

## Sound Steps But No Step Change in Budget

“The government deserves credit for correcting some of the economic mistakes of its predecessor but is still well away from putting the economy on a strong and balanced growth path”, Roger Kerr, executive director of the New Zealand Business Roundtable, said today.

“The rebalancing of the tax system is generally in line with sound tax advice and will improve incentives to work, save and invest. The planned reduction in the company tax rate, combined with the removal of accelerated depreciation, will be welcomed by business.

“However, it should be recognised that the overall package basically restores a measure of integrity to the tax system which was lost under the Labour government, but at a higher overall level of tax, given the increase in GST.”

Mr Kerr said that tax reform without spending reform was something of an oxymoron. A worrying feature of the budget was that overall government spending, and hence the total tax burden, was not falling as a share of national income.

“Indeed, at 34.7% of GDP for the coming year (a \$5.9 billion increase), core Crown spending is at an all-time high, and throughout the forecast period it is not projected to fall below the spending ratios of any of the Cullen years. It will therefore continue to crowd out productive private sector spending and be a drag on growth.”

Mr Kerr said it was pleasing that government deficits are projected to be eliminated by 2015, three years than earlier expected, but nevertheless three years after Australia is expected to achieve surpluses. Science and infrastructure spending plans may also be positives, although to date the government had not presented any economic analysis justifying its investment in broadband and KiwiRail.

The budget documented the effects of past economic mismanagement: a halving of New Zealand’s potential growth rate over the last decade; a current account deficit averaging 8% of GDP from 2004 to 2008; real output in export and import-competing industries 12% below 2005 levels; a 50% increase in government spending in 5 years; a ‘broken’ tax system; and red ink all over the Crown accounts.

“Against that background the government has acted prudently through the recession but the announced shift to its growth objective lacks critical mass”, Mr Kerr said.

“Major gaps in the budget include:

- No uptake of most of the 2025 Taskforce’s recommendations
- A disappointing lack of progress on regulatory reform, including a Regulatory Responsibility Act

- An abandonment of plans for a legislated cap on spending
- No indication of a timetable for achieving the goal of maximum income tax rates of 30%
- No response to the Capital Market Development Taskforce's main recommendation, partial privatisation of SOEs
- No report on progress with opening ACC up to competition
- No indication of plans to suspend the ETS until Australia takes action on climate change.

“The upshot is that the fiscal and external debt situations still look precarious and the economic outlook is not consistent with narrowing the income gap with Australia in the next few years, let alone eliminating it by 2025. Medium-term growth is forecast to rise to only around 3% (compared to 4% in Australia) and then fall away; large current account deficits are set to resume; and New Zealand has one of the highest net external debt positions in the world.

“New Zealand is still vulnerable to future financial crises in Europe or elsewhere, and in its latest forecasts the IMF puts the per capita GDP gap (PPP basis) between New Zealand and Australia at 47 percent by 2015.”

Mr Kerr said businesses and New Zealanders at large who want a better business environment and higher incomes must call for and support more ambitious moves.

“Much more needs to be done to eliminate low quality government programmes and unnecessary agencies, strengthen legislative constraints on spending and regulation, and increase workforce participation and productivity.

“A ‘big bang’ approach to economic reform is not necessary but we need many more ‘rolling mauls’ that make it over the line”, Mr Kerr concluded.

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