

Answering the \$64,000 question

2025
TASKFORCE

Context

- Established by the National and ACT Confidence and Supply agreement
- “Our vision is to close the gap with Australia by 2025” – Hon John Key, Prime Minister

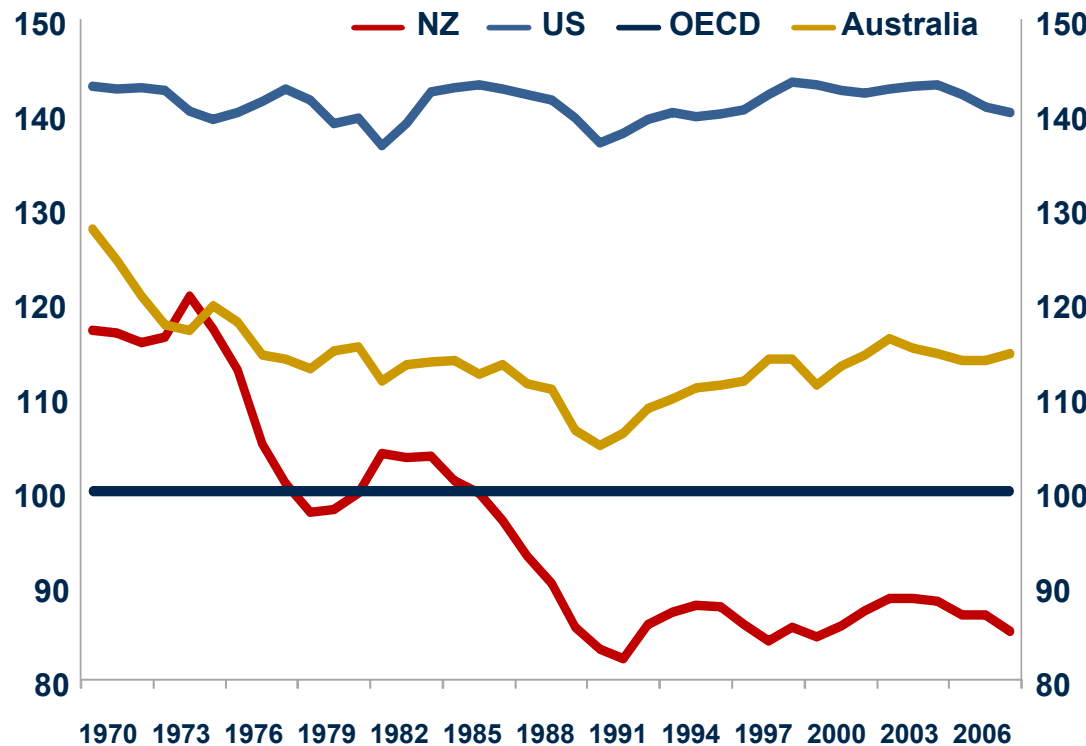
Role:

