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NEW INSTITUTIONAL ECONOMICS AND THE ECONOMIC DEVELOPMENT IN NEW ZEALAND AND URUGUAY SINCE 1984

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ABSTRACT

This paper evaluates the validity of key propositions from North, Wallis, and Weingast (2009) and Olson (2000) in the shine of the economic reforms in New Zealand and Uruguay since 1984. It is shown that both theories possess more similarities than previously observed. Based on a conceptual framework, the comparative country analysis reveals that New Zealand's low political competition as well as missing fiscal and monetary incentives for modern export structures withheld it from its ascribed ideal-type economic blossoming. The theories hold to a larger degree in the case of Uruguay, where its volatile catching-up is explained by an amendable institutional setup, contradictionary economic policies and the reliance on the export of its natural factor endowments. The paper concludes that the institutional theories of NWW and Olson hold to a limited extent only and need further amendments to account for the divergence between institutions and policy making, social cohesion in small economies, the impact of external organisations and informal barriers of trade.

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INTRODUCTION

At the core of this paper shall be the critical evaluation of the key propositions from the latest works of Douglass North, Mancur Olson and their respective co-authors by a comparative analysis of the economic reforms of New Zealand and Uruguay after 1984. Thus, this paper addresses current debates in economic theory as well as in economic history.

At the beginning of the 21st century New Institutional Economics (NIE) remains a lively field (Hodgson, 2009). Besides continuing discussions of particular institutions, scholars are still concerned with the establishment of a unified theory (Chang, 2005; Williamson, 2000). Among others, North, Wallis, & Weingast (NWW, 2009) and Olson (2000) provide recent additions to the collection of such frameworks.[1] Their authors argue independently that they are capable to explain actual economic history of the Western World by focusing on proposed interrelationships between political and economic development. Despite the theories' broad reception in academia, scholars have not realised their astonishing similarities nor have they examined them empirically.[2]

This paper contributes to the academic debate by evaluating NWW's (2009) and Olson's (2000) propositions in the shine of the socio-economic development in New Zealand and Uruguay since 1984. Both modern settler economies are selected as they share similar factor endowments and earlier economic development patterns, but diverge in the origin of their institutional setups (Denoon, 1983). A decade after the global events during the early 1970s and their harsh consequences for New Zealand and Uruguay, the year 1984 became a watershed for both countries (Belich, 2001; Finch, 2005). In this year, a dramatic reversal towards laissez-faire economic policies began in New Zealand ("Rogernomics") as well as democracy was reestablished in Uruguay. Because of their different institutional backgrounds, both countries should have adapted very differently to external changes. In other words, New Zealand's and Uruguay's most recent economic histories provide an ideal case study for the evaluation of economic theory.

To successfully address the research objective, the paper is structured in the following way. In section one, a brief literature review determines key differences and commonalities in NWW's and Olson's propositions about political and economic markets. Next, a brief methology section discusses the transformation of these findings into a applicable research agenda. Following this agenda, the third section contains a concise comparison between de-jure institutional setups and the respective economic growth records of both nations. The fourth section is devoted to a systematic inquiry into de-facto political markets. The fifth section provides an analysis of major differences in fiscal policies and their results. The next section discusses the means and ends of both countries to achive monetary stability. The seventh section deals with their attempts of international reinsertion and its implications for national economic growth. To enhance understanding, these findings are set into context, where applicable, with respective economic data from OECD high-income countries.[3] The final section concludes the paper and outlines future paths in research.

THEORETICAL BACKGROUND

The earlier contributions from Douglass North (1981, ,1990) and Mancur Olson (1965, ,1982) have been highly influential in the fields of New Institutional Economics and Public Choice theory (Fine & Milonakis, 2007, p. 27; Schelling, 2000, p. 799). However, both scholars have responded to their

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[1] Acemoglu & Robinson (2006), Greif (2006), and Tilly 1992) are further important recent contributions.

[2] See McLean (2000), Kiewit (2010) and Schofield (2003, 2009) for reviews.

[3] NWW (2009) and Olson (2000) consider OECD countries as Weberian ideal-types.

critics and novel movements within academia and have redefined their propositions. Hence, North together with J. J. Wallis and B. R. Weingast, has developed the *Recorded Human History framework* (RHH framework) since 2005 and presents it extensively in their common book *Violence and Social Orders* (2009).[4] On the other hand, Mancur Olson's yet to become *Theory of Power* (ToP) emerged gradually from the end of the 1980s and is depicted more comprehensively in his posthumously published book *Power and Prosperity* (2000).[5] Although both theories share the same scope and base their reasoning on similar literature from adjoining fields of social science, North and Olson largely avoid examining each other's work in greater detail.

Despite NWW's (2009) bold claim of novelty, the RHH framework does not differ substantially from the ToP in their use of an almost identical mix of 'standard' elements from NIE. Within their rational choice theories, the state has a central role. However, NWW continue to use North's approach of planting the origins of institutions deeply into culturally influenced belief systems, whereas Olson (2000, p. 194) prefers to address formal institutions.[6] Other aspects are indeed novel. NWW do not mention North's earlier key concepts of 'path-dependence' and 'transaction costs' at all, both main pillars in North (1990).[7] Nevertheless, NWW still adhere to North's approach but wraps it into a concept of 'higher gains from impersonal exchange'. Moreover, already the title of NWW (2009) reveals the risen emphasis on 'violence' compared to North's earlier work, but it has already been a core element in Olson (2000). Further novel matches between NWW and Olson are their emphasis on interest groups and public goods provision.

NWW and Olson combine their elements into a holistic framework that simultaneously addresses the political and economic national realms. The RHH framework follows the ToP's evolutionary three-stage social order approach from Olson with varying degrees in the level of institutional quality. However, both NWW and Olson only consider the last two social orders as key to understand the divergence during the era of modern economic growth, and, hence, establish an implicit 'autocracy–democracy' dichotomy.[8] In the case of NWW, these role models are defined as *Natural State/Limited Access Order* or *Open Access Order* (OAO).[9] Olson dubs them *Stationary Bandits* and *Democracies*.[10] Both approaches emphasise the crucial need to distinguish between de jure and de facto institutional layouts. A further essential point of divergence between both theories is the influence of interest groups. For NWW, only OAO can sustain balanced political competition among different interest groups on clearly defined impersonal rules. In the case of the ToP's institutional sclerosis paradigm, the rising impact of rent-seeking interest groups can force formerly successful democratic societies away from their distributive efficiency. In other words, NWW turn Olson's collective action theorem deliberately on its head.

Yet another crucial difference between the two frameworks lies in the opportunities for transition. As NWW argue, a transition towards political and economic prosperity is lengthy and hardly possible. Furthermore, once this third stage is achieved, it is to be contained automatically in the future. However, NWW provide many examples of intra-transitions within the second social order. NWW appear to diverge considerably from North (1990) in their potential allowance for

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[4] North, Wallis & Weingast (2005). The Natural State: The Political-Economy Of Non-Development. UCLA International Institute.

[5] Charles Cadwell (in Olson, 2000, p. xvii) attributes the start of Olson's last major scholarly episode to the paper "Diseconomies of Scale and Development" (1987).

[6] As NWW (2009, p. 28) refers to North's earlier book, the link between the elements can be shown explicitly: "beliefs -> institutions -> organizations -> politics -> outcome"(North, 2005, p. 155).

[7] NWW might have considered Olson's (2000, p. 81) rejection of the importance of transaction costs.

[8] NWW (2009) connect economic prosperity to high democratic values based on a principle of 'double balance.'

[9] Until NWW (2007) the terms were Limited Access Order (LAO) and OAO.

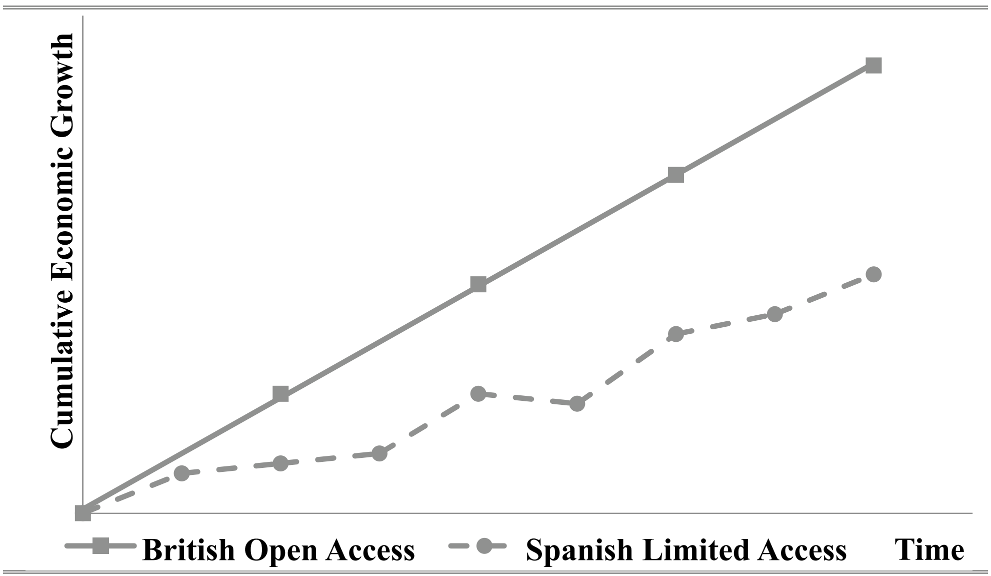
[10] For the sake of clarity, the terms 'open access' and 'limited access' are used to address Olson's 2nd and 3rd social orders in the remaining paper.

plurality of institutional setups that can achieve and maintain social progress and economic success.[11] Nevertheless, NWW still refer extensively to the economic histories of the UK and the US to build up their theoretic core. They assign the current ‘open access order’ status to former British offshoots. On the other hand, NWW (2009, p. 2) deny a successful dissociation of former Spanish colonies from the ‘limited access order’ label. This leads implicitly to the continuation of North’s (1990) ‘British-Spanish’ dichotomy in the case of settler economies. In contrast, Olson (2000, p. 78) allows for an easier upward transition (‘accident of history’) as well as for drift backwards (‘institutional sclerosis’). Moreover, Olson considers the inheritance of formal institutions as one of these ‘accidents of history’. In other words, there is no automatism that prevents former British or Spanish colonies from experiencing characteristics of the opposite order.

According to NWW (2009, p. 2) “over the past two centuries, political and economic development appear to have gone hand in hand.” Similar statements can be found in Olson (2000). In other words, the configuration of the institutional basis is the prime determinant for an economy’s capacity to exploit its theoretical output limit. Their assertions are hardly new.[12] Therefore, both concur that only at the third order Schumpetrian-style entrepreneurs can spread their powers and creativity unhindered in economic markets. In the case of NWW, unrestrained competition among them assures the most-efficient adaption to external shocks and, thus, to the economy’s sustained ‘taking-off’ into the income spheres of the OECD club on a less volatile path. On the other hand, Olson second social orders might be equally capable to adjust to external shocks in the short and medium term. In the long run, democracies also take the economic lead in Olson’s model, although institutional sclerosis might cause the divergence from a once successful path.

