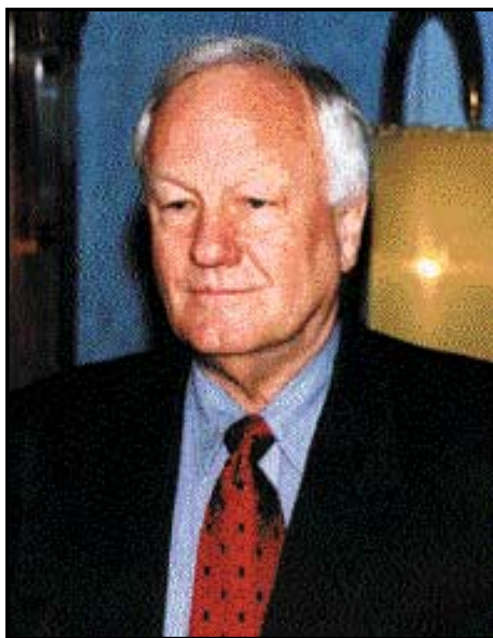


# ROGER DOUGLAS



*Roger Douglas*

**AUTHOR OF THE MOST  
SUCCESSFUL ECONOMIC REFORM  
OF THE XX<sup>th</sup> CENTURY**





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CENTRUM  
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# **ROGER DOUGLAS**

**AUTHOR OF THE MOST  
SUCCESSFUL ECONOMIC REFORM  
OF THE XX<sup>th</sup> CENTURY**



**Josef Šíma and Ján Pavlík (eds.)**

**Roger Douglas: Author of the Most Successful Economic Reform  
of the XX<sup>th</sup> Century**

**Prague 1999**

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# 1.

JIŘÍ SCHWARZ

## **SIR ROGER DOUGLAS: ONE OF THE GREATEST ECONOMIC REFORMERS IN THE 20<sup>th</sup> CENTURY**

Sir Roger Douglas, former Minister of Finance in New Zealand (1984-88), is considered an architect of the fundamental economic reform that diverted New Zealand from its “successful” road to serfdom (socialism) to a flourishing economy. This economy relies on private ownership and is one of the most free economies in the world. Due to profound structural reform, Roger Douglas managed to get rid of the most devastating elements of New Zealand’s welfare state while diminishing the impact of the remaining few. His reform has substantially changed the size and structure of the public and private sectors of the economy. It has brought about a significant increase in economic growth, lowered the rate of inflation and unemployment, and contributed to the internal and external economic equilibrium of New Zealand. The method, speed, and elegance of his reform not only bewitched theoretical economists, politicians, and public policy designers, but many others as well. Even the majority of New Zealand’s population expressed its support for the radical reforms, resulting in more votes for the “reform” party in the elections of 1987 than in previous elections. This successful and radical economic policy managed to accomplish many of its objectives and hence, managed to become known in economic policy textbooks as Rogernomics. Side by side with Reaganomics and Thatcherism, Rogernomics stands as a firm example of applicability of liberal paradigms into the practical economic policy.

Roger Douglas was born in 1937 and received his economic education studying accounting at the Auckland University. Between 1969-1990, he sat in the New Zealand parliament representing the Labour Party, the third generation in his family to do so. In the 70’s, before he was appointed the Minister of Finance, he served as a Minister of Telecommunication and Transport and the Minister of Housing. In 1990, he ideologically left the Labour Party and set up (and chairs) a new party, the Association of

Consumers and Taxpayers (ACT), which in recent elections got 6% of the votes and entered the parliament. The interesting point of his liberal reform is that it was started under the Labour government. In 1990, the opposing Conservative Party won the elections. Ruth Richardson became the Minister of Finance and continued in Douglas' reforms until 1993. Bill Birch, who became the Minister of Finance in the next conservative government, followed the line started by Douglas. The limitation of the role of the state in the economy, the dismantling of artificial barriers, and the creation of the conditions to increase competition are all pragmatic policy measures. These measures have to be taken sooner or later by all governments in developed countries, most of whom are on a road similar to that of New Zealand in the first half of the 1980's. Those pragmatic steps brought about higher competitiveness between domestic producers as well as higher comfort and lower prices for consumers. The experience of New Zealand has shown the most effective long term protection of consumers we know of today.

At this point it is helpful to go into some detail about the basic pillars of this radical reform. The experience of the Czech Republic after 1990 provides a good framework to appreciate of the depth, magnitude, and consistency of the reforms undertaken in New Zealand.

What was the situation like in New Zealand before the reform started? The economy of New Zealand developed successfully till the 1930's, which ranked New Zealand among the most developed countries in the world. In 1950, New Zealand was still the second most successful country in the world, following the U.S. according to GDP per capita. The Great Depression (1929-33) resulted, as in other countries, in the increase of government interference with the economy. New Zealand's island location attracted politicians to implement effective protectionist measures. New Zealand became an exemplary model of the welfare state. Its economy started losing competitiveness, faced high inflation and unemployment, and produced a low rate of economic growth. At the beginning of 1980's, heavy farming subsidies were frequent. There was a high degree of tariff protection in the form of import taxes protecting domestic producers. Legally set opening hours in shops, long waiting lists of telephone applicants, compulsory unionism and bureaucratic arrogance was commonplace. If someone wanted to buy margarine, he or she needed a medical prescription. If someone was interested in buying a refrigerator, he or she simply had to choose from two products made by the same producer.

At the beginning of the 1980's, New Zealand's welfare state was famous for its tough regulation, which made its economic system very similar to the system of a centrally planned economy, something we know quite well from

our past experience. A huge magnitude of regulation, disorganized public finances, double digit inflation, and external economic imbalances brought about the fall of New Zealand's dollar right before the election of 1984.

In this situation, the newly appointed Labour government and its new Minister of Finance did not have any other alternative besides radical economic reform. From the very substantial, deep, and consistent structural reform in New Zealand, we can pick up the areas that evoke comparisons to the reform of the Czech economy.

## I. Deregulation of markets and price liberalization

New Zealand abolished wage, dividend, loan, credit, and exchange controls in a time span shorter than one year. The most subsidized sectors, agriculture, was completely deprived of any subsidies after the reforms. Subsidization of industry was totally abolished. At the beginning of 1985, the New Zealand dollar began to flow freely. Virtually overnight, competition in banking was allowed with one domestic central bank and three foreign banks given privileged positions. The licensing of foreign banks was virtually stopped, as well as quantitative credit limits, holding of compulsory minimal reserves in the central bank, and foreign exchange regulations.

In the sector of foreign trade, the idea of even, unilateral, free trade prevailed. Thus, most of the quotas and tariffs were abolished.

In the sector of foreign trade, the idea that abolishing artificial trade barriers and promoting free trade are indispensable for any small economy aiming at prosperity became widely accepted. This argument alone was enough for New Zealand to opt for liberal policy, regardless of the non-liberal outside environment. The process of radical reduction in tariffs began with the aim to decrease trading quotas by 5% by 2000 and eventually abolish the import quotas altogether.

The reform gave a substantial touch to the network industries. The monopoly of local airlines was abolished as airlines were sold. The same thing happened to state-owned railways. Regulation of other industries was drastically limited and free entry into them was introduced (taxicab industry or rental housing can be used as examples).

Competition was introduced in telecommunications as the state-owned telecommunications company was privatized. The number employed was lowered after privatization from 27,000 to 7,000 while the whole telecommunication sector went up to 30,000. The majority of fired

workers was absorbed by private companies providing telecommunications services. After this reform, the quality of New Zealand's telecommunications became the second best in the world. Digitalization of the network skyrocketed, with 98.8% now converted. Only Hong Kong has higher digitalization. New Zealand improved the quality of services as the prices fell by nearly 25%.

## II. Tax reform

Before the reform, the tax system of New Zealand was extremely complicated, nontransparent, and a system inviting tax evasion. The radical tax reform took place in 1986. A single 10% goods and services tax (in 1989 the rate was increased to 12.5%) replaced a number of turnover taxes. The progressive nature of income taxes was dramatically reduced to only two rates, 24% and 33%, respectively. Corporate income tax was also 33% (the tax went down from 48%), which decreased the room for tax evasions. In 1992, all the inheritance taxes were abolished. After this reform, the tax system in New Zealand was considered to be the most market-friendly and least distortive systems in the world. Its system hampers the market least in terms of the quality of price signals which the economy responded to with substantial growth.

## III. Corporatization and privatization

After the State Owned Enterprises Act of 1986, the state-owned enterprises were transformed to joint stock companies without any state liabilities. In the case of bad management, the firms had to face immediate bankruptcy and liquidation. The corporatized firms were sold to the highest bidder in the next year. Foreign investors were not excluded from this process. The privatization criterion was chosen because the government wanted to fulfill its obligation to properly take care of taxpayers' property, ensure the highest possible quality of services provided, while paying the same or lower prices for them. The results of privatization are even now considered to be very positive, which is appreciated respectfully by Roger Douglas' political opponents. It is interesting to note that in the process of privatization, even the railways and radio frequencies were sold out. Neither government, nor the army reserved a single state-owned airwave for its own exclusive purposes.

New Zealand did not stop its effort to privatize what is conventionally considered to be "public sphere." Government administration was not left

aside. Each minister has the right to negotiate a 5-year contract with his ministry directors. Each one receives his annual budget along with the goals he has to fulfil. It is up to him to decide how to spend the money he is allotted. If the individual fails to reach the set goals, he is not only fired, but also financially penalized.

One of the first steps done by Roger Douglas was the abolition of collective wage bargaining among employers, employees, and the government. This action has brought a substantial increase in labour market flexibility.

All the reforms in New Zealand were undertaken in the environment of strict fiscal and monetary discipline. Fiscal rules do not prohibit budget deficit, the deficit, however, must be clearly defined and the terms of repayment must be submitted and approved. The Central Bank is to guarantee price stability which is the main goal of monetary policy. The Central Bank was not made completely independent from the government, as it is often mistakenly claimed. The law stated that the bank should lower the rate of inflation below 2% by 1993 and keep it between 0% and 2% in the future. The governor of the bank is personally responsible for the accomplishment of this goal.

Thanks to liberal economic reforms in the second half of 1980's, New Zealand's economy became one of the most free in the world. In 1995, New Zealand ranked 3rd in an index of economic freedom that measured economic freedom of more than 100 countries. New Zealand is a wonderful example of the correlation between economic freedom (by the Index of Economic Freedom) and the rate of economic growth. The economic growth experienced in New Zealand is more than double compared to other OECD countries. The annual rate of inflation was pushed down to less than 2% and the unemployment rate settled down to 6% in the middle of the 1990's. The per capita GDP has moved New Zealand among the most developed countries in the world.

Roger Douglas' reform can be called the reform benefiting the largest, though less organized special interest group, consumers. Douglas' reform is highly appreciated by his political opponents, who nominated him for his successes as a candidate for the title Sir. The British Queen awarded him this title in 1991. Sir Roger Douglas was invited, thanks to kind support of Česká pojišťovna and the PPF Group, to the Czech Republic to deliver the Third Annual Lecture of the Liberální Institut.

## 2.

JÁN ORAVEC

### **NEW ZEALAND 1984 AND SLOVAKIA 1998 – PARALLELS**

#### **An Introduction to the Annual Lecture of the F. A. Hayek Foundation Bratislava**

Ladies and Gentlemen,

Sir Roger Douglas is well-known as the man who initiated the first and the most courageous wave of economic reform beginning in 1984 in New Zealand. This reform is widely acknowledged as the most radical and the most complex ever undertaken by a developed country.

You may ask yourselves “What does Slovakia have in common with a remote country like New Zealand?”. And what importance does this reform of the mid-80’s have for us today when we must face the problems of the end of the 20<sup>th</sup> century?

Sometimes we tend to take non-standard solutions and justify them by the “specifics” of the transformation process. However, it is important to keep in mind that transformation is not owned exclusively by former socialist countries. It is not an exaggeration to say that transformation is a permanent state of every society – it just takes on more intensive forms from time to time.

The transformation experience of other countries – especially if their reforms are successful – can be applied universally, and both geographical distance and time gaps are of minor importance. There are two aspects of the New Zealand experience which are most relevant for Slovakia:

First, the New Zealand economy prior to 1984 and the Slovak economy today have a very similar diagnosis:

- Unfavourable developments in the main macroeconomic indicators: high inflation, unemployment, rapidly growing public expenditures as a share of GDP, and a high government budget deficit and debt,

- Trade barriers and exchange rate regulations that have almost isolated the economy from the rest of the world,
- At the micro-economic level almost all prices – rents, wages, dividends, etc. – are regulated by the state,
- a social security system dominated by extensive schemes that levy a serious financial burden on the shoulders of taxpayers.

Second, the economic troubles in New Zealand brought about a need to change the existing economic policy. Slovakia is in a position today where it has an opportunity to critically reassess economic policy applied by the previous government and propose a new direction for economic policy.

It is absolutely impossible to briefly present the New Zealand reform in all its complexity. Sir Roger Douglas would have to stay in Slovakia for weeks in order to explain in detail all the reform measures. I am sure that many people in Slovakia would be surprised by what Sir Douglas would say to them.

I imagine that:

- **Slovak farmers** would be surprised to hear that their New Zealand colleagues are some of the most competitive in the world despite the fact (I should rather say, thanks to the fact) that massive subsidies and trade barriers were removed at the very beginning of the reform,
- **Slovak commercial bankers** would be surprised to hear that New Zealand banks are free of the supervisory regulation of a central bank and that this system was replaced by a market discipline approach,
- **Slovak trade union leaders** would be surprised to hear that the monopolistic power of trade unions was removed as part of labour market reform and that industrial relations are much more flexible since,
- **Slovak executives** would be surprised to hear that their colleagues in New Zealand are working in a much more challenging environment today, created by significantly increased transparency; they have more decision-making powers and at the same time more responsibilities to bear,
- **Slovak taxpayers** would be surprised to hear about a radical tax reform that reduced income taxes from 66% to 24% and 33%.

Sir Roger Douglas was a member of the New Zealand parliament from 1969 to 1990. During 1984-1988 he was minister of finance. *Euromoney* awarded him the Finance Minister of a Year award in 1985. What is more important, his reform efforts were accepted by the population and his party achieved better election results than previously.

The implemented reforms finally brought results: today the economy is generating mostly positive signals – inflation and unemployment are relatively low, public finances consolidated, the state budget in surplus, state debt reduced, and state administration is more transparent and effective than ever before.

According to Donald Brush – governor of the New Zealand central bank – their reform was not inspired directly by any theoretical economic school. It was rather a reaction to the failure of Keynesian economics. Despite this, I would like to mention two important links between the New Zealand reform and the ideas of F. A. Hayek:

First, Hayek, in his famous book *The Road to Serfdom*, warned how dangerous it can be for any society if freedom is undermined. It can be destroyed not only by Soviet-type totalitarian systems, but by bureaucratic systems that over-regulate the economy in mostly democratic societies as well. New Zealand is a textbook example of this.

Second, one of the most dominant themes in almost all of Hayek's writings is the rule of law. There is no doubt that general rules applied equally to everybody were also one of the most important foundations for the success of the New Zealand reform.

These reforms and their results especially received world-wide recognition. New Zealand is in recent years consistently ranked as the third freest economy in the world by the index of economic freedom co-published by the F. A. Hayek Foundation Bratislava. It also occupies first place as the freest country among the 20 most developed countries of the world as rated by *The Economist. The World Competitiveness Report* put New Zealand at third place of 48 rated countries.

Ladies and Gentlemen, dear friends,

I am honoured that today we can welcome Sir Roger Douglas here, the author of this breathtaking wave of reforms. The man who contributed to the transformation of New Zealand from the most to the least regulated OECD country. The man who helped New Zealand escape from serious economic troubles and placed it among the top performing countries of the world.

Finally, let me express my greatest appreciation to our sponsoring institutions and the organizations that helped us organise this annual lecture: Slovnaft, a.s., Friedrich-Naumann-Stiftung, Liberální Institut, Prague and Devín Hotel.

And now I have the pleasure to invite Sir Roger Douglas to give his speech at the 1998 annual lecture of the F. A. Hayek Foundation Bratislava.



### **3.**

**SIR ROGER DOUGLAS**

## **CRITERIA FOR THE EVALUATION OF A SUCCESSFUL ECONOMIC REFORM**

### **The Annual Lecture of the Liberální Institut**

**Prague, The Adria Palace, October 26<sup>th</sup>, 1998**

Thank you for the introduction and thank you for the welcome. I feel very honoured this afternoon to have been asked to deliver this 3<sup>rd</sup> Annual Lecture and in particular to have the opportunity to follow Milton Friedman. There is no way that I can hope to match his knowledge or experience in the area of economics, but I do hope that at least the New Zealand experience will prove to be of some interest to you.

The areas I'd like to cover this afternoon are briefly to tell you where New Zealand was or found itself in 1984, how we managed as a country to get into the mess that we did, the policies that we put in place to solve those problems, and I'll dwell on those for a little while, the results that flowed from the introduction of those policies, and then finally the lessons, both economic and political, that could be learned from the New Zealand experience.

#### **Past Economic Problems in New Zealand in a Nutshell**

In the decade to 1984, New Zealand's economic growth rate averaged half that of the OECD. Our inflation rate was one and half times the OECD average. Government expenditure rose from 29% of GDP to 39% GDP with a large amount hidden in various government business agencies. Net public debt multiplied 6 times over and the cost of servicing that debt rose from 6.5% of government expenditure to around 20%. Unemployment rose from 5,000 to 132,000 with no sign of stopping. In the 25 years to 1984, if we took a longer view, New Zealand's average annual increase in productivity was

amongst the lowest in the developed world. New Zealand's relative standard of living fell from 3<sup>rd</sup> highest in the world in the late 1950's to the mid 20's ranking. To look at it another way, had New Zealand managed from 1960 through 1990 to achieve a growth rate equal to the average of the developed world, our standard of living in 1990 would have been double what it in fact was. That gives you an indication of how far New Zealand actually fell during that period. To give you another indication, in 1967 1 New Zealand dollar was worth 1.43 American. By 1984, it was worth 43 cents American.

