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GOVERNMENT IN THE NEW ZEALAND ECONOMY

G. R. Hawke

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By: G. R. Hawke

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GOVERNMENT IN THE NEW ZEALAND ECONOMY

FOREWORD

The Planning Council has invited a number of experts to contribute to its work on the public sector. In April 1980 the Council published The Stabilisation Role of Fiscal Policy by R.S. Deane and R.G. Smith and in May 1981 Measuring the Cost of Government Services by Ian Ball. Other papers and reports are in various stages of preparation.

Government in the New Zealand Economy by Dr G.R. Hawke provides an historical perspective to the intervention by the government in New Zealand's economic activity. The work gives important insights to those who make judgements about the desirable role of government intervention in the decade ahead. It is thus a major contribution to the discussion of the appropriate economic role of the government in New Zealand. I hope that the work will be widely read and its findings taken into account when changes in the government's role are being considered.

Frank Holmes
Chairman

I. THE ISSUES

Governments are natural targets for criticism. From time to time this concentrates on their economic role. Comments tend to follow overseas fashions with successive foci of media attention being presented as new discoveries of weakness, if not ineptitude. Academic discussion is somewhat less discontinuous, but too frequently it fails to set issues in a long-term perspective. In the early 1960s, attention internationally was directed to the "displacement effect" expounded by Peacock and Wiseman.[1] They suggested that governments had an inherent tendency to expand their share of economic activity so that all influential groups could be induced to support a munificent government; in normal times, governments were restrained by the unpopularity of taxes; in times of emergency, especially wars, the constraint was relaxed; governments then expanded their economic role and were not subsequently required to return to former levels. Thus the share of government expanded in a series of plateaus with each displacement marking some national emergency. This was recognised by Peacock and Wiseman as a sophistication of a much older "Wagner's Law", a simple postulation of an expanding tendency in governments.

The fruitfulness of the "displacement effect" varied from country to country. In the case of New Zealand, the evidence available in the 1960s suggested that if New Zealand differed from international experience, it was in not having experienced a marked increase in government's share of economic activity after the Second World War. A postwar expansion of the economic role of governments could explain why they attracted more attention and criticism overseas, but could not be taken to apply to New Zealand too. Nevertheless, intermittent attacks on the economic role of New Zealand governments continued through the 1960s.

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1. A.T. Peacock and J. Wiseman, The Growth of Public Expenditure in the United Kingdom (London: Oxford University Press for National Bureau of Economic Research, 1961)

There was a new impetus from overseas in the 1970s. In November 1974 the Sunday Times of London published the first of a series of articles by Bacon and Eltis tracing Britain's economic problems to an undue expansion of the public sector.[2] The movement towards restraining government expenditure in the United States was well under way by the mid-1970s, being symbolised by Californian Proposition 13 which set limits to property taxes. These themes were readily absorbed into local political discussion and phrases like "reversing the growth of socialistic restrictions on freedom" and "cutting the bureaucracy to size", which had been part of local political stock in trade since at least 1949, seemed to have renewed force in the 1975 election campaign.

More serious discussion soon showed that the issues involved were complex.[3] Exactly what should be counted as government economic activity? Public corporations and government departments which operate as commercial undertakings are only two of the definitional problems involved. What criterion of economic activity should be employed? Government's share of the labour force may differ from its share of income creation and both may differ from its share of spending if only because governments make grants to individuals so that public and private spending overlap. Are we concerned with the availability of resources in a physical sense, or equally concerned when social changes such as equal pay for women result in an increase in the relative value of the resources used by government? These are all conceptual issues, and they are further complicated by deficiencies or ambiguities in the relevant empirical information. Now that improved data are available for the 1970s and have been reconstructed for the 1960s, albeit less securely, the issues are worth exploring again and that is done in other papers commissioned by the New Zealand Planning Council.

2. Robert Bacon and Walter Eltis, Britain's Economic Problems: Too Few Producers (London: Macmillan, second edition, 1978).

3. See especially Mervyn J. Pope, The Public Sector Overload - Is there any? (Wellington: N.Z. Institute of Economic Research, Occasional Paper No. 5, 1978), and "Is the Government really taking too big a bite?", N.Z. Economist (May 1978), pp 3-4

However, these papers will necessarily leave room for different judgements about the relative importance of trends that can be established, and they will not answer all the possible charges that can be levelled against government's economic role. Nothing can be done to answer those that are really a general complaint that the world is not as we would wish, but there are other questions about how the government came to have the economic responsibilities it has and whether the reasons for intervention in the first place remain valid. Such enquiries can be seen as directed to establishing the motivations which underly government's share of various aspects of the economy. They can also be regarded as a search for reasons for dissatisfaction with government independent of the size of its economic role. When their arguments fail to carry the day with policy-makers, economists often find consolation in Keynes's famous dictum that ideas eventually prevail over vested interests:

> Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately, but after a certain interval; for in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five or thirty years of age, so that the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest. But, soon or late, it is ideas, not vested interests, which are dangerous for good or evil.[4]

But the dictum has other implications. When popular ideas persist for a long time and are not removed by greater understanding of certain aspects of the broad area of enquiry, there is often a still unanswered question in a related field.

I therefore seek to complement studies of the size of government's economic activity in recent decades by enquiring

4. J.M. Keynes, The General Theory of Employment, Interest and Money (London: Macmillan, 1936), pp 383-4.

into the basis for intervention as it evolved in New Zealand. I seek in particular to elucidate any change in that basis in the postwar economy such as will provide an alternative or supplementary explanation for continuing dissatisfaction.

II THE ORIGINS

For most of the nineteenth century, Britain's theorists and politicians were moving towards a less interventionist view of the state. It was only in the seventeenth century that a more or less clear distinction was made between the finances of the state and those of the monarch. In the eighteenth century, public funds were used to support the private privileges of those to whom their management had passed. Partly in reaction against that, nineteenth century thought and practice moved in the direction of reducing state interference in private activity. Writers from Adam Smith onwards also saw positive merits in permitting private enterprise freedom from the restraint of special privileges. The careful and systematic thinkers who had most influence never tried to eliminate the state; they sought to avoid imposing burdens and hindrances in the way of private activity. Some people advocated complete freedom from government interference but their views did not prevail. Laissez faire meant freedom to act within certain general restraints such as state enforcement of contracts and regulation of monopolies which were designed to prevent private actions which could not be reconciled with the public interest.

British ideas were readily disseminated in New Zealand, but these particular ideas did not carry great weight with colonial decision-makers.[5] The role of government was worked out mostly in the light of local realities. As early as 1854, the Canterbury politician, Sewell, referring to another leading Canterbury politician, FitzGerald, noted in his diary:

> In the Evening a Meeting of the Colonists' Society to consider the best way of improving the Town which needs improvement sadly. Here is a controversy. What ought government to do? What the people themselves? And how are things needed to be done at all? Nobody has clear notions. FitzGerald's

5. G.R. Hawke, "Acquisitiveness and Equality in New Zealand's Economic Development", Econ. Hist. Rev. Sec. Ser., XXXII (1979), pp 376-90.

> (preposterous) measure for providing "useful and necessary works" of all kinds of Rates,* has been thrown out. Some people want Government to do everything. FitzGerald wants people to do everything themselves without Government help, keeping the money for main roads and for immigration ... The question how to provide for public works is a question of circumstances. Where the immediate benefit is private, things should be done by individuals: footways and pavements are always considered of this class, adjuncts to Houses. In England they are generally made in the first instance at the expense of the adjoining Proprietors, and afterwards repaired by public rate. Roads are matters of public concern. I do not know exactly what line to draw here. If there were an old established liability as that of Parishes in England, or if the Settlement were subdivided as in England into Parishes, Counties etc., it would not be difficult to make the liability local - but as yet there are no divisions and no fixed rates ... But people did undoubtedly buy with the vague notion that the roads would be made somehow, and when the time is clearly arrived for their completion that is when particular lines of street or road are fully occupied, I think the liability rests on Government to finish the work in the first instance, leaving it to be afterwards repaired by local rate.[6]

Sewell was more of a High Tory than most colonists, but his eventual turning to government would certainly have been endorsed by subsequent generations.

Even Sewell saw the need to consider the boundary between public and private activity in a colonial context, and that brought a great deal more government activity than would have been approved in contemporary England. With hindsight, we can see three broad motivations for government action in nineteenth century New Zealand. Government undertook those activities which by their nature required governmental intervention: it inherited diplomatic and public order functions from Britain. Thus it created diplomatic offices, provided police and a court system, and exercised the power to borrow on the security of the essentially coercive power to levy taxes to fund repayments and interest obligations. The last of these was much more important, and the first much less, than in England. Second, New Zealand governments inherited powers to protect New Zealanders

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* That is for financing public expenditure from local taxes.

6. W.D. McIntyre (ed.), Journal of Henry Sewell (Christchurch; Whitcoulls 1980), Vol. II, pp 488-9.

against foreigners, but this meant not gunboat diplomacy but the use of government corporations or government patronage of local concerns to compete with overseas business interests in New Zealand. Third, government used its ability to balance the powers of competing interests within New Zealand so as to maintain the close-knit and homogeneous character of a small settler community. Balancing interests could be defended in the terminology of laissez faire; British governments thought it legitimate to intervene when parties to a contract were not regarded as equal in power and able to look after themselves, as in matters like the working hours of women and children and eventually workers' compensation. But New Zealand governments carried the principle so far as to leave doubt over whether there was any area in which the government did not have a legitimate interest. Furthermore, in New Zealand, government was overwhelmingly central; Sewell's hope that municipal governments would be established was partly met, but from the 1870s local government was weak relative to central. This is not unexpected in a community which even in 1930 was only 1½ millions in number. Central government was always accessible, and the colonial instinct was to use its powers and institutions wherever they were likely to be useful, irrespective of European ideas of propriety. European observers thought that New Zealanders practised socialism without doctrines, but they thought in European terms. New Zealanders simply found new roles for government in a pioneering society.

Government actions usually involve several people whose motives need not coincide. One cannot therefore neatly assign particular government interventions in the nineteenth century economy to one of the perceived motives for intervention. Rather, one must start from interventions and disentangle the motives underlying them.

III. GOVERNMENT INTERVENTION BEFORE 1930

Land Issues

Many of the key issues in nineteenth century New Zealand involved use of the land.[7] Government inherited responsibility for distributing land among settlers through the English legal tradition that "waste" land accrued to the public domain. It accepted responsibility for acquiring land from Maori owners (except for periods like 1862-94 when supervision of land purchases by individuals was delegated to a court system) for a variety of reasons. These included benevolence, since government was intended by some to ensure that Maoris unfamiliar with pakeha business practices should have some protection. There was also concern that private land transactions would lead to disputes and threats to peace and public order. And there was a fiscal motive in that a gap between the government's monopsonistic purchase price and its monopolistic selling price provided revenue for all the functions of government, including sponsorship of new immigrants to swell the settler community.

Government also introduced the "Torrens" system of land registration in the 1860s although it was not made mandatory until the 1920s. In essence, the system provided that title to a particular piece of land rested with the person registered as its owner in a centralised, government-organised set of files, rather than with the holder of deeds prepared by lawyers and tracing ownership from the original Crown grant. In one aspect, government used its powers to simplify the demonstration of property rights and to reduce the cost of transactions in land. In another, government used its powers to favour the interests of dealers in land, whether buyers, sellers, or lenders secured on it, at the expense of lawyers, for whose services colonial demand tended to outrun supply.

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7. The key sources are J.D. Gould, "The Occupation of Farm Land in New Zealand, 1874-1911: A Preliminary Survey", Business Archives & History V (1965), pp 123-41 and "The Twilight of the Estates", Australian Economic History Review X (1970), pp 1-26 and the literature cited therein.