These commonalities and differences between the RHH framework and the ToP lead to two similar, yet different stylised depictions of the rising divergence between the two role models. In NWW’s opinion, stable institutional foundations led the British open access model persistently outperform its crises-driven Spanish limited access counterpart after an external shock (Figure 1):

FIGURE 1: RHH-FRAMEWORK - STYLISED ECONOMIC GROWTH PATTERNS



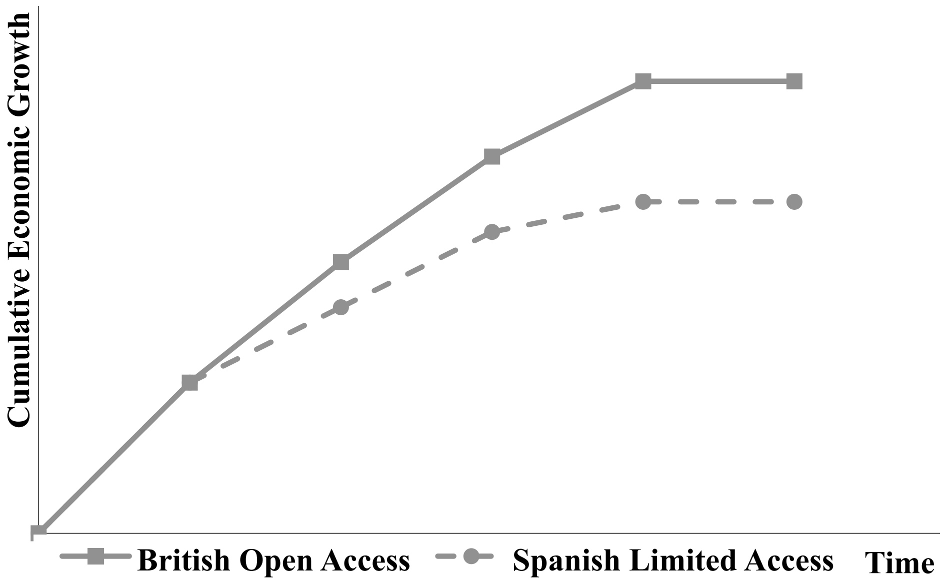
Source: Own elaboration based on NWW (2009)

[11] Spain is now considered as a ‘success story’ after a lengthy, but yet not explained transition (NWW, 2009, p. 27).

[12] North (1994, p. 361) states, “if the institutional framework rewards piracy then piratical organisations will come into existence.” Olson (2000) refers to a Mafia family’s impact on business in its neighborhood.

In contrast, Olson (2000) permits similar high economic growth rates or even higher ones of the Spanish limited access model after an external shock, while he also sees sclerotic economic stagnations in the case of the British open access model in the long-run (Figure 2).

FIGURE 2: TOP - STYLISED ECONOMIC GROWTH PATTERNS



Source: Own elaboration based on Olson (2000)

Summarised, NWW's bold claims for novelty of their RHH framework hold to a limited extent, even when being compared only to Olson's ToP. The elements of both rational choice frameworks and their *Stufentheorien* (theories of stages) are fairly similar to each other. Moreover, many ideas from North's earlier work have survived, such as deeply rooted differences in belief systems, their incremental change, and their transfer to the New World. Regarding novelties in their work, NWW have followed current general academic trends and incorporated 'conflict' and 'interest groups' into their line of reasoning. Especially Weingast's scholarly ties with political science might have a reasonable stake in this outcome. On the other hand, NWW have responded to North's earlier critics and formally abandoned some of his highly debated core concepts, such as 'path-dependency', 'transaction costs', and a pronounced 'success and failure' story for the European core. Taken these selected facts together, it can be hypothesised that NWW have been, at least, inspired by Olson's work, refurbished his ideas by recent academic contributions, and continue to tell North's major story.

After having lined-out key characteristics of both theories, the propositions of NWW and Olson have to be transformed into a feasible research agenda. Based on the scholars' proposition, New Zealand is treated as an ideal-type OAO, while a LAO-status is ascribed to Uruguay.

METHODOLOGICAL ASPECTS

For simultaneously assessing both the RHH-framework and the ToP in the shine of the socio-economic developments of New Zealand and Uruguay after 1984 settler economies, a more structured research mode has to be developed than the scholars provide themselves. However, a systematic evaluation cannot be achieved by establishing a single abstract deductive model either. Such a project rather requires the analysis of a comprehensive set of country and time specific phenomena of human interaction in the political and economic sphere. A certain degree of simplification is needed to deal with the complexity of the data. Consequently, a multiple-layered conceptual framework based on quantitative and qualitative indicators, based on NWW's and Olson's reasoning, is established.[13] On the other hand, this structured search for systematic differences and similarities in patterns of institutions might result in the abstraction of some country-specific phenomena with the creation of particular categories.

The first layer of a conceptual framework has to focus on NWW's and Olson's common top-level comparisons of institutional quality and national income per capita data. Regarding institutional quality, the rule of law, control of corruption and political stability are among the most important differentiating characteristics between the two social orders. According to NWW's (2009) concept of double balance, these results should be mirrored in top-level analysis of real GDP per capita data. Hereby, the RHH framework draws a separating line between the social orders at a level of international $20,000 in 2000 (ibid, p. 3).[14] Additionally, NWW (ibid) consider differences in average real GDP per capita growth rates as a distinguishing characteristic. Variations in the occurrence, lengths, as well as depths of periods of negative economic growth are further separating determinants (ibid, p. 5). Consequently, New Zealand should have profited from its British heritage by experiencing higher national income levels and economic growth rates than its Spanish sibling Uruguay. For the purpose of this study, the values from the World Governance Indicator database are taken as feasible proxies for institutional quality. Next, national real GDP per capita (PPP) data are used as proxies for economic prosperity. The data from 1984 to 2008 are obtained from the World Development Indicators database. This procedure provides consistency in the dataset and allows for the comparison of New Zealand and Uruguay with the performance of the OECD countries, NWW's role models for successful development.

The second layer has to take into account the setup of national political markets and resulting fiscal and monetary policies. Instead of assessing the abstract nucleus of institutions, the focus is on organisations, since they "reflect the opportunities provided by the institutional matrix" (North, 1994, p. 361). Among them, studying the influence of interest groups, such as the military, lawyers or labour unions, on the executive provide further possibilities to examine vested interests in politics (North et al., 2009, p. 15; Olson, 2000, p. 29). Considering fiscal policy, levels of sovereign debt are decisive according to the RHH-framework (North et al., 2009, p. 132). In addition, Olson (2000, p. 190) deems increasing governmental budget discipline as a basic feature of the rich. Moreover, further differentiated fiscal incentives can have a clear impact on national economic growth over the long run (Olson, 2000, p. 119). Finally, Olson (ibid, p. 158) pinpoint the quality of monetary policy down to price stability and to lower interest rates in rich countries.

The third layer of the conceptual framework comprises the evaluation of the efforts for international reinsertion. According to NWW (2009, p. 140), the foreign trade sector constitutes a mirror of a country's competitiveness in the world markets of certain consumer products. In the case of the RHH framework, low institutional barriers of entry encourage entrepreneurs to continuously enter the market and maintain competition (North et al., 2009, p. 24). As well, only sophisticated institutional environments can support modern internationally successful company structures and the evolution of a skilled workforce (ibid, p. 211). Moreover, higher turnover rates of firms, products, and consumption patterns contribute to on-going rejuvenation of the economic markets (ibid, p. 136). This enthusiasm for competition within a privately owned and managed economy is echoed in the ToP (Olson, 2000, p. 143). Furthermore, higher specialisation of economic entities leads to breaking-up of larger heterogeneous companies and concentrations within certain industries (ibid, p. 162). Likewise, Olson (2000, p. 194) regards national capital

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[13] A comprehensive presentation of an extended conceptual framework based on NWW (2009) and Olson (2000) can be found in Schlueter, A. (2010). *Towards a Coherent Institutional Framework for Small Settler Economies: A Comparison of North and Olson.*

[14] NWW (2009) rely on real GDP (PPP) per capita data from Heston and Summers (2009). Olson (in Olson, Sarna, & Swamy, 2000) uses data from the World Development Indicators (WDI) database.

markets as the most sensitive economic markets with constant need for adjustment and maintenance. Hence, institutional quality, which underpins financial markets, can easily be read off capital streams and capital costs (ibid). The quantitative part of analysis for the second and third layers of the conceptual framework is based on information obtained from national and international databases, such as Infoshare, INE, BCU, World Development Indicators database and others. These figures are accompanied by a critical review of specific secondary literature to enhance understanding and to allow for a credible judgment of the theories.

Summarised, the framework offers the opportunity to evaluate the RHH framework and the ToP in the light of NZ's and Uruguay's reforms in a focused and structured way. Additionally to macro-scale comparisons, specific analyses of the political and economic markets will guide to the secrets of both countries' trajectories and to substantiated judgments of both theories (Table 1).

TABLE 1: THE CONCEPTUAL FRAMEWORK

	New Zealand (OAO)	Uruguay (LAO)
Institutional quality	- Rule of law, low corruption, high government effectiveness	- Higher levels of corruption, selective rule of law, inefficient government
Economic growth	- Higher average growth - Lower volatility	- Lower average growth - Higher volatility
Political diversity	- Political competition - Working checks and balances	- Rent-seeking and lobbying - High barriers of entry
Fiscal policy	- Balanced budgets - Equal income redistribution - Incentives for modern sectors	- Fiscal mismanagement - Skewed income redistribution - Consumption, not investment
Monetary policy	- Lower inflation - Stable currency	- Higher inflation - Volatile currency
Global Insertion	- Creative destruction and sophisticated products in international open markets - Stable monetary flows and lower real interests	- Self-enforcing markets with rent-seeking and barriers of entry - Volatile monetary flows and higher real interests

Source: Based on NWW (2009) and Olson (2000)

THE REFORMS AND THE ECONOMIC GROWTH RECORDS

Grim economic conditions and subsequent exchange crises led to a tremendous institutional upheaval in both New Zealand and Uruguay in 1984 (Evans, Grimes, Wilkinson, & Teece, 1996, p. 1860; Jacob & Weinstein, 1992, p. 46). After a snap election, lawyer David Lange became Prime Minister and formed the Fourth Labour Government of New Zealand (Sinclair & Dalziel, 2001, p. 336).[15] Finance Minister Roger Douglass and his associates immediately began their ambitious programme of comprehensive market deregulation (Evans et al., 1996, p. 1856).[16] In the case of Uruguay, the institutional turnaround in 1984 appears even more substantial. After several months of civil protests, the Naval Club Pact between military and civilian representatives led to a rapid reestablishment of the democratic system based on the 1967 constitution (Jacob & Weinstein, 1992, p. 46).[17] The Colorado Party won the first (semi) free elections since 1971 and Julio María Sanguinetti became president in subsequent March (ibid, p. 47). Furthermore, the earlier orientation towards market liberalisation was maintained (Finch, 2005, p. 316). According to the conceptual framework, New Zealand's primacy in democratic tradition should still be visible (Table 2).