What were the main elements of the regime of economic controls when we came into office in July 1984? Regulations freezing all wages, prices, dividends, rents and interest. All prices and charges for government supplied services were frozen. We had exchange controls which restricted all foreign exchange transactions to items approved by the reserve bank. We had quantitative licensing of imports to preserve the domestic market for local manufacturers. We had extensive subsidies for all major export sectors. We had tariffs that were very high on items where there were domestic substitutes and low or zero for intermediate inputs to industry. We had requirements on financial institutions to hold government bonds at below market interest rates. There was a prohibition in public sector pension funds investing other than in government stock. We had extensive regulatory protection and/or government ownership of the non-tradeable sectors: transport, energy, communications, finance, construction, and others.

### **How did New Zealand Drift into that Type of Structural Imbalance?**

Firstly, government policies distorted price signals from the world economy about the best use of resources, particularly tariffs and import controls. Macroeconomic policy focused on stability at the expense of growth through efficient resource use. Regulatory policies by which I mean labour, trade, and commercial laws were bias against efficiency and innovation. They were used for protection and stabilization. Inflation and tax policies channeled resources into risky and unproductive activities. Financial controls brought about an inefficient capital market. Social policies resulted in high marginal tax rates and unaffordable universal benefits. Government businesses were badly managed, protected, subsidized, and influenced a large share of the country's resources. Government administrative activities were unresponsive to changing priorities and performed inadequately in terms of effectiveness and efficiency.

## **What were the Policies that We Implemented in New Zealand to Achieve Structural Change after 1984?**

For those of you who are coming fresh to the changes in New Zealand, I suggest that you not attempt to absorb the detail of every change. Instead I suggest you focus on the comprehensive nature of the change and the consistency that underlines the type of change that we made in New Zealand.

### **Policy Reforms: The Removal of Border Protection**

Border protection, tariffs and import licensing, had been intended to permit the growth of viable domestic industry. Instead their main effect was to reduce the range of goods available and push up prices. The consequence of this was to reduce New Zealand's competitiveness and so reduce our participation in world trade.

### **What were the Policies We Put in place to Rectify the Situation?**

First we had a free trade agreement between New Zealand and Australia, open entry. We had the removal of import licensing in the mid-1980's. We had the reduction in tariffs which are due to be totally eliminated by the year 2003. The second policy area was the removal of industry assistance. In order to compensate for increased domestic costs and as a result of border protection, we had developed a growing range of subsidies and guarantees to assist exports. These subsidies had even extended to the farming area, income support and input subsidies. So what actions did we take in this area. We removed regulations on prices and incomes. We abolished farm subsidies over a period of 5 or 6 years. We removed tax concessions to exporters. We removed all export guarantees. We removed low interest rate loans. Now both farming and manufacturing are growing in New Zealand, based entirely on world market prices. Third area of reform was tax reform. We abolished sales taxes so that all goods would be taxed on the same basis in the future. The wholesale sales taxes that we had in New Zealand were very distortionary. We introduced a goods and services tax, a VAT if you like, at a single rate on all products right across the board, except financial services. We reduced marginal tax rates from a top rate of 66 cents on the dollar to a top rate of 33 cents, with most people being taxed at 19.5 cents in New Zealand. Company and personal tax rates are now aligned. Old depreciation regime that offered favoritism for some industries has now gone.

## **Infrastructure Reforms that were Especially Important**

There have been a number of important changes in the area of transport and communication. All protection for railways has been removed. Railways had total protection in New Zealand in the transport area beyond a 40 mile limit. We deregulated ports and corporatized them. The real reduction in freight rates or costs in our ports has been over 50%. Air New Zealand's domestic monopoly was removed with competition coming from an Australian airline called ANZI. Air New Zealand was then privatized. We have competitive tendering for bus routes in New Zealand. We have open entry for taxis. There is no cost, no licenses. Telecom New Zealand was sold. The result has been that prices are down. Connections in New Zealand now take 1 day instead of 1 month or more. The Ministry of Works, which had a monopoly to build all New Zealand buildings, etc, was corporatized and then privatized. The television and radio spectrum were auctioned off to the highest bidder. We probably have more radio stations in New Zealand than anywhere else in the world.

## **Competition Policy**

In many countries of the world, there are regulators who closely scrutinize the activities of various monopolies or dominant providers of services. They are supposed to understand the operations of these providers and to prevent them from manipulating the market. However, in New Zealand we have no such regulators. Instead we rely on the threat of possible competition, protected by standard market entry provisions to control the monopolist. The government has not privatized any industry in New Zealand without first ensuring that there will be contestability or hopefully actual competition for that market. It is this contestability which the government relies on as the main means of preventing excess price rises. So far this reliance on the overall market test appears to be working well. The principle evidence for this is the decline in real prices across a range of previously government controlled industries and the improvement of competitiveness of New Zealand providers in virtually all sectors of the economy.

## **Changes to Financial Markets**

Control on entry to financial markets was removed. Now any bank, anywhere in the world, that can demonstrate soundness can get a license in New Zealand. We removed formal controls on banks and financial intermediaries, for example to hold specific ratios or to invest in particular

sectors. The inflation goal is 0-3 and there is a public contract between the Minister of Finance and the governor of the reserve bank to achieve this. Operational independence to the reserve bank is provided. In the labour market, the various policies we adopted were a flatter tax scale, reduced welfare benefits targeted to those in need, tighter eligibility rules, education and training for unemployment.

### **Industrial Relations Law**

We used to have a closely regulated and centralized system of industrial relations. The law enshrined compulsory unionism, national wage rates for different occupations, we called them rewards, and compulsory arbitration in disputes. There was very little flexibility in terms of employment and very rigid relativities between jobs so wages all ratcheted up together. There were a number of changes in the 1990's, but the Employment Contracts Act of 1991 was probably the most important. Today, we have voluntary unionism. The new act abolished compulsory unionism. Instead, the legal presumption is that the individual employee negotiates with employer. It permits the employee to nominate an agent for wage bargaining purposes. The agent may be and generally is a union, but unions are not the only bargaining agents. We have enterprise bargaining. We also abolished the national award system. Instead wages are negotiated in workplace contracts. For the first time, employers and their staff can negotiate agreements that take account of conditions and opportunities applicable to their own workplace. It is no longer mandatory to pay workers of one occupation the same pay in all parts of the country. This flexibility has increased job opportunities enormously in New Zealand. We now have fixed term contracts. All contracts are now for a fixed term, determined by the parties to the contract. During the term of the contract, it is illegal to have a strike or lockout against the provisions of the contract. This has brought a new certainty to industrial relations, but also introduces a new flexibility as the parties may determine their own contract provisions. Overall, these changes add up to a story of improved incentives and flexibility which offer new opportunities through productivity and employment.

### **The Reform of Government was the Fourth Area of Change**

For many people, government management is a fairly esoteric subject which is not considered to be at the heart of economic management. In New Zealand, we take the opposite view. We consider that it is impossible to construct an efficient economic process if the largest player in the economy,

the government, is inefficient. Government expenditure in New Zealand accounts for more than 30%. It is therefore impossible for exporters to maintain international competitiveness if the government services that they need are provided on an inefficient basis. The main reforms in New Zealand in relation to government fell into three areas. First, we corporatized governmental departments and then we privatized most of them. Some of the improvements in productivity in New Zealand government organizations has been nothing short of amazing. For example, in railways, real freight rates are down by more than 50%. In 1984, railways employed 22,000 people. Railways today employ 4,500 people and they carry more freight. The same is also true in our ports and in a number of other government organizations. I'll come back to that.

The second area is in public sector employment. The changes to government management has been in our institutional structure and employment system. We used to have a system in which lifetime civil servants worked as administrators carrying out government policies. They were lifetime because they could not be sacked. We have moved to a structure in which senior staff work on fixed contracts, no more than 5 years, with performance related pay to deliver outputs that the ministers have contracted for. We actually advertised for our senior civil servants all around the world. For example, when we advertised for head of treasury or head of the health department, anyone in this room could apply and would be considered. That was a major change. Some civil servants now get paid bonuses. I don't think any department these days overspends. The departmental head doesn't want to lose his or her bonus.

The other area of change that I'll dwell on a little more is government financial management. We have shifted from a March year, cash based, input focused system to a June year, accrual based, output orientated system. This represents a dramatic change in accounting, and the accountability of all aspects of government. Its symbolic representation is our government balance sheet and profit and loss account. Let me just touch on this in a little more detail. I won't be able to go into as much detail as I'd possibly like, but let me just touch on one or two aspects. The underlying reason for the reform of our public accounting system is to allow us to have better information on the use and management of assets and the production of goods and services. Overall, our public finances have been rewritten to allow us to answer the following series of basic management question. What are we buying? Under the old system, we were purchasing inputs but we had no means of knowing what they were being purchased for. We also asked, What does it cost? Under

the old system, we knew the cash cost in any given year, but we had no measure of the ongoing costs. What is the capital being used for? Who is responsible? Those were the questions that we asked and answered.

So what are the changes that we made? We now have contracts for outputs. We now have a system of contracts with the minister. The politician contracts with the department for the purchase of outputs. It is the minister's job to determine what social outcomes he or she wishes to achieve and to select what set of outputs will be purchased from the department to achieve or contribute towards those social outcomes. In the case of treasury where I was a minister, under every area, the industry branch, the social policy branch, the tax branch, we listed the items that other departments would want to raise or which we wanted to raise. In the next column, we put down what would be the approach to that particular issue which we believe would be in the interests of the country. In the next column, we put down how long would it take treasury offices to develop those policies so that they were to a stage where they could be implemented. We then made an estimate. What would that be worth to the country if we could get that policy in place? We then asked the question, Can one get it past one's political colleagues in the cabinet? and How do you sell it? For example, port reform at that time, we believed that was worth at least 1% of New Zealand GDP, so we put it right on the top of the list. I think we got about 90% of what we wanted. That approach focused you on what you wanted to achieve rather than on what you could achieve. We have a government balance sheet and a government profit and loss. Every six months, I think that we're the only country in the world that publishes a profit and loss account and a balance sheet on an accruals basis. Accountability and responsibility is now clearly defined.

### **What were the Results of some of those Policies?**

#### **What were the Outcomes?**

Government expenditure ratio to GDP peaked in 1991 at around 43 or 44%. Today it is down to 33% and the government plans to reduce it to below 30. The government ran its first fiscal surplus in 17 years in 1995. When I talk about fiscal surplus, I don't take into account any proceeds from asset sales. We had fiscal surpluses from 1985 if you take asset sales into account. Net public debt is now 25% of GDP having peaked at over 50% in 1991. The ratio of debt servicing to government revenue is down from around 20% to less than 10%. The country risk premium in interest rates has fallen. The OECD says our tax system is the least distorted in the world.

So what other results can you point to? The first and unequivocal result is that inflation is down. The second is that we now have economic growth where we didn't have it before. Initially, we had no growth when we started on the reform program. It then moved to around 2-3%. It managed to get around 4-6% for a while and is now back in the 2-3% region. We've had export growth particularly in manufacturing products which have been growing each year at about 15% in real terms. One of the interesting things, and I don't really have time to go into this, is that an important sign of a strengthening and transformed economy is the evolving regional picture in New Zealand. As New Zealand stumbled into long term stagnation in the 70's and early 80's, there were some rural areas that suffered particularly severely. The results that are now showing is that some of these regions are among those that are now growing fastest. Their recovery is the result of greater flexibility in the labour market, reduced transport costs, lower capital costs, and improved competitiveness. These factors have allowed traders to produce goods for export from those regions and to sell them competitively in the world market where that was impossible in the late 70's and 80's. In fact, our recovery came out of the regions rather than our large cities of Auckland and Wellington. In the case of infrastructure, our costs are down for key infrastructure as a result of the reforms. I've mentioned this before. Port handling charges are down by a massive 60% in real terms. Rail freights in real terms are down by 50%. Government administration, that's the core government departments like health, treasury, defense, these types of departments, is now smaller, this is the administrative part. Staff numbers are down from 88,000 to 34,000 and are far more effective.

### **What then are the Political and Economic Lessons to be Learned from New Zealand's Experience with Structural Change?**

The first point I'd make is that it is the interaction of policies that matter rather than any one policy. There is no one magical policy that will ensure that a country recovers. In our case, it was the fact that the policies we introduced in the goods market worked well with those in the labour market, the financial market and the government sector reform. Had we just carried out reform in the goods market on its own, the policies, frankly, would not have worked. The second point I'd make is that if you're going to undertake reform, then it should be comprehensive reform. There is little point in tinkering with some areas while leaving other areas untouched. If you simply tinker, then the cost of the uncertainty that you create is likely to be more damaging than the benefits that will flow from small amounts of change.



Two further points I'd like make. Politicians should not underestimate the ability of their citizens to adjust. In New Zealand in 1984, 1 dollar in 3 of farmers income came from the government. Today, it is zero. Whilst they were losing that support from the government, 1 dollar in 3 of their income, our exchange rate, which we had floated, was going up. I always remember the president of Federated Farmers coming to see me after March 1, 1985 and we'd floated our dollar. Our dollar had gone up from 43 cents American to 48. He came into my office and he said, "Look minister, at 43 cents farmers were only just managing to survive. 48 cents is nonsense." So we had a quiet talk and we, I guess, differed in our approach somewhat and he went away. Well about 6 months later he was back. Our dollar was worth now 55 cents and he was saying to me, "Minister, 48 cents only just, 55 cents this is ridiculous." Three months later it was 60 cents and he was telling me that maybe 55 but 60 was impossible. When it got to 70 and I was sweating, he was telling me that maybe 60. So please don't underestimate the ability of people to adjust if the change is real.

The next point I'd make is that it is not speed that kills a reform program, rather it is uncertainty. People need to know that the government is firm about the decisions it's made. If they believe they can persuade to change your mind, then all their efforts will be focused on getting you to change your mind and putting the old order back in place. Reform is only successful when people believe that you're going to carry it on and they adjust. Speed doesn't kill, but uncertainty does.

Another important factor in any reform program is that of efficiencies. Policies must encourage efficiency. By this I mean that production and the use of goods and services should be maximized with the least use of resources. This goal should satisfy most people including environmentalists. Initially, that might look at odds with where you want to go. For example, in my first budget, I put up electricity charges by 28%, road user charges by 48%. That was all about getting resource use. When we underpriced electricity, what we did was encourage people to get into industries which are high users of electricity, where you may have, in the long term, no comparative advantage. Putting up road user charges by 48% was all about another principle, the principle of neutrality. What we did in New Zealand was to put road user charges up by 48% so that they were paying the full cost of any damage they were doing to the road. At the same time, we abolished the privilege if you like, or the protection that railways had. We abolished the 40 mile limit, so that we had open competition. The result of that was that real freight rates as far as rail was concerned came down by more than 50%.

Staff levels fell from over 22,000 to 4,500. On the other hand, a lot of manufacturers, when faced with those high rail costs and high port costs could not sell overseas all of the sudden found that they could. The result of that was an increase in not only regional growth, but the number of jobs in New Zealand.

Another important lesson from the New Zealand experience is what I call transparency. That's what the 6 monthly profit/loss account and balance sheet were all about. You need to have transparency right across the board. If you do, it changes the way both politicians and civil servants look at things, and I'll give you but one example. When we established the state owned enterprises and we turned them into corporations, and there were 10 of them, we said to them, "In the future, as corporations, you only have one role, you set up in the private sector, you have your own private sector board, you are run by the same rules and regulations as the private sector. You only have one objective from now on, that is to make a profit. We as a government expect you to make the same profit on the capital we have invested in you that the private sector would. If you carry out any social policy, and they all claim to carry out social policy because that was the reason they said they couldn't make a profit, then you come to us and we will tell you if we want you to continue with it. If we do, we will pay you. If we don't, then you will stop."

Guess what happened? First point, only one of the 10 corporations, most of which have now been privatized, came and said they needed a subsidy. The reason the rest didn't is that they found that in an open contestable market, things that they had called social services before were actually just good business practices which they needed to continue to do in order to hold their customers. The one corporation that came was the post office. They said, "Minister, we've got 467 post offices throughout the country that only do 8% of the business. They're not profitable. We would close them tomorrow on commercial considerations. Do you want us to? Do you want to subsidize?" We said, "How much?" They said, "\$80 million." We said, "\$20 million." We finally settled at \$40 million. We wrote out a check from then on every month for 3 and 1/3 million. We had a line on our budget, \$40 million for the post office. 5 months later, when we were doing our budget, we decided we could spend that \$40 million to better account in the areas of education and health. We closed 467 post offices in New Zealand in one day. That was by making it transparent. It wasn't the most popular move, but it was better to do it on one day than 467 days. The interesting fact is that if you look back now 10 years later, the post office now has 500 more outlets than they had

before we closed the 467. They're all agencies with people in the private sector.

The next point, and I'm going to be rather quick, is contestability. You should have contestability. That's a good form of privatization. For example, we had a government printer that had a monopoly on doing all the printing for government departments. We abolished that. We then sold the government printer and all government departments get it done in the private sector. The result of that sort of approach in the works department, government printing and a whole lot of other areas was lower cost, higher quality, and greater variety.

A lot of people say to me, "Look, you're a Labour politician. Your party was supported by the trade union movement. How could you actually advocate the things you did?" I always say to them that if you want to sum up the policies that we put in place in 1984 to 1987, I can do it in three words: We abolished privilege. That's what we did. The government is there for the consumer and tax payer. The government is not elected to look after the interest of the vested interest group. We had import licensing. If you had a license in New Zealand and were one of the only people who had a license to import cars or to import anything else, you didn't have to be a genius to make a profit. You had privilege. Farmers had privilege in their subsidies. Manufacturers had privilege. The interesting thing in New Zealand is that once we took all those privileges away, you know what? Most of the vested interest groups came to understand that they are actually better off. Whilst the farmer had the privilege of the government giving them subsidies for their inputs and subsidies for their production. They lost that, but when they lost that they won by the fact that they didn't have to pay for all the privileges and export incentives that manufacturers got. They all of the sudden found that all their inputs were cheaper because we no longer had import licensing. We had lower tariffs, close to 0, so the price of their inputs had gone down. The government was more efficient. Their freight rates were only half of what they used to be. The cost of getting their goods across the port was half. The deal is: You lose your privilege, but you win because everyone else has lost their privilege. That's the nature of the approach.