Perhaps the most interesting government intervention with land ownership is its willingness to create and use a power of compulsory purchase from 1894 onwards. This was probably a minor element in the reorganisation of landholdings which was part of the response to market opportunities created by refrigeration. The new technology fostered a more intensive form of agriculture and the optimal size of landholding was reduced more by private transactions than by government intervention. It is nevertheless significant that the colonial parliament was willing to override the sanctity attached to the private ownership of land by British political theory, and that this was far from unpopular with most of the electorate. There were people who talked in terms of the arbitrary use of state power, but they were a minority of the political leadership and struck no chord in popular feelings. Rather, there was a perceived need for a redistribution of the land in the interests of society as a whole, even if the perception was often confused in slogans like undoing the "locking-up of the land" or "bursting up" the great estates. State power was a convenient supplement to the movement of the private market in the same direction. Compulsory purchase was directed against absentee owners and companies more frequently than against individual settlers.

Thus government intervention in the land market followed from all three of the motives we have discerned. There was an entirely orthodox concern with facilitating the enforcement of contracts, a desire to prefer settlers over "foreigners", and a desire to adjust the relative interests of groups within settler society.

Overseas Borrowing

Governments were also involved in decisions about the use of land, most clearly through their role in foreign borrowing. Governments were useful because they could borrow more cheaply than individuals, a premium being paid for the

guarantee that governments could offer because of their unique power to enforce payments of taxes. Government borrowing was common in the nineteenth century, being just as characteristic of the states of the United States as of New Zealand. What was less common was that government should itself engage in building railways or in other forms of capital formation financed by the borrowing. Government could reserve to itself decisions on railway routes if they involved non-commercial considerations, and still permit private railway-building while passing on the benefit of lower interest rates. That was the pattern evolved in the United States but it was exceptional in New Zealand. As the government became concerned about its total expenditure in the 1880s, it did indeed allow and subsidise some private railway-building such as the Wellington-Manawatu line and the link between Canterbury and the West Coast. But this was unusual. (In the latter case, the contractors were unable to fulfil their obligations and the contract was eventually resumed by the government itself; the line was not completed until the 1920s.)

The normal pattern was for the railways to be built by the government itself and that requires some explanation beyond the lower interest rates made available by its taxing power. The settlers wanted to control the building and operation of railways, and no body of colonists other than the whole community as represented by the government had the ability to buy the materials and expertise needed. Private railways would have introduced a new and probably foreign element into the delicate balance of interests constituting the evolving New Zealand society and could most easily be avoided by use of the government apparatus. The railways were not to be an independent economic power; their prices were controlled, eventually expressed as a limit of their return to 3 percent of the invested capital, with any surplus being returned to the users through lower charges. (Because of deficiencies in accounting for capital maintenance, the return was less than 3 percent.)

Concern of the colonists for control of the railway system was also shown in restrictions imposed on land grants to the abortive private contract for the Canterbury-West Coast line.

Government thus both facilitated railway-building and constrained it to serve the interests of colonists. In time, government ownership and operation of railways was a major factor in its attempts to "coordinate" the whole transport system.

The greater borrowing power of the State was turned to agricultural activities more directly in the Advances to Settlers scheme from 1894. This appears to be a simple matter, a use of the State's ability to borrow at cheaper rates when agriculture required investment to become more intensive. While that is basically correct, there was a little more to it. In the 1890s many British investors, both private and institutional, were anxious to withdraw funds from New Zealand. From 1888 it was public knowledge that the Bank of New Zealand had some difficulties. Those of the National Bank were acknowledged in formal reductions of capital in 1885 and 1891. A bank crisis in Australia in 1893 created doubts about the safety of investments in Australia and many people in Britain did not make a firm distinction between Australia and New Zealand. The Advances to Settlers scheme was, in effect, a use of State power to prevent the doubts of foreign investors from becoming a significant limitation on the development of New Zealand farming.[8] From there, it was easy to use the same State power for financing other activities such as workers' housing from 1908.

8. M.N. Arnold, "The Market for Finance in late Nineteenth Century New Zealand with special reference to Rural Mortgages". (M.A. thesis, Victoria University of Wellington, 1981)

Financial Sector

One can see a similar mixture of actions by governments for various kinds of convenience in the financial sector. The settlers overturned the British conception of the proper organisation of the currency under a State Bank of Issue as soon as they had the power to do so. Even though banks were then again permitted to issue their own notes, the government did not retire from the field. Power to regulate the currency derived from an ancient component of the royal prerogative and rested firmly with the government. Each bank therefore required a separate act of parliament, authorising it to issue notes and securing some protection of the public by imposing certain conditions such as a minimum holding of reserves in gold or government securities. To permit scrutiny of compliance with these conditions, returns had to be made quarterly and were published in the Gazette.

Beyond these duties inherent in the nature of government, the operation of the State apparatus required the services of a banker. At the same time, the government's need to remit funds between Britain and New Zealand made it a customer from whose account a banker could expect to derive profits. There was therefore a business relationship between the government and at least one trading bank. From its foundation in 1861 the Bank of New Zealand obtained almost all of the government's banking business. As was the case in most of the Australasian colonies, the government preferred to give its account to a "local" rather than an outside organisation. The government's business therefore had the effect of fostering a local bank at the expense of its competitors. The National Bank and the Colonial Bank made intermittent attempts to persuade the government that they were just as local as the Bank of New Zealand, but although their claims were sometimes acknowledged - they were after all, not Australian as the other banks were - they never obtained a significant share of the government's business.

Banks and settlers did not always agree, especially over the interest rate charged for bank loans. Unlike railways, the return on investment in banks was never limited, but there was a continuing lively concern with the level of interest rates, intensified no doubt by the existence for all but brief periods of an open agreement among the banks not to compete in prices charged for their services. Throughout the nineteenth century, there were advocates of a State bank whose competition would effectively regulate the interest rates charged by all banks and a State Bank League was especially active in the 1880s. It was unsuccessful. Most banks did not make surplus profits in nineteenth century New Zealand, and senior bank officials were able to persuade opinion-formers that there was no excess to be returned to bank customers through the competitive power of a State bank. The Bank of New Zealand did pay good dividends to its shareholders but they included many of the people who stood to benefit as bank customers from the successful operation of a State bank, and the dividends looked less wise when the Bank of New Zealand followed the National Bank in acknowledging losses in the late 1880s.

Government intervention in banking came not to prevent banks from gaining too much from their customers but to enable some banks to avoid collapse. The National Bank overcame its situation by writing off capital and calling more resources from its shareholders (the majority of whom were residents of Britain although between a quarter and a half lived in New Zealand). The Colonial Bank and the Bank of New Zealand both needed outside assistance. In the 1890s the government took power to declare bank notes to be legal tender so providing a defence mechanism against any panic-stricken attempt to withdraw bank deposits. The longer-term problems could be overcome only by giving the banks extra resources until they were able to realise the illiquid assets that had passed into their hands when borrowers defaulted. The government first guaranteed a loan raised by the Bank of New Zealand in London, assisted the Bank of New Zealand to absorb the Colonial Bank, and then

itself raised loans and purchased shares. Through the Assets Realisation Board, the government took over the task of realising the illiquid assets. There were voices which said that commercial organisations should reap the reward of their folly, but the opinion which prevailed was that the State's powers should be used to prevent a financial collapse which would bring hardship to a substantial fraction of the community. The government was simply the most convenient instrument available.

There was a price for this assistance: more formally, the government ensured that it was in a position to protect the public's investment in the bank. It appointed a president who had some independence from the board of directors, and even when that office was allowed to lapse, it retained the right to appoint some of the directors. By 1911, riding the refrigeration boom along with other banks, the Bank of New Zealand was in a position to dispense with government assistance and some of the shareholders and directors thought it was time for the government to retire. But the government did not share their view; the public had participated in hardship and it could do so in prosperity too. The Bank of New Zealand continued to have government shareholding until its eventual nationalisation in 1945. The government, however, saw little need to interfere with banking operations. It appointed directors and left them to combine with directors elected by shareholders and appoint a senior management who would ensure efficient competition with other banks. Concern about interest rates persisted, but the directors of the Bank of New Zealand were able to persuade leading politicians that those charged by the banks were reasonable. Proponents of a State bank remained unsuccessful although in the 1930s the more modern concept of a central bank found favour, and in the 1920s pressure on and by governments for lower interest on longer-term rural lending was one of the reasons for the creation

within the Bank of New Zealand of a long-term mortgage department especially devoted to such business.[9]

Governments were also concerned with other financial institutions. As early as the 1840s some settlers saw merit in copying the British trustee savings banks, essentially organisations whereby district notables provided a means of investment for small savers through aggregating their savings and lending on mortgage or buying government securities. Certain features of the British institutions were not retained. There was a smaller element of aristocracy and gentry performing good works for the deserving poor, simply because such distinctions were less apparent, and the trustees for individual banks were not self-perpetuating oligarchies, but were appointed by the governor (on the advice of his ministers from the 1850s). The British trustee banks were early enough to precede the diminution of government's involvement in the economy and they were given a subsidy to permit them to pay higher interest on deposits than they earned from government securities. In New Zealand, the trustee banks were given only a government guarantee of their deposits and their interest rates on deposits were governed by their returns on mortgages and other investments, for which the government prescribed various prudential rules intended to keep the trustee savings banks solvent. Under an ordinance of 1847 and an Act of 1858, trustee savings banks were established in Wellington (1846), Auckland (1847), New Plymouth (1850), Lyttelton (1855, becoming Christchurch in 1864), Nelson (1860), Napier, Dunedin and Invercargill (all 1864) and Hokitika (1866). One might see the growth of a regional network whereby small savings were facilitated and funds channelled into local mortgages, but the smoothness of its development did not continue. Under an Act of 1865, the Post Office Savings Bank began operations in 1867 and thereafter trustee savings banks were limited rather than facilitated by government actions.

9. N.M. Chapple, New Zealand Banker's Hundred (Wellington: Whitcombe & Tombs for BNZ, 1961); B.D. Moore and J.S. Barton, Banking in New Zealand (Wellington: Bank Officers' Guild, 1935).

The Post Office Savings Bank was derived from Britain where Gladstone (over optimistically) saw it as a means of eliminating the subsidy paid to trustee banks. Although no subsidy was involved, supplanting trustee banks was also favoured by some people in New Zealand. The original act empowered the Post Office Savings Bank to do so, and in 1870 the House of Representatives was willing to require the trustee banks to accept absorption but the Legislative Council deleted that clause. Wellington, in 1871, and Christchurch, in 1872, were absorbed voluntarily, followed by Napier in 1898 and Nelson in 1899, each of the last two following discovery of crippling managerial embezzlement. But the other five trustee banks struggled on, and eventually benefited from a new encouragement of local savings institutions in the 1950s.