- make recommendations
- report annually on progress

Comparing our economic performance

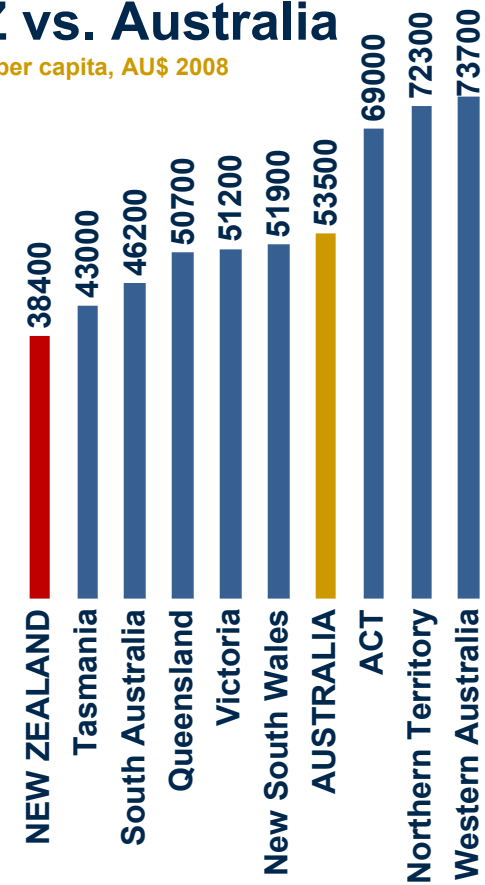
The gap is wide and not closing

GDP per capita relative to OECD



NZ vs. Australia

GDP per capita, AU\$ 2008

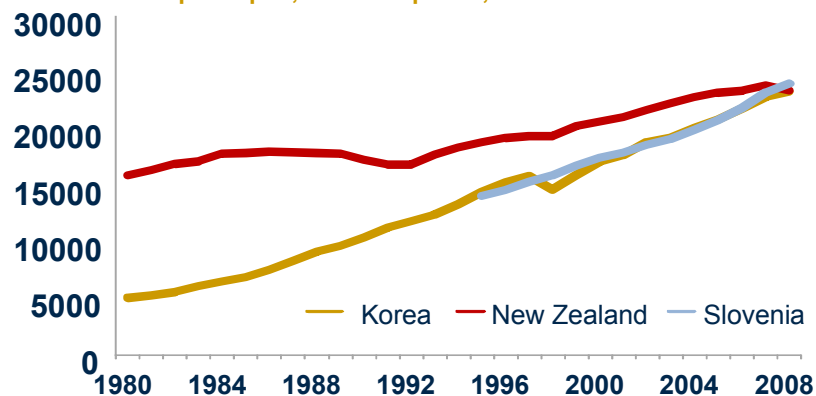


Source: Australian Bureau of Statistics and Statistics New Zealand

How big is the gap?