The final point I'd make, or maybe the second to last one, is that in the end, only quality decisions deliver the results you want. The experience in New Zealand is that wherever we have introduced a real quality decision, where we asked ourselves, "What is in the best interest of New Zealand?," worked it out, and then implemented it, the problems that we were trying to overcome went away. The political problem you have with quality decisions

is that the costs are always up front and easily seen. The benefits take some time to become apparent and are not always quite so clear. I can show you that we lost 18,000 in railways, but I cannot point out precisely where the 100,000 new jobs came from. They came one here, two there, three there amongst manufacturers and in the regional areas. Quality decisions are important. Wherever we had quality decisions, the political problems ultimately went away. Wherever we compromised, wherever we went half-way, wherever we did something with less than quality, then the problems in New Zealand are still there, particularly health, education and welfare.

I think I might leave it at that. I guess in those last remarks, I've indicated that in New Zealand we haven't solved all our problems. It's quite clear that there is a large amount of unfinished business yet to do. They are largely in the social policy areas. They're largely in the areas of health, education and welfare. By that I mean pensions in retirement, health care in retirement, unemployment benefits, sickness/accident benefits and the like. This an area that we haven't solved. It's an area where government still wants to be a monopoly supplier. I can't actually understand how New Zealanders can't quite make the connections. They've seen wherever we've put the right incentives in place the huge improvements that we've got or we achieved in productivity in areas like the railways and the ports. In health, education and welfare, we still insist on running them like we used to run the post office or the railways. Until we actually start to run them, education, health and welfare, like we now run the railways or the post office, we won't solve those problems in New Zealand. To me, the answer is relatively simple. We simply have to get back to individual New Zealanders. The money, which the government now spends on their behalf in health, education and welfare, should be given to people to allow those people to start providing for themselves. Actually, I think the insurance business in most of those areas would do rather well. Thank you very much.



## DISCUSSION

PAVEL BERKA (Dresdner Bank):

I was quite lucky because I spent nearly 4 years in New Zealand from 1990 to 1994. I have 2 points: First, in regards to your book, *There is No Alternative*. It has a nice abbreviation. I like it very much: TINA. Secondly, when I was in New Zealand, I met the chairman of the New Zealand Manufacturing Federation, Czech-born Fred Turnovsky. I would like to ask you, how do you see the industrial policy that was previously lacking in the Czech Republic?

SIR ROGER DOUGLAS:

I'm sorry I had the microphone on the wrong number for a little while, so I didn't catch the first part of the question. What I do know about New Zealand reform is that as a result of the reform process, three of four things happened with manufacturers. First, manufacturers, instead of trying to make a very wide product range, narrowed the product range that they manufactured down. They decided what products within the industry that they were involved in they could manufacture on a competitive basis, and then concentrated on those. Secondly, there is not a manufacturer in New Zealand who doesn't look upon Australia as part and parcel of their local market. As a result of the greater flexibility in the labor market and reduced cost of transport and manufacturing, small and medium sized manufacturers, not so much the large firms, have been growing annually in terms of export at 15 to 20% real growth. They're much more efficient, but they have had to make high quality products and they have had to be cost competitive in order to do it.

LUBOMÍR SEDLÁK:

I have recently read in *The Economist* that you have the highest foreign debt per capita. They mentioned a figure of 80 billion dollars. I hope you will be able to explain that, otherwise your whole success was paid by someone else.

SIR ROGER DOUGLAS:

In terms of government debt, government debt has come down, as I said, from well over 50% to around 25%. As a result of floating the New Zealand dollar, the private sector has been able to borrow as much money as they like offshore. Offsetting the borrowing that the private sector companies have,

would be New Zealand companies that have assets that they own offshore. For example, I am on the board of a large New Zealand company and 70 % of our assets would be offshore assets as opposed to New Zealand assets. One thing that happened in manufacturing is that when we had licensing and when we had capital control, a lot of people got into businesses that they weren't very good at.

Our biggest company, Fletcher Challenge, which is in building supplies, energy and forestry found itself in finance companies and whole range of other businesses. Once capital controls went away, they sold all those fringe businesses. In the forestry area, for example, they owned businesses in Australia, Canada, the US and Europe. Business started to concentrate. I think what you have to do is not only look at the debt. You have to look at the assets that New Zealand companies own, but that is private debt you're talking about, not public debt, not government debt.

DAN ŠŤASTNÝ (Prague Univ. of Economics, the *Laissez Faire* Journal):

I have one question: You were talking about the fact that what you basically did was abolish privilege. When one talks about privilege, one is implicitly thinking about special interest groups. How did you deal with these groups? I can't really understand if it was really enough to tell them that they should not worry because they actually win because you abolish the privilege of everyone else. Could you elaborate on this a little bit? Thank you.

SIR ROGER DOUGLAS:

I think that's a very fair question. I think the point I'd make is that it was some time after the event that they came to realize that maybe they could be winners out of abolishing privilege. What we did, and I think the political process was to package our reforms. It would have been impossible, for example, to have taken away the privilege or the support payments to farmers without having reform for the ports, railway, the government, import licensing and the like. Rather than just dealing with one issue at a time, what we tended to do was to have major packages so that everyone was affected at one time. For example, in my first budget, I got rid of farm subsidies and manufacturing export incentives. We increased road user charges by 48%. We got rid of import licensing. All those things we did in one package. The key was packaging.

I always remember the Monday after the budget. I had the budget on Thursday and I thought I'd better get all the interest groups in on Monday

and talk to them. I thought they weren't going to be very happy with me, but the interesting thing was that only the road users, the truckies, were the ones who were still very unhappy. They thought a 48% increase in their tax was just a bit too much. I'm not sure if it was collective pain or what it was, but most of them were prepared to go along with it. I don't want, by the way, you to run away with the idea that it was all easy, it wasn't. For example, land prices fell initially by 50%. A lot of farmers were actually under water in the sense that their borrowings probably exceeded their land value. In the commercial world, the banks didn't sell them up. If they were good farmers, it was better to keep them on the land, to restructure the deed and move through the situation in that way.

Let me tell you a story: I went to a place in New Zealand called Parmister Northern during this time and met with farmers. They were not totally happy with me for some reason. It was a huge meeting. There was standing in the aisles and they were standing in the foyer. I spoke for a little while and then answered questions for an hour and a half. After the meeting, the farmers and their wives were still sitting down. One or two of them were still giggling. As I walked down this long hall, they were still giggling at me, or at least some of them. I had with me a person named Jeff Sweir who was in my office. You could always see Jeff in any room because he was 6'6". As I walked out, I looked around for Jeff to see whether he was going to come with me. He was about 6 yards behind me. I got out to the car and I said to him, "Jeff, where did you get to?"

He said, "I didn't mind them thinking I was your bodyguard, but I sure as heck didn't want them to know I was your economic advisor."

**TOMISLAV ŠIMEČEK (The Civil Association of Homeowners):**

One of the groups of people who are usually privileged in countries are tenants, thanks to rent regulation. You have also been responsible for housing in New Zealand. Can you let us know how you coped with this problem?

**SIR ROGER DOUGLAS:**

Yes, we removed rent regulations and rent controls within a week or two of becoming the government. All the rent controls were doing were actually ensuring that the private sector would not build any more houses. Once we removed the rent control, a lot of people from the private sector started to build houses and whilst the rents might have gone up initially, ultimately demand and supply got into balance. Right at this moment in New Zealand, rents are probably falling.

ZBYNĚK FIALA (The *Právo* Journal):

How did New Zealand cope with the current currency turbulations that have shaken Asia? I noticed that the current account deficit is 6.7%, but interest rates still correspond to the level of low inflation or even deflation.

SIR ROGER DOUGLAS:

We certainly have been impacted by recent events in Asia, some industries more than others have. Our forestry industry has been particularly hard hit. Almost 40 to 50% of our exports in forestry, which is a very big industry for us, went to Korea and purchases stopped virtually overnight. Agriculture in general and small manufacturers have been impacted to some extent. Export sales have definitely dropped off. Tourism has been badly affected from Korea, Taiwan and other parts of Asia. That's definitely been an adverse consequence. If I look at the other thing that has gone wrong in New Zealand, our reform program probably stopped at the end of 1992. Since then, we have been undertaking some reform, but at a very slow pace. After 1992, new reform stopped, but we were still getting the benefits of the old reform. In 1995-6, we were looking at a surplus of government revenue over expenditure of somewhere between 7 and 8% of GDP. We had as a result of that a really huge opportunity in New Zealand to give that money back, to lower taxation and to really ensure that the country moved ahead. Instead, the politicians couldn't resist. They had to spend it on our behalf and that is having adverse consequences. There is a very simple test for politicians, which should be put in place in every country in the world. Politicians should not be able to spend a dollar of our money until they can demonstrate that they can spend it to better social and economic effect than we could. If you put in that test, government expenditure in every country in the world that I know of would fall by 70 or 80%.

MAREK MATĚJKA (Prague University of Economics):

Mr. Douglas, you have mentioned that taxes went mostly down. Is this true even when speaking of excise taxes, e.g. taxes on petrol, cigarettes, alcohol. How did you deal with these taxes?

SIR ROGER DOUGLAS:

In New Zealand, prior to the reform, we had what we called wholesale sales taxes. Those wholesale sales taxes ranged from 0 to 60%. They were very distortionary. They were based on what people regarded as luxuries in the 1930's and weren't necessarily luxuries in the 1980's, like refrigerators and washing machines and things of that nature. What we essentially did was



we got rid of all those wholesale taxes except some extra taxes on alcohol, fuel and tobacco. Apart from that wholesale taxes have all been removed. So fuel, tobacco, and alcohol...apart from that they're all removed. Maybe gambling has a small amount. In its place, we put in what you would call VAT, what we call goods and services, 10% across the board without exception, except for financial services, where we couldn't find a way of doing it. It's not that we didn't want to. Actually the banks and other financial institutions wanted us to because the fact that we couldn't meant they couldn't claim it back. That actually in many ways was one of the policy changes that we made in the goods and services area. Before we had a distortionary tax which influenced investments or where people made purchases. Now we have a totally neutral tax system in the indirect area.

TOM HOWE (Deloitte & Touche):

You mentioned when you spoke that the ability to abolish subsidies in such a dramatic way was the result of the electorate's feeling that the government was determined to carry out that policy. Government determination is a reflection presumably of the mandate that they are given by the people. Do you think that such a policy is possible whether it's coalition government or proportional representation?

SIR ROGER DOUGLAS:

I think it's much more difficult to do it where you have coalition government or proportional representation, but I think ultimately it doesn't alter the fact that sometimes a country needs to make these types of changes. First of all, I have a view. This is really a political view, but I think it also extends to a lot of other aspects of life: In many cases you cannot win until you are prepared to lose. I think that one thing that was unique about the Labour government in 84-88 was that we started from the basis of what should we do in the interest of the country. Only then did we ask the question: How will we sell it to the public? The problem with most politicians in most countries is they start with the question: What can we get away with? Given that you start there, you never manage to have the type of reform that is most needed. I think the other thing about the New Zealand experience is that one should not underestimate the ability of the electorate to understand. They might not understand every fine point of the policy, but they have a lot of experience with life. They know deep down whether what you're doing is right or wrong. I think that in the end of the day they voted us back in 87, with an increased majority, because they knew essentially that what we'd done to that stage was right and that they voted us in to finish the job. Now

that was despite the fact that we had 20% interest rates on housing mortgages, for example. At one stage we had 25% interest rates on 90-day bills, which for New Zealand was just simply unheard of. Both business and individual New Zealanders saw that in the long term it was right for us. There may have been an element that didn't want to go through it again, as well, of course.

MR. BUBENÍK (MacKenzie and Co):

Mr. Douglas, you mentioned many times that the fact that you did away many of the privileges actually was a very important part of your reform. Would you also agree with the hypothesis that doing away with their privileges also very much narrowed the opportunity for government corruption?

SIR ROGER DOUGLAS:

The answer would be yes, but the issue of government corruption had never been an issue in New Zealand. I think in that sense we've been very lucky. The obvious answer to your question is yes. An example of an area where there could potentially be corruption in New Zealand would have been with import licensing. I don't believe there was ever any but it was minor if it corruption had existed. By issuing someone with an import licensing, you are actually printing money for them, so that was an obvious example. I don't think it happened, but it was an opportunity where it could have happened.

JIŘÍ ZEMAN (SEVEN):

You say that speed is not the problem but uncertainty is. My question is, how long did it take or how much time did you spend on creating the consensus and informing the people before you started the reforms?

SIR ROGER DOUGLAS:

I think that's a really important area, this whole question of consensus and consultation. Where will I start? Maybe I'll start at the end and then go back. I have never personally seen consensus in government before the event. If you seek consensus by putting all the interest groups in same room (doctors, lawyers, farmers, manufacturers, unions and the teachers) and try to come up with a policy, all you know is that you'll have mess. The only time I've seen consensus is after you introduce the right policy and it worked. You've got consensus then. If you introduce a policy and it doesn't work, of course you've still got a mess. Now I think that what you need to do is not confuse consensus with consultation. We did use consultation in New Zealand and we used it extensively. Therefore, the government always

adopted a policy of announcing its intended direction and asking for feedback on specific issues. That is what we did with the goods and services tax. We put our policy on the table. Then we formed a committee from the private sector to look at the details of that policy and to make suggestions. That consulting committee heard from anyone in the private sector that wished to be involved and heard. We published the results of that. That was consultation. We didn't seek to arrive at consensus. We put our policy on the table. We got people from the private sector to look at it and report to us on the details. They could consult with whom they liked. Their paper was published. As a government, we couldn't run away from it. We did that in a large number of areas and that enabled us to bring in a lot of experience and a lot of skill from the private sector that hadn't previously been available. It was consultation, but it wasn't consensus. There is a difference.

MR. PROKEŠ (GIGA, Ltd.):

Mr. Douglas, allow me to pose to you a hypothetical question. Imagine that New Zealand is a Central European country and you are today the minister of finance. Do you think that vis a vis European Union which is in favor of awarding different sorts of privileges to some interest groups, such as to the already mentioned agriculture, you would succeed with your reform as much as you did in New Zealand?

SIR ROGER DOUGLAS:

I'm sure they would be as successful. Possibly they'd be even more successful, because I think a lot of European countries are probably naturally richer than New Zealand was. They're closer to markets and they don't have those disadvantages. Maybe Europe or whole parts of Europe have been so rich that they can afford to do it, but Brussels, to me, in certain cases seems to be a bit of a nightmare. I'm going to generalize here and one should avoid generalizing, but I'll do it. If I were looking at Europe, the important things that I see here is that in Europe, especially in regards to the European Community, there is too much regulation, which is a problem. I think the labor market needs to be sorted out and it must be costing jobs, especially in countries like Germany. I would say tax reform would be quite high on my agenda. The other area is what I've already mentioned, where New Zealand has not made the changes, is health, education and welfare. I do not think that there is a country in the OECD that has gotten on top of those issues of health, education and welfare. All of them are facing major problems into the future unless they actually start to tackle them.

JÍŘÍ SCHWARZ:

So, may I ask you about the regulation of the capital market in New Zealand? In my country there is consideration of a regulatory body with similar obligations as the Security Exchange Commission of the United States. It is considered that this regulatory body is a very efficient tool for making our capital market competitive with other capital markets in Europe. What is the level of capital market regulation in New Zealand and does a regulatory body exist there?

SIR ROGER DOUGLAS:

Essentially the reserve bank, as I see it, has a role in terms of the entry of new banks, but any bank can apply. If they have the appropriate skills, they will be issued a license. There is a free flow of capital both in and out of New Zealand. There are no questions asked if you want to take money out or bring money in. We do have some controls in terms of foreign investments. If a foreign company wishes to purchase more than 25% of a major New Zealand company, they need to apply to the reserve bank. In my experience in the last 12 years, there's only been one such application refused. There are some controls, but generally people do get around them. That's a problem with controls of course. In terms of farmland, there is measure of protection. It's a hangover to the 70's and 80's. If you look at New Zealand, we do have quite a large deficit in our current account, in our trading with other nations. That, frankly, is primarily because New Zealanders are poor savers. If we want to solve that problem, we in New Zealand better start saving more. Then we can own our own assets again. I think the problem with controls is that quite often people see a problem and therefore try to deal with it by way of control rather than go back to the fundamental problem and deal with the fundamental issue. I think in the main that's what we've tried to do in New Zealand or at least that what we did in the 80's and early 90's. Maybe we've stopped now.

ROMAN BINTER (Prague University of Economics):

Sir Roger, you were saying that other than the trade unions, there are other agents negotiating the wages. Could you just briefly describe the basis these agents work on. Thank you.

SIR ROGER DOUGLAS:

Well they work on behalf of a group of workers or in some cases an individual worker. The result of the changes in New Zealand has been enormous flexibility. So, you get all sorts of arrangements that suit both the employer and the employee. What happened is in many areas there is no

longer what we used to call overtime. Under New Zealand law you used to work 40 hours and then if you worked any more you got time and half and then double time. In most areas, that went. If you worked on Saturdays or Sundays you got time and half or double time. Most of that went by negotiation and the basic hourly rate of workers went up. Then you had much more flexibility because people didn't really mind working. It didn't whether they worked Monday, Tuesday or in fact Friday and Saturday. Some people now work 4 days a week and have 3 days off. It's either individual negotiation or negotiation is generally on a firm basis. So the employees and the employer sit down together and negotiate. Sometimes it's a union who represents the employees. Sometimes it's one of their members at the factory level or enterprise level. Sometimes they get an outside agency. Not a union, but someone who specializes in providing this type of service.

AN UNIDENTIFIED DEBATER:

I would like to ask Mr. Douglas the following: The Czech people are known for being able to get around all regulations and bans. If you got an offer to be appointed as a minister of finance here in the Czech Republic, would you accept that?