The survival of the trustee savings banks was due to the presence in the Legislative Council of individuals who were trustees themselves and anxious to preserve their institutions, and to a more general concern with regional autonomy. When the provinces were abolished, the trustee savings banks were too small to worry about, although their legislative powers did require some amendments in the 1880s and 1920s, more in the nature of tidying up than substantial changes. What is less clear is the motivation for seeking to have the Post Office Savings Bank absorb the trustee banks. There are several possibilities. The first is that the Post Office Savings Bank was linked to the Post Office which necessarily had branches throughout New Zealand, including rural districts. It was simply fairer to see the facilities for small savings spread widely and the trustee banks were anomalous. The government was going to run a small savings institution and lingering responsibility for trustee banks was administratively inconvenient. Second, trustee banks invested in mortgages while the Post Office Savings Bank invested in government securities; there was therefore a financial incentive for the government to favour the Post Office Savings Bank. (The clause requiring absorption was a private member's measure, and the government declared its support while disclaiming any

responsibility for it, but such protestations cannot always be taken at face value.) Third, the Post Office Savings Bank was run by the representatives of the whole community while the trustee banks had an aura of deference to local notables. Whatever the relative strength of these motives, the Post Office Savings Bank became the main vehicle for small savings but the less-governmental trustee banks maintained a tenuous existence. Nevertheless, it can be observed that the Post Office, a government activity as part of the British tradition, was extended to small savings facilities as a useful addition to State activities despite the absence of the subsidy which led to the creation of the British Post Office Savings Bank.[10]

In a somewhat similar manner, the government became involved in the insurance field through the Government Life Insurance Office founded in 1869. An individual miner enquired whether New Zealand had an annuity scheme such as that run by the British Post Office Savings Bank and the Colonial Secretary set in train enquiries into the scheme. At about the same time Vogel, speaking as an ordinary Member of Parliament, drew attention to the failure of some private insurance companies and to the possibility that the State might usefully supplement the availability of schemes for saving through insurance policies. The two initiatives came together and an Act establishing a Government Life Insurance Office was passed in 1869. Operations began in 1870, initially using Post Office premises and staff, but gradually evolving a separate organisation. The first effect of Government Life was probably to make life insurance more readily available than it otherwise would have been. As sound private life insurance companies became more plentiful, the Government Life Office became a means for checking that the premiums charged did not provide them with excessive profits. The worldwide tendency from the late nineteenth

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10. The discussion of savings banks is drawn mostly from Parliamentary debates. See also Moore & Barton, Banking in New Zealand, and Howard Robinson, A History of the Post Office in New Zealand (Wellington: Government Printer, 1964), pp. 128-9

century was for mutual insurance companies to grow at the expense of proprietary ones; that is, schemes in which the gains from the investments financed by premiums were paid as bonuses to policy-holders excluding only a management fee, grew faster than schemes which provided dividends to shareholders. The existence of a government office then became only a check on the level of management fees. Nevertheless, the existence of Government Life again shows a willingness to use the government machinery where it could be useful, and as some private companies were foreign ones, as a check for the local community against overseas companies.[11]

This is shown by the State's movement into the fire insurance business. Despite the common use of the word "insurance", the fire and life businesses are different. Life insurance is essentially a savings scheme whereby income is invested in return for a later lump sum or annuity although it includes an element of collective sharing of the cost of premature death. It is often called "assurance" as the investor is assured of a return at some time, at least from a sound scheme. Fire insurance is more like the purchase of any other service; the payment of a premium buys security from some risk and there is no expectation of the premium being returned at a later date. Fire insurance is one class of risk, with accident and marine insurance being other important ones. Both forms of insurance involve collection of premiums, investment management, and payment of claims, so that it is sometimes convenient for a single business organisation to combine them.

The Government Life Office did not, initially, have cause to extend its activities beyond assurance. However, in the 1890s there was considerable dissatisfaction with the premiums charged by insurance companies and a suspicion that a ring led by some overseas companies was gaining monopoly profits at the

11. Cf. C.W. Vennell, Tower of Strength (Auckland: Wilson & Horton for Government Life, 1969)

expense of the New Zealand community.[12] The simplest device to prevent this from happening, and to show that it was not, was for the government to enter the field. A State Fire Office was established. There was initially some confusion between the spheres of insurance and assurance; it was the Government Life Office which began accident insurance in 1901 when employers were made more responsible for accidental injury to their employees, but the business was transferred to the State Fire Office in 1924.

The payment of pensions to former employees on other than a charitable basis became more frequent as the nineteenth century drew to a close. The government's first involvement was through being itself an employer, and a civil servants' scheme was provided by the Government Life Office from 1893. In the early twentieth century, a separate Government Superannuation Fund was established. It was then realised that the government's organisation could be useful to a wide range of small businesses unable or unwilling to operate their own schemes. The National Provident Fund was the result.

Yet another case where the government was simply the most convenient way for making a service available at a reasonable price was the establishment of the Public Trust Office in 1872. Accidental deaths at an early age were not uncommon in a pioneering community, while the availability of people able and willing to manage estates in trust for children was limited. The solution was again found in a government agency and the Public Trustee began operations on 1 January 1873. The enabling act was opposed by some lawyers who doubted the ability of a public official to carry out sensitive personal services and the first bill was actually defeated in the Legislative Council. But the majority of parliamentarians had no such qualms about what the government machine could do and a second bill was passed. The concept of a public trustee was unprecedented although offices with some similarities had

12. Cf. T.B. Byrne, A Century in New Zealand (Auckland: Guardian Royal Exchange 1978)

long existed in Scotland and India. The New Zealand scheme was later copied in England (1896-1908), Tasmania (1913), New South Wales (1914), Queensland (1922) and Victoria (1939).[13]

Protection

Government activities extended beyond the land and financial sectors to other kinds of productive activity. Railway operation included the running of railway workshops which assembled new rolling stock as well as carrying out maintenance. There is also a line of continuity from railways to concern with the price of coal and so to the establishment of State Coal Mines from 1901, although that step into direct commodity production was also influenced by wider public suspicion of monopoly pricing of coal and unfair distribution of the earnings of collieries between owners and miners. The latter were, too, the constituents of the Premier, Seddon. There was not a great deal of government participation in manufacturing industries although bonuses and incentives were used to stimulate some industries, notably dairy factories. Governments were, however, involved with manufacturing in general through tariff protection. In the 1880s there was a surplus of labour, but at prevailing wage rates, some manufacturing activities found it difficult to compete with imports. Modern analysis suggests that both the fall in international freight rates and the increasing ratio of local value added to the sales revenue from finished commodities were reducing the effective protection conferred on local industries by distance from alternative sources of supply. Contemporaries would not have followed that argument, but they were aware that industries seemed to need a greater level of tariff protection. The New Zealand response was a moderate one but protective tariffs were erected.

13. C.W. Vennell, A Century of Trust: A History of the New Zealand Public Trust Office 1873-1973 (Auckland: Wilson & Horton for Public Trust, 1973).

Free trade was the clearest possible symbol of economic orthodoxy in contemporary Britain and there were many opponents of protection in New Zealand. Local legislators were well aware of the deep division between free trade New South Wales and protectionist Victoria, the labels being debating terms rather than the result of any sophisticated analysis of practices in the two Australian colonies. The moderate tariff which they enacted was a deliberate attempt to balance competing interests within New Zealand, to foster local industry while avoiding unnecessary costs to farmers and consumers of imports. The attempt to maximise the degree of harmony within the colonial economy was recognised in the near-contemporary account by Reeves.[14] Protection was one of the major political issues of the 1880s, but it died away very quickly when refrigeration changed the balance of international pressures and opportunities for the New Zealand economy in the 1890s.[15]

Industrial Conciliation and Arbitration

There was, however, another balance of interests which the government proved useful in maintaining. In a major dispute, the maritime strike of 1890, the strongest unions were defeated and it seemed that a weak trade union movement would be at the mercy of employers. To redress this, and to avoid disruptive strikes, the Industrial Conciliation and Arbitration Act of 1894 provided a different framework for industrial relations. The Act was intended to strengthen trade unions. It secured their recognition by leaving no choice in the matter to employers. It was thought that recognition would enable trade unions to perform useful services for their members, making it more likely that workers would be unionised and better placed to negotiate with employers.

14. W.P. Reeves, The Long White Cloud (London: Allen & Unwin, 4th Edition 1950, originally 1898), p.259

15. Cf. K. Sinclair, "The Significance of 'the Scarecrow Ministry' 1887-91" in R. Chapman and K. Sinclair (eds.), Studies of a Small Democracy: Essays in Honour of Willis Airey (Auckland: Paul's Book Arcade for University of Auckland, 1963), pp. 102-26

The system also included the provision of conciliation facilities to assist unions and employers to reach agreement, and a Court of Arbitration as a last resort, when even conciliated negotiations failed. In practice, the conciliation proceedings were not taken seriously and the Court became the main vehicle for settling of wages and conditions.

The system provided some years of virtual freedom from strikes but the legal procedure of a court could not forestall direct action by groups of workers who felt strong enough to tackle their employers. From 1906 there were again intermittent strikes by groups such as tramway employees, miners, and water-front workers. Some became major conflicts, as in 1913, but they were exceptional. The Arbitration Court remained the main mechanism for settling industrial negotiations as well as the means by which the wages of workers in less powerful positions were kept approximately in line with the more powerful. Other forms of conflict were reduced too; one of the effects of wages being determined by a court was that employers were assured that their competitors did not have the advantage of lower labour costs.[16]

Producer Boards

State intervention in wage fixing was as direct as any in the production of commodities, but governments did provide other services to private producers. The Ministry of Agriculture had an interest in winemaking as well as in the more important dairy industry from the 1890s. In the 1920s the Department of Scientific and Industrial Research began a series of contributions to farming practice, and its very title shows that its interests were not confined to agriculture even though that was where its greatest contribution lay. Also in the 1920s

16. N.S. Woods, Industrial Conciliation and Arbitration in New Zealand (Wellington: Government Printer, 1963); J. Holt, "The Political Origins of Compulsory Arbitration in New Zealand: A Comparison with Great Britain", N.Z. Journal of History 10 (1976), pp. 99-111; J. Holt, "Compulsory Arbitration in New Zealand, 1894-1901: The Evolution of an Industrial Relations System" N.Z. Journal of History 14 (1980), pp. 179-200

the government lent its support to joint action by pastoral producers in the market for their produce. Concern about monopolistic practices in the international meat market, especially by American companies, resulted in parliamentary enquiries in Britain as early as 1909 so that concern in New Zealand in the 1920s was hardly innovative. Advantages in joint action had been demonstrated in the First World War "commandeer" whereby the British Government made bulk purchases of some New Zealand exports, and in the inter-war years international capital became more prominent in the New Zealand meat freezing industry. The government was readily persuaded to promote a Meat Board once it was clearly supported by a majority of farmers, while some ministers such as Coates helped to create that majority. Similarly, the government willingly gave its support to the predominantly cooperative dairy factories in founding the Dairy Board. It was more adventurous than the Meat Board, but its attempt to market all New Zealand dairy produce was unsuccessful and it was then content to operate its own subsidiary in London as a check on private traders, much as the government insurance offices operated in a predominantly private enterprise field.

Transfer Payments

Before 1930, there were only tentative steps towards what has subsequently become one of the major activities of government; maintenance of minimum levels of income. New Zealand governments were concerned with moderating sectional conflicts, but not much with reapportioning economic rewards. Some early steps were taken. Old age pensions were introduced in 1898, initially with severe restrictions to ensure that only the "deserving poor" among the aged received State assistance, and even when these were relaxed, the pensions were little more than token amounts. In 1926, family benefits made their appearance. For the most part, support of those unable to fend for themselves was left to private charities and to local hospital boards.

Conclusions

Nevertheless, the economic actions of the government spread over a wide range. This has sometimes been attributed to accidents of political personality, usually with emphasis on Vogel.[17] But even Vogel had to achieve widespread acceptability. Nor was government intervention restricted to particular periods. While it is clear from the examples already discussed that the 1870s and 1890s were periods of innovation by governments, they were also periods when new directions were taken in the economy generally. Neither the 1880s nor the 1920s were devoid of government interventions, ones with considerable novelty as well as the maintenance and progressive adaptation of existing programmes. It has also been suggested that governments could afford a longer planning horizon than individual entrepreneurs and could accept greater risks because of the lower interest rates available to them.[18] These points have weight, but government intervention went beyond what was needed to exploit its advantages. Reeves came closest to the analysis suggested here when, referring to public borrowing and advances to settlers, he wrote:

> "In the colonies, governments are, rightly or wrongly expected to be of use in a public emergency, and under the head of public emergency dull times are included." 19

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17. Valerie Muir, "The Emergence of State Enterprise in New Zealand in the Nineteenth Century", Explorations in Entrepreneurial History V (1953), pp. 186-97

18. J.A. Dowie, "The Course and Character of Capital Formation in New Zealand, 1870-1900", N.Z. Economic Papers I (1966), pp. 38-58; J.A. Dowie, "Business Politicians in Action: The New Zealand Railway Boom of the 1870s", Business Archives & History V (1965), pp. 32-56

19. W.P. Reeves, State Experiments in Australia and New Zealand (Melbourne: Macmillan of Australia, 1969, Orig. 1902), I, p.333

And when referring to industrial conciliation and arbitration he wrote:

> "Yet the wisdom of a householder who might allow his family or servants to settle a domestic dispute by smashing the furniture, while he philosophically locked the front door and kept strangers from the doorstep, would not impress any one."[20]

His departure from the British philosophy of laissez faire was quite explicit. The State was not to be confined to setting the framework within which private enterprise should be undisturbed; it was expected to act where it could be useful, to moderate conflict within society as well as protect it from outsiders. Observers might see "socialism without doctrines" but the close-knit homogeneous settler community had evolved its own doctrine of what the state apparatus should do.