Others have caught up

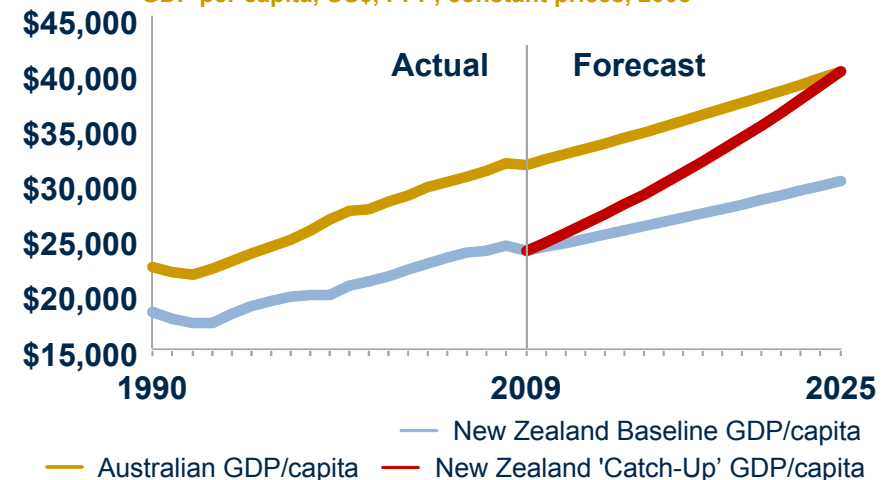
GDP per capita, constant prices, PPP



Source: OECD and Statistics NZ

We need to get started

GDP per capita, US\$, PPP, constant prices, 2008



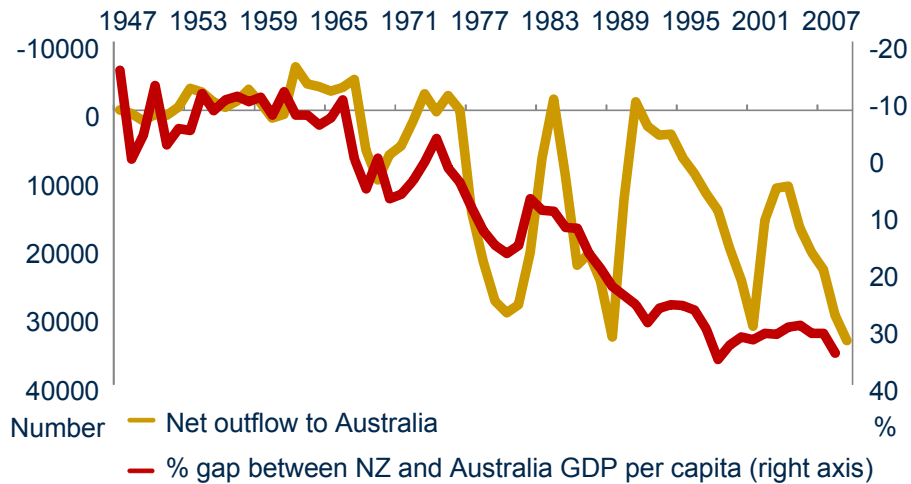
The \$64,000 question: For an average family of four, the gap is around \$64,000 per year.