SIR ROGER DOUGLAS:

If the pay is right. (*laughter and applause*)

MIROSLAV ZAJÍČEK (Prague Securities):

I would like to ask only one short question. We are talking about monopolies. We are talking about privileges and about the abolishment of these monopolies and privileges, but there is one monopoly, a very old monopoly, which is not discussed in almost any political debate. This privilege is the monopoly of government in issuing money. What do you think about this monopoly? What do think about the central bank? Do you think that there is any possibility to abolish the central bank and to have a free banking system? Thank you.

SIR ROGER DOUGLAS:

We weren't brave enough in New Zealand. Our reserve bank or central bank is much smaller than it was. I think it's fair to say it could be a lot smaller than it is today, but frankly, I think maybe that question would have gotten a much better answer from your speaker last year than from me. I do believe that an argument can be made, but I personally probably wasn't brave enough to introduce such a policy. I'm not sure I would be today either.

## 4.

# THE NEW ZEALAND REFORM AS INSPIRATION FOR THE CZECH ECONOMIC TRANSFORMATION

## Special Seminar with Sir Roger Douglas

Liberální Institut, Prague, October 27<sup>th</sup>, 1998

JIŘÍ SCHWARZ:

It is a pleasure for me to welcome Sir Roger Douglas to a special seminar for the Liberální institut on the theory and practice of economic reforms. We heard yesterday that New Zealand was a good example for discussing the practice of reform that was realized there. It is pleasure for me also to thank the sponsors of the whole event. The general sponsors: Česká pojišťovna and the PPF Group, as well as to the other sponsors: Giga s.r.o., Friedrich-Naumann-Stiftung, Deloitte & Touche, and Bristol Group. We have also a publishing partner for our discussions and it is a journal, *Banky & Finance*. The journal is available in the library. Then I'd like to inform you that we record this seminar and part of the seminar will be published in the traditional book that we issue about the visit of famous economists here. The book will be published within 4 or 5 months. The general title will be *Roger Douglas in Prague*. So, Roger Douglas would prefer to get to the questions, so I think that we will finish the seminar about a quarter past 11 and then if there are any special questions by journalists, these questions can be addressed. I have the opportunity to put the first question and because we are in the Liberální Institut, we are always very interested in the intellectual sources. My question for Roger Douglas is: What stream of economic theory or which famous economist affected you? Are there any books or textbooks that have influenced you so greatly that you felt such an obligation to put these ideas into practice?

SIR ROGER DOUGLAS:

I don't believe there was any particular economist or any particular school that we followed in a sort of religious way. If you look at most of the

policies we put into place, they were based on common sense. If you look for a thread or approach, probably the Chicago School would be the one that we'd marry up more closely to what we did in New Zealand. Maybe this is going just a little bit beyond your question, but there was quite a lot of commenting when we were making our reform in New Zealand that we were doing it in the wrong sequence, that we weren't actually doing it in an appropriate order. My feeling about that was that's fine in theory, but in politics there is that window of opportunity to do something that you know is sensible. You should do it. Some things you can do very quickly, others things take time. In our experience, we probably moved more rapidly on the financial market. The reason we did that was because all we really needed me to do was sign my name on a piece of paper. When you're doing things like a bank or changing some aspects of the labor market and it's decent legislation, it takes time.

JIŘÍ SCHWARZ:

From my point of view, the Chicago School should be an intellectual source for a formal instruction on how to promote reforms and also what should be the aims of reforms. Have you ever met Milton Friedman, an economist from Chicago?

SIR ROGER DOUGLAS:

I have met him on a couple of occasions. Apart from having an enormous intellect, he's quite an individual. He obviously was of some influence. As I see it, I think we just dealt with issues as they came and tried to do it with common sense. I think that's really important.

JIŘÍ SCHWARZ:

What was interesting was the openness, the intellectual openness of New Zealand's Labour Party. I know of an institution in New Zealand called the New Zealand Round Table. It is headed by Roger Kerr. He is a member of the Mont Pèlerin Society. I think that this think tank was also influential in changes that were done in New Zealand under the Labour government.

SIR ROGER DOUGLAS:

Certainly towards the end. Initially they weren't. Initially, Roger was a member of the New Zealand Treasury. He left the New Zealand Treasury, I think, in 1985 and headed the New Zealand Round Table. He really changed the New Zealand Round Table. The New Zealand Round Table was a collection of leading New Zealand businesses and as such it tended to be a

lobby group. He really influenced the members of that business round table to come to understand that what was ultimately in their best interest was having New Zealand doing well rather than rely on any special privileges or preferences. That was a big turning point for the program, because we had the support of big business. In some cases, that support was against the personal interests, someone like Al Gibbs, someone you've probably met, was a strong proponent of what we were doing. Yet, he had one business, Saranco, which made crockery, that actually closed as we opened up import licensing. However, he still supported the changes because he saw the overall interest of New Zealand and his own as well.

JIRÍ SCHWARZ:

Let me turn to the key issue of our economic reform, that is deregulation. Perhaps that is the point in which the Czech economic transition was stopped. The reform was stolen away by lobby groups representing different industries following their vested interests. You were able to avoid this very natural behavior of these groups. You also described how you did it in yesterday's lecture. I would be interested in a very special case. Why were you successful in the deregulation of telecommunications and why did you fail in the deregulation of the electric network?

SIR ROGER DOUGLAS:

Well, first of all with telecommunications, we worked with that from around 1985-6 and it was deregulated ultimately in 1990. With electricity, it was still being worked on with the change of government in 1990, but hadn't been finalized. I think the difference is that a lot of the electricity industry in New Zealand is actually controlled and owned by local government. Local government wasn't as inclined as we were at the central level to give in to the business of deregulation. They still loved ownership and still hadn't recognized some of the benefits that flow from competition and deregulation. So, in part, it was outside of central government's control, particularly in terms of the regional operational side. You're right. We hadn't done as well as we might have.

JIRÍ SCHWARZ:

Yes. As I know, in New Zealand, the production of electric power is still controlled by the government. In spite of this, is there competition in this special provision?



SIR ROGER DOUGLAS:

They're working towards that. They're breaking up the major electricity corporation into 3 companies. I'm not sure that in itself is going to do a lot. What they are doing or starting to do, and the jury's still out, is that they're going to separate the lines business from the retail business. It'll be a lot of competition, but there is difficulty in that quite a lot of this is natural stock monopoly. In telecoms, opening access to the network which is owned by the telecom or any other companies, has worked reasonably well.

JIRÍ SCHWARZ:

We always have the problem whether competition, as a separate factor, can defend the consumer or do we need a regulatory body defending consumers? That is a general question. For example, today there has been discussion about opening the electricity market to competitiveness. What is your opinion? To reach a level, is competition able to protect consumers? And when is it necessary to set up special regulatory bodies for preserving consumers as well as preserving competition?

SIR ROGER DOUGLAS:

The first point I'd make is that New Zealand, unlike most other countries in the world, does not have regulators who closely scrutinize the activities of various monopolies or dominant providers of services. In most countries they do have that. We looked at that and we rejected that idea. Those official regulators, in our view, are supposed to understand the operations of these providers and to prevent them from manipulating the market. I had a look at some of those regulators, in the United Kingdom in particular. The danger was that they were going to set up their own huge bureaucracy.

From my perspective, I believed that no matter how many regulators you had and how smart they were, they were never going to understand as much about someone else's business, like the telecom business, as the people who worked in telecom. In any case, what is the right price? You only sort of know that after the event and often circumstances have changed. In New Zealand, we have no such regulators. Instead, we rely on the threat of possible competition protected by standard market entry provisions to control the monopolists. In telecom, anyone can use or can apply to use the telecommunications network owned by Telecom. It's done by negotiation. If Telecom and the other user can't agree, it is settled within the courts. The interesting thing is that whilst Telecom will probably delay making agreements at a given time, they never ever allow it to go to the court. In the

end, they want to make a commercial decision. The other thing that you need to understand about New Zealand is that the government hasn't privatized an industry without first ensuring that there will be contestability, or hopefully actual competition. The threat of competition often works almost as well as actual competition, for the particular market. It is this contestability which the government relies on as its main means of preventing excess price rises.

There is another thing that you need to understand in New Zealand. All industry and commercial activity is regulated over the Commerce Act. We don't have special regulators with telecom or electricity. Every business in New Zealand is regulated or needs to comply with the provisions of the Commerce Act. This gives the Commerce Commission the power it requires in order to fight monopolies and to prevent mergers that establish a dominant market position. In some cases you need to get Commerce Commission approval such as when you wish to take over a certain company. So far, this reliance on an overall market provision appears to be working pretty well. The principle evidence for this is the decline in real prices across the range of previously government-controlled industries and the improvement in the competitiveness of New Zealand providers and virtually all sectors of the economy. If you look at telecoms in New Zealand, the second supplier – Cleare – has a much larger share of the toll market, for example, without any regulator than the second supplier has in the United Kingdom. Cleare has been going probably for 7 or 8 years and has over 20% of the toll market. If you look at the second supplier in the United Kingdom, they have regulators and they still, 3 or 4 years ago, only get 7 or 8 % of the market.

**JIRÍ SCHWARZ:**

I would like to ask the audience whether they have additional questions on regulation and deregulation. I would like to cover some issues. Regulation and deregulation are very important topics. I would like to focus more on this topic.

**AN UNIDENTIFIED DEBATER:**

It is said that the New Zealand government made sure before any decisions about the privatization was made, that competition or at least contestability existed. When speaking about the privatization in the Czech Republic, the problem rests in the huge magnitude of the whole process. Almost all property went from the state to private hands and you never knew whether you did not sell a monopoly. If there is at least some market, then you know what are you selling. However, there was no market here and the fear of private monopoly was so strong that it caused substantial problems.

SIR ROGER DOUGLAS:

I believe it's a combination of those factors. In New Zealand, what we tended to do was open up industries for competition before we actually privatized. An example of that would have been before we sold the national airline in New Zealand. We allowed ANZ (Air New Zealand) to compete for internal airline business. What you are looking for is not necessarily the highest price. In fact, allowing ANZ to compete publicly lowered the price we got for Air New Zealand. The benefit from ANZ was that we had a more efficient internal airline market. As a result of the competition, prices went down a set or so. That was one of the benefits from our reform. Regarding internal communications, once we worked out what would be the environment and rules would be, we worked out the legislation and we corporatized and reorganized telecoms. Telecom, during the two year period we were working on the regulatory environment, came out a much more effective and efficient company and we probably got a higher price for it. As a rule, we did not like privatizing unless we had genuine competition or the threat of competition. I think the other thing that you have to remember is that sometimes you think about privatization as simply selling a company. A lot of the privatization that took place in New Zealand was really opening up and making contestable markets. One of the other things that happened, take the telecommunications industry for example, Telecom employed 27,000 people. Today it probably only employs 7 or 8 thousand people, but has a huge range of services, much wider than they were in 1990 and a much bigger impact industry. What it did was allow the private sector to develop. The private sector does a lot of the work that Telecom, as a monopoly, did internally. Of course, there's a lot of competition at the edges. If you look the communication market, the telecommunications market, they probably employ over 30,000, but instead, in 1990, 27,000 people were employed in the market and they were all employed by Telecom. Now Telecom employs 7,000 and there's 26,000 people out there in the private sector doing the right thing one way or another, all providing telecom services.

I'd like to make one more comment on local government. One of the things that I think is going to happen over the next few years and is certainly happening in New Zealand, is that more and more of government is going to be contracted out and the writing of those contracts is going to become very important. We have not had, in my view, genuine local government reform in New Zealand. We had some amalgamation, but I don't see, making amalgamations, making things bigger necessarily as reform. It's the climate you create and the contestability. Now local governments are natural

monopolies, because they look after a local area. One local government used to employ over 300 people. It now only employs 20 to 30.

What has happened is that they have basically entered into contracts for other people to carry out much of the work that they used to do internally. The important thing about that was that they actually had to, once they decided to contract a service out, think, “What are we trying to achieve? What’s our objective?” To use a minor, even silly example: They used to run two swimming pools as part of the local government service and they used to lose over \$200,000. They put it out to contract and they now get it done for \$70,000. The interesting thing was they had to decide what level of water purity they wanted, and how many hours as a minimum they wanted. They had to lay all these things out. They had to ask themselves and think about things that they’d never ever thought about when they actually ran the pools themselves. The interesting thing was what they specified as the minimum number of hours, which was probably the numbers of hours they kept it open when it was owned and operated by the city government. It is now open a lot more to the public. The public is getting a coffee bar and can sit around to watch their children. You never know what happens. That process, in and of itself, was pretty important.

JIRÍ SCHWARZ:

Another hot topic in this country is the regulation and deregulation of the capital markets. I mean under the capital markets and the securities markets. I would like to ask you what is the level of regulation in New Zealand, whether there is competitiveness among market organizers. Is there competitiveness between stock exchange as a classical market organizer and electronic exchange, similar to NASDAQ in the US?

SIR ROGER DOUGLAS:

Electronic.

JIRÍ SCHWARZ:

All is electronic, yes? Is there only one market organizer for that business in New Zealand or more?

SIR ROGER DOUGLAS:

There is one New Zealand stock exchange. That’s all. I suspect, because we have a relatively small capital market, that even though it’s relatively efficient, the New Zealand stock exchange could get together with the Australian stock exchange. We do have a securities commission. If you want

to start a new public company or if you want to issue a particular security, then you have to issue a prospectus. All rules that you have to comply with are laid out in the conversation. The security commission is a body that approves the prospectus and keeps an eye out that they hold it up to the undertakings they made and that the information is accurate and correct.

JIRÍ SCHWARZ:

The control, the checking process is based on transparency and disclosure of the companies.

SIR ROGER DOUGLAS:

Absolutely. One point, just getting back to competition, is fundamental. Wherever we opened up a government business to competition, and that's what we did, a few things happened:

First, you had price rebalancing and that was fundamental. Sometimes consumers saw that as a bit of a negative because what politicians had often done is charge business, for example, too much for electricity, but it undercharged the consumer. If you're going to have open competition, then there is always price rebalancing. Price for the consumer in the case of telecom and in the case of electricity tend to go up and the price for business actually comes down. If you didn't do that, niche suppliers would have come in and taken away the business market, for example, for the sake of just aiming at that market. You do have price rebalancing. Put price rebalancing aside and three other things happen.

The second thing that happened was that the real price went down. In the case of railways, it went down 50%. The post office, which used to put its price up every year ten years ago reduced prices by 10% from 45 cents to send a letter to 40 and in the last ten years has not had a price rise. I might add the quality of the service is hugely better. The first thing they did was to set some standards of service. They found that only 70% of all the letters got through to the customers within 24 hours. They set a standard that they wanted to get up to 93%. That's the standard they meet today, 93% of the letters get through in 24 hours. The quality of the service went up. The price went down.

I think probably the next point is the most important. All of those organizations actually started to ask: What service does the consumer want? You saw a whole range of products developing. You can get fast post in New Zealand now and they'll guarantee delivery within a certain amount of hours. In all of these areas, the nature of the service changed. You had a basic

service, but you can buy a diverse range of products, which was fundamentally quite important. The tragedy is that we haven't done that in health and education or welfare. That's the next chapter of the reform.

JIRÍ SCHWARZ:

My last question on the securities market: What sort of savings do the New Zealanders prefer? Do they prefer savings into banks to savings in the capital market or savings in securities shares?

SIR ROGER DOUGLAS:

I think if you look at the New Zealand capital market, the average person tends to invest in their own home. Probably that does create some problems. We have a very high level of personal home ownership; around 70%. What a lot of people do is save and then pay off their home. Then they upgrade. They sell it and buy a house that's more expensive and do the whole thing over again. There is participation in the stock market. Some people, depending on their risk, may just put it in a bank. Obviously, you have people who are entrepreneurs and starting their own businesses. That's happened a lot more. If you're just talking about the average person that works in a factory or the average person who works for a wage or salary, their big investments tend to be their own home. Sometimes a home can beat you. We are not good savers in other words.

MR. SÍGLER (Prague University of Economics):

Mr. Douglas, I don't know if in the 1980's in New Zealand you had the support of foreign investment, but can you say something about your opinions on government support of DI? My second question is: What do you think about taxation of international capital flows? Thank you.

SIR ROGER DOUGLAS:

In terms of foreign investment, we have a very liberal regime. We have a very open marketplace following the removal of exchange controls on the first of March, 1985. Capital can move in and capital can freely move out of New Zealand. In terms of foreign ownership, depending on the size of the company, they do have to apply to the reserve bank. There is a three-person board who looks at new foreign investment which goes beyond 25% of a particular company. It's more of a recording mechanism than anything else. As I said yesterday, of all the applications, and there would have been thousands of applications that would have gone forward in the last ten or

twelve years, I think there's only been one or two refusals. The criterion is: If it's going to do good for New Zealand, it is allowed.

Just to give you an indication of how open we are on that, we sold 100% of Telecom to two American companies, Ameritech and Bell Atlantic. We did say to them that there was a requirement on them to sell down 50% of the company, 50.01% over a three year period. I think there may have been a specification that 20% or 25% had to be sold New Zealanders. We have been probably been more open in that respect and less protective in terms of foreign ownership than any other country. We sold the big New Zealand insurance company to Prudential of the UK. Telecom as I said was sold. The Bank of New Zealand, which was the biggest bank in New Zealand, was sold initially to some New Zealanders who opted to sell it to a big Australian bank.

We often put the whole company on the market and were prepared to sell it to the highest bidder. We believe that in doing that, we were likely to get the greatest level of increase in efficiency and effectiveness. There was always the argument that we should sell it to the employees or that we should give more preference to New Zealand companies. Essentially, we said no. As far as we were concerned, the way the New Zealand economy would benefit most, say in telecoms, was to get someone in there with knowledge, who had a lot of money on the line and who had to make it efficient and effective. Telecommunications is absolutely fundamental for a whole lot of industries. Having the best telecommunication industry in the world is what you should aim at. We probably went from having one of the worst to one of the most efficient telecommunication system in the world in 10 – 15 years. That's what it was all about. As a result of that, we probably started businesses that we might not have had before. It's not unknown for Australians to use the New Zealand telecom system to poll Australians about how they're going to vote and things like that. Since we're in the complete opposite time zone, we do certain work for European companies. While Europe's sleeping, New Zealand is working. It's all dependent on having a good telecommunications system. The key in all of those things was to make it efficient and effective.