TABLE 2: QUALITY OF INSTITUTIONAL STRUCTURES AND PROCESSES

	New Zealand	Uruguay
Voice and Accountability	97	82
Political Stability No Violence	89	78
Government Effectiveness	95	69
Regulatory Quality	98	57
Rule of Law	98	67
Control of Corruption	99	85

Sources*:* World Bank (2011), World Governance Indicators*;* Year 2008 values; Range 0 (worst) to 100 (best)

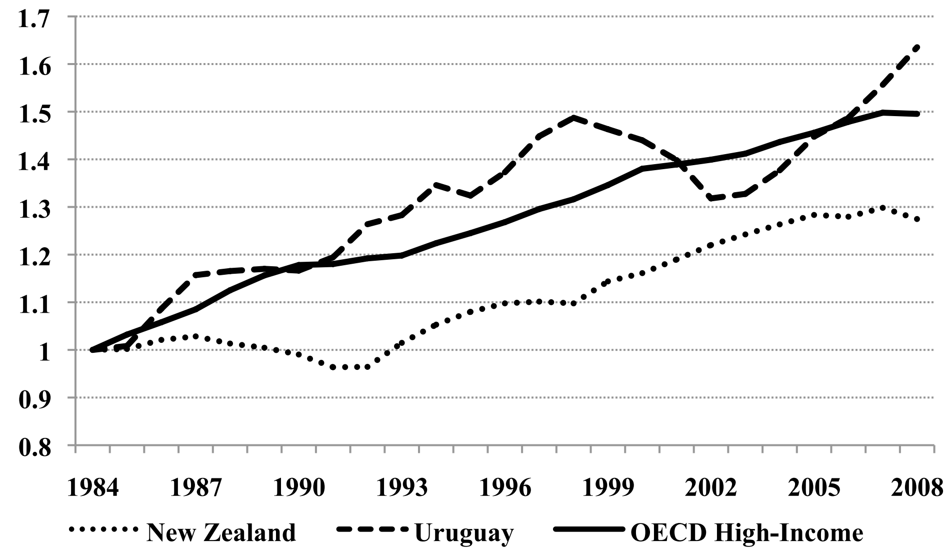
New Zealand seems to provide a nearly ideal-type formal institutional setup, including many institutional renovations over the last quarter century. Uruguay has seen major upgrades too, although regulatory quality has slipped substantially. Nevertheless, the better institutional underpinning should have favored New Zealand in adapting to external shocks and to experience higher sustained economic growth (Figure 3).

[15] As before in the 1890s (Liberals) and 1935 (Labour), a reformist political party was elected as response to a national crisis (Bertram, 2009, p. 552).

[16] For a detailed analysis of Rogernomics see B. Easton (ed.) *The Making of Rogernomics*, Auckland: Auckland University Press (1989).

[17] A detailed account of the transition period is given by Gillespie (1991). *Negotiating Democracy*. Cambridge, Cambridge University Press.

FIGURE 3: ECONOMIC GROWTH AFTER 1984



Source: World Bank (2011), World Development Indicators; GDP per capita (PPP); Values in 2005 international GK-Dollars; Compounded log return rates own calculations; 1984 =1;

New Zealand experienced its 'lost decade' until the early 1990's and could not regain ground to other leading nations afterwards (Dalziel, 2002, p. 37). On the other hand, Uruguay's catching up was more than once one of temporary nature with massive losses after 1998 (Table 3).

TABLE 3: ASSESSMENT OF ECONOMIC DEVELOPMENT

	NZ	Uruguay	OECD HI
Real GDP per capita in 2008	$25,087	$11,681	$34,270
Real GDP per capita in 1984	$19,063	$6,189	$20,882
Av. annual GDP p. c. growth rate	1,14%	2,65%	2,06%
Av. annual volatility	2,08%	4,37%	1,05%
Max negative GDP p. c. growth rate	-2.66%	-8.05%	-0.03%

Source: World Bank (2011), World Development Indicators; Values in 2005 international GK-Dollars; own calculations

Taking these facts into account, the promises of flourishing economies based on the economic reforms have not been fulfilled as predicted (Dalziel, 2002, p. 28; Bertola & Bittencourt, 2007, p. 326). The framework may not explain why an 'economic sclerosis' crippled New Zealand, despite its strong democratic heritage and continued rejuvenation. On the other hand, Uruguay's still lower institutional ranking may have been one of the reasons for its oscillating economic growth patterns. In other words, both economies must have missed important elements to fully exploit their production potential during this period. Some of the reasons might be found in the de-facto political markets in both countries, which are discussed next.

THE MAINTENANCE OF POLITICAL DIVERSITY

Following the conceptual framework, there should have been fundamental differences in the political bargaining process between both countries. In general, New Zealand's reforms should have been based on a more pluralistic and balanced approach, where Uruguay's rejuvenation might have been hampered by rent-seeking old elites. Likewise, this Olsonian 'windows of opportunity' could have healed New Zealand from its institutional sclerosis.[18]

In the case of New Zealand, the often-called "New Right Revolution" had tremendous impacts on the society and, as a matter of fact, showed characteristics of a coup (Easton, 1997, p. 225). Their proponents, who represented a risen urban elite with privileged education and middle-class or better background, were led by the leitmotif of TINA ("There is no alternative") and objected much of their primary-products exporting 'fathers' (ibid, p. 226).[19] Roger Douglass as well as further members of the Cabinet, the Business Roundtable, and other strategically located institutions represented the exclusive 'inner circle' of the new right (Goldfinch, 2000, p. 12).[20] Because of their influence at the Treasury and the Reserve Bank, they could exclude other sources of economic advice by its sheer numbers of economists, and, therefore, dominated the orchestration of the neoclassical policies until at least 1988 (Belich, 2001, p. 411). Opponents were driven out to other departments and the private sector through informal pressure, or became subject of petty harassment (Easton, 1997, p. 220).[21] Moreover, a widespread bipartisan consensus prevailed, which preferred individual to collective solutions, and exhibited a special dislike for inflation, unions, and the welfare state (Bertram, 2009, p. 553). Even after the 'abdication' of Douglass and further Labour politicians in the late 1980s, no serious programmatic competition between the major parties emerged (Sinclair & Dalziel, 2001, p. 342). Therefore, the post crisis consolidation led by the National Party during the 1990s continued in the earlier footsteps (Bertram, 2009, p. 552). In other words, only the lack of diversity maintaining political structures in the system allowed for the 'crash through' approach to economic liberalisation and alignment of governmental interests to the new economic structure, especially the rising financial sector, but simultaneously undermined the political legitimacy of the process (Goldfinch, 2000, p. 17). [22]

During the process of turning the public sector upside down and trimming it through privatisations, semi-corruption prevailed due to a built-in 'looking for your mates' culture; which dominated the governmental procedure of the appointment to over 4,000 positions (Belich, 2001, p. 403). Moreover, the associated private sector benefited from lucrative consultancy contracts from state-owned enterprises (Easton, 1997, p. 227).

On the other hand, delayed labour market reforms hindered economic growth during the 1980s due to Labour party's traditional links to unions (Evans et al., 1996, p. 1871). Only with the new National government, the Employment Contracts Act of 1991 transformed New Zealand's job market to one of the most flexible worldwide (McMillan, 2004, p. 13). The Act resulted in halving of trade union membership numbers within three years and undermined the union's negotiation power (Sinclair & Dalziel, 2001, p. 345). In turn, it contributed to a large real-income loss for employees, but did not significantly increase productivity as proposed before (Dalziel, 2002, p. 42).

[18] Brian Easton (1997, Chapter 13) presents a potential scenario for New Zealand based on Olson (1982).

[19] New Zealand's (contemporary) establishment is typically male, older, white, wealthy, middle-class and of middle-class origin, living in Wellington or visiting Wellington regularly (Easton, 1997, p. 211).

[20] The Business Roundtable, a self-selected lobby group of about forty chief executives of New Zealand's biggest business took up an active role in promoting in – as it said – the 'public interest' from 1986 (Easton, 1997, p. 228).

[21] Even university staff was affected, as controversial articles were less likely to be published in 1990 than in 1930 (Easton, 1997, p. 221).

[22] A compact overview about the areas and dates of the initial reforms can be found in (Evans et al., 1996, p. 1859).

Furthermore, major institutional renovations, such as the setting-up of the Waitangi Tribunal in 1985, the Constitution Act 1986, the new MMP election system in 1996, and the biggest reconstruction of local government since Vogel's 1870s reform, were undergone (Belich, 2001, p. 410; Sinclair & Dalziel, 2001, p. 339). These institutional reforms fostered political diversity but also reversed many of the initial policies in a manner of stop-and-go policy making. As such, the more corporatist Employment Relations Act of 2000 replaced the Employment Contracts Act (Dalziel, 2002, p. 42). The Waitangi Tribunal became an industry of income distributions for Pākehā lawyers and small Māori elite based on an increase from 180 claims in 1989 to over 700 in 1999. The Treaty was worth something, which means that contractual rights were enforced, but it was misused (Belich, 2001, p. 480). Moreover, the government proposed the commercial exploitation of the shoreline in 2004 without considering the rights of the indigenous owners (Hill, 2009, p. 536). Thus New Zealand's political markets still remained highly personalised by a small predominately urban elite even after the 'revolution'.

In the case of Uruguay, the evolution of political processes after 1984 was substantially slower. However, the constituency as well as the national elite sought a restoration and not a renovation of a largely conservative system, which was even mirrored in almost identical national election results in 1971 and 1984 (Wagner, 1997, p. 210). Immediately after the election, the Colorado government announced that policymaking remained an exclusive right of the executive and that no major modifications of the preceding economic policies were planned (ibid, p. 217).[23] The influence of the earlier established informal coalition of the major parties, economic interest groups and unions (CONAPRO) withered. Uruguay's right-wing presidents from the 1980s and 1990s, such as Sanguinetti (1985 – 1990; 1995 – 2000), Luis Alberto Lacalle (1990 – 1995) and Jorge Battle (2000-2005), followed their earlier established tracks from the 1960s (Garcé & Yaffé, 2005, p. 116). Many other high-ranking individuals also continued to hold significant positions within the 'new' system (Wagner, 1997, p. 226).[24] Moreover, the two traditional parties continued to use formal and informal means in an alternating bipartisan system to keep growing left-wing parties from national government as long as possible (Finch, 2005, p. 302).[25] Furthermore, traditional business interest groups began to work again through their established channels (Becker, et al., 2001, p. 55).[26] However, their persisting negative public image, internal quarrels among their heterogeneous members as well as repeated rejections from the ruling elite constrained them to a largely passive force (Wagner, 1997, p. 216). In contrast, the individualistic Asociasión de Bancos, which was eschewed by other interest groups and the public, could continue its earlier large influence into policy making even without official links (ibid, p. 248). In 1986, the controversial Ley de Caducidad granted amnesty to the military to ensure the generally preferred *cambio en paz* (Hudson, 1992, p. 158).[27] Subsequent cuts in size and budget, the disregard of the seniority principle for nominations and new guidelines should assure its subservience to the national democracy. Nevertheless, the army remained far from a passive role, as the nomination of General Hugo Medina as Minister of Defence in 1987 or public threats of the military against the

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[23] As Colorado Senator Wilson Sanabria still stated in 2000; "evidently, we are the State and therefore regard State issues as our own, and our greater responsibilities implies political leadership of the country (cited in Puntigliano, 2003, p. 177).

[24] Among these individuals were José Villar (Minister of Tourism), Ricardo Zerbino (Minister for Economic Affairs and Finance), Ariel Davrieux (Planning Director), Jorge Sanguinetti (Minister of Transport), and Ricardo Pascale (President of BCU), see Wagner (1997, Chapter 6.1).

[25] "[…] when there was a Blanco government, the Minister was a Colorado and when the Colorados were at the Government, the Minister was a Blanco" (Puntigliano, 2003, p. 183).

[26] The Cámara de Industrias del Uruguay, Unión de Exportadores, Federacíon Rural, and the Asociación Rural belong to the most notable business interest groups (Wagner, 1997, p. 230).