Not all features of the society are attractive to modern observers. Close-knit communities often make outsiders uncomfortable. Attitudes towards Chinese immigrants were insensitive or even callous and brutal. Yugoslav settlers in the north also suffered and even Scandinavians could do so. While there was usually acceptance of Maoris who adopted a European style of life, there was little understanding of Maori culture and aspirations. Nor was the settler community a paradise of harmony. Some were always richer and more powerful than others and there was room for dispute about the merits of those who were favoured. There were also differences of opinion on the way in which the State could achieve an optimal balancing of sectional interests.

Much political debate was concerned with roads and bridges, and with suggestions that the "pork barrel" of

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20. Ibid., 12, pp. 80-1

government largesse was being raided unfairly. The near-unanimity of Canterbury members of parliament on the desirability of subsidies for the railway line between Canterbury and the West Coast is difficult to reconcile with any idea of wise and farseeing legislators. But it differs only in degree from the careful balancing of geographical and political interests in successive statements of priorities in the railway-building programme.

New Zealand did not have a group of people who had retired from business life to devote their services to the community. Still less did it have sufficient people who had inherited wealth to be free of personal financial interests while pursuing a political career. People with an active concern for their personal affairs took time off for politics, and politics was partly an extension of the business interests of themselves and their constituents. The line between personal and public affairs was sometimes blurred or even crossed. The activities of Russell and Whitaker in the 1860s in connection with the confiscation of land from Maoris with little regard for their part in the wars but much for the interests of the politicians and their business associates looks decidedly suspicious. Even clearer is the combination of Stout and Vogel in 1884 to gain political power and have the government relieve them of some embarrassing commitments to investors in land in Southland. In the 1890s and 1900s even Reeves allowed a friend to approach the Minister of Works and suggest that road plans should provide for servicing a farm of which he was part owner. Curiously, while Ward was much maligned for allegedly seeking to have the Bank of New Zealand quietly absorb his personal debt to the Colonial Bank, a careful scrutiny of his part in the government's rescue of the banks suggested that while he may indeed have hoped to avoid

embarrassment, his legislation was not designed to facilitate that outcome.[21]

These examples of the use of public office for personal gain have to be seen in the context of continuous government action in areas of interest to individual politicians over many years. They do not constitute widespread graft, patronage, and corruption, but occasional transgressions of both contemporary and modern standards of official behaviour. More continuous was the attempt to combine public and private interests, with governments genuinely endeavouring to promote the interests of the settler community at the expense of outsiders while keeping conflict within it to reasonable levels.

Governments provided the means whereby the community acted in some respects as a unit. When one person or group of people is prepared to gain satisfaction from the consumption of another, their decisions will be as though made by a unit rather than by competing individuals, and they may willingly transfer income or costs among themselves. This analysis has been developed mostly with special reference to families[22] but the relevant considerations survive translation to a small

21. D.A. Hamer, "The Agricultural Company and New Zealand Politics, 1877-1886", Historical Studies: Aust. & N.Z. 10 (1962), pp. 141-64; G.R. Hawke, "William Pember Reeves: Some New Evidence", N.Z. Journal of History 7 (1973), pp. 60-9; G.J. Rosanowski, "The West Coast Railways and New Zealand Politics, 1878-1888", N.Z. Journal of History IV (1970), pp. 34-53; R.C.J. Stone, "The Maori Lands Question and the Fall of the Grey Government, 1879", N.Z. Journal of History I (1967), pp. 51-74

22. The most recent statement is Gary S. Becker, "Altruism in the Family and Selfishness in the Market Place", Economica 48 (Feb. 1981) pp. 1-16. See also, Gary S. Becker, "Altruism, Egoism, and Genetic Fitness", Journal of Economic Literature XIV (Sept. 1976), pp.817-26 and the subsequent exchange, J. Hirshleifer, "Shakespeare vs Becker on Altruism: The Importance of Having the Last Word", G. Tullock, "Economics and Sociobiology: A Comment 'with Becker's Reply'", in Journal of Economic Literature XV (June, 1977), pp. 500-507

community. For many commodities and services it was apparent who was using the resources available and the cost fell on particular individuals. However, there was also a general desire for "development" for a larger, prosperous settler society. The relevant users of resources were not then necessarily only those immediately involved and some cross-subsidisation was justified. Cash gifts fell outside the range of measures considered acceptable by contemporary criteria of etiquette and charity, but the powers of government, readily accessible to settlers, provided an alternative.

It has long been recognised that New Zealand's economic development included some sharing out of the income generated by farming.[23] But it should not be thought of as an appropriation by urban interests from rural producers. The composition of parliaments and the absence of significant urban pressure groups in the nineteenth century suggest that the initiative lay as much with the benefactors as with the beneficiaries of redistribution. There were fears that the 1890 election passed too much control of the government apparatus into new hands,[24] but the tradition of State activity was not greatly changed in the succeeding years. Social control and social justice cannot be distinguished when the government is employed in reconciling competing interests within a community.

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23. C. Blyth, "The Special Case: the political economy of New Zealand", Political Science XVIII (1966), pp. 38-51

24. cf. L. Richardson, "Parties and political change", ch. 8 of W.H. Oliver with B.R. Williams (eds.), The Oxford History of New Zealand (Wellington: Oxford U.P., 1981), pp. 198-200. See also F. Parsons, The Story of New Zealand (Philadelphia: Equity, 1904), Ch.74

IV GOVERNMENT AND THE DEPRESSION OF THE 1930s

The idea that governments should attempt to counter the impact of hard times was tested in the 1930s. There is a widespread impression that governments did not do much towards alleviating the Great Depression, but that is not entirely justified, and even if it were, lack of success does not necessarily imply lack of effort. The historical record shows that governments approached the problems of the 1930s in the same spirit as had inspired earlier economic intervention; if there was a problem facing the community and if government could usefully counter it, then government should intervene.

It is clear in retrospect that the problems of the 1930s stemmed from a significant loss of income spread unevenly among the community as events overseas reduced the value of New Zealand exports. Such clarity was not available to contemporaries. Rather problems crept up at different times, and in each case the government attempted to formulate and implement an effective response.

Unemployment

One of the first problems in the sequence was unemployment. In the nineteenth century, unemployment had been mostly a matter of insufficient work available in particular places and at particular times for people accustomed to earning their incomes from seasonal or casual labour. By the 1920s unemployment among people used to secure employment in some industry or occupation was becoming undeniable. Government's response to it can be dated no later than 1928 when an Industrial Conference was convened, bringing together academics, employers and trade unions. But the problem with which it was concerned was hardly that which faced the government after 1931. In mid-1930 registered unemployment was 5,500, while by mid-1931 it was 44,500 on its way to a peak of nearly 80,000 two years

later. Unemployment was not one of the areas where government action was successful in the 1930s but that does not imply it was absent. Immigration assistance was stopped, wage rates were reduced, and employment was promoted in a large number and variety of special and subsidised projects. The dole was introduced after initial hestitation based on the demoralising effect obvious to contemporary observers of Britain as it is to people in both New Zealand and other countries at present.

Work of a hard physical nature was provided in camps, often in isolated sites. They have been justly criticised as inappropriate for many of the unemployed and for giving authority to officious and bullying supervisors, but our experience since 1967 has shown that it is not easy to organise special work which makes sensible use of available labour without upsetting other employment arrangements.

Balanced Budgets

It was even more difficult for governments in the 1930s since they had to work within an almost universal belief in the virtue of a balanced budget. The orthodoxy was widely and strongly held. Even Keynes, who in 1936 published the theory which did most to change conventions and beliefs, commented in 1931 that his advice to the Australian government would include reduction of its budget deficit. The 1932 report of an Economists' Committee in New Zealand referred to the budget deficit as a "critical situation" and called for "drastic action". To be radical was to suggest that the deficit should be eliminated gradually rather than immediately. Belief in the virtue of a balanced budget was more a matter of public morality than of economic analysis, a carry-over from the days when it was a mechanism for preventing a monarch from calling for additional taxation. Thus while it is true that governments in the 1930s did not succeed in countering unemployment,

this must be considered in the light of the bounds imposed on them by contemporary thinking. Persistence of unemployment does not indicate any change in New Zealand attitudes towards the proper economic role of government. There were extreme views, as in other places and at other times, that unemployment was the just reward of the shiftless and inadequate, but they did not prevail. Government attempted to do what it could in the light of the analysis provided in the late 1920s and to adapt its measures to the vastly greater problem of the first half of the 1930s.

Central Banking

A second set of measures which preceded recognition of the Depression as a loss of income began as a technical banking question. In the late 1920s, the rate of exchange between Britain and New Zealand diverged from the parity which had long been customary. Analysis by a Treasury official, Ashwin, suggested that the New Zealand rate was being affected by the balance of payments position of Australia and that some institution was required to establish the distinctness of the Australian and New Zealand economies. At Treasury's suggestion, the government sought technical advice and accepted the recommendation which resulted from it. This was to found a central bank and the outline of the bill which established the Reserve Bank of New Zealand was ready by 1931 although it was then delayed until 1933; the technical question receded as the income loss of the Depression was recognised and there was a debate over the issue of whether it was desirable to return the exchange rate to parity after all.

Overseas and Local Prices

The government's willingness to respond to community problems as they arose was also demonstrated in the field of prices and wages. A fall in export prices was one of the first

aspects of the Depression to be recognised. Overseas prices were not readily amenable to action by the government but its willing participation in the Ottawa Conference of 1932 and the World Economic Conference of 1933 resulted from the hope that international cooperation or bilateral agreements would restore their levels. In the meantime, government could act to ameliorate the effects of lower export prices and it did so. In 1931, a moratorium was imposed on actions leading to the foreclosing of mortgages on farms, and commissions were established to help parties to mortgages to reach agreement on revised terms. State lending agencies were encouraged to refinance exporters embarrassed by their mortgage commitments. The State was used to prevent what was hoped to be a temporary decline in export prices from having unjustified ill-effects on a section of the community.

Thus the government responded with traditional readiness to the problems of the day as they appeared in the early 1930s. But by late 1931 it was apparent that New Zealand was not experiencing simply another brief interruption of prosperity as had occurred in 1908-09, 1921-22 or 1925-27, but a marked loss of income. The government was faced with a new problem. There was not much doubt that if the government could usefully respond to it, it would, just as it had in the cases of unemployment, the exchange rate, and the effect of falls in export prices. The difficulty was deciding how the government's power could best be used.

Policy Options

In retrospect we can discern three lines of thought laid out before the government, two of them being formulated at its initiative. One was that the world economy had changed in such a way that New Zealand costs were out of line with international values, and that the government could best promote recovery by eliminating the consequent gap. The

National Expenditure Adjustment Commission, composed mostly of urban businessmen, was charged with advising on how the required policy of deflation could best be implemented. It is easy to poke fun at its recommendations of wage-cuts and reductions of government expenditure by such expedients as raising the school entry age from 5 to 6 and closing teacher-training colleges. The acerbic pen of Fisher, an Otago economist, paraphrased some recommendations as:

> We object so strongly to having our own incomes further reduced by taxation that we think the incomes of pensioners should be reduced instead.
>
> In times of depression it is necessary to curtail the community's consumption of many goods and services. Already people with large or moderate incomes have diminished their expenditure on many pleasant but unnecessary things which formerly they enjoyed. Most of them are, however, still tolerably comfortable. A great deal of money is spent on motor cars and holidays, on racing and other amusements. But rather than curtail still further expenditure of this kind, we think it has now become necessary to reduce expenditure on education, in such a way as will definitely handicap the children of poor parents, and make it more difficult than it has been in the past for them to develop their natural capacities in the way which would be most advantageous to the whole community.
>
> We fear that if people with moderate and large incomes are asked to reduce their customary expenditure still further in order to maintain a decent level of education for the whole community, they will prefer to encroach upon their customary savings.25

This was hardly fair to the commissioners who approached the task with which they had been charged with great conscientiousness and who, like most businessmen, were not accustomed to probing arguments and expressing them in writing. Furthermore, the last of the passages quoted recognises, as the former two do not, that the limits to practicable proposals might be set by community reactions rather than by the preferences of the commissioners. Fisher's complaints, however, were both striking and forceful.