The other point I'd make is that in selling it that way, we often got a higher price than people believed it was worth. We were told Telecom was worth somewhere between 2.8 and 3.2 billion dollars by all the advisors. In most of these cases, we had both a New Zealand advisor and an offshore advisor. If we wanted to float it to the general public, it would be 2.5. When we actually sold it, we got 4.2 billion.

JIRÍ SCHWARZ:

When you spoke about banks, you said you abolished the minimum obligatory reserve that the commercial banks have to keep with the Bank of New Zealand. How did that function? Were there any risks associated with that action?

SIR ROGER DOUGLAS:

I don't believe so. We removed controls on the entry to financial markets. Any bank that can demonstrate soundness can get a license in New Zealand. I think the capital requirement is somewhere around 10 million dollars, which is not a lot of money. In contrast, Australia issued 12 licenses. People did apply for those licenses, and there was a lot of competition to get those 12 licenses. It was limited. We took the view that we didn't care how many came in. Having an open market, no one rushed, because they always knew they could come to New Zealand when they had a particular need. Outside the standard trading banks, there were banks half-there like Citibank, but we had a regulation where any bank like Citibank would be 75% owned by Citibank and 25% owned by New Zealanders. They bought the New Zealanders out. Most of those banks have tended to specialize. We had some banks from Europe in agriculture. No one actually came in and competed with the 4 main banks. It came and added competition in the industry sector, specializing in that sector. One or two of them moved into the exchange market and added competition there. The margins were doing this sort of business.

JIRÍ SCHWARZ:

Can I start a business if I just open a bank without having a license in New Zealand?

SIR ROGER DOUGLAS:

No, you have to get a license.

JIRÍ SCHWARZ:

What sort of license? Can you buy it?

SIR ROGER DOUGLAS:

You don't buy it. Any bank that can demonstrate soundness can get a license in New Zealand. It's issued by the reserve bank. You still have to apply to the reserve bank to get a license. The capital requirement is only 10 million dollars.



JÍŘÍ SCHWARZ:

Concerning the other industries, is it necessary to obtain a license, such as in an area like telecommunications?

SIR ROGER DOUGLAS:

No, you could start a telecommunications business and a lot of people have. As I said, there are thousands of people offering services in that area. Obviously, if you were going to break in, you'd have to have a lot of capital.

In general, we've tried to get away from a lot of that licensing situation. It turns out that we're one of the only countries in the world where you don't need a taxi license. You go along and pay a hundred dollars and you get a sticker on it. Before we did that, that taxi license was probably worth 30 or 40 thousand in New Zealand. In some countries, they're worth hundreds of thousands. Now they're probably worth 10 to 12 thousand. A lot of them have gone up-market. They wear suits and whatnot and on weekends they provide the service for weddings and what have you. They take the taxi sticker off the side of the door since they've got that market powers they provide taxis for those events.

MARTIN KOMÁREK (Czech National Bank):

Mr. Douglas, I might ask you about whether you have a special institution that serves as banking supervisor or provides supervision?

SIR ROGER DOUGLAS:

The reserve bank, but what a lot of what the reserve bank used to do, they no longer do. The reserve bank issues the license and the reserve bank's main role is to ensure inflation is within the band. We rely on the market. In other words there is self-supervision between the banks. They watch one another.

MARTIN KOMÁREK (Czech National Bank):

My second question is what is your experience in inflation targeting and a floating exchange rate? The Czech National Bank has a special strategy for inflation targeting. Could you discuss the role of exchange rate in this policy? What do you think about it? Do you have some experience with floating exchange rates and inflation targeting?

SIR ROGER DOUGLAS:

I may not have got the question right... In terms of the inflation target, we have an inflation target. It was 0 to 2%. The most recent government, a couple of years ago, extended the range to 0 to 3. I'm not sure if that was a wise

move, but it's now 0 to 3. What you have is a contract between the minister of finance and the governor of the reserve bank that set the inflation target. That is tabled in the House and can only be changed by tabling another letter which changes that target. Once that target and the agreement are reached, operational independence is provided to the governor of the reserve bank to make that target. Over the last 10 or 11 years, they've only been outside the target on one occasion. They, well he, since it's only been Roger Kerr, has actually stayed within the target. Operational independence is provided to the governor and his sole focus is to keep within that range. He doesn't have subsidiary targets like employment or growth, he's got the one of price stability. If you're going for growth or if your going for jobs you see another range of policies and that helps to make sure your macro policy and central bank are in line as well.

**JIRÍ SCHWARZ:**

No other questions? Concerning decision making of the central bank, there is discussion in this country whether inflation targeting is the proper way for the central bank to function. The Chicago School prefers money supply control.

**SIR ROGER DOUGLAS:**

What we're doing is saying that we want a 0 to 2% inflation range and we leave the operational control to the government to achieve it. Obviously monetary control is a major factor there.

**JIRÍ SCHWARZ:**

Let me turn to another issue, that of the pension system. Did you make any reform of the pension system in New Zealand or do you have a system based on the solidarity approach, the pay as you go system that we inherited from Otto von Bismarck?

**SIR ROGER DOUGLAS:**

We have a pay as you go system. I think it's one area of reform that is still left undone in New Zealand. There's quite a lot of debate about it. Roger Kerr and I disagree on this. He's not unhappy with the system. What he sees doing, which I see as politically totally unrealistic, is moving the age of retirement out and lowering the benefits. I think that at the end of the day we have to come up with a better answer.

My own view is that you should look at all social policy areas together. I include education and health and welfare. By welfare, I don't just mean

retirement pension, because the biggest cost of retirement is actually going to end up being health. Health costs rise rapidly. Health costs in New Zealand for the retired are currently between 50 and 60% of pensions. It's growing all the time. Also, people have accidents, sickness, disabilities, and things of that nature. We've got to move from a state provided monopoly system to a system where people start to provide for themselves over their working life. The real issue is how you handle the transition, transferring from a pay as you go to a situation when people are providing for themselves. It's inevitable that some people will pay twice for a period of time at least. Initially, you should forget how you handle the transition and ask yourself, "What's the best system?" To me, I think that people should be able to take what the state spends on their behalf in education and health, as a deduction on the tax they pay, and make the investments correctly themselves. The equivalent amount of tax which they currently pay for pensions, they should be able to deduct from their taxes as well and save on their own behalf. If you did that, people would be substantially better off in retirement.

The major issue is how you pay for the transition. To me, that's relatively simple for the first countries that do it. If everyone did it together, one would lose one's edge. What I've advocated in New Zealand is that as a result of doing all those things, we'd have 0 personal tax in New Zealand. We'd have 0 corporate tax if we did all those things. If you did that, you'd be so attractive to people from other countries that you would option your immigration. The money you got from optioning the immigration would pay for the transitional costs. By the way, it's better than striking oil because you don't even have the cost of digging the hole in the ground. Very good, your advantage goes away when everyone does it though, so it's rewards for the first.

ONDŘEJ SCHNEIDER (PATRIA Finance):

I have one question regarding the pension system. I know there was a referendum in New Zealand in which people refused to support a new pension system. I would like you elaborate a little bit on the flavor of the discussion which was there before the referendum. Your argument was that people saw the benefit of market reforms. It seems that they did not believe that pension reform would be good for them.

SIR ROGER DOUGLAS:

First, the politician that was promoting it, Winston Peters, was hated, so it didn't have a chance anyway. Putting that aside, it got beaten because it was an unholy alliance between the left and the right. The left saw it like this:

If people actually saved the money that they currently spent to meet the pension requirements of the retired, health and the pension itself, and were actually able to invest that over their lifetime, then most of these people in New Zealand would retire as millionaires, given a reasonable real rate of interest, about 4 or 5%. The left didn't like that. To have people independent would be a terrible thing. I mean, gee, they wouldn't have a role in life would they. They have to do all these good things for people with people's money...

The right was opposed to it, including Roger Kerr, primarily on the grounds that it was compulsory. They didn't like this idea that is was compulsory. The fact that people paid compulsory taxes seemed to escape them. It was an unholy alliance of compulsion.

What I'm saying that people should have not only freedom of choice but also the possibility to opt out. The fact is that if you let people take what they currently pay in taxes and opt out for superior health and education, within two years, everyone would have opted out. You wouldn't come up against this argument, which I don't think holds water, of compulsion. We've got it now. We compulsorily take taxes from people to pay for things. The prime reason it lost was Winston Peters was advocating it.

EVA DVOŘÁKOVÁ (Prague University of Economics):

I'd like to ask a few questions. The first is in respect to first aid. Are there still things like extended benefits so that even though you suffer an accident at work, you still get compensation? I would also like to ask if you think there is a danger of being too radical since it's such a political game in every country. From my point of view, you cannot be too radical. Politicians always say, if you raise any questions of further privatization, that it's too radical. Do you think that you actually can be too radical being a politician? I mean radical in the sense of free oriented. One more question: What are the chances that New Zealand can get back to market-oriented reforms under the political system, since it has been changed from the (majority rules) to mixed member proportional system? Are there any chances that similar reforms could be carried out in the future? Thank you.

SIR ROGER DOUGLAS:

First, let me deal with accident compensation. Yes, we do have accident compensation in New Zealand. We've probably got the worst scheme in the world. If you have an accident at work, you are entitled to go onto a benefit which is related to the income you earn in work. It is approximately 80% and there's a very limited standard. As a result of that, we had more people with

back injuries in New Zealand than any other country in the world. They can play rugby on the weekends. They can lay a concrete path, but they can't work. It is all about incentives.

If you create a bad incentive, people act silly. If you create the wrong incentive, you get the wrong outcome. It's very easy to solve. We should give people individually what they pay or their employer pays on their account in terms of accident, which you do for sickness, by the way. Tell them to put it in their bank account and make them buy catastrophic insurance. If they have an accident or get sick and are off work for more than 6 months or 12 months for a particular time, they have to draw initially out of their own account, it would change the incentive entirely. In 3 or 4 years or 5 years, when they have 20,000 in there and they had an accident, they'd go to the doctor and say, "Look I've hurt my back." The doctor would say, "Well, you've gotta go and do a physiotherapy course." Since they'll be paying out of their account rather than someone else giving it to them, they'd be saying to the doctor, "How many times can I go a day, doctor." They wouldn't want to lose their 30,000. That's easy enough.

I think speed is important in any program of change. You can't really go fast enough. The truth is, the political system will always slow you down. The bureaucracy will always slow you down. I don't mean that in a nasty way, about the bureaucracy, but it just takes time to put in the legislation and get it passed. I think speed is in fact important. In any case, it takes time from putting a program in place before you see the benefits. If you take too much time, the general consensus in the country that something needs to be done is lost. People don't see the benefits. Speed is pretty important.

Are we going to get real reform in the future? I'm not sure. The present political system will make it more difficult. If the new party, ACT (Association of Consumers and Taxpayers), gets enough seats, maybe we can influence the national party to undertake some real reform. We'd always be a minority in a government of that nature, but maybe we can. The problem is the areas still left undone. Those areas were just seen politically the toughest, like education, health and welfare. Frankly, half the supporters who vote national, their views on welfare are the same as Labour party supporters, and that's a difficulty.

LEOŠ VÍTEK (Prague University of Economics):

Mr. Douglas, did you announce to voters before elections in the 1980's that you planned a change in the government's economic policy or was it an after-election surprise?

SIR ROGER DOUGLAS:

A very good question. We were lucky. Our then prime minister, Sir Robert Muldoon, got drunk one night and called it a snap election. The result of calling a snap election 4 months ahead of time was that we as a party didn't have to have a manifesto. We got elected without a manifesto. In the true tradition of Labour parties, we published one after the election, which was the silliest thing we ever did, but nevertheless we didn't have one during the election and it gave us a lot more freedom. There were 2 or 3 things going for us. There was a feeling that New Zealand was in crisis. That was important. There was this feeling amongst the public. There was consensus that we needed to do something. There was no consensus about what we should do, but there was a consensus in the sense that New Zealand needed to face up to its difficulty. I think the fact that we didn't have a manifesto probably helped, although it was pretty well known what my views were. I'd published a book, but I think most people hadn't read it anyway. That was probably just as well.

RADOVAN KAČÍN (Prague University of Economics):

Sir Roger, your book, *Unfinished Business*, sold quite well in Canada, the UK, and Australia also. Do you think your lesson is applicable to our countries as well? For example, the European Wall Street Journal article bore a title something like let the dog see the rabbit, that means you have to explain to the public what is going on and what the benefits will be. I got the impression, for example, in Asian countries, or even here in Europe, that people don't spread it.

SIR ROGER DOUGLAS:

Look, it is difficult to actually sell a program, say from the opposition. I think had we had all the things we were going to do and put them out, whether we would've gotten elected or not is quite questionable. When you're in government, you do need to be up front. You do need to explain your program. If you don't appear to believe in your program, why should anyone else? That was the story about the Labour government.

When we united, despite doing all these things, we got reelected after 3 years with an increased majority. When the prime minister, David Longley, and myself fell out, over a flat rate tax of 23% and the government became divided, we went from being 6.5% ahead in the polls to 15% behind in the matter of a month. We were finished as a government. We were always in the program up front. We weren't always successful in explaining it to people.

Even if you aren't successful during the period that you're trying to implement the program, the fact that you've done all that education helps once the program is in place. People can see the results.

The best example of that would be the goods and services tax (GST). We announced that in November 1984, my first budget. We had 28% support. We introduced it in 2 years, well actually 23 months later, and during that period we spent a lot of money. We had a consultative committee which was headed by the current governor of the reserve bank. We published that. We had a goods and services publicity committee, a committee that was really aimed at explaining it. They did, to professional groups and what have you. We never got more than 36% support, even during that 23 month period. Women hated it more than men. The older hated it more than the young. The less affluent hated it more than the affluent. Within 2 weeks of its introduction, we had 65% support. 65% support, which is unheard of for a tax. The reason was that people, when they went into the grocery shop after the tax reduction, still had more money and they could buy more goods, so they were happy. It wasn't the monster that they thought it was. Before it was actually introduced they believed we put the tax on them. They never thought it would give them additional tax return, which is fair enough, since they don't trust politicians. It was interesting. We went to 65% support. It was so popular, in fact, that the pollsters didn't like that. They stopped polling after that. They couldn't have the government getting majority support for something. That's about political leadership though. I knew we had a good plan. I knew we were going to make people feel better off. They were able to that because we were taking privileges. We were going to get new taxes from that as well as the taxes from the goods and services tax. We were actually able to give tax reductions. They were much higher than the actual money than we got in from the GST. Then, sometimes, you've got to back yourself.

As I said, if you're going to win, you've got to be prepared to lose. One advantage we had though, was that it didn't cross an election. We announced it 3 weeks later and we had it in place a year before the election.

PETR MACH (Prague Univ. of Economics, the *Laissez-Faire* Journal):

I have a question about the privatization proceeds. You had the money you had received from the privatization. Was it made part of an ordinary permanent project or do you still have a privatization fund?

SIR ROGER DOUGLAS:

That's a good question. I introduced the concept of having two budget balances in our fiscal policy. One was what I'd call a genuine fiscal balance,

which did not include asset sales. Now a lot of countries say they've got surpluses, but they've only got surpluses because of asset sales. We introduced, I think it was about '86 or '87 when we started, two balances. One balance without asset sales and then another balance with asset sales. We were actually in surplus with asset sales from about '87 on, but the first time we had a genuine surplus was 1995. Our deficit was about 1% from about 1986 on, I think. With asset sales, of course, we were in surplus. I don't regard it as hard, personally.

ROBERT HOLMAN (Prague University of Economics):

Sir Roger, you spoke yesterday about the privatization of government. Would you specify what type of government administration you would privatize? How would you do it and how would it function?

SIR ROGER DOUGLAS:

We're talking about privatization or the overall reform of government? In terms of privatization, I probably specified. We saw an awful lot of the government businesses privatized. We also privatized in the sense that we opened up to contestability a lot of the operations of government that had hitherto been monopolies, like the government printing office. If you were a government department, you had to get all of your printing done at the government printing office. We got rid of that. We had a works department that did all government buildings and did all the architectural work and the survey work. We opened all those up to competition. We had really genuine reform of government apart from that.

Put aside the corporatization and privatization. People are familiar with that. We did two other things. We had reform of whole government departments in terms of the way people were employed. Before 1987, you had lifetime employment in the government sector. If you were appointed to a position and I was working in that department and I didn't like it that you were appointed, I could appeal to a higher authority and see if I could get you displaced so I could have that job. We had all those things. We had a state services commission that set the pay rates across all government departments. We got rid of all that. We now have a situation where the chief executive officer is similar to the chief executive officer of a private company and is the employing authority. That the CEO employs all the people in his or her department and fixes their wages and salaries. We don't have a state services commission. There are no appeals.



The top 200-300 civil servants are all on contract for 5 years and don't necessarily get re-appointed. The top jobs, and some of the other jobs, are advertised internationally, so you could personally apply to become head of the New Zealand treasury. There is no set salary for that job. You negotiate it at the time of your appointment. There's been huge changes in that area, very important changes. If I were head of the treasury and you were head of the health department, you could pay your personal assistant two or three times what I'm paid and it's your responsibility. You have a contract with the prime minister. If I'm the minister and you're the head of the department, we have a contract. I set the objectives: What the department is trying to achieve. We agree that you will produce certain outputs that will achieve those objectives. These objectives are made known and are public documents scrutinized by the Parliament. The most important thing is that you then have that contract and that form of measurement. People are looking at how much you spend on pencils or pens. They're concentrating on whether you are achieving what you said you would achieve. People can argue whether what you're trying to achieve are the right things, but they can also measure. Now no government departments overspend in New Zealand. This is some unforeseen event. The head of the department doesn't want to overspend because they'd probably lose their bonus. His or her bonus would get hurt. We pay bonuses and it's not unknown for some people to get salary reduction. The improvement in performance has been tremendous. We've gone from 88,000 people in the core public sector to 34,000 as a nominal figure.