[27] In a 1989 referendum, a majority of the population upheld the law (Hudson, 1992, p. 158).

communist party in 1991 demonstrate (Hudson & Meditz, 1992, p. xxx; Wagner, 1997, p. 216). After the attempt to abolish the amnesty at the Congress in 2003, no further open confrontation was sought and the military retained much autonomy from the executive (Garcé & Yaffé, 2005, p. 107).

In other words, as the same political system as before the coup was re-established in 1984, it came together with all of its merits and flaws. Sanguinetti (1985-1990) just managed the transition, but did not provide incentives for innovation and rejuvenation (Wagner, 1997, p. 216). Lacalle pursued a more active neoliberal policy in accordance with the suggestions from the IMF and intended to undergo far-reaching reforms (Finch, 2005, p. 321). However, the *gobernabilidad* remained a big issue under the existing electoral system, despite considerable programmatic overlapping between both traditional parties (ibid). During the terms of Lacalle and Battle, fragile parliamentary majorities established by an elected president with a minority background created a high turnover of cabinet ministers and, thus, slowed the executive's effectiveness (Wagner, 1997, p. 251; Buquet & Chasquetti, 2008, p. 337). Intended social reforms and the privatisation process were markedly inhibited (Wagner, 1997, p. 257). On the labour supply side, unions began immediately to pressure for rising salaries through the equally re-established myriad of Consejos de Salarios (Garcé & Yaffé, 2005, p. 42). Due to their missing institutionalisation they remained a government's vehicle to drastically reduce labour disputes, even at the cost of indexing wages to inflation (MacFeeters, 1992, p. 188). After achieving its ultimate target, the government de facto abolished the Consejos de Salarios again in 1990, which contributed to sinking real-wages and to the unions' loss of about 30% of their members until 1992 (Wagner, 1997, p. 253; Finch, 2005, p. 312).

Only after its 1989' victory in the local elections for Montevideo the left-wing Encuentro Progresista-Frente Amplio (EP-FA) could emerge as a valid political power with an alternative party programme (ibid, p. 74).[28] The conservative central government responded with limiting local fiscal autonomy (Becker, et al., 2001, p. 64). Thus, the victory in the elections in 2004 and the appointment of Tabaré Vázquez as President in 2005 demonstrated the first real deferral in national power and an important step to more mature political markets (Garcé & Yaffé, 2005, p. 103). The left-wing government from 2004 onwards retained the distinguished role of the state as an economic actor, re-established the Consejos de Salarios in 2005 as a mean for union's bargaining again, and intended further reforms (ibid, p. 90).

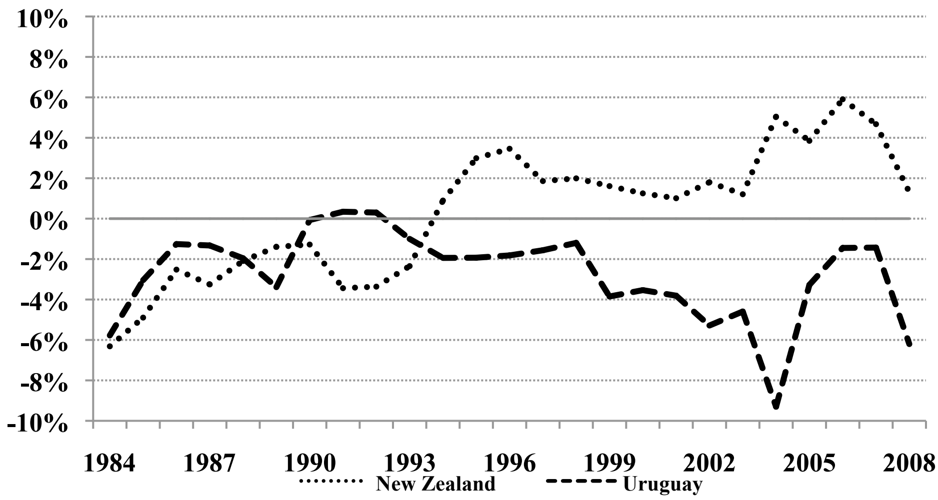
It can be concluded that de-facto political processes in New Zealand and Uruguay demonstrated more similar phenomena than suggested by the conceptual framework. The former's 'flexible' system failed quite dramatically to maintain political diversity among tightly intertwined traditional parties and made it vulnerable to ad-hoc policies and lobbying. In other words, New Zealand demonstrated crucial LAO characteristics. In the Olsonian sense, the reforms freed a sclerotic policy circus just to paralyse it again towards new objectives. On the other hand, Uruguay's high barriers of entry and its party fragmentation favoured the established elites regardless of re-democratisation. Uruguay's 'windows of opportunity' did not break up the influence of existing interest groups, nor immediately changed it into a 'country in transition'. Moreover, in both countries unions and the traditional business sector were severely limited. Only at the beginning of the new millennium, more competitive political markets emerged in both countries. Thus the way of political competition may not only depend on institutional setting.

[28] For a detailed picture of the emergence of the left and the evolution of its party strategy see Garcé & Yaffé (2005).

THE RENOVATION OF NATIONAL FINANCES

The aforementioned power distribution has considerably influenced the implementation of reforms after 1984. Both new governments faced inherited fiscal droughts and debt loads right away. Roger Douglass' programme, often called "Rogernomics", tried to attack the huge budget deficits by focussing on the reduction and reorganisation of the state sector and the ending of the state support for industry (Belich, 2001, p. 408). Another goal was to break-up existing lobbying structures by following the principle that "individual groups lose their privileges but simultaneously they no longer have to carry the cost of paying for the privileges of other groups" (Roger Douglass, as cited in Belich, 2001, p. 412). On the 28 April 1985, Sanguinetti presented his initial strategy, which focussed on the reduction of public investments to put the fiscal budget back on its feet (Wagner, 1997, p. 218). Furthermore, the vast public debt burden should be lifted through rescheduling, the return of exiled capital and an improvement of the trade balance (ibid).[29] The similar aimed reforms of Douglass, Sanguinetti and their successors achieved very different ends (Figure 4).

FIGURE 4: FISCAL BUDGET BALANCES AS PERCENT OF GDP



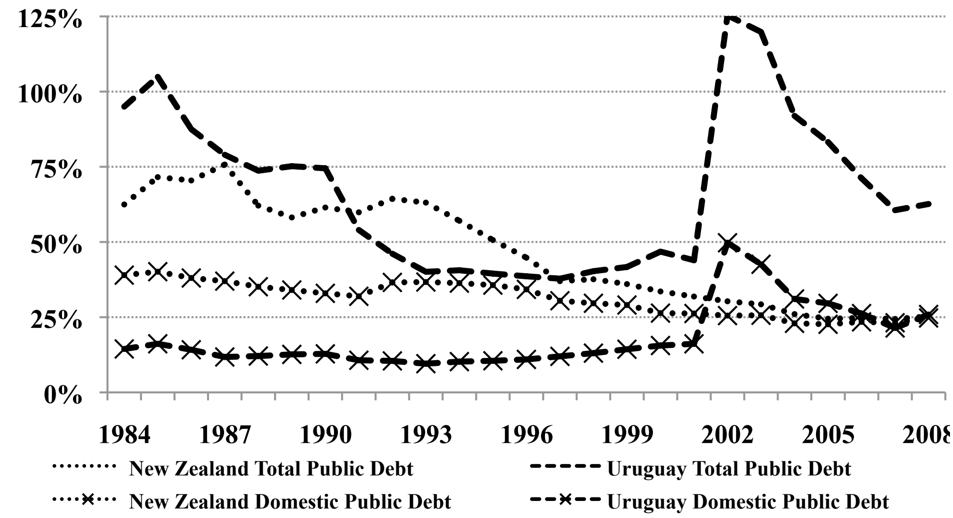
Source: The Treasury (2011) for New Zealand; Azar et al (2009, Table 1) for Uruguay until 2000, INE (2011) until 2008

New Zealand achieved balanced annual fiscal budgets after 1994. On the other hand, Uruguay continued its history of fiscal deficits with a dramatic worsening after the 2002 crisis. Moreover, Figure 4 also clearly marks Uruguay's electoral cycle with budget slips in 1989, 1994, 1999, and 2004. In other words, the initial analysis supports Olson's theory (2000, p. 157-158) of continued profound differences in fiscal management practices.

Likewise, the public debt patterns followed different tracks (Figure 5).

[29] Uruguay had to pay 715 USD million or 80% of its total export receipts for interest and capital payments in 1985 (Wagner, 1997, p. 219).

FIGURE 5: GROSS PUBLIC DEBT AS PERCENTAGE OF GDP



Source: NZ Treasury (2011), year ending 30 June; INE (2011)

New Zealand's fiscal surpluses translated into a continuous decline of its generally more domestically financed debt after 1994 and it basically withdrew from external debt markets until 2008. In contrast, Uruguay's hefty debt burden dropped only periodically, exhibiting high volatility in its external balances. New Zealand's debt management mirrors its general fiscal management, which is accordance to the conceptual framework. Nevertheless, the consequences of these policies diverged considerably from the theoretical predictions.

In regards to cutting support to industries, the NZ government implemented a 'hands-off' policy in the early 1980s to not give special preference to particular trade-able products (Easton, 1997, p. 239). Douglass' policy removed most agricultural subsidies within a year (Dalziel, 2002, p. 31). Furthermore, monopoly rights in the transport sector, and international barriers, like import tariffs or export incentives, were unilateral removed (Belich, 2001, p. 410). On the state reduction side, NZ sold NZD 19 billion of state assets between 1987 and 1999 (Sinclair & Dalziel, 2001, p. 344).[30] More than 80,000 people, around 29% of core state services, were laid-off (Belich, 2001, p. 409). This led to substantial productivity improvements in many sectors (Dalziel, 2002, p. 32).

Further fiscal actions involved the cutting and streamlining of the income tax system; the introduction of 'user pays' for the use of public services and the Goods and Services Tax (GST) from 1986 onwards; and the abandoning of assisted home ownership, free tertiary education, and other aspects of the welfare system (Belich, 2001, p. 409; Skilling & Waldegrave, 2004, p. 25). The fourth National Party government from 1990 followed 'Rogernomics' enthusiastically, and cut a further 1.6 billion NZD from the welfare system, semi-corporatised schools and hospitals, and reduced income taxes further (ibid, p. 408; Dalziel, 2002, p. 32).

During the implementation of the right-wing policies further economic or social needs were not considered (Belich, 2001, p. 412). Because the original problems were misdiagnosed, NZ's earlier fiscal reforms did not achieve the outcomes as predicted. The changes did not solve the initial surge in the costs of the state, lobbying, and slow economic growth (ibid, p. 423).

Regardless of other reforms, failed alignments of the superannuation and unemployment policies led to a sharp increase in social security payments to 40% of state spending in 1990

[30] Sales included New Zealand Steel, Petrocorp, the Shipping Corporation, the Postbank and the Telecom Corporation. Other state entities were turned into commercial state corporations, such as Forestry and Lands (Sinclair & Dalziel, 2001, p. 338).

(Belich, 2001, p. 421). In 2003, 80% of people over 65 depend on national superannuation as an almost exclusive source of retirement income (Skilling and Waldegrave, 2004, p. 11). Hence, in contrast to limiting government spending, current expenditures peaked at 39.4% of GDP in June 1991 (Evans et al., 1996, p. 1868). Long-lasting periods of fiscal surpluses were finally achieved with the introduction of the Fiscal Responsibility Act in 1994, and continued to be achieved since then (Dalziel, 2002, p. 32). However, the sole focus on fiscal deflation led to pro-cyclical cuts and to further harm to the already weakened export sector (Goldfinch, 2000, p. 19; Skilling & Boven, 2005). Furthermore, the reforms led to almost constant amounts of state funding for the tertiary education system until the 1990s, despite the quadrupling of tertiary students within 20 years, and to a dramatic drop in public funding of research and development (Belich, 2001, p. 422-423).