25. A.G.B. Fisher, "The New Zealand Economic Problem - A Review", Economic Record VIII (May 1932), pp. 86-7

The second line of thought revolved around devaluation. Rather than worrying about the depreciation of the New Zealand pound relative to sterling, it should be welcomed and deliberately increased. The incomes of exporters expressed in the local currency would thereby be increased and their consequent expenditure could be expected to percolate through the whole community. To formulate proposals in this vein, the government established a committee of four academic economists and the Secretary to the Treasury, the last being the only member not predisposed towards devaluation and obviously charged with keeping academics in touch with reality. The committee duly recommended devaluation by a majority of 4-1 but also formulated a package of measures intended to counter the unequal fall of incomes being experienced. The devaluation itself should raise the worst affected incomes, those of exporters. Other incomes should be reduced to "share the burden" and achieve "equality of sacrifice"; wages should be lowered and interest rates and dividends should be cut too. The budget deficit would be countered by taxation of the exporters' increased incomes, but a new sales tax should be introduced as well.

The third line of thought did not achieve the same prominence as those based on deflation and devaluation. It emphasised the usefulness of "cheap money" or low interest rates as a direct stimulus to private investment. It was the policy favoured in Britain in the 1930s and was very much in the mind of Ashwin and other officials in 1932. It was also advocated, but on a different and deficient analysis, by those influenced by Douglas credit ideas.

The Policy Response

Faced with a variety of advice, the government first adopted those measures which were favoured by all the groups of advocates. Reduction of interest rates could be seen as

part of the deflation needed to bring internal costs into line with overseas prices, or as part of the package of measures recommended by the Economists Committee to achieve equality of sacrifice, or as the implementation of cheap money. The underlying reasoning differed and was not always compatible across different lines of advice, but the recommended measures were clear and were adopted by the government. In 1932, interest rates on mortgages, debentures, preference shares, government stock, and bank overdrafts were all reduced. This involved overriding the sanctity of private contracts, but while this stimulated some political opposition in the 1935 election, the government's decision was that it was more important to attempt to counter the Depression.

Wage reductions, too, could be justified on various grounds and were taken another step in 1932. But eventually the government had to face the conflicts between its various sources of advice. The central issue was devaluation. It was advocated as desirable to boost incomes and achieve a fairer distribution of the income loss being experienced; it was opposed as undesirable "tinkering with the currency". There were doubts over the economic argument; would the extra exchange costs be offset by higher taxation or would the budget deficit be worsened? Could the claimed advantages not be achieved more simply by lower interest rates or tariffs? These issues called for judgement; judgement that depended on discussion among economists and officials which was only beginning in the 1930s. There were also political questions. Those who stood to lose from devaluation at least in the short run included urban wage-earners who would experience higher import prices before benefiting indirectly from exporters' greater incomes. The farming community, including its members of parliament, could see advantages to itself, but some politicians within the coalition government were not sure that the community interest lay with the farmers while others were representative of urban interests who foresaw reduced profits from importing as a consequence of devaluation.

It is not surprising therefore that there was a delay before it was decided whether this was an area in which the government's power could appropriately be used. A Cabinet decision was required, and in January 1933 Cabinet accepted a clear lead from Coates and decided to devalue the New Zealand pound from an exchange rate of NZ£110 = Stg£100 to NZ£125 = Stg£100. The decision was innovatory in that it took government into an area previously left to non-governmental interests; exchange rates had always previously been decided by banks. But innovations in this sense had been required for the Public Trustee, government insurance companies, State advances to settlers, and all the other public agencies we have already discussed. In a longer and broader perspective, devaluation continued the tradition of a willing recourse to government intervention where it could be expected to be useful.

The effectiveness of the 1933 devaluation is debatable. It was accompanied by a Banks' Indemnity Act which was intended to be an innocuous arrangement whereby the government rather than the banks assumed the capital loss that would result from any return to parity but which had two unforeseen implications. First, it effectively set a floor to interest rates and cut off further experiments with cheap money. Second, while government gained ownership of sterling assets, it had no mechanism for using them directly and was commited to reselling them to the banks on request, while its negotiations over financing their purchase were readily confused with government needs for bank finance for its usual activities and contributed to an impression of an intractable budget deficit. Consequently, the beneficial effect of the devaluation within New Zealand was reduced. Furthermore, devaluation was considered and decided in the context of income trends in New Zealand, but from Denmark it looked like an attempt to gain a competitive advantage in the British market for dairy products through lower sterling prices; Denmark responded with depreciation of its own currency so

that some of the advantage of devaluation passed to British consumers of butter and cheese, and the different impact on the incomes of dairy farmers and sheepfarmers introduced a new inequality into New Zealand. But most major policy decisions involve some unforeseen problems and the devaluation does show continuation of the traditional role of government in the New Zealand economy.

Devaluation was probably the single most important example of this, but although export prices for the most important commodities started to recover from 1933-34, the government's willingness to intervene to assist recovery did not falter. A major tariff revision in 1934 implemented preferential rates agreed on at the Ottawa Conference and supplemented the protection conferred on local industry by the devaluation. Efforts towards international cooperation were continued even at the expense of political unpopularity when this involved contemplation of a British quota on imports from New Zealand. The relative position of dairy farmers was pursued in a committee of enquiry. And the government's various initiatives in the mortgage market were consolidated in a Mortgage Corporation. The title shows the effect of tiredness on political skills since "mortgage" is a much less attractive label than "state advances" in a community of borrowers, especially rural ones, but the economic issue of whether improvements would flow from reorganisation and an injection of private sector capital and personnel was not resolved when the coalition government was voted from office.

The first Labour Government

The international political experience of the Depression years was that whatever government faced the decline of incomes lost office. In Britain and Australia, Labour governments were swept away; in the United States the Republican administration of Hoover gave way to Roosevelt and the Democrats. In New Zealand the coalition formed in mid-1931 lasted an extra

year because the parliamentary term was extended, but the 1935 election brought into existence the first Labour Government. It was fortunate in taking office at a time when the economy was benefiting from rising export prices but it gave an admirable display of activism sweeping away the gloom of the Depression years. Wage cuts were reversed, and public works were pursued vigorously with modern technology, sweeping away the "slave-camp" image of the employment schemes of its predecessor.

The new government's policies did not involve much departure from the practice of its predecessors. It abandoned the public/private corporations of its predecessors returning the railways to the status of a government department, establishing a government State Advances Corporation in place of the Mortgage Corporation, and buying out the private capital in the Reserve Bank. But these measures were merely symbols of a determination on activist government while there was not much room for an increase in activism. The Labour Government had won office with a promise of "guaranteed prices" for dairy farmers. One element in the thinking of its principal proponent, Nash, was a trade agreement with Britain, exchanging preferences for imports from Britain for a guarantee of adequate prices of dairy exports. But as was foreseen by politicians and officials who had been engaged in the labyrinthine negotiations after the Ottawa Conference, the British Government refused to entertain such a scheme. There was then no way to reconcile the "adequacy" of prices with their market determination overseas and guaranteed prices became simply a price-smoothing exercise. They increased the element of government decision-making in New Zealand, but by less than the devaluation had done earlier. The Labour Government had also offered some support to the idea of credit creation, but in office this was limited to a very modest use of Reserve Bank funding for the state housing scheme. Nor was concern with price-fixing and profiteering taken very far

despite the Industrial Efficiency and Prevention of Profiteering Acts of 1936. The Labour Government did begin the planning of a wider income-maintenance scheme in the Social Security Act of 1938 making clear its intention to implement a significant change in income distribution, but in its first term of office it did not markedly change the kind of government intervention in the production of income to which New Zealand had long been accustomed.

Exchange Crisis in 1938

However, in 1938 a combination of lower export prices, the import demand sustained by government spending within New Zealand, and a capital outflow presented the government with a balance of payments crisis. Formerly, dealing with such a situation would have been the responsibility of the banking system, but by 1938 action was called for from a central bank while there had been substantial progress towards the idea that government's responsibility included the overall level of economic activity. The Labour Cabinet saw itself as having only two alternatives; it could dampen demand in New Zealand, or it could seek to control the outflow of foreign exchange directly. It chose the latter. On 8 December 1938 import licensing and exchange controls were introduced. They were a crisis measure, related to the earlier Depression years only in that it was determination to avoid deflation which led government to believe that it had no alternative.

The Second World War

Whether or not the controls adopted in 1938 were able to reverse the balance of payments crisis was not fully tested. The foreign exchange position was not rectified when the Second World War began, but control systems take some time to have their full effect so that they cannot be said to have failed.

The War itself reduced the availability of imports and brought the exchange problem to an end.

The War also brought many further decisions which seemed to parallel that of 1938 in extending government's direct role in the economy. Contracts between the British and New Zealand governments determined the prices of exports, and even the priority to be accorded to cheese and butter production. Government negotiated cost-plus contracts for the provision from New Zealand industries of war supplies. Manpower controls were used. Inflation was countered with vigour. A Stabilisation Scheme involved the tying of wages to a price index and the use of subsidies to control the prices of key goods. The Stabilisation Scheme was the most visible part of the anti-inflation policy but it was supported by directives to the banking system, a vigorous attitude towards internal borrowing in order to reduce liquidity, and a fiscal policy that aimed at the same objective.

During the War, officials and politicians in New Zealand as in other countries absorbed the Keynesian lesson that fiscal policy should be concerned with balancing aggregate demand and supply within the economy as a whole and not merely with government housekeeping. The movement for government responsibility in hard times to responsibility for aggregate output at all times was reinforced. But in New Zealand wartime controls appeared much more as normal policy than they did in most countries where direct controls originated in war conditions and were more strongly regarded as a transitory phenomenon.[26]

26. For documentation and further discussion of the Depression years and the 1938 decision, see G.R. Hawke, "The Government and the Depression of the 1930s in New Zealand: An Essay towards a Revision", Australian Economic History Review XIII (1973), pp. 72-95; G.R. Hawke, Between Governments and Banks: A History of the Reserve Bank of New Zealand (Wellington: Government Printer, 1973). For a critical view of the argument advanced here, see Keith Sinclair, Walter Nash (Auckland: Auckland University Press and Oxford University Press, 1976).

V. GOVERNMENT IN THE POST-WAR ECONOMY

We have seen that there was criticism, not all well-founded, of the government's intervention in the economy in the Depression years, but it was mostly for too little rather than too much. However, the introduction of import licensing and exchange controls in 1938, and the extension of direct controls during World War II, gave government a much more direct impact on private economic activities. I seek now to show that this remained true in subsequent years, and constitutes the main change in government's economic role. It was, in any case, more difficult for the government to continue the tradition of reconciling competing interests as the economy became more complex and diversified.

Regulations

Broad general influences on the economy remained important, but government involvement in matters of detail affecting the economic activities of only a few people became much more readily apparent. Examples can be found in many industries. Whether or not a licensing trust (itself a semi-governmental body) could borrow in order to establish a bottle store was a matter for ministerial decision. The establishment of a "backyard" cooperative, bottling fruit and vegetables, required approval from the Health Department which administered public hygiene requirements, from a local authority which issued building permits, and from another local authority department, or in some cases a distinct local authority, which administered regulations allocating certain activities to specified zones. There were always reasons for the existence of the various sets of regulations; most people prefer to have some guarantee against the marketing of unwholesome food, or against buildings which are dangerous to the public, or to prevent the siting of noisy, traffic-generating, and dirty factories in residential areas. Their value was less obvious to individuals and firms

who found themselves entangled in what could easily be portrayed as bureaucratic red tape. Political rhetoric against socialistic restrictions and petty dictators recurred constantly, but as had been foreseen before 1938, new regulations were needed to plug loopholes in earlier sets, whether the loopholes were discovered by ingenuity or uncovered as new products and processes were introduced. Governments were not different from other rule-makers but they were bigger and affected more people.