In addition to that, we've made big changes in accounting. We're totally on accrual accounting. We have a balance sheet and a proper loss account for government every 6 months. It's all the contingent liabilities and it's available to anyone. I can't see why every country shouldn't do that. It should be above politics. Although, I guess it does put some disciplines on government. When we first published the balance sheet it was awful. Our liabilities exceeded our assets by a considerable margin. It was good for politicians. They were saying, "Well, I'm going to improve that situation! I'm going to get it in a synch!" Of course it locked them into actually running surpluses. Today our balance sheet does have surpluses. Part of the problem was depreciation on roads and depreciation of buildings. All those things are taken into account just like any business enterprise. Losses or gains on foreign exchange transactions are also taken into account. Liabilities for government services as well.

JIŘÍ SCHWARZ:

Does it concern also the local level?

SIR ROGER DOUGLAS:

No.

JIŘÍ SCHWARZ:

No municipal level?

SIR ROGER DOUGLAS:

Uh, no. I think we've passed legislation that may have to do something similar. Remember that local government in New Zealand is very small, maybe 3 or 4% of GDP, so it's not big.

EVA DVOŘÁKOVÁ (Prague University of Economics):

I wanted to ask what the reaction of IMF officials to the changes in accounting methods. Why do they not recommend it to other countries? They do recommend quite a lot of things, but not this.

SIR ROGER DOUGLAS:

I don't know. I haven't been Minister of Finance for 10 years now. I'm old and gray, but I think it's been generally accepted as a worthwhile approach. Some of the people that worked on it within the New Zealand Treasury had been working on it within the IMF. Graham Stock, I think, has done work with the IMF. One or two of the other people who were key people have done work for other governments. Whether the IMF and World Bank endorse it, I don't know, but certainly they've looked at it.

JIŘÍ SCHWARZ:

Any more questions? Nobody can use the corporate welfare agreement? Well, I have a very, very stupid question, because there were no stupid questions. It is only this so we can close on time. So... the Czech Republic was considered to be a good pattern for the other countries under transition. We represented the model of economic reform based on privatization, price liberalization, foreign trade liberalization, internal convertibility of Czech currency, and monetary and fiscal austerity. We represented this economic reform abroad and we also recommended that the pattern would be a good one for other ex-communist countries. I think that it really was until 1994. I would recommend comparing the latter proceedings of our transition to any country, and perhaps we could find some successors like the Baltic countries

with their fiscal and monetary austerity, or Slovenia's fiscal and monetary austerity, perhaps the privatization process in Ukraine, but I'm not sure if that's a success or not. I would like to ask you whether there is any other experience for applying Rogernomics in other countries. I know that it's quite difficult because you're 10 years out of business. In 1994, I was quite certain in saying that there were 5 or 6 countries inspired by our economic reform. Now, I am very uncertain. I really don't know. I am not sure what countries follow our approach. What about Rogernomics? Do you have any other example that could benefit from your experience? I know that deregulation in the provision of electricity in Scandinavia is very positive. Also, liberalization of prices and so forth... There are a lot of examples, but considering the comprehensive, consistent reform applied in New Zealand, is there any other country in the 90's?

SIR ROGER DOUGLAS:

I'm not sure if I can point to any other country. I do know that the World Bank, for example, would have probably used the New Zealand experience in terms of the privatization as a model that could be followed. Obviously, different countries, just as yours, had a whole series of different problems. You were doing it on a much bigger scale than we were. I spent some time in Russia and Brazil, and you couldn't just transplant the New Zealand model necessarily as it was. I know there are South American countries that have leading politicians and civil servants that come to New Zealand to have a look at the model. I've been associated with some of their visits, but I couldn't point to any particular country that sort of followed the New Zealand model to any length. I think every country has got to follow its own program. It normally should be based on common sense, and just sound economics. I think that's where we all stumble... I have to say the program here was much admired around the world and probably has stumbled like the New Zealand one. Most of these programs, if you actually start, have their own momentum.

The problem with any program is that it takes quite a long time to gain credibility. You have to be consistent in order to gain credibility. It takes time to gain credibility, but you can lose it overnight. We lost it overnight. I think my experience is that other countries that have started on the road sometimes lose their credibility quite quickly when they do a U-turn, or what appears to be a U-turn. In our case, it was silly. We announced a flat rate tax of 23 cents on the dollar. We were at 48 cents. A number of other changes were proposed. We started to do something in the health area. We were 6% ahead in the polls. The Prime Minister went overseas and I was supposed to make

a speech in Dover, so I was actually in London at the time about to go. He decided without reference to the cabinet that we weren't going to go ahead with that 23 cent tax. We actually went from being 6% ahead in the polls to 15% behind. We actually gained it up with a 33 cent top tax rate. The silly thing was that if we'd gone down from 48 to 33, it would have been great. One the other hand, having held that we were going to do 23 flat rate, it looked like a huge U-turn. The government's credibility was gone. It had been nearly 4 years building a real credibility and that was important because people believed that we as the government said we were going to do something and in fact knew we were going to do it. That was part of our success. Here was a case where we did an absolute U-turn. We lost it. 4 years down the drain in the matter of 50 seconds.

## 5.

### **“THERE’S GOT TO BE A BETTER WAY”**

#### **From Sir Roger Douglas’ Meeting with the Czech Economic Public**

**The House of Czech Trade Unions, Prague, October 27<sup>th</sup>, 1998**

JAROSLAVA HOLEČKOVÁ (Vice Dean, Prague University of Economics):

I have a question about the social system. How is the social system in New Zealand designed? I’ve read in a book that you have abolished social security contributions. You follow a liberal approach in this social insurance. We have quite high social security contributions paid by employers and employees as well. Our government intends to increase this percentage of this contribution.

SIR ROGER DOUGLAS:

To answer the final point, we used to have what we called “one six in the pound.” People used to have a deduction of one shilling and six pence in the pound. Today I guess it’s the equivalent of 15 cents. This was supposed to go towards social security. In fact it was a bit of a fraud. It was a bit of accounting trickery really, because social welfare always costs more than that. All we did was get rid of that and include it in the overall tax system. We have a social welfare system that is not working very well. My own view is that the biggest problem for the developed world, in particular the OECD countries, is their welfare systems. It’s basically in the end going to kill them. It isn’t efficient and it’s not working well, primarily because the incentives are wrong. In New Zealand, 90% of education is provided by the state. 75–80% of health care is provided by the state. The government provides a universal pension in retirement, universal health care, accident, sickness and unemployment benefits. Frankly, it doesn’t work.

In the end of the day, what we have to do is to allow each individual New Zealand citizen to do for themselves what the government is currently doing. The government isn’t able to care for us or any one of us as much we are able to care for ourselves. They don’t care for our children as much. They

don't know as much about you or your children as you do. What we need to do with welfare is precisely what we did in the economic areas. We currently spend 5000 New Zealand dollars on educating our children each year. If a parent has got 3 children we should give them 15,000 of their tax and let them make the choice of where they send their children in a totally contestable marketplace. If we did that, the improvement in the quality of education in New Zealand would be equivalent to the improvement in the quality of the services in the post office and in the telecommunications, etc. We should do that with health care. We should do that with super-annuation. Instead of paying that, we should let people keep it if they choose and invest it themselves. They would be much wealthier in retirement. It is a controversial area.

VOJTĚCH DOHNAL (Prague University of Economics):

I have a question as to whether it was your original political program to do these changes. Were you elected to do these changes or did you just do it after you were elected?

SIR ROGER DOUGLAS:

Everyone hear the question? "Were we elected to do these changes or did we do them afterwards?" I'd written a book in 1980 called "There's Got To Be a Better Way." Everyone agreed with the title, but I'm not sure if everyone necessarily agreed with what was between the covers. Maybe, fortunately, not too many people had read it. It wasn't a big bestseller. It only sold about 5000 copies. That aside, there was nothing hidden. If people had read speeches, listened to me or read that book, they would have known broadly what I was going to do, but not many people had.

Now to answer your question: We were very lucky. The former Prime Minister Robert Muldoon got drunk one night and he declared that we were going to have an election 4 months before it was scheduled. As a result of that, we didn't have to publish a manifesto.

PETR MACH (Prague University of Economics, the *Laissez-Faire* Journal):

Sir Douglas, you were inspired by the Chicago Scholars, weren't you? My question is whether you find their concept of the negative income tax as a good idea.

SIR ROGER DOUGLAS:

Yes, broadly I accept that as a good idea, particularly if you're going to have reform in social welfare. I think what one should do is, as I was saying, if you've got two children and the government is currently paying 5000 per

child for their education, let a person take 10,000 dollars off their tax. If their health care is costing 4000, then take another 4000 off their taxes. To save for their retirement, take off another 4000. 18,000 off their taxes, if they're paying 10,000 it would put them in a negative position, but I would agree with that and I would support that, because it changes people's approach. What's important in any of these things is to the incentive right. As soon as you become the buyer of your product, then you will demand that the quality of the service that you are receiving for that money is much higher.

Another important factor, however, it's not just about getting individual people to be the buyer rather than the state buying it on your behalf. You've got to open up those areas to competition. You've got to have contestability. If you're going to do it in education, you've got to allow new people to enter the marketplace and compete. You have to do that in health and in welfare. You change the incentive. All incentives are crazy in New Zealand. We have a situation where all the schools, not the universities, compete for students until March 1. On March 1, if you have 1000 students, you get 5 million to run your school. March 2 you hope all the troublesome students, the ones who make all the trouble and are hard to teach, never come back to the school again. They're the ones who make it hard to teach the other kids. They're the ones who are difficult for the teacher. A lot of those kids drop out. Sometimes they come to school, but a lot of the time they don't. They're in the video parlor or at snooker tables when they should be at school. They're the kids who will cause problems in a law and order sense later on. If you change the incentive, that's the incentive when you have 100% state monopoly.

If you had a contestable market where anyone could attract those children and get that 5000 it would change. You wouldn't see those kids if you went down to the video parlor as a problem anymore. No way, not if you're in the education system. You'd see them as an opportunity and you'd look in there and you'd see 20 of them. You'd see 5000 smackeroos right there on the forehead of every one. You'd think there's 20, there's a hundred thousand. You think, "I'm going to go talk to those youngsters. I'm going to find out why they don't like school. I'm going to design a program that gets them into school and gets them to learn." That's the difference because you've changed the incentive.

RADOVAN KAČÍN (Prague University of Economics):

You wrote in 1990 that you need working people to make quality decisions. My question would be: Are incentives enough? (SIR ROGER DOUGLAS: Sure.) If you want to change the mindset of civil servants and politicians from either lazy bureaucrats or power hungry, power seeking bad guys to customer oriented ones, are incentives enough or do you have to get rid of those people?

SIR ROGER DOUGLAS:

I hope I got the question right. I think the point I was trying to make was that even when you get the framework right, even when you get the incentives right, you need people of real ability to be able to make those institutions work. What we did in New Zealand, say with the post office, telecom, forestry, coal corporation, all of those, we put in boards of directors and we chose the very best people from the private sector to run them. We did that because we felt that if we got talented people, their performance would be good. The experience was wherever we chose the right people, we got an excellent outcome. Wherever we put someone in that wasn't quite up to it, the outcome wasn't as good. It was our job as politicians, and my job as one of the two shareholders on behalf of the government, to actually, if you like, sack that person and appoint someone else. Quality people really mattered in getting things done. It was good politics too. A lot of people said, "Well, why did you appoint all those people from the opposing party?" I had a very simple answer to that. I said, "Look, if I appoint a quality person and they do a great job, I'm going to look good whether I'm good or not. If I appoint an idiot and he does a bad job, I'm going to look like an idiot whether I'm an idiot or not." If you want to look reasonable, always appoint someone good, it actually helps.

MICHAL ČECH (Czech Technical University):

Mr. Douglas, I would like to ask if you think that because New Zealand is an island country, an isolated country, it helped you in carrying out your reforms?

SIR ROGER DOUGLAS:

I'm not sure it helps. The fact that we're a small country with only 3.5 million people certainly helped in terms of the communication. I think the other thing that helped was that we did have a crisis. I think there was a genuine feeling amongst the public that we had to have change. Therefore, there was more tolerance to change. I think, however, that there also had to be that political willingness to lead from the front. We went a lot further than would have been really required of us. That's a lesson about change too. Once you get the momentum going, it is quite hard to stop. Frankly, you shouldn't stop really until you've finished the job. The fact that it's easier to communicate say to 3.5 million people than to say 100 million people, the fact that New Zealand needed to do something, that we weren't very happy, that we used to have the 3<sup>rd</sup> highest standard in the world and all of the sudden we were 25<sup>th</sup>, led us to think, "Where was it going to end?" In the end we did have politicians that actually said, "We are prepared to lose." I believe that in life, and in politics, that you can't win unless you're prepared to lose.



I think that the unique thing about the Labour government in 84-88 was a fundamental change in approach. We first asked, “What should we do with regard to this issue? What is the best thing to do in regard to this issue on behalf of the country? What’s the best possible solution? Forget politics. Forget all the problems with it. What would you do if you had a clean sheet of paper? What would you do?” Once we decided what we’d do, only then did we ask ourselves how we were going to sell it. Quite often we found it was just as easy to sell that as some minor change or something close to what we really wanted to do. A lot of the problems went away. We jumped right over them.

DAN ŠŤASTNÝ (Prague University of Economics, the *Laissez-Faire* Journal):

Sir Roger, do you see any tendency towards re-regulation in the fields that your government previously deregulated? In other words, how likely do you think history is to repeat itself?

SIR ROGER DOUGLAS:

I think that’s an interesting question. I think the center of gravity in New Zealand politics has moved a long way. If that was the center previously, the center is now here. People aren’t going to go back to there. I think the Labour party at the present time has found its more traditional roots, if you like. I’m not sure whether I’d be welcomed back in the Labour party any more. Having said that, they’re not going to put in place, if they’re elected and they look as if they might be in 12 months time, some of the crazy policies that they might have advocated or some of them might have advocated previously. I think the center of gravity has changed and that’s a good thing. Some of the changes, like the reserve bank, all of those things together, largely remain in place. They might fiddle at the edges, but they’re not going to do anything major to change them.

JAN TOMÁŠ (Czech Technical University):

Sir Douglas, I want to ask you about the problem of the farming sector, of regulation in agriculture. We have some big problems at this time with competition from the European Union. The production of the farmers in the European Union is subsidized. Our farmers have problems with that. It’s normal. They want to protect our market. Would you say that we should protect this market or just destroy our sector with this competition? I think the problem is that the subsidy would be removed in two or three years as the current agriculture policy will be changed. Should we destroy them and just import everything or not? Thank you.

SIR ROGER DOUGLAS:

Well, I probably don't know enough about agriculture here and the rest of Europe, but essentially if someone else does something silly like bang their head against a brick wall, I wouldn't recommend you going and banging your head against a brick wall. As I said, subsidies normally benefit someone other than the person they were intended for.

Let me give you a couple of examples: Take lamb production. Europe subsidizes lamb production. New Zealand would be the most efficient in the world. We export 95-6% of all the lambs we produce. The cost would be 1/10 probably of what they are here. I don't know, since Switzerland recently heard that a milking cow was worth 15,000 dollars. Heaven forbid, they're only a fraction of that in New Zealand. "OK," we thought, "That's terrible. They've all got subsidies. So we're going to subsidize our farmers to produce more lambs." We couldn't sell the ones we had, but we subsidized them to produce more. So instead of producing 13 million, we all of the sudden were producing 40 million. Guess who benefited? The consumers of other countries. The prices that we were getting went down. Iran in particular just picked up the last 10 million for virtually whatever they would pay for them. We got rid of the subsidies. Bang! Gone! Production went down from 40 million to 24 million. Guess what? Our farmers get 40 to 50 dollars in an open market instead of 15 dollars. More importantly, when you have subsidies based on weight, the old lambs used to be fat and no one wanted to eat them. Now they produce what the market wants, nice lean ones. All these things get captured by someone else.

In Australia, they used to have, and maybe still have, export incentives based on making plastic, etc. New Zealand always used to buy them. New Zealanders could buy 25% cheaper than the Aussies. We used to buy all their raw materials, make it up into various products and sell it back to them. It cleaned all the Australian manufacturers out. Here was a subsidy that was supposed to help an Aussie manufacturer and who was it helping? It was helping the New Zealand manufacturers to clean out the Aussies and cost them jobs. Seriously, if you try in the Czech Republic to give all the subsidies that the Europeans give to their farmers, forget any other sector of the economy, you'll need about 200% of GDP to subsidize yours. Don't bother. Don't worry. Just enjoy the cheap food...

JIRÍ SCHWARZ:

Thank you for your participation. Thank you very much, Sir Roger Douglas.