Moreover, NZ's privatisation involved sharing the losses but not the gains by the taxpayer, and was accompanied by comprehensive lobbying. Before the state sold its family silver, it took over the accrued debt of many former national businesses (Easton, 1997, p. 165).[31] Thus public debt did not sink significantly between 1984 and 1990. On the other hand, by 1999 the fair-market value of the combined sales of state assets has been estimated at about NZD 16.7 billion higher than the actual receipts, where the difference mainly wandered into the pockets of private investors (Sinclair & Dalziel, 2001, p. 344). The realisation of these gains and the transfer to their overseas owners resulted in considerable balance of payments problems afterwards (ibid). Moreover, former permanent secretaries of state-owned businesses became chief executive officers of the new privatised companies with even higher salaries (Belich, 2001, p. 409). The process of privatisation also involved substantial transaction fees to financiers, accountants, lawyers, economists, public-relation specialist and others (Easton, 1997, p. 246). In the case of Telecom NZ, the government spent over 100 million NZD on private advice immediately after the stock market crash of 1987 had dried up the financial industry's income basis (ibid).

In addition, the restructuring ravaged a lot of the pre-1984 social capital, which led to a significant increase in transaction costs (Belich, 2001, p. 458). Young, singles, people of Māori or Pasifika descent, and people with many children were negatively affected by NZ's fiscal policies (Skilling and Waldegrave, 2004, p. 7). For instance, violent offences increased from 4,000 in 1960 to 40,000 in 1999 (Belich, 2001, p. 464). In 1997, 44% of the prison population was Māori, although they represented only 15% of the total population (ibid, p. 481). At the same time, the unemployment rates of Māori had risen to four times higher than of the Pākehā (ibid, p. 474). Moreover, non-Pākehā earned less money throughout the time, and suffered more during the economic stagnation until the early 1990s (Chatterjee & Podder, 2007, p. 20). Further demographic and ethnic income differentials remained, where the recently retired benefited from previous housing schemes and from higher retirement benefits, while students were required to pay compulsory tuition fees (Belich, 2001, p. 419).

Furthermore, the rich benefited more than the poor from most of these changes (Belich, 2001, p. 409; Dalziel, 2002, p. 44).[32] While the rising income and wealth distribution could be seen in other nations over the last two decades, New Zealand is unique with its 16% share of its citizens with negative wealth, compared to 4% to 8% in other Anglophone countries in 2002 (Skilling & Waldegrave, 2004, p. 8). The reforms established a virtual 'threshold level' for incomes, which did

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[31] The debts of New Zealand Steel were taken over by the NZ government at a cost of around 3 billion NZD, but the company was sold for only 327 million NZD. The debt of the Marsden oil refinery was also taken over by the government and paid by an extra levy on the motorist. Seventy percent of the government owned Petrocorp was sold to Fletcher Challenge Ltd for 802 million NZD in March 1988, after the government already had injected 800 million NZD of fresh money in 1987. Furthermore, the government also wrote off debt generated by the Railways Corporation (Easton, 1997, p. 165).

[32] According to Skilling and Waldegrave (2004, p. 5), 10% of New Zealand's population hold more than 50% of total household wealth of NZD 367 billion while the poorer half of the population had accumulated only 3% of total household wealth in 2001.

not allow almost 50% of the population to save (ibid, p. 12). Moreover, the immediate deregulation of imports also fostered the decline in savings (ibid, p. 22). In other words, the abolishment of the aforementioned means of income redistribution and channelling exports receipts away from consumption of imported goods contributed considerably to New Zealand's inability to build up sophisticated national capital markets (ibid, p. 25).

In the case of Uruguay, the aforementioned continuation in the established elite also mirrored itself in the initial cautious policy towards the massive structural financial problems instead of undergoing fundamental changes (MacFeeters, 1992, p. 111). Instead of trimming the huge public sector and the burdensome social security system, Sanguinetti's first government cut public investments, captured the democracy dividend and rescheduled foreign debt repayment (Finch, 2005, p. 318; Wagner, 1997, p. 218).[33] Although some tax adjustments were made, the higher real fiscal revenues stemmed mainly from strong external demand (ibid, p. 320). Furthermore, Sanguinetti did not abstain from using the money press once the economy slowed down at the end of his first term (MacFeeters, 1992, p. 113).

These hands-off policies changed partly with the Blanco presidency of Luis Lacalle.[34] During Lacalle's term the tariff structure was further lowered, fiscal spending again restrained and the tax base widened by introducing new taxes on wages and increasing value-added tax rate, gasoline prices, and public-sector tariffs (Finch, 2005, p. 321; Hudson & Meditz, 1992, p. xviii). With the approval of the Brady Plan at the beginning of 1991, the external debt problem seemed finally resolved and Uruguay's public debt gained investment grade rating (Finch, 2005, p. 307). As neoliberal ideas spread through the traditional parties during the early 1990s, some state enterprises were privatised, such as Banco Commercial in 1990 and PLUNA in 1994, certain monopoly rights lifted, public-private partnerships fostered, for instance for the Banco del Seguros del Estado, ANCAP and AFE, and the reform of the social security system initiated (ibid, p. 301-325).[35] Sanguinetti and Battle followed the Blanco's right wing policies with privatisation, market liberalisation, social reforms and selective support for the export sector (ibid, p. 327). The education system was reformed in 1995 and the market for tertiary education was liberalised to foster competition between the universities after 1996 (ibid, p. 329). Although further fiscal incentives for the development of tourism and viticulture were provided, spending continued rather towards consumption than investment during the 1990s (ibid, p. 327).

Nevertheless, the reforms of the 1990s were much less comprehensive than in New Zealand. In 1990 one successful referendum pushed for the indexation of the pension system to salary development (ibid, p. 321). The process of privatisation basically stopped after the electorate repelled the Ley de las empresas públicas in a plebiscite in 1992 (Wagner, 1997, p. 258). Apart from these electoral constraints, other measures were ill implemented. Massive lobbying hindered the rise of the qualifying age for retirement pensions (Hudson & Meditz, 1992, p. xxxv). The privatisation of the pension system in the 1990s lowered the contributions to the governmental system, but the obligations continued (Finch, 2005, p. 327).[36] This ever-increasing deficit required a substantial rise of GST and large fiscal transfers to the Banco de Previsión Social (ibid, p. 324). Together with interest payments for the external debt these transfers represented 50% of central

[33] When the inefficient passenger rail service was discontinued in 1988 because of declining ridership, workers were not released but were transferred to other government jobs (MacFeeters, 1992, p. 99).

[34] President Lacalle termed it "modernización" o "reforma" (modernisation and reform) to avoid the unpopular term privatisation (Finch, 2005).

[35] Initial plans for privatisations included ANTEL, PLUNA, UTE, ANCAP, the National Printing Press, hospital services, administration of air terminals and three port terminals, and agricultural development facilities (Hudson & Meditz, 1992, p. xxxv).

[36] In his speech to the nation on May 26, 1992, Lacalle pointed out that the country's social security bill had risen from US$718 million in 1985 to US$1.1 billion in 1991 (Hudson & Meditz, 1992, p. xxxv).

government spending in 1999 (ibid, p. 310). Subsequently, the government responded with the reduction of real wages (ibid, p. 321). Another attempt to downsize the large public apparatus was the layoff of around 14,500 state employees between 1995 and 1998 (Finch, 2005, p. 330). However they represented only 5.9% of the total public employment and it cost more than USD 200 million in compensations (ibid). Moreover, the public debt structure continued to be denominated in foreign currency and to finance short-term fiscal deficits instead of long-term investments (ibid, p. 308). This made Uruguay not only more susceptible to fluctuations in international capital markets, but also hindered the evolvement of mature domestic debt markets (ibid). In addition, fiscal income depended on taxes and duties, which were highly inelastic (ibid, p. 309). Moreover, the problem of income inequality remained pressing as sufficient means of redistribution were missing (Garcé & Yaffé, 2005, p. 74). As Uruguay lacked a similar mechanism of preventing fiscal deficits as in New Zealand, the electoral cycle trapped new governments between the need for spending cuts and external demand shocks at the same time (Finch, 2005, p. 304).[37] In other words, the problem was that fiscal surpluses could not be achieved during times of strong economic growth (ibid, p. 310). Consequently, when the combined crises in Argentina and Brazil hit Uruguay at the beginning of the new millennium, no precautionary measures were in place. The new leftist government faced again the vicious cycle of spending cuts and renegotiation of debt (Garcé & Yaffé, 2005, p. 101). On the other hand, income redistribution and the fight against extreme poverty became more prominent with the FA (ibid, p. 142). Nevertheless, the FA government refrained from reforming the large public enterprises profoundly (Finch, 2005, p. 331).

Summarised, New Zealand's fiscal reforms and the laissez-faire policies were not unique among OECD countries, but their extent and rapidity were (Dalziel, 2002, p. 34). However, by cutting taxes, export subsidies, tariffs, and social benefits, important incentives for economic growth and income redistribution were abolished. Instead of fighting interest groups, these 'hands-off' policies resulted in a worsening of social structures and in a lowering of the incentives to engage in economic activity. NWW's British model does not provide the right propositions to explain NZ's fiscal policy of the last quarter century. Lobbying could not be eliminated; valuable social capital was destroyed; the important export sector was harmed; and private savings soured. Olson's picture of a well-working governmental policy-making is also not supported by the data. Although fiscal discipline was achieved, further incentives were missing, for example to foster competition and the accumulation of capital.

In the case of Uruguay, ill-implemented fiscal policy provides evidence for the conceptual framework. Over the decades the management of the national finances remained unbalanced. A fractionalised political system met a deeply entrenched Uruguayan resistance to modernisation:

> "Uruguay is the most difficult country in Latin America to change because, being the smallest country, it lacks masses that could switch rapidly or violently from one side to the other, and it has a relatively prosperous middle class that feels there are few opportunities for easily finding another destiny without losing what they already have." (Jorge Batlle Ibáñez 1989 cited in Hudson & Meditz, 1992, p. xxiv).

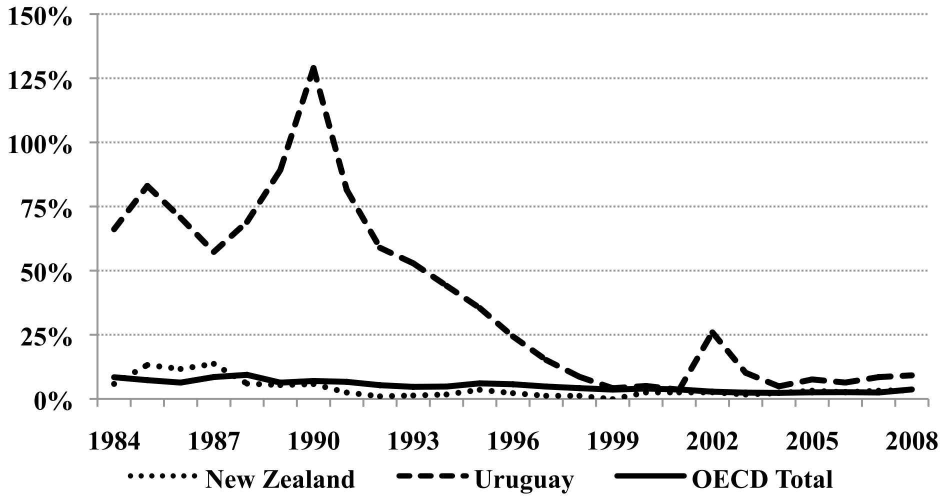
Similar to New Zealand, Uruguay did not consider cross influences of single policy means between each other. While the voters' rejection of large-scale privatisations might have saved Uruguay's taxpayers similar losses as in New Zealand, they also forwent potential productivity gains, lower charges and taxes. Moreover, a hefty state apparatus and the successful lobbying loaded a massive burden on Uruguayan taxpayers, who themselves experienced sinking real wages. Although fiscal incentives for the broadening of the production sector were given, they focused mostly on a more efficient exploitation of natural factor endowments.