Scrutiny occasionally went beyond rhetoric. In 1961, the newly-elected National Government directed government departments to review the legislation and regulations of the preceding 25 years (which included the 8 of the first National Government) and remove all unnecessary restrictions on freedom. Few were found. Increasing urbanisation meant that there were more conflicts of interest to be regulated, and successive governments and local authorities turned to more and more complicated regulations. Outmoded requirements were left to provide amusement to occasional antiquarian enquirers. Righteous indignation occasionally imposed limits, as when the National Government in 1975 promptly reversed a hygiene requirement that excluded cats from corner dairies, but for the most part objections came only from a minority directly affected and were ineffectual. There was never any great support for an alternative strategy, such as leaving preparers of food free to choose between conforming with hygiene requirements or not, but supervising the use of labels such as "prepared on approved premises" so that a consumer could decide individually whether or not compliance was important. The government provided some finance to an independent Consumers' Institute which tested competing products and advised its members on their relative worth, but its results could not be used in advertisements. The condition was supported by many friends of the Consumers' Institute for fear of commercial pressures on its independence but they existed anyway, and the Institute could not become a

major force in society. New Zealand remained attuned to compelling compliance with communally-determined standards rather than leaving individuals to choose despite their increasing number and heterogeneity.

Not all detailed measures affecting individual businesses were negative. "Regional development" was a declared aim of many governments, a desire to give preference to certain locations for industrial activities mostly intended to foster communities for social reasons. The policies usually amounted to little more than ad hoc transport subsidies and concessional interest rates on loans, but they could be important to individual firms, vastly increasing the significance to them of government decisions. In one sense, they resemble the "pork barrel" aspects of nineteenth century development schemes, but they went beyond projects such as railways and bridges, important to many producers, to assistance to individual ones.

Licensing

Licensing schemes of various kinds appeared to be general in scope but their detailed administration required decisions on individual applications. There were long-standing requirements for licences of various kinds, such as the entry requirements of professions like law and medicine, enforced in the last resort by laws and courts. They had been joined before the Second World War by transport licensing, both certification of drivers and cars as roadworthy and licences for public transport services. Licensing was usually justified in earlier times on some kind of public safety argument, and the same lack of examination of any possible alternative, ensuring dissemination of knowledge of qualifications but leaving individuals free to choose, applies as it does to the other regulations discussed earlier. But licensing introduced for one reason could readily be adapted to new issues. By restricting transport operators to particular routes and preventing road transport

from competing with rail, transport licensing became a method of preventing what was seen as a wasteful use of investment in transport. Licensing of meat export works was designed to prevent poor products from endangering the reputation of the New Zealand industry as a whole, but came to be a means of protecting the investment of existing works. Changes in the relative costs of shifting live animals and frozen meat made the original coastal locations of freezing works increasingly inappropriate, but changes were retarded before the abolition of licensing in 1980.

Import licensing underwent a similar transformation. It was introduced because it was thought to provide a means for an equitable distribution of a limited resource, foreign exchange. It was retained because it gave protection to local industries. Economic arguments against protection, essentially that it prevents an economy from achieving the maximum level of income of which it is capable, were well known. The arguments against import licensing as a means of protection, that other forms of protection such as tariffs make it easier to determine what level of protection is being conferred, and give local producers more incentive to respond to changes in world costs and prices, were equally well known. The weaknesses of some arguments for import licensing, that it was less inflationary than tariffs and that it substituted social purpose for private profit, were also known. But import licensing prevailed. The best reason was probably that it was desirable to have a variety of industries so as to provide opportunities for New Zealanders to develop a range of skills and aptitudes. It has been said of industrialisation programmes in general that the alternative was "a small scattered population of farmers, shepherds and miners, a few market towns, a scanty clutch of civil servants, lawyers, doctors and clerics. New Zealand in 1900 in fact. Or Gold Coast in 1950."[27] Despite its doubtful accuracy

27. I.M. Drummond, "The British Empire Economies in the 'Great Depression'" in H. Van der Wee (ed.), The Great Depression Revisited: Essays in the Economics of the Thirties (Hague: Martinus Nijhoff, 1972), p.233

both as regards the description of New Zealand in 1900 and the implication about the employment-promoting power of agriculture, this probably gets more to the heart of support for industrial protection than most economic critiques. Emphasis on variety of employment prospects also helps explain the preference for licensing over tariffs although the vested interests of firms with a history of licensing, so securing preference in the distribution of licences for successive years, also contributes to that. And the history of import licensing shows how government's intervention moved from a broad, macroeconomic issue to details of importing to be permitted by individual firms.

Other controls followed a similar course. Building controls, for example, were used during the war to ration scarce commodities and labour. They were revived in the early 1960s when building was judged by government to be taking too large a share of available labour, capital and imports. They applied to a whole sector but to individual producers they appeared as more government control over their activities.

Wages and Prices

Other detailed controls were introduced as more generalised influences seemed to break down. For 20 years after the dismantling of the wartime Stabilisation Scheme, the important matter of wage regulation was left to the Court of Arbitration. An independent judge, with an assessor from each of the employers and employees, heard arguments and made general reviews of economic trends and of the distribution of income, while after the waterfront strike of 1951 compulsory conciliation and arbitration was widely accepted as a sensible means of minimising strikes. Employers and employees were free to bargain independently of the court structure since its awards were concerned formally with minimum wages. Furthermore, much of the work of the court was concerned with interpreting

the terms of awards and adjudicating on individual rights rather than with wage levels. But the general wage orders were of major economic significance, and the court provided a kind of "incomes policy" before that term was widely used.

The court system depended on the support of a large number of small, mostly craft-based unions who found it an effective and cheap means of bargaining. As industry became more complex, wages had to be settled on an industry rather than craft basis. "Composite" awards, covering all workers on a particular site were negotiated for such large projects as some of the early forestry-processing plants and the coal-fired Meremere electricity generating plant. But such one-by-one procedures could not cater for the growing number of factories employing a wide range of crafts.

In 1968 the court rejected an application for a general wage order. It had previously always compromised between what the unions claimed and what employers conceded to be practicable, and surprised unions and employers were soon able to persuade their assessors to outvote the judge and substitute a figure agreed between themselves. The "nil award" was a prelude to widespread disaffection with the court and direct bargaining between employers and employees tended to supersede it. It is doubtful whether the "nil award" was as significant as often claimed both because the court was getting further and further out of touch with industrial realities and because it is doubtful whether its intricate machinery could have coped with the much faster inflation rates of the early 1970s.

Direct bargaining produced larger wage increases, and more disturbance to long-established relativities between industries and occupations (and sometimes to newly-discovered convenient ones as well). Successive governments intervened with wage regulations, aimed at economic stability in general but necessarily dealing with many individual situations. After an experiment with an Industrial Court to deal with disputes

over rights and an Industrial Commission concerned with wage levels, something like the Court of Arbitration was eventually re-established, but the direct role of government in wage determination remained much greater at the beginning of the 1980s than it had been in the 1950s and 1960s.

Controls over wages were often accompanied by controls over prices, if only because of the political advantage of an appearance of even-handedness. The price controls of the Stabilisation Scheme were mostly allowed to lapse although some were retained on commodities deemed to be "basic", or produced in conditions of limited competition, and the general prohibition of profiteering was retained. Price freezes and controls of various kinds became much more prominent in the 1970s as governments searched for an answer to inflation, either by directly controlling prices or by making wage controls palatable.

Monetary Policy

Not all of governments' economic interventions moved consistently towards greater detail and specificity. Monetary policy changed in the opposite direction. Yet it too served to emphasise the greater degree of governmental control over private activity, especially in any contrast with the pre-World War Two situation.[28]

Monetary policy advanced little before the Second World War as the Reserve Bank was unable to establish a clear role for itself. The Bank was nationalised in 1936, but nobody had attached much importance to private shareholders and Nash reappointed the same directors telling them to carry on as before. At its first meeting, the board of the Bank had

28. See Hawke, Between Governments and Banks, Ch.8 and R.S. Deane and P.W.E. Nicholl (eds.), Monetary Policy and the New Zealand Financial System (Wellington: Reserve Bank, 1979).

resolved that monetary policy and the exchange rate should be decided by the government and implemented by the Bank, but the government did not adopt a clear and coherent policy distinct from its day-to-day preoccupations. The Bank warned against, but accepted, the Labour Government's timid experiments with credit creation for the guaranteed prices scheme and housing, but in the 1930s it was more concerned with taking over management of the public debt and providing banking services to the government and the trading banks. From late 1938, the administration of exchange controls was added. There was a somewhat confused dispute over whether interest rates were part of monetary policy or a means of implementing it, and in 1939 Nash used legislation to ensure that control of interest rates lay with the government.

During the Second World War, government and officials wished to ensure that flows of credit in the private sector did not conflict with military needs for resources or stimulate inflation. Direct controls were used. The banks "voluntarily" agreed to restrict interest rates on overdrafts to figures determined by the government, and other interest rates were controlled under the authority of the Public Expenditure Adjustment Act, the language of which was wide enough to cover a situation unforeseen when it was drafted. Trading bank lending was subjected to official directives on certain kinds of lending to be avoided and other kinds to be preferred. It was initially intended to lower lending by eliminating or reducing some classes of loan, and over time, it evolved into "selective advance control" concerned especially with directing loans towards exporting. Capital issues controls were used to prevent circumvention of restraint on bank overdrafts. Finally, trading bank investments in government stock were restricted. This final element has a curious appearance to those familiar with the idea that trading bank investments in government stock were

an alternative to lending to the private sector and so to be favoured as an anti-inflation instrument. But in the 1940s governments were sure of trading bank cooperation and expected them to remain in disequilibrium with excess reserves while there was still strength in the idea that government spending would be limited by the funds available to it. The policy was not indefensible in those conditions. It also restrained government's interest costs and reduced the profits of banks, something which was both more explicit and more important in Australia during the war.

These controls were a sensible adjunct to the wartime Stabilisation Scheme but they were retained long after their justification ended. Banks had few political friends, and politicians preferred a quiet life. The first National Government allowed trading banks to maintain their holdings of government stock but not to increase them; the permitted interest rate on overdrafts was made slightly more flexible but control was maintained; so was selective advance control although it was little more than exhortation.

In the 1950s a new means of influencing private sector credit was used. Power to change the ratio of required reserves to deposits of the trading banks had been written into the Reserve Bank Act in 1936 when it was suggested by Ashwin in order to calm Nash's misplaced fears that the trading banks might somehow frustrate the guaranteed prices scheme. From 1952 it was used in order to discourage trading bank credit creation.

At first it was thought that the trading banks would maintain their traditional distaste for borrowing from the central bank so that using an increased reserve ratio to leave only small balances of excess reserves would be sufficient to induce restraint in their lending. But bankers soon reconciled themselves to small balances and occasional indebtedness. The reserve ratios were then deliberately

raised sufficiently high to force the banks to borrow from the Reserve Bank, and to pay interest on the debt so created. The amount of the interest penalty thus exacted was determined by the extent to which trading bank lending exceeded targets determined by government officials. Monetary policy became a matter of "targets and penalties" with the reserve ratios being merely a mechanism rather than an instrument intended to affect lending behaviour. As is customary in banking, the system remained subject to a great deal of consultation and adjustment; in particular, the important targets were soon those of "bottom tier" advances, that is, excluding overdrafts to farmers and other exporters.

The targets and penalties system was always subjected to many criticisms. It was not always equitable as penalties were imposed on the trading banks as a group but the bank which had caused the target to be exceeded was sometimes able to avoid its share of the debt to the Reserve Bank by which a penalty was exacted. This was eventually overcome by dealing separately with each bank. The targets were not always "correct", but official policies of all kinds suffer from the same defect (as do private plans). The system was not widely understood; the balances of the banks at the Reserve Bank varied with the balance of payments and with the pattern of government's revenue and expenditure as well as with their own lending, so that changes to the reserve ratios were needed even when the intended level of indebtedness was unchanged and it was difficult to persuade the public that it was not changes in the reserve ratios which were important. But the same point has applied to all systems of monetary policy employed in New Zealand. Implementation of the policy required the assent of the Minister of Finance to changes in the reserve ratios and sometimes, as in 1957, it was withheld for reasons of electoral advantage. But again this is true of other policies and defects inherent in

democracy that cannot be avoided. The system was said to lack "flexibility", a criticism which contained the valid point that adjustments could not be made as frequently and in such small steps as can be achieved with open market operations, but which often meant only that the system was unorthodox and not "respectable" in international banking circles. Finally, it was often argued that the system discriminated unfairly against banks relative to other financial institutions. There was some validity in the point, but not as much as often claimed, and trading banks did have unusual privileges as well.

