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OPINION: THE WEEKEND INTERVIEW | MARCH 6, 2009, 10:32 P.M ET JOHN KEY

You Can't Spend Your Way Out of the Crisis

New Zealand's prime minister wants to give his country a competitive advantage instead.

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By MARY KISSEL

Wellington, New Zealand

These days, you have to travel far to find a national leader who is talking about market-based approaches to the global recession. All the way to the other side of the world.



Terry Shoffner

"We don't tell New Zealanders we can stop the global recession, because we can't," says Prime Minister John Key, leaning forward in his armchair at his office in the Beehive, the executive wing of New Zealand's parliament. "What we do tell them is we can use this time to transform the economy to make us stronger so that when the world starts growing again we can be running faster than other countries we compete with."

That idea -- growing a nation out of recession by improving productivity -- puts Mr. Key and his conservative National Party at odds with Washington, Tokyo and Canberra. Those capitals are rolling out billions of dollars in stimulus packages -- with taxpayers' money -- to try to prop up growth. That's "risky," Mr. Key says. "You've saddled future generations with an enormous amount of debt that then they have to repay," he explains. "There

is actually a limit to what governments can do."

The 47-year-old Mr. Key, a pragmatist by nature, knows a thing or two about how the public sector works. The youngest of three children, he was raised in state-owned housing in Christchurch, on New Zealand's South Island, after the death of his father. His mother worked at blue-collar jobs to keep the family afloat. Mr. Key earned a bachelor's degree in commerce from the University of Canterbury, took a job the next day at a local accountancy firm, and married his high-school sweetheart. After seeing a TV advertisement about a foreign-exchange trader, he started canvassing banks for a job. That kicked off a career as a foreign-exchange trader, with postings in Singapore, London and Sydney -- most recently at Merrill Lynch. "Bank of America," he says, with not a little mirth, "it's probably soon to be owned by Barack Ob-ah-ma!" -- emphasis on

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the "ah" in Kiwi-speak. His press secretary rolls her eyes.

Mr. Key's coalition government, which includes parties to the right and left of the Nationals, has moved fast to implement a program of tax cuts, regulatory reform and government retooling. He won't label it supply-side economics and smiles when I ask if he's a Milton Friedman or Friedrich Hayek acolyte. "I'm not deeply ideologically driven," he says. "I believe in good center right politics."

Mr. Key is returning the country to a formula for prosperity that's worked in the past. As in Britain, the U.S. and Australia in the 1980s, New Zealand's government implemented a wide-ranging program of economic liberalization, including deep reductions in tariffs and subsidies, and privatization of state-run industries. The plan, nicknamed "Rogemomics" after then-Finance Minister (now Sir) Roger Douglas, was akin to Reaganomics, and the island nation grew smartly.

But while the U.S. and Australia broadly continued their economic liberalization programs under both right- and left-wing governments, New Zealand didn't – until now. Over the past nine years, Helen Clark's left-wing Labour government rode the global economic expansion and used the revenue surge to expand government welfare programs, renationalize industries, and embrace causes like global warming. As a result, the economy stagnated while Australia took off.

"We have been on a slippery slope," Mr. Key says, pointing to the country's slide to the bottom half of the Organization for Economic Cooperation and Development's per-capita GDP rankings. "So we need to *lift* those per-capita wages, and the only way to really do that is through productivity growth driving efficiency in the country." He talks at length about how to attract and retain talented workers. What does he think about populist arguments about the end of capitalism? "Nonsense!"

Mr. Key's program focuses first on personal income tax cuts, which – given that the new top rate, as of April 1, will be 38% – are still high, especially when compared to Hong Kong and Singapore. "We just think it's good tax policy to lower and flatten your tax curve," he says. "People will move in labor markets and they look at their after-tax incomes."