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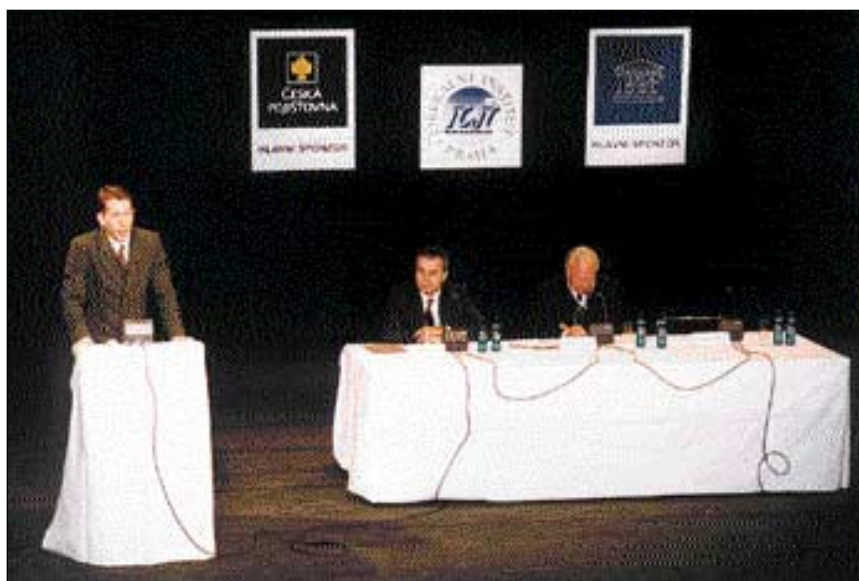




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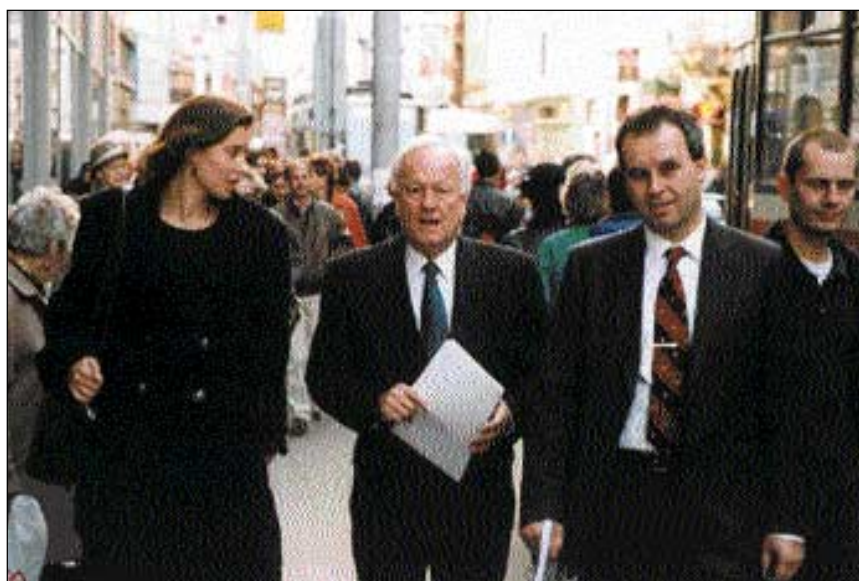




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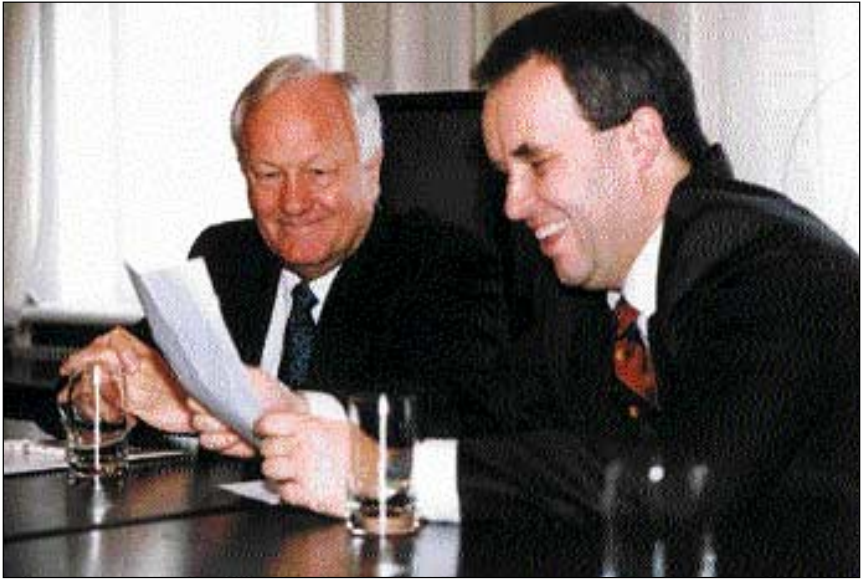




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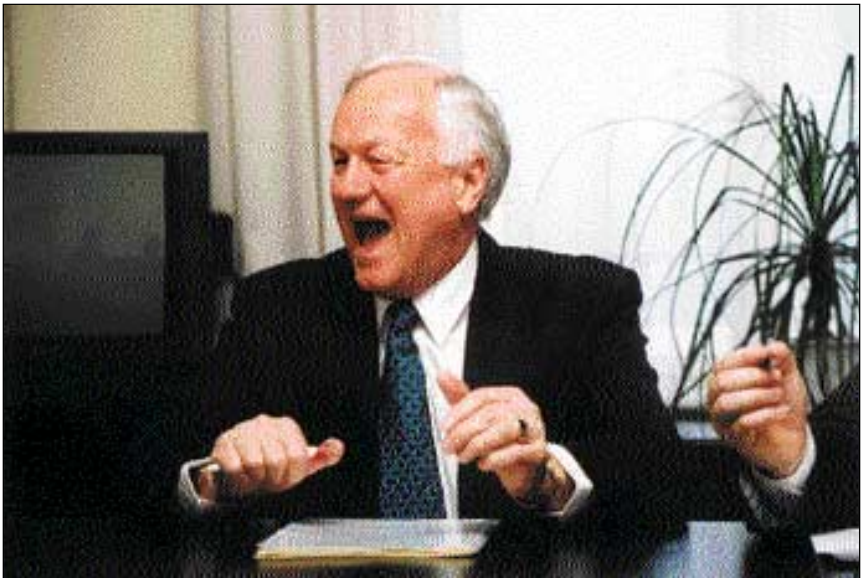




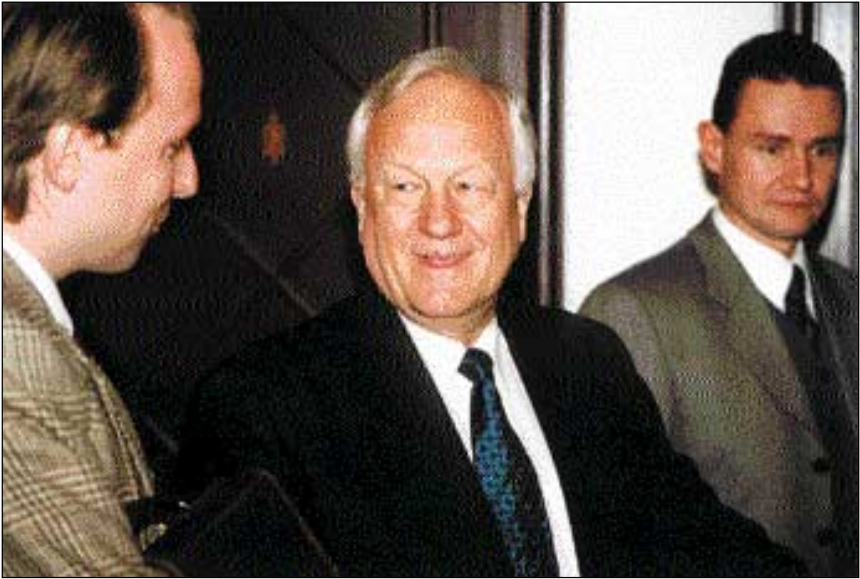
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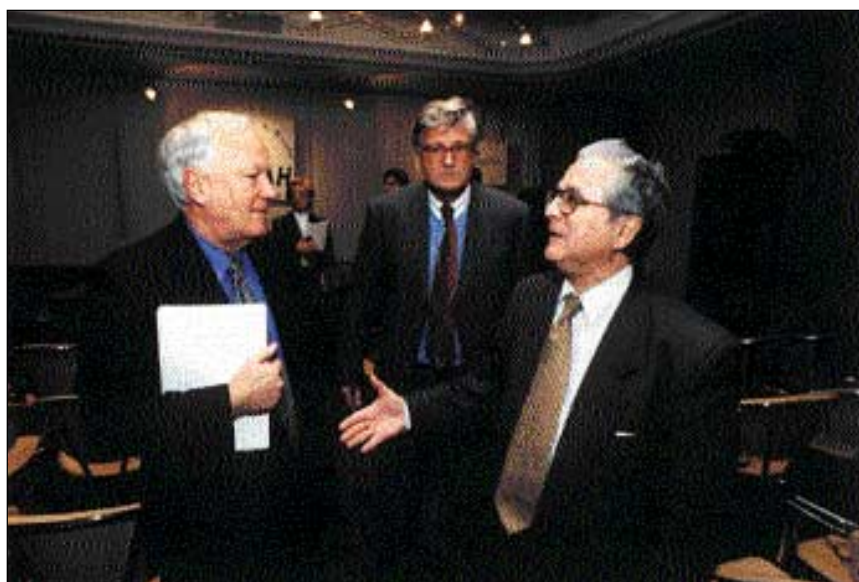




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## CAPTIONS

1. Sir Roger Douglas' meeting with representatives of the PPF Group and Česká pojišťovna; from the left: Mrs. Douglas, Sir Roger Douglas, Jiří Schwarz, PhD., President of the Liberální Institut, Ing. Štěpán Popovič, President of the Czech Union of Transport and Industry. (Prague, October 25<sup>th</sup>, Restaurant "U modré kachničky.")
2. A dinner honouring Sir Roger Douglas, organized by the PPF Group; from the left: Ivan Kočárník, PhD., President of the Board of Directors of Česká pojišťovna, Sir Roger Douglas, Vlastimil Tlustý, PhD., Chairman of the Budget Committee of the Czech Parliament (Civic Democratic Party), Miroslav Ševčík, PhD., Executive Director of the Liberální Institut, Ing. Alena Schwarzová. (Prague, October 25<sup>th</sup>, Restaurant "U modré kachničky.")
3. Welcome of the prominent guest at the Liberální Institut; from the left: Jiří Schwarz, Sir Roger Douglas, Miroslav Ševčík. (Prague, October 26<sup>th</sup>, 1998.)
4. Ing. Ladislav Bartoníček, MBA, Director General of Česká pojišťovna, introducing Sir Roger Douglas at the Third Annual Lecture of the Liberální Institut; at the board from the left: Jiří Schwarz and Sir Roger Douglas. (Prague, the Adria Palace, October 26<sup>th</sup>, 1998.)
5. Sir Roger Douglas delivers the Annual Lecture of the Liberální Institut. (Prague, the Adria Palace, October 26<sup>th</sup>, 1998.)
6. Again in the Liberální Institut: Sir Roger under the portrait of Friedrich August von Hayek, having a look at the books published by the Institut, especially at the Czech translation of *Liberalism* by Ludwig von Mises. (Prague, October 27<sup>th</sup>, 1998.)
7. Sir Roger among the members and collaborators of the Liberální Institut. (Prague, October 27<sup>th</sup>, 1998.)
8. Sir Roger Douglas in a discussion with the young workers and supporters of the Liberální Institut; from the left: Eva Dvořáková, Radovan Kačín, Dan Šťastný, Ing. Josef Šíma, Ing. Miroslav Zajíček. (Prague, October 27<sup>th</sup>, 1998.)
9. Sir Roger Douglas on a walk through Prague with Jiří Schwarz and Eva Dvořáková. (Prague, near the seat of the Liberální Institut, October 27<sup>th</sup>, 1998.)

10. At a special seminar, “The New Zealand Reform as Inspiration for the Czech Economic Transformation”: Sir Roger as making explicit his vision of a successful economic reform.  
(The Liberální Institut, October 27<sup>th</sup>, 1998.)
11. Sir Roger in a debate with Jiří Schwarz and Miroslav Ševčík.  
(The Liberální Institut, October 27<sup>th</sup>, 1998.)
12. Sir Roger and Jiří Schwarz in a pleasant mood caused by coming to full agreement on the principal questions.  
(The Liberální Institut, October 27<sup>th</sup>, 1998.)
13. Sir Roger in the moment when, reacting to the question “How did you manage it?” gives the following answer: “Our then prime minister, Sir Robert Muldoon, got drunk one night and called it a snap election. The result of calling a snap election 4 months ahead of time was that we as a party didn’t have to have a manifesto. We got elected without a manifesto. In true tradition of Labour parties, we published one after the election, which was the silliest thing we ever did, but nevertheless we didn’t have one during the election and it gave us a lot more freedom.”  
(The Liberální Institut, October 27<sup>th</sup>, 1998.)
14. Sir Roger Douglas with Josef Šíma (at the left).  
(The Liberální Institut, October 27<sup>th</sup>, 1998.)
15. Sir Roger Douglas’ meeting with the representatives of political and economic life in Karlovy Vary (Carlsbad); from the left: Ing. Josef Singer, Chairman of the Board of Trustees of Bristol a.s. (Bristol Hotel Company, PLC), Michael Kuneš, MP (Committee for Constitution and Legislation), Ing. Josef Remeš, Director General of Bristol a.s., Sir Roger, JUDr. Josef Pavel, Lord Mayor of Karlovy Vary, Ing. Edmund Janiš, Deputy of the City Parliament of Karlovy Vary.  
(Karlovy Vary, October 24<sup>th</sup>, Hotel Bristol.)
16. Sir Roger Douglas delivers the Annual Lecture of the F. A. Hayek Foundation Bratislava; at the board from the left: Ing. Slavomír Hatina, President of Slovnaft Holding, a.s. (Slovnaft Holding, PLC) and Ján Oravec, PhD., President of the F. A. Hayek Foundation Bratislava.  
(Bratislava, October 28<sup>th</sup>, Hotel Devín.)
17. After the Annual Lecture: Sir Roger Douglas in a discussion with Ludker Burstedde, Ambassador of Germany to Slovakia (in the middle), and Laureano Cardoso, Ambassador of the Republic of Cuba (at the right).  
(Bratislava, October 28<sup>th</sup>, Hotel Devín.)

# **LIBERÁLNÍ INSTITUT**

## **THE CENTRE FOR DEVELOPMENT OF INDIVIDUAL FREEDOM, PRIVATE OWNERSHIP, FREE MARKET, AND THE RULE OF LAW**

*We need courageous thinkers who are not influenced by tempting flattery, and who are prepared to battle for ideals, even if the chance of immediate success is still quite small.*

Friedrich August von Hayek

The Liberální Institut is an independent, non-profit organization aimed at development and application of classical liberal ideas and programs, such as:

- inalienable rights of each individual and the value of human life
- the principle of voluntary action in human activity
- the institution of private ownership, freedom of contract, and rule of law that are essential in the protection of human rights
- a self-regulating market, free trade, and a well-defined framework for the activity of government in the legal state

The Liberální Institut was founded on February 28<sup>th</sup> 1990 as a result of the initiative of leaders of the F. A. von Hayek Liberal Association, set up to support the social changes during the events of November 1989.

The Liberální Institut is financed from its own funds – proceeds from its activities, and through donations from individuals and private organizations.

# THE YEAR'S STANDARD PROGRAM

Over the past eight years, the programme of the Institut has come to include, but not be constrained to, the following activities:

## **I. Research**

1. Specific research projects, as listed below
2. Presentations in the form of discussion-fora, colloquia, and conferences

## **II. Education**

1. Economics for Future Leaders and Their Teachers (August/September)
2. The Liberální Institut Summer University (June)
3. The Road to a Free Society (a seminar on the transformation of former totalitarian societies – September/October)
4. The Gary Becker Prize for the best student paper in economics (May)

## **III. Public Service**

1. The Liberální Institut Annual Lecture (February/March)
2. Regular discussion-fora on current affairs (monthly)

## **IV. Publishing**

1. Annual presentation of the most significant book published by the Liberální Institut (September/October)
2. Publication of press-releases from the discussion-fora (monthly)

## **I. RESEARCH**

Liberální Institut's research activity is concerned not only with the process of transformation of Czech society at a macro-level, but also with analysis of these processes in other transition economies. With the continuing transition of our society and economy, we are increasingly turning our attention to the microeconomic sphere and the conditions necessary for private sector development. We study issues of legal framework, state regulation, and the efficiency of state administration.

Research activity of the Liberální Institut currently consists of the following projects:

- 1. Macroeconomic Analysis and Construction of an Index of Economic Freedom**
- 2. Deregulation of the Electricity Market**
- 3. Railroads as a Component of the Transportation Market**
- 4. The Capital Market in a Transition Economy**
- 5. Pension System Reform and the Role of Pension Funds**
- 6. Free Market Approach to Environmental Protection**
- 7. The Cost of Trade Protectionism in the Czech Republic**
- 8. Tax Reform in the Czech Republic**
- 9. Individual Health Accounts and Insurance Plans**
- 10. The Liberal Paradigm**

Liberální Institut's research activity also covers areas of theoretical research, which mainly follow from the philosophical-methodological heritage of F. A. von Hayek. The **Theory of Spontaneous Order** project holds the dominant position in this field.

Discussion-fora, colloquia and conferences represent important forms of research presentation. Liberální Institut is organizing them in cooperation with foreign institutions and universities. They are attended by eminent scientists, politicians, and entrepreneurs. The Mont Pèlerin Society Regional Meeting "A Search for Transition to a Free Society," which took place in Prague in 1997 was organized by the Liberální Institut and was definitely an unforgettable event

## **II. EDUCATION**

After the political changes of 1989, general economic education in the Czech Republic fell by the wayside. In addition to a shortage of qualified teachers there was also a lack of quality textbooks.

The Liberální Institut made a significant contribution towards solving this problem. A group of its fellows translated the well-known economic textbook by Paul Heyne *The Economic Way of Thinking*. This was the first standard economic textbook published in the Czech Republic in almost fifty years, and the entire edition of 20 000 pieces was sold. In addition, many prestigious professors lectured in Prague on the invitation of the Liberální Institut. The

appearance of Milton Friedman in 1990 and 1997 enjoyed the greatest public response.

The Liberální Institut promotes the development of general economic education by awarding **The Gary Becker Prize for the best student paper in economics**. This method of providing financial support to top students is realized in cooperation with the Faculty of Economics and Public Administration at the Prague University of Economics.

In 1991, the first “Road to Economic Thinking” conference was organized in cooperation with the Foundation for Teaching Economics (FTE). 310 people took part in this conference, and it was held again the following year thanks to its initial success.

Since 1993 we organize with FTE a week-long seminar, “**Economics for Leaders and Their Teachers,**” and since 1998 a week-long seminar, “**Financial Economics for Leaders and Their Teachers.**” We have learned from experience that no method of supporting ideas and knowledge is more effective than through teachers. Thirty high-school students and thirty high-school teachers take part in the program. This seminar has been a great success story and the demand expressed by submitted applications exceeds our capacity several times over.