In the 1960s the system was gradually modified, but "patched up" rather than overhauled. Targets were set less frequently and penalties made more discretionary as well as separately for each bank. Government stock ratios were extended to other financial institutions. Trading banks were permitted to open savings banks and to take shareholdings in other financial institutions. They were also allowed to increase their holdings of government securities to the extent that they increased their holding of longer-term deposits, this being an endeavour to widen the market for government stock, improve the profitability of banking business other than lending to the private sector, and reduce the velocity of circulation by making longer-term deposits more attractive to the public. Interest rates on lending were gradually freed from control. These steps were spread through the 1960s with the 1969 Budget being especially important, but governments were still ready to resort to controls to meet short-term problems and an interest-on-deposit order was used, and capital issues controls on finance companies, to control interest rates in the late 1950s and late 1960s.

However, also in the early 1970s the Reserve Bank was able to persuade the government that the market in government stock was sufficiently active for open market operations to be feasible. In 1973 the focus of monetary policy was changed to "reserve assets" rather than Reserve Bank balances, the

main difference being that government stock constituted a reserve asset. The Reserve Bank and some other advisers such as the Monetary and Economic Council proposed that the system should be automatic, in that required levels of reserve assets should be tied to the balance of payments and other influences on the liquidity of the trading banks. The banks, however, feared that such a system could too easily be turned into nationalisation and the system which was adopted still required numerous changes in reserve requirements. It did free banks from the wartime limitation on investment in government stock and from detailed controls on lending levels and interest rates. It was carried further in 1976 when the government announced its intention of leaving all interest rates uncontrolled and to influence the market through changes in the rates offered on government stock. The transition from controls to general influences on the market seemed to be complete.

Changes are seldom as sharp as that. After 1976 interest rates fluctuated but as inflation was high, increases were more frequent than declines. Small savers benefited from higher interest rates but they could seldom match the rate of inflation, while many borrowers complained to politicians about the high rates they were required to pay. The government was startled by the success of the Reserve Bank in 1979-80 in using interest rates on government securities to finance a government deficit, and responded only too readily to complaints from the private sector of being unable to secure loan finance. The Minister of Finance, Muldoon, had never been entirely convinced that he should not keep control of interest rates in his own hands, and the Reserve Bank was prevented in 1980-81 from following the policy apparently adopted in 1976. Monetary policy again threatened to become ad hoc interventionism rather than a coherent package of influences on the financial system.

It is easy to forget, however, how far government's influence had changed from that in existence at the beginning of the Second World War. Before 1934 the main influence on private credit in New Zealand was the level of "London funds" held by the trading banks, and they determined the response appropriate to any diminution in those funds. In the postwar economy "London funds" were, in effect, replaced by the official reserves of the banking system, centralised in the Reserve Bank. Before 1934 the trading banks had decided whether to borrow in the London market or to curtail credit in New Zealand; that decision passed to the government, and because of the availability of central bank credit, the government had a little more freedom of manoeuvre. Trading bankers complained about the new level of government influence, but seldom recalled their freedom from the anxiety their predecessors had about their ability to manage their "London funds". Bank customers had merely exchanged one influence for another, but whereas bankers had been able to persuade them that they were controlled by an inexorable economic law, they now saw deliberate decisions of governments frustrating their requests for bank finance.

Fiscal Policy

Postwar developments in fiscal policy also led to an increase in perceived government control over individual business and households. The idea that the government's revenue and expenditure plans should be concerned not only with government housekeeping but with balancing aggregate demand with the goods and services available won acceptance overseas only in the late 1930s and 1940s. It was readily accepted locally by officials such as Ashwin who was Secretary to the Treasury from 1939-1955, and it was understood, at least in part, by leading politicians from Nash to the present day. Backwoodsmen appeared from time to time, even in high places, and by the 1970s there was growing regret

that the discipline of having to balance the budget had been destroyed too completely; the surplus or deficit appropriate to any particular prevailing economic conditions was necessarily more ambiguous than equality of government revenue and expenditure and pressures for increased expenditure were greater than for increased taxation.

It was long thought that fiscal policy had a very simple general outline. Governments spent more than their revenue, and the resulting deficit sustained a high level of demand in New Zealand and so promoted full employment. The excess demand was prevented from spilling into imports and consequent balance of payments difficulties by import licensing except in years like 1957 and 1967 when a shortfall in exports upset a precarious balance. The general effect, therefore, was that the budget promoted full employment at the expense of fuelling inflation and, many commentators added, of maintaining inefficient users of resources.[29] Parts of the analysis were always suspect. Import licensing was probably more effective in changing the composition of imports than in determining their total value. The rate of inflation in New Zealand paralleled that in her main trading partners. Furthermore, when government's internal spending was distinguished from its call on overseas funds, it was shown (in 1971) not to have had the long-term deficit assumed in the conventional analysis. Fig. 1 shows along with the widely-cited "Budget Table 2" measure of the budget deficit, the "internal deficit" which is much closer to a measure of the budget injection to internal demand. Throughout the 1960s it fluctuated around zero and that was almost certainly true of the 1950s as well. Only in the 1970s did the budget begin to feed internal demand, and it was only in 1975 that the deficit became substantial.

29. This was a consensus view shared by many commentators although they differed on details and relative emphases. See e.g. H.G. Lang "Price and Wage Policy" in R.S. Parker (ed.), Economic Stability in New Zealand (Wellington: N.Z. Institute of Public Administration 1953) and W.B. Sutch, Problems of Prosperity (Wellington: Price Milburn, 1962).

The government drew on export earnings and so intensified the foreign exchange constraint on the private sector, but this was not obvious to individual businessmen even though estimates of the import requirements of government capital expenditure were readily available. The Reserve Bank provided banking services to the producer boards and the foreign exchange earnings from the Dairy Board's sales to the United Kingdom market went directly to the Reserve Bank. It could therefore supply government's needs and still normally be in the position of selling foreign exchange to the trading banks. The government appeared to be distributing largesse rather than drawing funds away from the private sector.

Before the early 1970s fiscal policy did not usually make a direct injection to demand in New Zealand and its main effect was indirect. Governments appeared to be able to maintain high levels of demand, and there was a buoyant attitude towards private investment. Even if demand did prove inadequate to justify a particular project, it could confidently be expected to grow sufficiently to recover the mistake, especially as competing finished goods could be excluded by licensing and some higher prices could help as well. This confidence was shaken in 1967-68, and even more after 1975-76. It has not been re-established even though fiscal policy has contributed directly to demand, especially from the mid-1970s. Ironically, during the 1960s many commentators called for more flexibility or "fine-tuning" in the government's fiscal stance, but when budgets became more frequent, their usefulness in this regard was overwhelmed by a general lack of confidence in government's ability to keep the economy at full employment or to prevent inflation.

"Welfarism"

This conclusion bears also on suggestions made from time to time that "welfarism" or government expenditure on things like health and education had become essential to capitalist enterprises in New Zealand. The conspirational overtones can be rejected simply because there was no significant net injection by government into the local economy in the 1950s and 1960s. Expenditure on social services and transfer payments was more or less balanced by government revenue and while certain enterprises may have been assisted, it must have been at the expense of other enterprises which would have had a greater turnover had taxpayers been left to decide individually the pattern of their expenditure.

Pursuit of the "welfare state" nevertheless had implications for the private sector. The notion was complex,[30] but its essence was that the government accepted responsibility for ensuring that all members of the community had access to certain minimum levels of consumption of some goods and services. Nash never tired of saying that the "first charge" on a nation's wealth should be the aged, sick and poor. The exact level of security that should be provided from the cradle to the grave was always a matter of debate, appropriately so since the desirable minimum changes with growing wealth and the tension between communal responsibility and individual initiative needs continual adjustment.

Fiscal policy affected the markets for individual commodities in various ways. There were some intended interventions as in the cases of taxes on cigarettes and subsidies on milk. Second, interventions aimed only at aggregate revenue or expenditure necessarily affected individual

30. Cf. The Welfare State? Social Policy in the 1980s and Public Expenditure and its Financing: 1950-1979 (Wellington: N.Z. Planning Council, NZPC No 12 and NZPC No 12A, 1979); Brian Easton, Social Policy and the Welfare State in New Zealand (Auckland: Allen & Unwin, 1979); and S.H. Franklin, Trade, Growth and Anxiety: New Zealand beyond the Welfare State (Wellington: Methuen, 1978)

commodities. Sales taxes on electrical goods probably fell mostly into this category. A more important example was government funding of housing where concern with total spending affected both the profits of builders and the aspirations of home buyers. Third, markets for individual commodities were affected less directly but probably as significantly whenever the spending patterns of recipients of welfare payments differed from those of taxpayers in general. When transfer payments were financed by taxation, the distribution of aggregate spending among individual goods and services would usually have been affected even if total spending was not. Throughout the 1950s and 1960s food producers and makers of children's clothing probably gained most at the expense of the much wider range of goods and services purchased by taxpayers generally. With the introduction of National Superannuation in the mid-1970s many older people found their financial position much improved and it is likely that more overseas travel was purchased, again at the expense of goods and services in general.

The indirect effects of welfare payments may have extended to affecting the level of total output. There were two main possibilities. If the composition of output was shifted towards goods and services where productivity growth was relatively hard to achieve, then over time total output would be diminished. In the 1950s governments induced preference for goods rather than services, and as productivity growth was generally greater in the former than the latter, any effect on total output could be expected to be limited. There was, however, some preference for housing, an activity in which productivity growth is notoriously difficult, and the goods fostered by fiscal policy were not those where productivity growth was fastest.

Still, it is likely that the effective fostering of services like air travel in the 1970s had more impact than was the case in earlier years. The second possibility is that the level of taxes needed to finance welfare payments could have induced people to reduce the time they spent at work. Pronouncements on the "disincentive" effect of taxes were legion from the 1930s to the 1980s but there is no worthwhile measurement of its strength. We can observe, however, that the effect was probably more pronounced in the 1970s than earlier as inflation carried people to higher marginal tax rates.

There were therefore good grounds for the belief that fiscal policy had come to have greater effects on the private sector than it had before World War II although not for the reasons usually advanced. There was little about the process that was peculiar to New Zealand; most countries experienced more government concern with the provision of health and education in some form or other. Nor were the programmes of the New Zealand Government entirely novel; they were a development of the earlier charitable funding of hospitals, provision of free primary education and state contributions towards child-rearing. The extent of development, especially in the substitution of universality for demeaning charity for the incompetent was certainly considerable, but perhaps the main reason for the prominence of the Welfare State in New Zealand was that it appeared to be linked to the idea of insulationism. The Social Security Act of 1938 more or less coincided with the introduction of import licensing and exchange controls, and the guaranteed prices scheme was only a little earlier. Other countries had both policies about economic stability and about the provision of "merit goods" but they did not seem so closely related.

Exchange Rate

Some government intervention in the postwar economy continued to be of the "ring-holding" kind. The clearest example was management of the exchange rate.[31] The government reversed the devaluation of 1933 in 1948. As usual, motives were mixed. The Secretary to the Treasury characterised the arguments of some proponents as no more than the archaic idea that "a pound is a pound is a pound", a desire to reverse the distinction drawn in the 1930s between New Zealand's currency and sterling that happened to be located overseas. There was also some offence taken at the apparent implication that the New Zealand pound was "discounted" relative to sterling. But there were economic arguments as well. At the end of the war, sterling reserves were substantial and the balance of payments posed no difficulty. Farm incomes were satisfactory, while inflation was being fed by rising import prices and diminishing the real incomes of urban employees. The decision to revalue to parity was made by Nash personally, and it is impossible to reconstruct the relative weights of the different arguments on him, although Walsh, later President of the Federation of Labour and an influential member of the wartime Stabilisation Commission, claimed a decisive influence for his advocacy of the usefulness of revaluation to protect the real incomes of trade unionists.