[37] By coincidence, several external shocks followed election years, such as the oil crisis in 1990, the Tequila-crisis in 1995, and the Brasilian crisis in 1999 (Finch, 2005, p. 304).

Towards a Stable Monetary Environment

Next to restructuring of the national finances, further aims in both countries were to achieve stability in prices and currencies (Dalziel, 2002, p. 31, Finch, 2005, p. 317). According to the conceptual framework, similar policy goals should have achieved different outcomes (Figure 6).

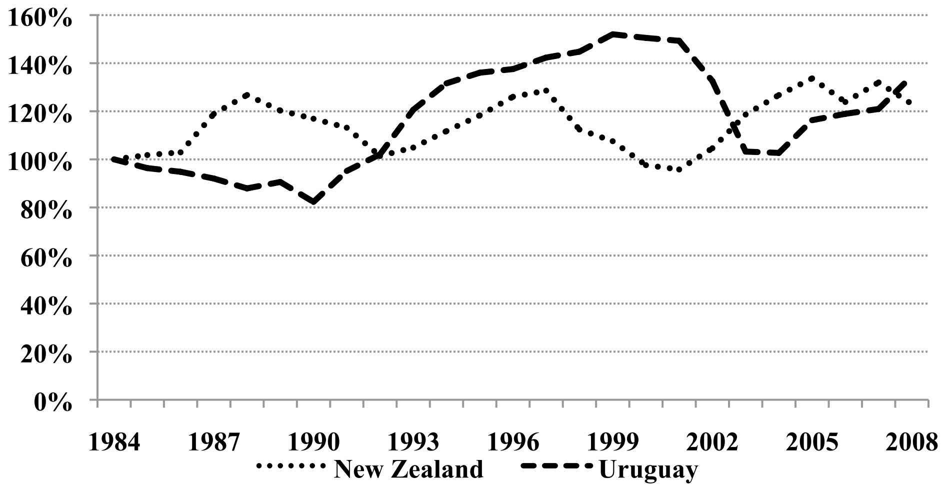
FIGURE 6: ANNUAL CHANGE IN PRICES



Source: CPI; NZ long-term fiscal series until 2004, RNBZ (2011) for 2005-2008; INE (2011) for Uruguay, OECD (2011) database for OECD Total

After 1984 rapid increases of prices continued in both countries, with a multiple of their levels in the case of Uruguay.[38] New Zealand was able to remedy its problems almost overnight at the end of the 1980s. On the other hand, Uruguay's annual price remained highly volatile despite a sharp drop during the 1990s. However, neither country achieved currency stability (Figure 7).

FIGURE 7: REAL EFFECTIVE EXCHANGE RATE INDEX



Source: World Bank (2011), World Development Indicators; Real Effective Exchange Rate Index; Year 1984 = 100%

[38] In New Zealand, the early high inflation rates were the response to earlier wage and price freezes, the devaluation and the introduction of GST in 1986 (Singleton, Grimes, Hawke, & Holmes, 2006, p. 104).

Both real exchange rates fluctuated highly over time. New Zealand's exchange rate pattern depicts cycles of around eight years each with a spectrum of roughly 30%. After a visible decline until 1990, a boom of the Uruguayan Peso occurred as inflation fell, just to slump at the beginning of the new millennium. Since then, both real exchange rates have converged to similar high levels. Therefore, the initial analysis shows that conceptual framework holds only partially. Furthermore, New Zealand's seemingly success in fighting price increases came at a cost. These divergences from theoretical propositions are elaborated next.

The rapidity and thoroughness of Rogernomics also applied to New Zealand's monetary policy.[39] A small group of radical monetarists followed fondly then-current IMF guidelines and developed a set of ideas and analyses, which was subsequently imposed without open debate on the rest of government economists, and ultimately the nation (Easton, 1997, p. 218). In 1984 almost overnight all interest rate barriers and international capital restrictions were abandoned (Easton, 1997, p. 238; Dalziel, 2002, p. 15). Due to the recognition of a substantial overvaluation of the currency in 1984, the New Zealand Dollar was devalued 20% and set to a total free float from March 1985 onwards (Belich, 2001, p. 408). The government abandoned any direct management of the exchange rate, but also denied that either monetary policy or fiscal policy had any impact on the exchange rate (Easton, 1997, p. 232). The Treasury mistakenly believed that "with a floating exchange rate, there is less risk that poor monetary and fiscal policies will impoverish those industries exposed to world trade while generating spiralling external debt problems" (ibid, p. 237).

However, the NZ Dollar became overvalued again just 1.5 years later due to a worsening of the current account balance, and periods of high inflation occurred until the end of the 1980s (ibid, p. 232). Moreover, the remaining high fiscal deficits attracted foreign capital through high-yielding government bonds, which contributed to the overvalued exchange rate (Easton, 1997, p. 241). On the other hand, New Zealand businesses and house owners began to borrow overseas at lower rates, which attracted even more foreign capital (Singleton et al., 2006, p. 109). New Zealand's monetary policy makers supported the constant overvaluation of the exchange rate in order to lower inflation despite substantial early criticism (Easton, 1997, p. 101). The Reserve Bank Act of 1989 finally led to the independence of the Reserve Bank from governmental interference, and effective inflation rate targeting was achieved (Belich, 2001, p. 409).[40] Indeed, New Zealand's novel measures to ensure price stability attracted a fair amount of international attention (Singleton et. al., 2006, p. 163). Nevertheless, the setup of the Reserve Bank granted far-reaching powers to the Governor, whose membership at the board created further accountability issues (Singleton et. al., 2006, p. 201).[41] Because of the narrowly focussed mono-regulation and missing links to other monetary triggers no efforts were taken to mitigate the externally driven rise of real interest rates (Easton, 1997, p. 235; Dalziel, 2002, p. 15).[42] Only in 1999 the official cash-rate regime replaced informal 'open mouth operations' of the Reserve Bank and put interest rates back on the agenda (Singleton et. al., 2006, p. 109). Additionally, due to the preceding extensive financial deregulation, former policy instruments, like ratio controls and credit restrictions, were no longer available (Evans et al., 1996, p. 1866). These circumstances, in combination with a low savings ratio and already outstanding high overseas debt, led to an increase in the already overvalued exchange rate (Evans et al., 1996, p. 1871; Skilling & Waldegrave, 2004, p. 21). Operations in the foreign exchange market to influence the exchange rate were not considered before 2004 (Singleton et. al.,

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[39] For an in-depth analysis of the Reserve Bank's monetary policy after 1984 see Chapters 4 to 7 from Singleton, Grimes, Hawke, & Holmes (2006) *Innovation and Independence.* Auckland, Auckland University Press.

[40] As the result from the trade liberalisation, prices for certain goods dropped significantly, for instance by 30% for cars (Sinclair & Dalziel, 2001, p. 341).

[41] In contrast, a pluralistic expert committee made the decisions at the Bank of England (Singleton et. al., 2006).

[42] New Policy Target Agreements in 1999 and 2002 widened the time-horizon of inflation targeting to account for business cycles (Singleton et. al., 2006, p. 171).

2006, p. 111). Moreover, New Zealand's 'hands-off' policies resulted in the further weakening of its terms of trade through damaging traded-good producers, while favouring non-tradable providers such as electricity, telecommunications, construction, transport and local financial services (Goeff Bertram, 2009, p. 547). Furthermore, New Zealanders accrued one of the largest stocks of external debt in the OECD, due to large capital inflows over the last decades (Easton, 1997).

On the other hand, Sanguinetti's first administration clearly subordinated inflation targeting to its restoration policies (Finch, 2005, p. 318). Moreover, the exchange rate was set to a 'dirty float', where authorities repeatedly intervened for higher competitiveness of the export sector (MacFeeters, 1992, p. 113). However, sustained fiscal deficits pushed inflation, interest rates as well as the dollarisation of Uruguayan bank deposits (ibid, p. 143).[43] Nevertheless, Uruguay's commitment to pay its debt obligations and its comparatively important gold reserves made the country to an atypical island of economic stability within the region (Hudson & Meditz, 1992, p. xxix). Due to the retention of liberal capital markets and bank secrecy laws, the 'Switzerland of the South' became a significant centre for money laundering and a refuge for foreign capital.

Despite early warnings from the BCU, President Lacalle introduced a currency peg to the USD to lower the enormous inflation rates incrementally to international levels (ibid, p. 323).[44] As annual inflation fell steadily and the debt was restructured through the Brady Plan from January 1991, further massive capital inflows into easily withdraw-able accounts occurred (ibid). However, policy makers held on the peg even after inflation had come down and the economy became even more dollarized during the 1990s (Becker, et al., 2001, p. 58). Thus, an important monetary control element was abrogated. This conscious overvaluation of the exchange rate severely harmed exporters (Finch, 2005, p. 304). Moreover, it fostered consumption of a new variety of import goods instead of capital investments (ibid, p. 305). As the major production factors were paralysed, salaries remained the only mean to stay competitive (Becker, et al., 2001, p. 58).

The peg finally collapsed on the 20th of June 2002, after reversed capital streams struggles to Argentina and Brazil had drained financial system. The international reserves at the Banco Central were too low for Uruguay's debt service obligations (Finch, 2005, p. 307). As the peso devaluated rapidly, many Uruguayans impoverished. International financial organisations rejected their influence in the occurrence of the economic crisis after 1999 (Garcé & Yaffé, 2005, p. 75). External debt had to be renegotiated again, where the IMF allowed the postponement of debt payment by 36 months in 2005 to follow important policy goals (ibid, p. 129). Although later on the government admitted "dollar inflation", its 'hands-off' policies after 2005 facilitated a rapid re-evaluation of the peso again (ibid, p. 150). Financial sector reforms, such as the autonomy of BCU and ending of the crisis of BHU, were only begun under the new leftist government (ibid, p. 131).

Summarised, the conceptual framework cannot explain why both countries' monetary policies were solely aimed at lowering inflation while forgetting to maintain links to the exchange rate and fiscal policies. Although the Reserve Bank of New Zealand's institutional framework appears more sophisticated than Uruguay's, the costs of forced disinflation, such as the overvalued currency, and the complete lack of the consideration for the business cycle harmed the economy and its export sector substantially (Evans et al., 1996, p. 1865; Easton, 1997, p. 247).[45] The absence of checks and balances enabled the partial gleichschaltung of economic interests between the Reserve Bank and the Treasury. In the case of Uruguay, the peg of the Peso to the US Dollar was the wrong monetary policy for its geographically diversified trade. Additionally, Uruguay also relied on lower yielding external funding sources. Its initial aim of raising investor confidence was

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[43] In 1989, 84% of money deposits were denominated in USD (MacFeeters, 1992, p. 135).