Catching up means per-capita growth of 1.8% p.a. more than Australia. If we don't start now, it will get much harder.

Why does it matter?

Migration and income appear related

Net outflow of NZ citizens to Australia, GDP per capita



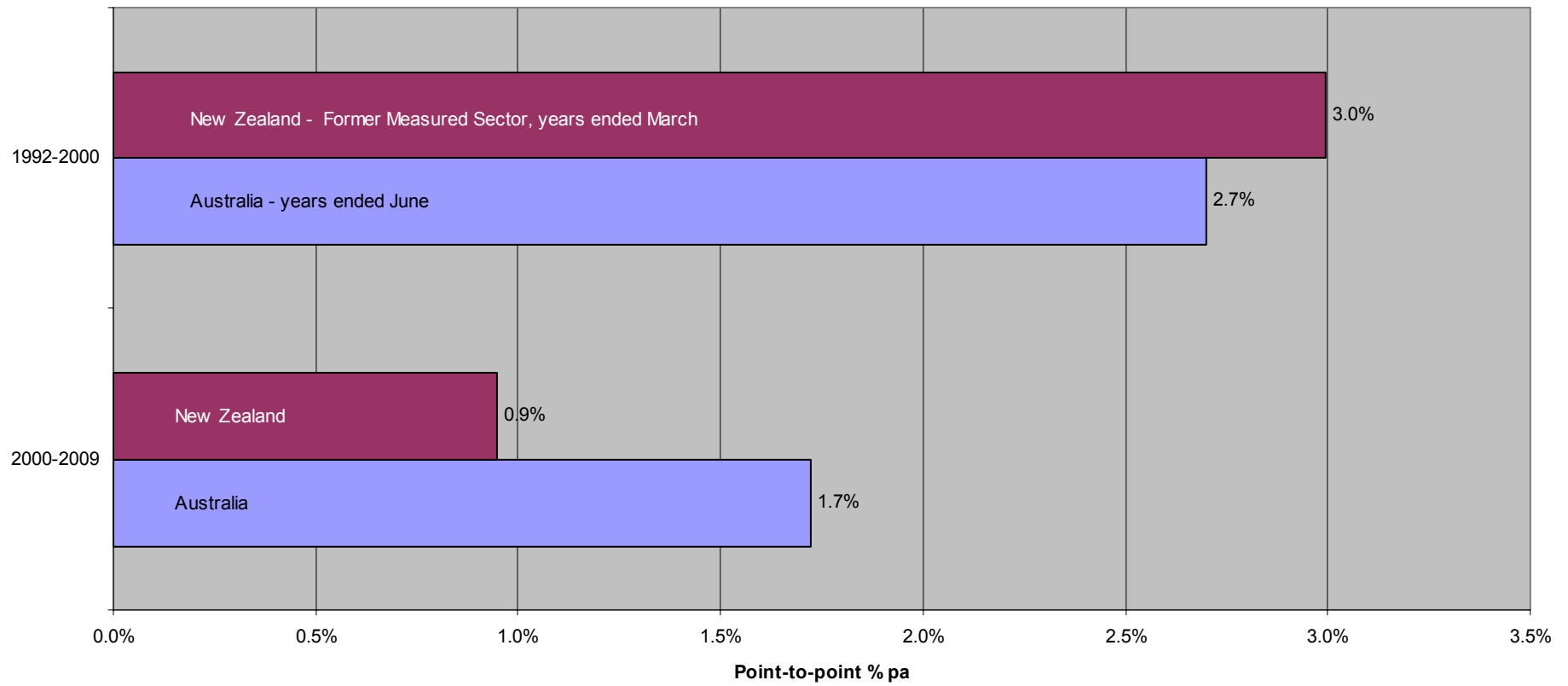
- People migrate for many reasons – not just higher wages
- As the gap has widened, so has net migration of NZ citizens
- Current outflow is comparable to Ireland during 1950s-1980s