A small part of the revaluation of 1948 was reversed a little over a year later when New Zealand matched the British Government's devaluation of sterling so that the value of the New Zealand pound was reduced relative to such currencies as the United States dollar. However, as the bulk of New Zealand's trade was with the sterling area, most of which devalued in line with sterling, the 1949 realignment was much less important than that of 1948.

31. Hawke, G.R. Between Governments and Banks, pp. 122-6

There was then a long period of 18 years in which the exchange rate between the New Zealand pound and sterling was unchanged except for technicalities as when the basis of the central value was changed in the course of joining the International Monetary Fund. At the same time the international economy mostly observed the system of fixed exchange rates agreed on at a conference at Bretton Woods during the war so that there were few changes in the value of the New Zealand pound relative to other currencies either. Devaluation of the French franc in 1958 and revaluation of the Dutch and German currencies in the early 1960s had slight effects on New Zealand's average exchange rate but to all intents and purposes the average was constant.

The immediate effect of the 1948 revaluation was generally judged to be favourable, but it was not long before the balance of payments constraint again became pressing and a relative decline of farm incomes caused concern. Export prices rose less than most prices so that an unchanged exchange rate had the effect of reducing farm incomes relative to other incomes within New Zealand, by about 30 percent by 1965.[32] Devaluation was sometimes recommended as a means of promoting exports or the incomes of farmers but did not find favour with governments.

In 1966-67 wool prices were exceptionally low and both the balance of payments and the incomes of sheep farmers generated some interest in devaluation in government and official circles. As early as February 1967 unofficial contacts were made with the International Monetary Fund as guardian of the system of fixed exchange rates, and discussion intensified in the middle of the year. The Minister of Finance, Muldoon, was less enthusiastic than most of his colleagues and he secured deferral for a month, during which

32. C. Gillion, "Structural Change in the New Zealand Economy: Data, Model and Strategy" (VUW Ph.D. Thesis, 1977), p.187

the British Government devalued sterling. The New Zealand Government then took the opportunity to devalue to parity with Australia, presenting the decision as a response to the British move.

The Bretton Woods system broke down in the early 1970s and realignments of exchange rates became more frequent. New Zealand was necessarily caught up in the change, but its initial response was limited. The New Zealand dollar was tied to the American dollar, reflecting the diminished importance of Britain as a trading partner and the international tendency to regard the United States dollar as the numeraire. In 1973 the tie was cut, and the Reserve Bank began to quote exchange rates intended to keep constant the value of the New Zealand dollar relative to a basket of currencies constituted according to the geographical pattern of New Zealand's trade. This was essentially a means of keeping to a fixed exchange rate in a world where floating exchange rates had become more common, although small adjustments to the "basic" rate were made from time to time. In June 1979, in a more fundamental change, the Reserve Bank was authorised to adjust the average exchange rate in line with changes in exporters' costs relative to the prices they realised abroad. The exchange rate was used as a means of maintaining the relative incomes of exporters; the pressure of internal costs against relatively fixed farm product prices was relieved as the New Zealand dollar was devalued by about ½ percent per month from mid-1979 to the end of 1981, but at the expense of exacerbating the impact of rising import prices.

Another factor leading to a more complex exchange rate regime in the 1960s and 1970s was the use of taxation incentives to encourage exports. Concessions were tied first to increases in exports of other than the traditional farming products, and then to the levels of such exports with the amount of the concession varying with the

proportion of domestic content in each class of product exported. Such export incentives in effect raised the value of foreign earnings for eligible producers and so constituted a kind of differential devaluation applied to exports but not imports. The Treasury, indeed, won elimination of export incentives as part of the package of measures including devaluation in 1967, but the government backed down in the face of political pressure even though export incentives were then much smaller than they became in the 1970s.

Thus government's economic role through the exchange rate changed quite clearly. Before 1933 if exchange rates changed at all, it was not by governmental decision. From the Second World War to the late 1960s governments were seen to have power to change the relative incomes of exporters, but the power was not one expected to be used actively except on rare occasions. From then on, government decisions were called for with increasing frequency. Furthermore, while exchange rate changes affected individuals according to broad categories such as exporters and importers, decisions on export incentives discriminated in more detail. The importance of government decisions to individuals was much clearer without requiring the use of more resources by governments. The effect of government decisions can depend on the community's response to them, and there were always some doubts over whether a devaluation could be made "to stick" or whether it would be negated by wage and price movements in New Zealand, but individual producers were aware that their fortunes lay in the hands of government to a very much greater extent than had been the case before 1933.

The Distribution of Income

Exchange rate decisions were probably the government's major influence on income distribution in the postwar economy, but the distribution of households by income level attracted at least as much interest as the relative positions of exporters and others. In that context, the role of the government was much less clear.

Redistribution from the relatively rich to the relatively poor was often thought to be part of the Welfare State. The tax system probably did become more progressive during the Second World War as direct taxes were increased relative to indirect. Thereafter the degree of progressivity changed little for 20 years, while tax avoidance ensured that it remained no more than mild. That probably accorded with community wishes as most people thought that progressivity should really begin to bite at a level of income somewhat above their own. In the 1970s inflation was not matched by changes in the tax scales, and as incomes were carried into higher tax brackets, income tax probably became less progressive just as it became a larger fraction of total taxation. The redistributive effect of government depends on the composition of its expenditure as well as its sources of taxation. Increased social security benefits for the aged and those with young families may well have come to be more important than progressive income taxes. Detecting the net effect of government policies on income distribution is difficult; concessions of low taxes on small incomes benefit the part-time worker in a household with a highly-paid member as well as the poor; those with low incomes may have inherited wealth which permits further untaxed capital gains (although there is little doubt that the relatively well-off benefited most by being able to exchange taxable income for untaxed

capital gains); the final incidence of indirect taxes and of company tax depends on the state of demand for individual products, and so on. The only safe conclusion is that the Welfare State was based on intervention in specific areas rather than on any coherent redistribution of income guided by levels of pre-tax income.[33] Nevertheless, there was a widespread belief that government was increasingly determining the distribution of post-tax incomes, a belief that intensified after the introduction of National Superannuation in 1976.

33. Cf. Suzanne Snively, "The Distribution of Tax Payments by Household Income Group in New Zealand:, Paper read to N.Z. Association of Economists, August 1977: Len Cook and Mervyn Pope, "Government Expenditure and Income Data:, Data set compiled for the Fiscal Reform Workshop of N.Z. Association of Economists, Dunedin, August 1981

VI CONCLUSION

Thus there were indeed reasons for thinking that government's role increased in the postwar economy in ways that did not require government to use a greater share of the available resources. The activities of government in matters like law enforcement continued and only occasionally caused controversy and then seldom for economic reasons. However, the nineteenth century practices by which New Zealanders were protected against competitors from abroad became of much less significance when governments accepted responsibility for maintaining the level of total output and found that the management of the foreign exchange constraint which this involved required a quite different kind of consideration of relations between New Zealand and other economies, a continuous and comprehensive degree of protection and control rather than reaction to isolated events. Reconciliation of competing interests became more difficult as New Zealand's export markets grew too slowly to permit growth of incomes equal to that attained in some overseas countries, while expectations widened to include employment suitable to a range of aptitudes and skills. When generalised influence seemed insufficient, governments turned to more detailed intervention with a readiness conditioned by the apparent success of such measures in 1938 and during the Second World War. Government decisions rather than the immutable laws of economics or finance were what individual producers and consumers saw as constraining them, and more varied pressure groups used the political process to secure and retain preferential positions for themselves. It can readily be admitted that bureaucracies, public and private, develop their own momentum without disturbing these central conclusions which encompass the origins of the bureaucracies.

Historical studies seldom lead to instant solutions of current problems, but they do lead to better understanding of those problems and may alert people to possible approaches to solutions. That is the case with an understanding of the evolution of government economic activity in New Zealand and present dissatisfaction with government's economic performance.

The central conclusion is that there is little choice but to adapt to a longstanding willingness to use the government apparatus where it can be useful, seeking to confine government to those things which it can do better than non-government organisations, taking into account both the direct cost of any intervention, and its impact on enterprises and households. In the case of things like law enforcement and diplomacy, this implies only that government's use of resources should be subjected to the best available economic and financial appraisal. The technique and procedures are already in place, and the conclusion which follows from our analysis is merely that they should consistently be applied.

In the case of interventions designed originally to protect New Zealanders from foreigners and to balance competing interests, it should be recognised both that the aims have become more difficult as a less homogeneous society seeks to adjust its position in the trading world and that governments now have powers and instruments alternative to those adopted in earlier years. The existence of a central bank makes ownership of a trading bank economically redundant; ability to secure knowledge about life and general insurance companies and powers to counter profiteering have the same effect on government ownership of insurance companies. There is little economic point in owning the coal mines when they have become a relatively minor element in the energy market.

These essentially negative dissertations do not make a compelling argument against public ownership. They do suggest that the reasons for public ownership must now be found elsewhere; inertia is not sufficient. As the 1980 Budget stated clearly, the distinction between the efficient and inefficient use of resources is different from, and economically more important than, the distinction between public and private ownership. If private enterprise was willing to purchase the Bank of New Zealand for more than the present value of the profits which can be expected to be paid into the public account under its current administration, then there is an initial case for denationalisation. There may be arguments about the social impact of banking in small towns to be considered, but the focus would be on the efficient use of resources, not on the quite different reasons for nationalisation that led to a government shareholding in the 1890s. Essentially the same argument applies to the Government Life Office and State Insurance. The creation of a Railways Corporation is a useful step in the same direction. It is, of course, equally important that efficient use of resources rather than form of ownership be the criterion applied to Petrocorp and the producer boards.

The argument advanced here is far from an advocacy of government withdrawal. It is that the powers of government should be used where they are useful. This includes the familiar point that policies need to be skilfully composed and all that historical perspective adds is that macroeconomic policies have come to be most important. Governments cannot divest themselves of responsibility for economic growth, inflation, and unemployment even though it is obvious that they have to create a general climate where their actions will not be frustrated by the reactions of individuals and groups.

It is more difficult to see ways in which the trend towards reliance on direct controls can be reversed even when they engender wasteful use of resources and a spirit of antagonism in those they affect. Direct controls are now readily to hand, and they offer the appearance of a strong response to any problem. Furthermore, restraining government to general rules rather than dealings with individuals, even if it were practicable, is not always to be recommended. Modern technology makes it possible for a central bank to borrow from individuals rather than only in "wholesale" dealings with institutions and the use of this power in the case of inflation bonds has no obvious disadvantages. The appropriate recommendation is that journalists and commentators should promote understanding of all the implications of controls including the proposition that what is apparently direct is not always best, and community leaders, political and otherwise, should use controls and regulations not as a ready resort but on the basis of careful analysis, including recognition that New Zealand is no longer a small community entirely attuned to paternalistic decisions about individual welfare.

Acceptance of diminished homogeneity does not imply that the "umpiring" role of governments can be abdicated. It was with economic growth in the United States in mind that a leading American economist recently wrote:

> Because the required adaptations can and do alter the positions, prospects, and power of established groups, conflict and resistance are intrinsic to the growth process. To resolve such conflict and resistance in a way which preserves a large consensus for growth, yet does not impose a cost which retards growth unduly, a mechanism of conflict resolution is needed. The national sovereign state necessarily becomes the arbiter of group conflict and the mitigator of those negative effects of economic change which would otherwise induce resistance to growth. 34

34. M. Abramovitz, "Welfare Quandaries and Productivity Concerns", American Economic Review 71 (March 1981), p.2

The responsibility of the "sovereign state" rests more clearly with the central government in New Zealand than it does in the federal system of the United States. The change required is not a retreat beyond the laissez faire of the nineteenth century, but a change of emphasis from government preservation of homogeneity towards government assistance to conflict resolution, to mediation between parties, together with some fostering of interests such as consumers who are less able to organise than are employers and employees.

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