of which constrain the role of government in the economy. It will be interesting to follow the further developments of the New Zealand economy. A current assessment of the reforms, however, cannot lead to an endorsement of any such package of measures for other small states. The costs are quite considerable, while the benefits of a policy of effective capitulation to the market seem fairly limited. As New Zealand enters the new millennium, journalists, policy-makers, and academics will probably continue to flock to Wellington to study this most ambitious of all public sector reform programmes. Yet a comprehensive candid assessment about the overall results of this programme leads to the conclusion that New Zealand in liberalising its economy has overdone it.

joy, rural gloom”, New Zealand Herald, 6 March 1999).

Political Developments in New Zealand 1984-1999
GDP Growth rates and Unemployment for New Zealand 1986-1997

### Political Developments in New Zealand 1984-1999

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
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<tbody>
<tr>
<td>14 July 1984</td>
<td>Labour wins the General Elections. David Lange becomes Prime Minister replacing Robert Muldoon. Roger Douglas becomes Minister of Finance</td>
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<td>15 August 1987</td>
<td>Labour Government is reelected</td>
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<td>15 December 1988</td>
<td>Following a year of drawn-out disputes between Douglas and Lange (who insists that it is time to “have a cup of tea and take some time out with the reforms”) Douglas resigns from the Office of Minister of Finance and is replaced by David Caygill</td>
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<tr>
<td>7 August 1989</td>
<td>Prime Minister David Lange is replaced by Geoffrey Palmer</td>
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<tr>
<td>29 October 1990</td>
<td>Following its promise to “create a decent society”, the National Party wins the elections and Labour is swept out of office. James Bolger becomes Prime Minister, Ruth Richardson becomes Minister of Finance.</td>
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<tr>
<td>6 November 1993</td>
<td>National wins the elections again. In a referendum the majority of New Zealanders vote to replace the current UK-style “first past the pole system” with a German-style multi-party government and mixed member proportional (MMP) electoral system</td>
</tr>
<tr>
<td>Fall 1996</td>
<td>Following the first MMP-style elections, a coalition government of National and the small newcomer party New Zealand First (NZF) is being formed; James Bolger remains in office, Winston Peters (NZF) becomes Vice Prime Minister</td>
</tr>
<tr>
<td>4 November 1997</td>
<td>Jenny Shipley replaces Bolger and becomes New Zealand’s first female Prime Minister.</td>
</tr>
<tr>
<td>5 October 1998</td>
<td>NZF leaves coalition over dispute about privatisation of Wellington airport; Shipley announces she will continue to remain in office until the end of her term in November 1999</td>
</tr>
<tr>
<td>March 1999</td>
<td>Elections are being expected in New Zealand</td>
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