[44] International experts, such as from IMF, supported the peg.

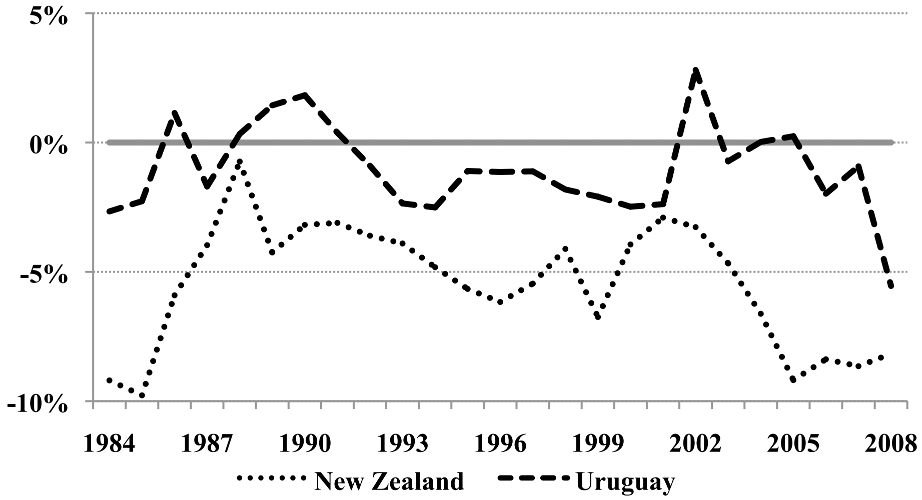
[45] Detailed calculations of the output sacrifice are done by Hutchinson, & Walsh (1998). The Output-Inflation Tradeoff and Central Bank Reform: Evidence from New Zealand, *Economic Journal*, Vol. 108, pp. 703-725.

not achieved, as approximately 80% of bank deposits and loans were denominated in US Dollars by the late 1990's. This cut off an important policy mean to influence monetary aggregates in Uruguay.

GROWTH AND STAGNATION AFTER INTERNATIONAL RE-INSERTION

Another cornerstone of the reforms was further trade liberalisation to recover the current account and to reignite national economic growth (Belich, 2001, p. 408; Finch, 2005, p. 316). New Zealand's 'open access' should have supported these efforts more successfully (Figure 8).

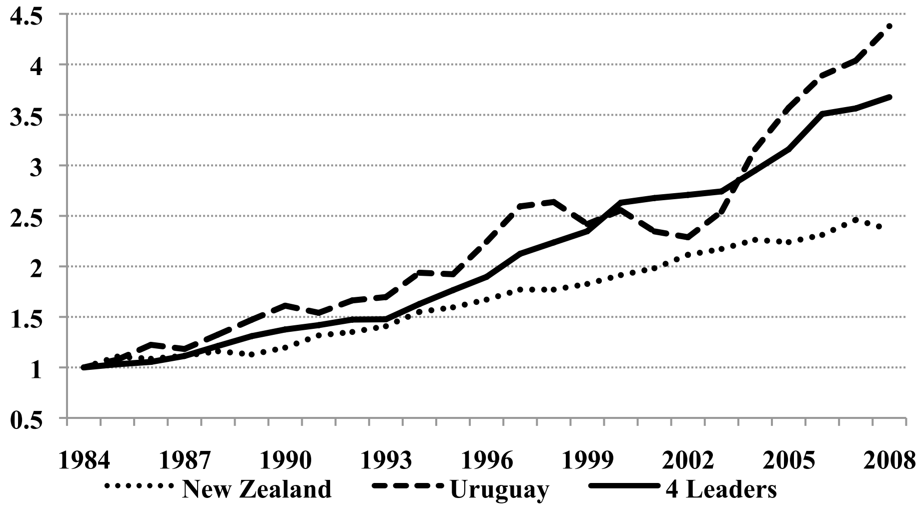
FIGURE 8: CURRENT ACCOUNT BALANCE (% OF GDP)



Source: Infoshare, years ending March; BCU (2011)

According to Figure 8, only Uruguay achieved shortly lived current account surpluses in the early 1990s and in 2002, while New Zealand's current account remained in substantial higher deficits at all times, which suffered from dramatic negative investment income after the privatisations. Furthermore, both countries' export growth followed different tracks (Figure 9).

FIGURE 9: EXPORT VOLUME GROWTH INDEX



Source: World Bank (2011), World Development Indicators; 1984 = 1; 4 Leaders = Germany, France, UK, US

New Zealand has adapted very badly to external changes, as its export growth after 1984 has been one of the worst among the OECD (Skilling & Boven, 2005) p. 7.[46] On the other hand, Uruguay's efforts appear more successful, but exports remained highly volatile. However, these numbers need further qualifications (Table 4).

TABLE 4: TRADE LIBERALISATION AFTER 1984

	New Zealand		Uruguay	
	1984	2008	1984	2008
Exports of goods and services (% of GDP)	28.6%	30.7%	26.6%	29.2%
Average applied tariff rate (%)		2.07%		3.48%
Share of 3 main export destinations*	47.2%	47.2%	54.8%	50.9%
Share of 3 main export product groups#	46.5%	36.9%	33.6%	36.9%
Non-manufactured products (% of goods & service exports)	61.6%	59.0%	45.3%	53.8%
Manufactured goods (% of goods & service exports)	16.8%	18.1%	26.4%	21.9%
Service (% of goods & service exports)	21.6%	22.9%	28.3%	24.3%

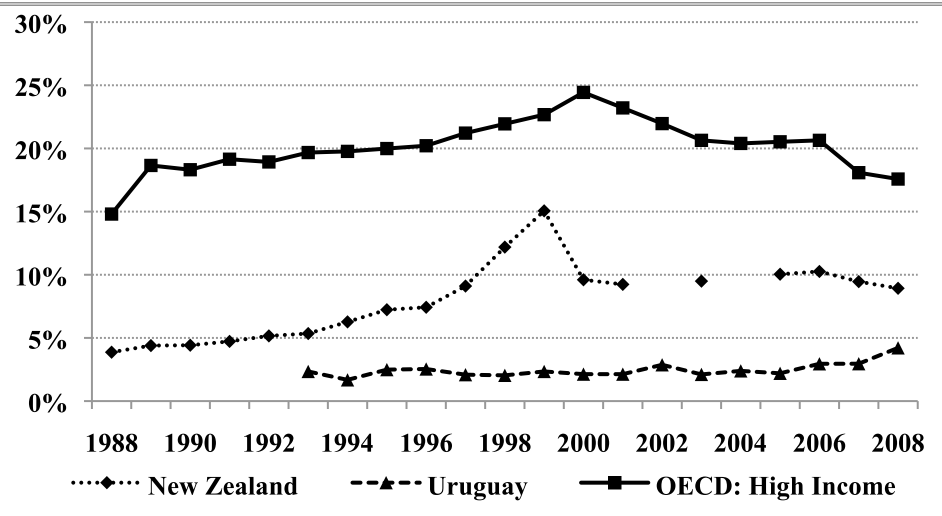
Source: Infoshare, BCU for major merchandise export destinations and products; World Bank (2011), World Development indicators for all other data

* Measured by combined share of three main regions (EU and Mercosur are taken instead of single countries)

Measured by combined share of three main product groups for export

Uruguay's story is partly a catching up on export volumes, whereas NZ's is one of missing contribution to economic growth (Skilling & Boven, 2005, p. 5). Moreover, Uruguayan exports remained more concentrated in terms of destinations and increasingly depending on key products making the economy more vulnerable to adverse shocks. Although both countries witnessed a shift away from traditional, none of two countries could change their export structure towards sophisticated manufactured goods (Skilling & Boven, 2005, p. 13; Becker, et al., 2001, p. 62).

FIGURE 10: EXPORT OF HIGH TECHNOLOGY (% OF MANUFACTURED EXPORTS)

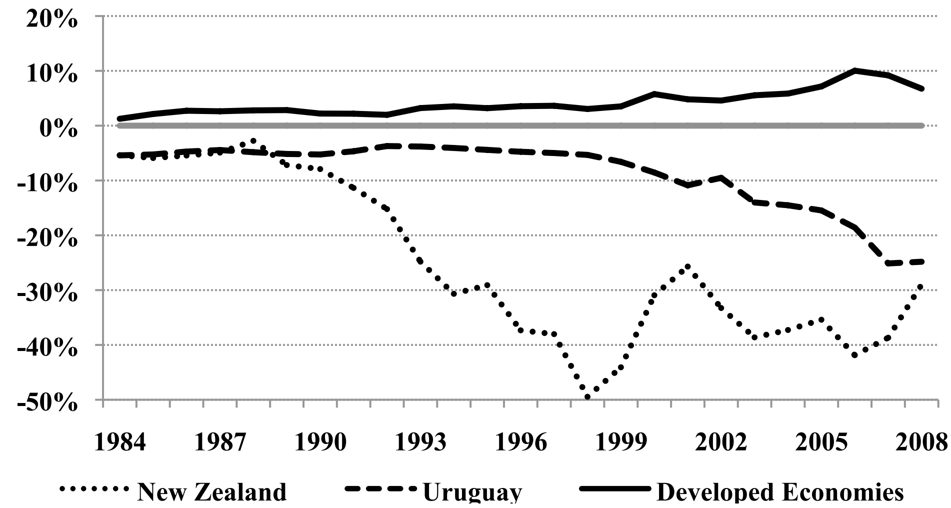


Source: World Bank (2011), World Development Indicators; Exports of High Technology

46 Other OECD members had a higher share of import content in exports (Skilling & Boven, 2005, p. 7).

Thus neither country's reforms provided substantial means to foster the export of high-value, low weight products, which could have made up for geographical disadvantages (Skilling & Boven, 2005, p. 13). Moreover, when global supply chains established rapidly through FDI over the last decades, New Zealand became even more re-colonised than Uruguay (Figure 11).

FIGURE 11: STOCK OF FDI AS (% OF GDP)



Source: United Nations (2011), UNCTADstat; Inward and outward foreign direct investment stock

The two preceding figures show that crucial opportunities to raise and stabilise the value of exports as well as to overcome potential domestic constraints on input factors, such as skilled labour, were not used in New Zealand and Uruguay despite their strive for re-insertion into global domestic trade (Skilling & Boven, 2007; p. 17; Bertola & Bittencourt, 2007, p. 332).[47] These divergences from the conceptual framework will be discussed more profoundly.

New Zealand's rapid demolishment of almost all trade barriers and the maintenance of a high-exchange rate did not encouraged the envisaged bloom of exports, but fostered the unrestrained surge in imports of manufactured goods. This eliminated many jobs and enterprises in the growing tradeable-goods sectors and de-industrialised the country again at the beginning of the new millennium (Bertram, 2009, p. 541). As low savings inhibited more capital-intensive production, the majority of manufactured products, such as tobacco, food and drink, still depended on primary product inputs. Therefore, the majority of New Zealand's merchandise exports are still bulk products (Skilling & Boven, 2007, p. 11).[48] Furthermore, 81% of New Zealand's merchandise exports were in categories that grew slower than the international average between 1990 and 2003, and in about half of these categories market shares were lost (Skilling & Boven, 2005, p. 18). This falling international competitiveness is also mirrored in the low returns of firms from foreign businesses (ibid, p. 30). Moreover, the persisting high concentration within New Zealand's export sector suggests the existence of informal barriers of export due to a variety of reasons.[49] Considering the service sector, successful public-private partnership marketing promoted the rise in exports of tourism and education, which simultaneously fostered New Zealand's air transport connectivity (Skilling & Boven, 2007, p. 23). However, these services themselves were rather

[47] Five OECD countries had lower FDI outflows than NZ in the 1990s (Skilling & Boven, 2005, p. 24).