Causes

- **Myths:**
- Size, though we're going to look more at this
- Minerals, likewise
- Investment in housing
- Past reforms (accelerated productivity growth in measured sector relative to Australia – next graph)
- New Zealand's monetary policy, and especially its effect on the exchange rate

Labour Productivity - Average Annual Growth Rates

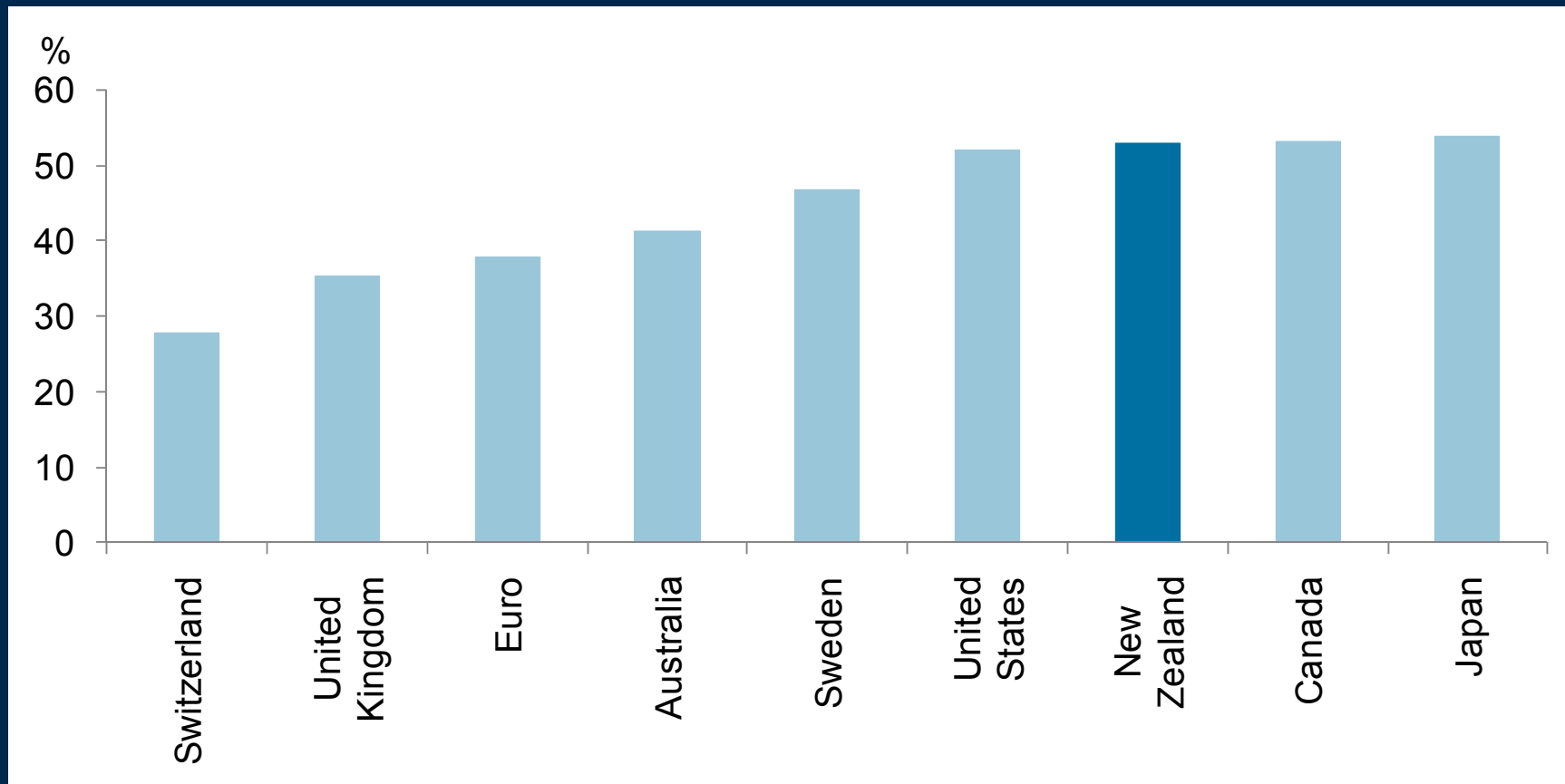
Australia New Zealand



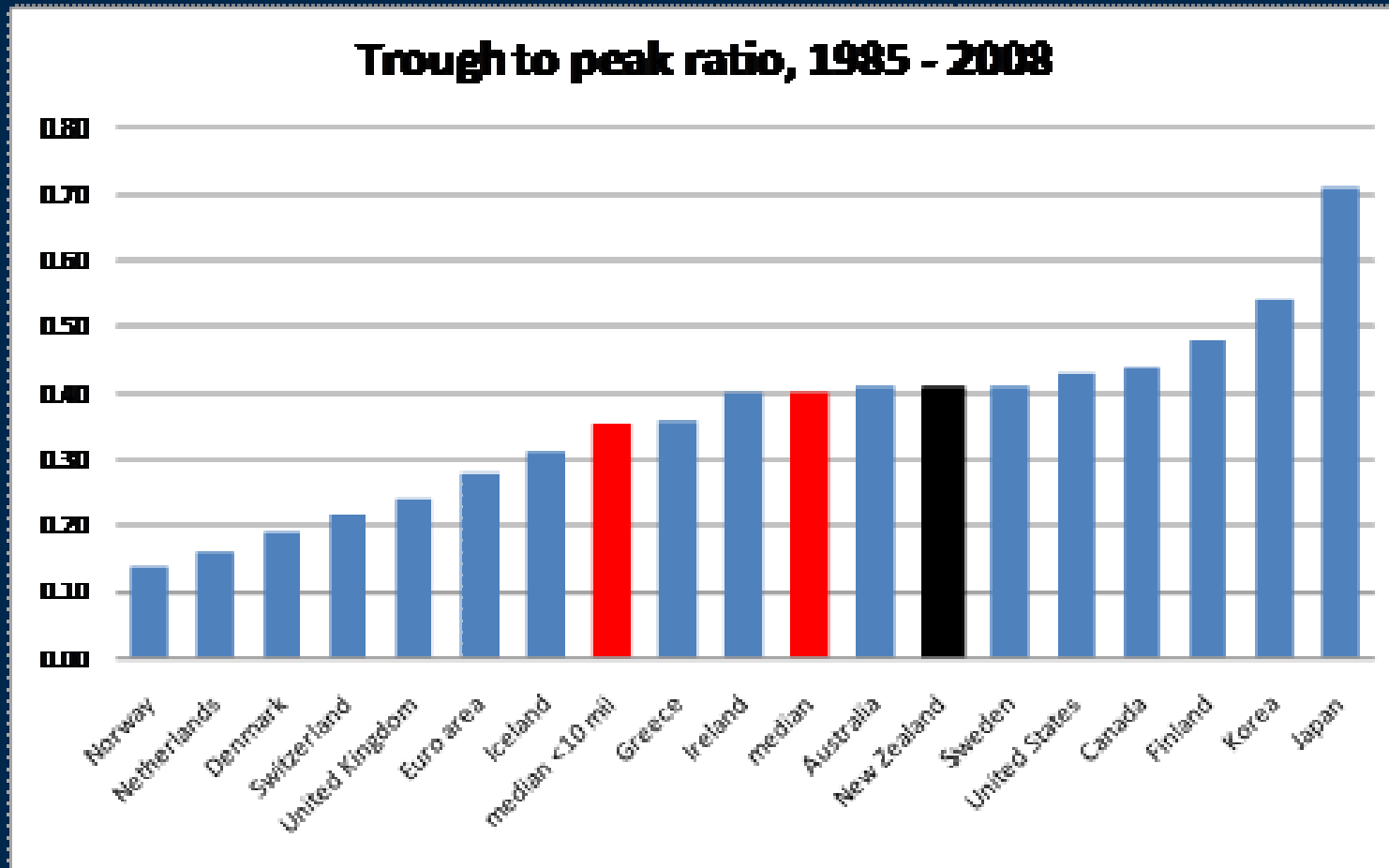
THE PRODUCTIVITY CONUNDRUM

	Labour productivity growth in measured sector, annual average % p.a.		MFP growth in measured sector, annual average % p.a.	
	New Zealand	Australia	New Zealand	Australia
Since 1992	2.0	2.3	1.4	1.2
1978 to 2008	2.1	2.0	1.1	1.0

Amplitude of nominal exchange rate cycles (peak to trough range, 1992-2009, Bank of England data)



Amplitude of real exchange rate cycles (peak to trough range, 1985-2008, OECD data)



CAUSES

- **Primary cause:** Poor policy choices by governments over long periods (notwithstanding intervals of outstanding reform)
- E.g. over the last decade, New Zealand has:
 - Increased EMTRs
 - Increased subsidies and concessions
 - Increased state ownership in business
 - Imposed heavier regulation on the labour market

What we are not recommending

- We heard proposals but do not recommend:
 - Increased government funding for R&D
 - Picking winning sectors, industries or firms
 - Compulsory private saving
 - New or enhanced government financial institutions
 - Changing the exchange rate regime
- Typically these address symptoms – our focus is on getting the overall economic environment right