Cutting the corporate tax rate – which is now 30% – isn't as crucial just now as keeping liquidity flowing, Mr. Key argues. "A lot of [companies] won't pay tax if they don't make money," he reasons. "So they might be slightly less focused on corporate tax in the immediate future. Longer-term, they will be." Why? Corporate money is "mobile." "If you really are out of whack with the prevailing corporate tax rates, and there's been a global shift toward countries lowering their corporate tax rate, then you're not likely to attract capital, or you're likely to lose capital." Mr. Key and his coalition partner, the ACT Party – Mr. Douglas's party – want to eventually align personal, trust and company tax rates at 30%.

For now, the prime minister is focusing on chipping away entrenched regulations that drive away foreign capital – a contrast to the U.S. and Australia, which are reregulating their markets in the wake of the financial crisis. "Good regulatory reform can be an important catalyst toward driving economic growth and coming out of the recession faster," Mr. Key says. His government is revising legislation meant to protect New Zealand's pristine environment from private-sector development but misused by greens to stymie all stripes of business plans.

Big government is also coming under the gun. Mr. Key launched a "line-by-line review" of every government department, and committed the government to cap new spending in its May budget. "If we want to fund new initiatives, we by definition have to stop [funding] some of the things we don't think were working. . . . We're just getting better value for money."

The Key government also is wary of climate change orthodoxy. "Half of all of our emissions come from agriculture," he says, meaning cows "burping and farting." "We don't have an answer to that. . . . So at the moment, we either become more expensive or we cut production. And neither of those options are terribly attractive." Mr. Key is reviewing the economic impact of the previous government's cap-and-trade plan. "New Zealand needs to balance its environmental responsibilities with its economic opportunities, because the risk is that if you don't do that – and you want to lead the world – then you might end up getting unintended consequences."

Much of Mr. Key's reform agenda hinges on his belief that he has to prepare his country

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to compete in the global economy. "The world, whether we like it or not, will become more and more borderless," he says. That means Wellington is planted firmly behind free trade. "The sooner Doha is completed," Mr. Key says, referring to stalled global trade talks, "the better from our point of view."

Mr. Key chuckles when I ask him about the "Buy American" provision tucked into the Obama administration's stimulus package. The previous government's "Buy New Zealand" campaign got a "lukewarm" reception, he recalls. "There are so many component parts manufactured in different parts of the world, you're chasing your tail the whole time about where something's actually made."

New Zealand last year inked a free-trade agreement with China, recently signed a deal with the 10-member Association of Southeast Asian Nations, and announced the start of negotiations with India and South Korea last month. Korea "obviously" wants an FTA with the U.S., he says.

Does New Zealand's model hold lessons for the Obama administration? Mr. Key says that might be "presumptive." But he does outline a few general lessons: "Your citizens are entitled to expect you to be realistic . . . to be specific about what it is you're going to do, what you can or can't do. And finally, I think, to be confident that you can get through it. Now there's plenty of doom and gloom merchants out there. But the single biggest risk is that everyone believes them and stops doing anything. I can't see how that helps us." What did he learn in his former trade? "It taught me not to panic."

Going forward, he worries about, among other things, the U.S. dollar's path. Like most other trading nations, the bulk of New Zealand's exports is denominated in dollars, and the country's private sector borrows heavily from offshore markets. Says Mr. Key: "For anyone trying to manage currency risk, and indeed often interest-rate risk, you know, it's not generally the absolute level, it's more the volatility that becomes the determining factor." A strong and stable dollar policy out of the Obama administration would be helpful.

But ultimately, Mr. Key says his biggest fear is rising inflation on the back of rising money supplies. "Economic theory will tell you that inflation is going to rise -- and that inflation will be exported around the world. . . . In the short term, I'm not criticizing U.S. policy: I think inflation is probably the thing that's going to be necessary to get them out of the current issue. [Federal Reserve Chairman Ben] Bernanke sort of signaled that. But longer term, inflation is cancerous to your economy."

So would Mr. Key, the onetime foreign-exchange trader, buy or sell the U.S. dollar? As we move toward the door, the press secretary steps in: That's one call that's off the record.

Ms. Kissel is editorial page editor of The Wall Street Journal Asia.

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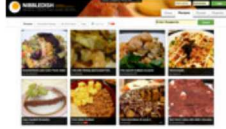
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