[48] The Top 20 accounted for 80% of exports in 1980 and 60% in 2004 (Skilling & Boven, 2005, p. 12).

[49] The Top 10 of exporters in 2005 accounted for about 50% of national total exports. Furthermore, 70% of export growth between 1996 and 2005 came from large companies (Skilling & Boven, 2005, p. 26).

inward-looking and land-based, while sophisticated 'weightless' business exports, such as banking and finance, remained marginal (Skilling & Boven, 2005, p. 16).[50]

A combination of lacking management skills and fiscal incentives hindered more comprehensive outward FDI despite the high Kiwi dollar during the 1990s (Skilling & Boven, 2007, p. 35). On the other hand, New Zealand's massive capital inflows are only partially a good sign for well-established institutions. Well-enforceable property rights and the aforementioned missing targeting of the overvalued currency assured international investors that they would not lose their capital investments. Because export industries merely could afford the high real interest rates, the incoming capital was directed towards newly privatised state enterprises, the real estate and financial sectors (Skilling & Waldegrave, 2004, p. 16). The increasing asset prices in New Zealand's small market contributed to threefold investment returns for inward FDI compared to the ones received from outward FDI (Skilling & Boven, 2005, p. 21). Moreover, the new 'wealth' of homeowners changed their saving patterns over time (Skilling & Waldegrave, 2004, p. 32). Because NZ's citizens took the upward spiral of house price changes for granted, their rising willingness to greater indebtedness blew up total overseas debt from 47% of GNP in 1983 to 103% in 1999 (ibid, p. 34). As a result, the following lower credit worthiness of the country led to higher financing costs for New Zealand's businesses (ibid). In other words, although fiscal tightening occurred from the mid 1990s, which resulted in the fall of overseas public debt fell from 50% of GDP in the late 1980s to 20% in 1999, there was a reversal from public to private overseas debt (Belich, 2001, p. 421). Thus, investment income deficit grew from 1.4% of GDP in the early 1970s to 4.7% of GDP in 2005 (Skilling & Boven, 2005, p. 22).

In the case of Uruguay, its total external debt balance of USD 6.7 billion in 1985 obliged to a positive trade balance (MacFeeters, 1992, p. 142). Thus free-trade zones were established in the late 1980s to attract foreign investors and innovative technologies (ibid, p. 147). Despite a more cautious lowering of tariffs, the decline in relative import prices after 1985 stimulated fierce competition for hopelessly inefficient Uruguayan manufacturers of final domestic products, especially in Montevideo (Finch, 2005, p. 317, Becker, et al., 2001, p. 63). In contrast, a significant rise of productivity in the tradable and import competing sectors was achieved through a significant cut in the employment of unskilled labour. Among the beneficiaries were especially producers of primary sector supplies (Finch, 2005, p. 306). Moreover, supported by the overvalued exchange rate, imports doubled between 1990 and 1994 and grew further until the new millennium (ibid. p. 307). Thus, trade deficits contributed to growth of external debt (Becker, et al., 2001) p. 58. Although attempts, such as from the Sanguinetti administration in 1987, were made to limit domestic demand, it rather suppressed further investments into machinery (Finch, 2005, p. 304). On the other hand, in the absence of comprehensive privatisations, the comparatively minor inward FDI flew mainly into wood production, tourism and infrastructure (Becker, 2007, p. 158).

Many of these impetuses stemmed from President Lacalle's visions of stimulating domestic competition through international reopening and establishing Montevideo as regional 'gateway' (Becker, et al., 2001, p. 58). Hence, Uruguay bargained comprehensively in the earlier commenced negotiations between Argentina and Brazil about the establishment of a regional free-trade zone. In 1991, Mercosur was founded, initially as tariff union and, later from 1995, with free capital and labour force movement between its members (Finch, 2005, p. 331). Uruguay's businesses benefited substantially from favourable tariff rates and further allowances for a predetermined basket of products until the new millennium (ibid, p. 333).[51] Moreover, Uruguay's negotiation potential with other large economic unions enhanced considerably (ibid, p. 334). Nevertheless, the efforts of Uruguayan political and economic players to further develop foreign trade remained light-hearted

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[50] In OECD countries, weightless service exports account for 50% of service exports (Skilling % Boven, 2007, p. 39).

[51] Uruguay could retain import tariffs for 958 products, Brazil only 324, Argentina 394, and Paraguay 439 (Wagner, 1997, p. 256).

during the 1990s. As Mercosur did not develop supranational institutions it became subject to repeated breaches of treaty obligations and individual government's ad-hoc policy making after 1996 (Finch, 2005, p. 331). Neither did Montevideo benefit economically from hosting the organisation's headquarter (Becker, et al., 2001, p. 64). Finally, the disregard of rising synchronisation of members' economies and the provision of free capital movements exposed Uruguay severely to Argentina's and Brasil's combined downturn after 1998, when Uruguay's exports plummeted and capital fled the country in 2002 (Finch, 2005, p. 306).

Further trade barriers persisted. First, Uruguay had little interest in establishing other trade agreements besides Mercosur, as business interests were mostly regional (Puntigliano, 2003, p. 195). In addition, the growth of new export sectors, such as wood, was severely constrained by Uruguay's incapable transport infrastructure (Becker, et al., 2001, p. 63). Furthermore, the coordination and funding of Uruguay's fragmentised export promotion entities, such as Uruguay XXI, remained poor (Puntigliano, 2003, p. 176). Although the importance of tourism increased over time, especially through Argentine visitors, the novel Ministry of Tourism was mostly concerned with regulation of hotel prices and further travel restrictions. Moreover, the state continued its alternating stop-and-go support scheme for either export-led growth or the creation of a financial market, which inhibited the emergence of long lasting structures (Becker, et al., 2001, p. 58).

Summarised, although the conceptual framework's proclaimed institutional open access existed in New Zealand, its foreign trade sector could not reinvent itself to such an extent as other leading nations did. Contradicting fiscal and monetary policies and informal barriers hampered the export sector, while the 'new right' rather enjoyed the benefits of capital inflows and higher consumption. On the other hand, Uruguay's reforms allowed for the recuperation of lost ground in international trade. However, the continuing importance of personal networks and the lower diversification of exports severely hampered a more profound transformation towards a more stable economy, which confirms the theoretical propositions. Furthermore, the conceptual framework needs extensions to account for the influence in policy-decision-making through foreign powers and the prevalence of oligopolies in small economies.

CONCLUDING REMARKS

A brief literature review of NWW (2009) and Olson (2000) has revealed that NWW's novelty claims hold only partially and that they share more commonalities with Olson's ToP than they might want to admit. Both theories are built up on the same core elements and employ a common 'Stufentheorie' approach. For both theories, a democratic system, preferably with British origin, is a fundamental necessity for successfully exploiting potential economic output limits. Hence, it is possible to subsume the essence of both theories into a conceptual framework.

The core propositions from NWW and Olson can explain the cases of New Zealand and Uruguay only to a certain extent. Although a connection between institutional quality and smoothness in economic development appears to exist, neither of both theories can explain New Zealand's economic sclerosis from a macro view. Digging deeper in the political markets of both countries, similar limitations in decision-making and favouable policies for a 'new' right could be identiified despite continuing profound institutional differences. The evaluation of foreign trade patterns and capital movements confirms these general patterns, with their persistent reliance on primary product exports and imports of capital. Therefore, New Zealand diverges further from its theoretical ideal-type than Uruguay does (Table 5).

TABLE 5: THE THEORIES AND THE ECONOMIC REFORMS

	New Zealand	Uruguay
Institutions and Economic Growth	+ Continued sophisticated institutional setup. + Low volatility in economic growth. - Economic growth sclerosis.	+ Hard to overcome backwardness in institutional quality despite democratic reforms (NWW). + More volatile economic growth.
Political Diversity	+ Higher flexibility in institutional processes. - Political diversity is missing. - Susceptibility to lobbying. - Windows of opportunity did not lead to unleashing efficient political bargaining (O).	+ Restoration instead of renovation. + Formal political diversity prevails, but is selective, and can be overridden. + Susceptibility to lobbying within political markets. + Hard to overcome inertial process of 'de-institutionalisation of politics' - Windows of opportunity only partially used (O).
Fiscal policy	+ Fiscal discipline achieved after 1994. + Substantial cutback of subsidies. + Fledging governmental borrowing. - Lobbying during the process of privatisation and other fiscal reforms. - Export sector was harmed by the unilateral removal of export incentives. - Tax reforms did not benefit the majority. - Missing fiscal incentives for the accumulation of capital. - Missing incentives for renovation of the business sector.	+ Unconstrained fiscal spending. + Continued offshore borrowing. + Slow implementation of profound fiscal reforms. + Susceptibility to lobbying during reforms, such as the social security systems. + Missing incentives for the accumulation of capital. + Unilateral removal of export incentives and import restraints damaged the export sector. - World Bank and others supported the reforms.
Monetary policy	+ Inflation came under control. +/- Independence of Reserve Bank only partially present. - No control of the exchange rate. - No control of domestic real-interest rates. - Did not provide an adaptive efficient environment to foster economic growth.	+ Lowering of inflation came at a cost. + Fail to abandon the peg in time. + No control of domestic real-interest rates. + BCU's independence was limited. - External experts, like IMF, encouraged the peg to the USD.
Global Insertion	+ Fast demolishment of formal trade barriers. + International diversification of exports. - Reliance on slow-growth exports based on exploitation of natural factor endowments. - Cartelism established informal trade barriers. - Strong capital inflows only partially sign for good institutions; lack of outward FDI.	+ Exports relied on personal networks and maximising the rent on natural factor endowments. + Remaining barriers of entry due to lacking governmental exports. + Lacking institutions for long-term capital investments (in- and outward). - Lacking institutional upgrade of Mercosur influenced by foreign nations.

Where: '+' = According to the conceptual framework; '-' = In contrast to the conceptual framework; NWW = North, Wallis and Weingast; O = Olson

In other words, the theories of NWW and Olson need an amendment to account for the evolution of New Zealand's policy-making away from its inherited institutional basis. Moreover, the impact of social cohesion on decision-making in small economies has to be incorporated. Additionally, the influence of foreign institutions, such as advice from the IMF and World Bank or certain actions from neighbouring governments, needs to be addressed to describe Uruguay's policy making. Finally, due to the small size of the domestic economies more incentives might be required than solely NWW's open access to overcome informal barriers of trade.

The complexity of NWW's and Olson's propositions together with the asymmetric development paths of New Zealand and Uruguay provide ample space for future research. The conceptual framework can guide further inquiries into other important periods of national development, such as the period of import substitution. The findings of these research efforts will converge to a broader picture of the merits and limits of both theories in explaining the long-term trajectories of New Zealand and Uruguay. In other words, it might be possible to adjust the institutional framework to provide a more viable account of specific economic histories. Therefore, these results will contribute to the growing debate over theoretical models within NIE. On the other hand, economic historians and national policy-makers will benefit from novel ideas.

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