The Liberální Institut, in cooperation with the Centre for Liberal Studies, holds a week-long seminar entitled **The Liberální Institut Summer University** for graduate and undergraduate university students. Through lectures and discussions, participants become familiar with the theoretical concept of classical liberalism, especially in the fields of philosophy, economics, history and law. **The Liberální Institut Summer University** is one of the projects of the Liberální Institut that have an international character and importance. It is made up of lecturers who are active, well-known liberal thinkers from the U.S., Germany, Switzerland, Belgium, and Slovakia, and young liberal students from the Czech Republic, Slovakia, and Poland.

More than 5000 people have participated in the seminars and workshops held by the Liberální Institut. The topics of these workshops include: “Accountancy, Auditing and Financial Management of a Firm in the European Union,” “Assessment of Companies in the Privatization Process,” “Preparing Privatization Projects,” “The Commercial Code – a New Legal Norm,” and “The Investment Funds and Companies Act,” just to name a few.



### III. PUBLIC SERVICE

Since its foundation, the Liberální Institut has publicly addressed current political and economic events not only in the domestic arena, but also in foreign affairs. Articles and comments by the Liberální Institut authors have been published in numerous domestic periodicals. These topical issues were also the subject matter of many of the Liberální Institut's publications. These booklets are published in cooperation with the Centre for Liberal Studies, and deal with problems of capital market deregulation, professional chambers, The University Act, rent liberalization and the privatization of apartments, etc. These topics have been presented in **the discussion-fora** (as a part of the Freeman Discussion Club network), in which authors, opponents, members of the Government, members of the Parliament, academics, and journalists participate.

The Liberální Institut celebrated the opening of the Friedrich A. von Hayek Library in March 1995. Participants included Gary Becker, dr. Laurence Hayek, and other famous thinkers. This library is our contribution to the promotion of classical liberal texts and to the improvement of services for Liberální Institut research fellows.

The occasion of the Liberální Institut's 5<sup>th</sup> anniversary was marked by the **Liberální Institut's Annual Lecture**, which took place in March of 1995. The first speaker was **Gary S. Becker**, a Nobel prize-laureate in economics. His speech was an impressive contribution to this tradition. The Liberální Institut's Annual Lecture in 1997 was given by **Milton Friedman**, who enjoyed a great reception from Czech media and society. In 1998, the Liberální Institut's Annual Lecture entitled "Criteria for the Evaluation of a Successful Economic Reform" was delivered by **Sir Roger Douglas**, the former finance minister of New Zealand and author of an extraordinarily successful liberal economic reform, known in the theory of economic policy as Rogernomics.

### IV. PUBLICATIONS

The Liberální Institut, through its translations and publications, has become an important player in the promotion of liberal ideas, opinions and theories in the Czech Republic. The following books (in Czech) have been or are set to be published by the Liberální Institut:

Paul Heyne: *The Economic Way of Thinking* (1990) [in cooperation with the Prague University of Economics]

Milton and Rose Friedman: *Free to Choose* (1992)

Milton Friedman: *Capitalism and Freedom* (1993)

Detmar Doering, ed.: *Small Textbook on Liberalism* (1994)

Robert Holman: *Evolution of Economic Thinking* (1994)  
 Friedrich August von Hayek: *The Counter-Revolution of Science* (1995)  
 Ján Pavlík, ed.: *Gary Becker in Prague* (1996)  
 Milton Friedman: *Money Mischief* (1997)  
 Milton Friedman: *The Methodology of Positive Economics* (1997)  
 Gary S. Becker: *Accounting for Tastes* (1997)  
 Ján Pavlík, ed.: *Milton Friedman in Prague: Ideas, Comments and Wisecracks* (1997)  
 Ludwig von Mises: *Liberalism* (1998)  
 Israel Kirzner: *How Markets Work* (1998)  
 Frédéric Bastiat: *What Is Seen and What Is not Seen* (1998)  
 Josef Šíma, Ján Pavlík, eds.: *Roger Douglas: Author of the Most Successful Economic Reform of the XX<sup>th</sup> Century* (1999)  
 Henry Hazlitt: *Economics in One Lesson* (1999)  
 Friedrich August von Hayek: *Denationalization of Money* (1999)  
 Ken Schoolland: *The Adventures of Jonathan Gullible* (1999)  
 Murray Rothbard: *Power and Market* (1999)

These books have been published in a circulation of 3000-5000 pieces, and have been distributed to bookshops in the Czech Republic and Slovakia. At the beginning of the 1990's, the bestseller in the Czech Republic, and likewise in the U.S., was *Free to Choose*. It sold out in four months.

The publication activity of the Liberální Institut includes, in addition to the aforementioned books, the following titles, published in cooperation with the Centre for Liberal Studies:

J. Pavlík: *On the Principal Prerequisites for a Liberal Democracy* (1990)  
 J. Schwarz: *Guide to Free Market Economics I.* (1992)  
 J. Schwarz: *Ronald H. Coase – the Nobel Prize-Laureate in Economics in 1991* (1992)  
 J. Vaněk: *Teleology of Karel Engliš and Liberalism* (1992)  
 O. Schneider: *Liberal Economics and Tax Policy* (1992)  
 J. Pavlík: *The Decline and Ascent of the Expected Utility Theory* (1992)  
 R. Raico: *Classical Liberalism in the 20<sup>th</sup> Century* (1993)  
 O. Schneider: *Negative Income Tax and Its Application in the Czech Republic* (1993)  
 T. Ježek: *Money* (1993)  
 R. Holman, Z. Šrein, M. Erbenová: *Deregulation in the Czech Economy* (1995)  
 M. Hemelík: *De Libertate* (1995)  
 J. Vaněk, D. Slouková: *Hayek's Defense of Freedom* (1995)

- O. Schneider, M. Horálek, O. Výborná: *State Pension Systems – A Time Bomb?* (1995)
- R. K. Filer, P. Rychetský, M. Strapec: *Liberalization of the Apartments' Market in the Czech Republic* (1995)
- J. Šťastný, J. Biskup, J. Pfeiffer, J. Vrbík: *Application of Individual Approaches to Healthcare for the Disabled* (1995)
- Z. Suda, J. Musil: *Germany 1995: Balance and Outlooks* (1995)
- M. Znoj, ed.: *Our Contemporary Disputes About Liberalism* (1995)
- J. Staša, V. Roskovec, M. Ševčík: *Universities: Independence or State Paternalism?* (1996)
- K. Čermák, V. Kupka, B. Svoboda: *Profession Chambers* (1996)
- J. Dědič, D. Tříška: *About the Nouvelle of the Commercial Code* (1996)
- V. Bělohradský, J. Musil, J. Novák: *The Civic Society* (1996)
- R. Dahrendorf, B. C. Witte, R. Jaworski: *Friedrich Naumann: A Contribution to the Understanding of Personality and Work* (1996)
- W. Hamm: *It is a Time of Changes – Apartments Policy versus Economic and Social Claims* (1996)
- M. Ševčík, J. Sedláček, L. Štícha, T. Ježek: *Evolution of the Czech Capital Market in the Short-Term Period* (1997)
- Quo Vadis, Social Democratic Party?* (1997)
- Quo Vadis, ODS?* (1997)
- J. Kinkor, O. Dědek, Z. Revenda, P. Zahradník: *Free Banking* (1998)
- J. Schwarz, M. Ševčík, J. Sedláček, L. Štícha,  
D. Tříška: *Will a Functioning Capital Market Arise in the Czech Republic?* (1998)
- L. Dušek, ed.: *Deregulation of Electricity Markets: An American Perspective* (1998)
- L. Dušek: *Competiton – the Road to Effective Production and Consumption of Electric Energy* (1998)
- A. Blanická, P. Pečený: *Do We Keep Away from Unfair Competiton?* (1998)
- P. Bém, J. X. Doležal, M. Volný: *Drugs and the State* (1998)
- D. Herman, M. Brož, Z. Novák, D. Štys: *On Relations between Church and State* (1999)

The Liberální Institut, together with the Centre for Liberal Studies, prepared two half-hour film documentaries for Czech TV about Gary S. Becker and Milton Friedman, and their visits to the Czech Republic. Both of these enjoyed an outstanding viewer response.

# LIBERÁLNÍ INSTITUT

**President:**

Dr. Jiří Schwarz

**Director:**

Dr. Miroslav Ševčík

**Deputy Director for Research:**

Ing. Josef Šíma

**Projects Co-ordinator:**

Ing. Jana Preuhslerová

**Projects Managers:**

Miroslav Ševčík, Jiří Schwarz, Michal Uryč-Gazda

**Macroeconomic Analysis and Construction of an Index of Economic Freedom**

Libor Dušek, Miroslav Zajíček

**Deregulation of the Electricity Market**

Emanuel Šíp, Jan Vorlíček

**Railroads as a Component of the Transportation Market**

Jiří Schwarz, Miroslav Ševčík

**The Capital Market in a Transition Economy**

Ondřej Schneider, Tomáš Jelínek

**Pension System Reform and the Role of Pension Funds**

Michael Volný

**Free Market Approach to Environmental Protection**

Dan Šťastný, Milan Žák

**The Cost of Trade Protectionism in the Czech Republic**

Miroslav Ševčík, Jiří Schwarz

**Tax Reform in the Czech Republic**

Robert Holman, Jan Šťastný

**Individual Health Accounts and Insurance Plans**

Jiří Schwarz, Miroslav Ševčík, Borek Severa, Dušan Tříška, Ján Pavlík, Petr Mach, Josef Šíma

**The Liberal Paradigm**

Ján Pavlík

**Theory of Spontaneous Order**

**Secretariat:** Petra Vondrová, Martina Bartošová, Helena Havránková

**Executive board:** Dr. Jiří Schwarz, Dr. Miroslav Ševčík, Associate Professor Ján Pavlík,  
Ing. Petr Šíma, Professor Milan Žák

**The further development of the Liberální Institut's activities depends greatly on the goodwill and support of those institutions and individuals who have, besides their belief in liberal principles, made an effort to promote specific projects and their application. We assure all those institutions and individuals that if they decide to support the Liberální Institut's activity with financial donations and sponsorship, their contributions and gifts will be used in the most effective way to benefit the development of a free society.**

**The bank connection of the Liberální Institut's bank account number is: 559488/5100**

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## ON THE F. A. HAYEK FOUNDATION BRATISLAVA

The F. A. Hayek Foundation was founded June 12, 1992 in Bratislava as a non-governmental, independent and non-partisan institution:

- ☞ representing a broad platform, it brings together social scientists, business people, and policy-makers to exchange their ideas on economic, social, political and other issues
- ☞ providing practical reform proposals for the transition of economics, health, education, social welfare, retirement and legislative systems
- ☞ establishing – until 1989 virtually absent in Slovakia – *a tradition of liberal thinking* and cultivating it further in order to demonstrate the advantages of market economy solutions over collectivist policies
- ☞ promoting the following liberal ideas and values:
  - ◆ **a free market economy** and **an open society** based on the concept of **individual choice** and **personal responsibility**,
  - ◆ **limited government**, which creates a supportive social and economic framework by its more cost-effective activities and **tax reductions**.

The members of the foundation have very good relationships with foreign partner institutions, which enables them to participate in discussions about problems that are common to Western Europe, the USA, and Central and Eastern Europe (deregulation, social security reform, etc.). It also creates a good opportunity to invite important personalities to Slovakia.

The institute cooperates most with American and European foundations such as the Cato Institute, the Heritage Foundation, the ATLAS Foundation (USA), TIMBRO (Sweden), Friedrich-Naumann-Stiftung (Germany), the Adam Smith Institute (GB), and the Liberální Institut (Czech Republic), etc.

Thanks to this cooperation, a lecture by **Kurt Leube** of Stanford University, USA, could take place in the summer of 1994. Leube is a close friend and colleague of **George Stigler**, an important representative of the so-called Chicago economic school and a Nobel Prize holder,.

In October of 1996, the president of the Adam Smith Institute in London (the think tank of Margaret Thatcher's government), Mr. **Eamonn Butler** visited Slovakia for the publication of the Slovak translation of his book, *HAYEK: His Contribution to the Economic and Political Thought of Our Time*. His stay (organized with the co-operation of the Institute of Liberal

Studies in Bratislava) was combined with a lecture for the public, a discussion with experts, and a press conference.

In April of 1997, foundation representatives came to Prague to take part in meetings with Milton Friedman, a Nobel laureate in economics who was on a visit there arranged by the Liberální Institut. Their stay in Prague was also occasioned by Friedman's acceptance of an honorary doctorate from the Prague University of Economics.

The F. A. Hayek Foundation Bratislava **Annual Lecture 1998** took place on October 28, 1998 as the first of a series of lectures which aim to create the opportunity for a Slovak audience to listen to highly distinguished people who have a significant influence on the economic and political course of their countries.

This lecture helped create a platform for the regular invitation of very respected foreign personalities who could promote liberal principles in Slovakia. At the same time, it helped to strengthen the access of top Slovak academic and business circles to recent trends in economic theory and policy.

The first foreign personality invited to give a speech at the annual lecture of the foundation was **Sir Roger Douglas**, New Zealand's former Minister of Finance. During the 1980's, he succeeded in changing the New Zealand economy from the most regulated to one of the least and most developed in the OECD.

# ČESKÁ POJIŠŤOVNA

Česká pojišťovna, joint-stock company, is a universal insurer offering a complete range of insurance, both life and non-life, in the following areas:

- life and retirement insurance
- accident insurance
- travel insurance
- foreign medical expense insurance
- property and casualty (P&C) insurance for individuals
- insurance for industry and business, both domestic and foreign
- agricultural insurance
- in addition to the above forms of insurance, Česká pojišťovna also offers active reinsurance.

Česká pojišťovna keeps in contact with many partners in the insurance sector, both at home and abroad. It is a member of a number of international insurance associations, as well as domestic organizations.

## **Domestic Organizations:**

- ČAP (The Czech Insurance Association - Founding Member)
- Union of Banks and Insurance Companies
- Bank Association (Affiliated Member)
- Czech Nuclear Pool

## **Foreign Organizations:**

- International Union of Aviation Insurers (IUAI)
- International Union of Marine Insurance (IUMI)
- International Credit Insurance Association (ICIA)
- International Association of Hail Insurers (AIAG)
- International Association of Hail Insurers (AIAG)
- Council of Green Card Offices



# THE PPF GROUP

The PPF Group is one of the largest financial groups in the Czech Republic and its structure has been tailored to the needs and conditions of the Czech Republic's changing economic environment.

The PPF Group has been a participant in the Czech capital market since 1991. Today, it offers its clients a wide range of capital services, including securities trading, investment management, underwriting issues of stock and bonds, and presentational support to investors.

The PPF Group is a significant shareholder in many large Czech companies. In selecting companies for the acquisition of strategic stakes, the Group focuses on the financial and other perspective sectors. The Group is an active shareholder, and is aware of its responsibilities towards companies and other shareholders.

The PPF Group has also entered the real estate business. It is currently building a Republic-wide office network so that it can manage and develop its clients' real estate needs at optimum economic and efficiency levels.

The PPF Group contains several independent entities active on the Czech markets.

## **Members of the PPF Group:**

### **PPF INVESTIČNÍ SPOLEČNOST A.S.**

Administers two mutual funds with total assets of nearly CZK 1,5 billion. Its portfolio consists of a mix of strategic and portfolio investments in the Czech Republic and an increasing portfolio of overseas stocks, focusing on growth as well as trading opportunities.

### **PPF INVESTIČNÍ HOLDING A.S.**

A company holding assets with a market value of CZK 2,3 billion. The portfolio consists primarily of strategic stakes, largely in companies in the financial sector.

### **PPF BURZOVNÍ SPOLEČNOST A.S.**

PPF burzovní is one of the largest securities traders on the Czech capital markets. It is a member of the Prague Stock Exchange and a Special Customer of the RM-System.

### **PPF CAPITAL MANAGEMENT A.S.**

This company is responsible for administering strategic investments. Through formulating medium and long-term strategies, carrying out restructuring programs, and influencing acquisition policy in Group companies, the PPF Capital Management contributes highly toward increasing the value of assets it administers.

### **PPF MAJETKOVÁ A.S.**

PPF majetková was established to manage and develop real estate funds. It became the first company to receive a permit to carry on such activities in the Czech Republic.

At the invitation of the Liberální Institut, and thanks to the generous contributions of Česká pojišťovna, and the PPF Group, sir Roger Douglas came to the Czech Republic and Slovakia in October of 1998. Douglas was New Zealand's renowned Minister of Finance during the latter half of the 1980's, and the architect of what would henceforth be called "Rogernomics," highly successful economic reforms that brought radical recovery to New Zealand's collapsing economy. The most important event during his stay in Prague was his speech, held at the "Liberální Institut's Annual Lecture," in which Douglas explained to leading actors in Czech economic, political, and scientific life the basic principles of his economic reform: a reform that was made in favour of and to benefit the worst organized interest group - consumers. Douglas' speech and his ideas complemented the speeches of the foremost liberal economists and Nobel Prize laureates G. Becker and M. Friedman, who delivered the Liberální Institut's Annual Lectures in previous years.

Some of Douglas' ideas:

The government isn't able to care for us or any one of us as much we are able to care for ourselves.

The experience in New Zealand is that wherever we have introduced a real quality decision, where we asked ourselves, "What is in the best interest of New Zealand?," worked it out, and then implemented it, the problems that we were trying to overcome went away.

I think speed is important in any program of change. You can't really go fast enough. The truth is, the political system will always slow you down. The bureaucracy will always slow you down. I don't mean that in a nasty way, about the bureaucracy, but it just takes time to put in the legislation and get it passed. In any case, it takes time from putting a program in place before you see the benefits. If you take too much time, the general consensus in the country that something needs to be done is lost. People don't see the benefits. Speed is pretty important.

Politicians should not underestimate the ability of their citizens to adjust if the change is real.

Wherever we compromised, wherever we went half-way, wherever we did something with less than quality, then the problems in New Zealand are still there, particularly health, education and welfare.



**ČESKÁ POJIŠŤOVNA**

PRINCIPAL SPONSOR



PRINCIPAL SPONSOR