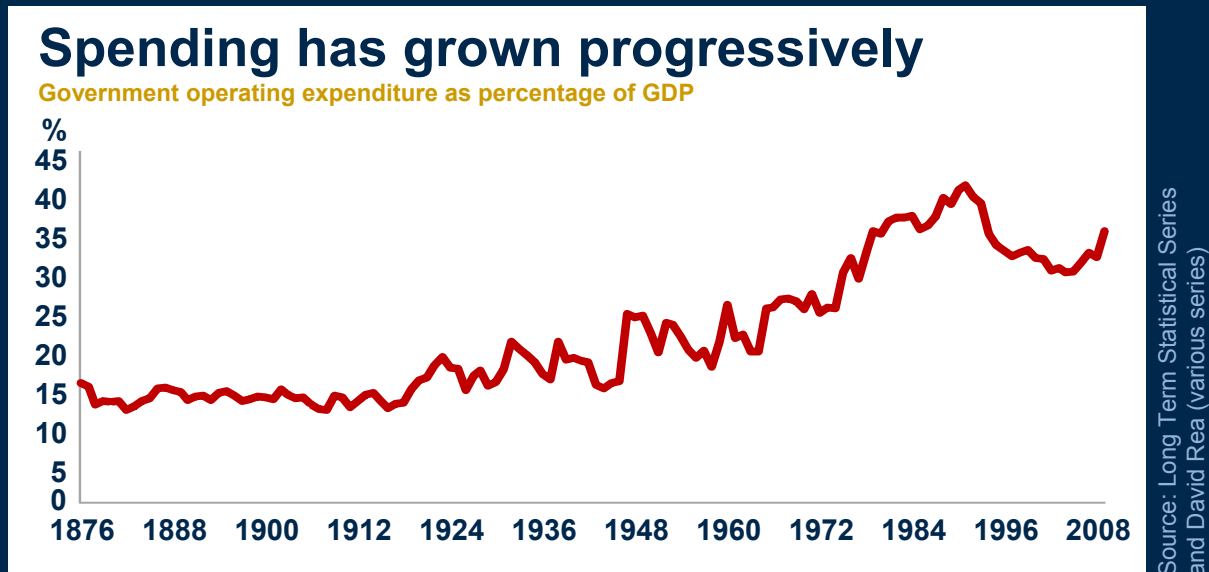
What we are recommending

- “Governments cannot make businesses ‘up their game’. They can only make it easier and more worthwhile”

– submission from EMA Northern

- Governments can remove obstacles and sharpen incentives:
 - Government as spender
 - Government as tax-collector
 - Government as owner of significant assets
 - Government as law-maker/regulator

Government as spender



- Government spending was reduced relative to GDP in the late 1980s and 1990s
- Spending has accelerated over the last 6 years, crowding out private sector activity and the opportunity to reduce taxes
- Core Crown expenses are now 36% of GDP, up from 29% in 2004/05
- **Recommendation:** Reduce Core Crown expenditure to 2004/05 levels as a share of GDP within three years, then cap in real terms per capita

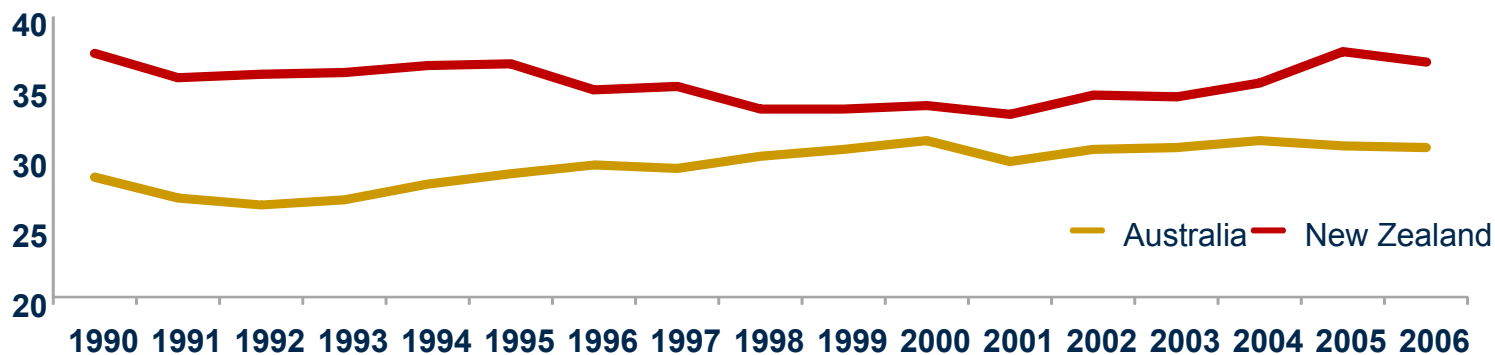
Government as spender (2)

- We also recommend further extensive reform of government services, for example:
 - **Welfare**: Significant reform – get people back to work, utilise skills, reduce costs
 - **NZ superannuation**: Significant reform – increase working population, reduce costs
 - **Health**: Funder-provider split, fewer universal subsidies – increase value from health system
 - **Education**: Governance reform in schools, tertiary institutions – increase value from education system

Government as tax-collector

We tax more heavily than Australia

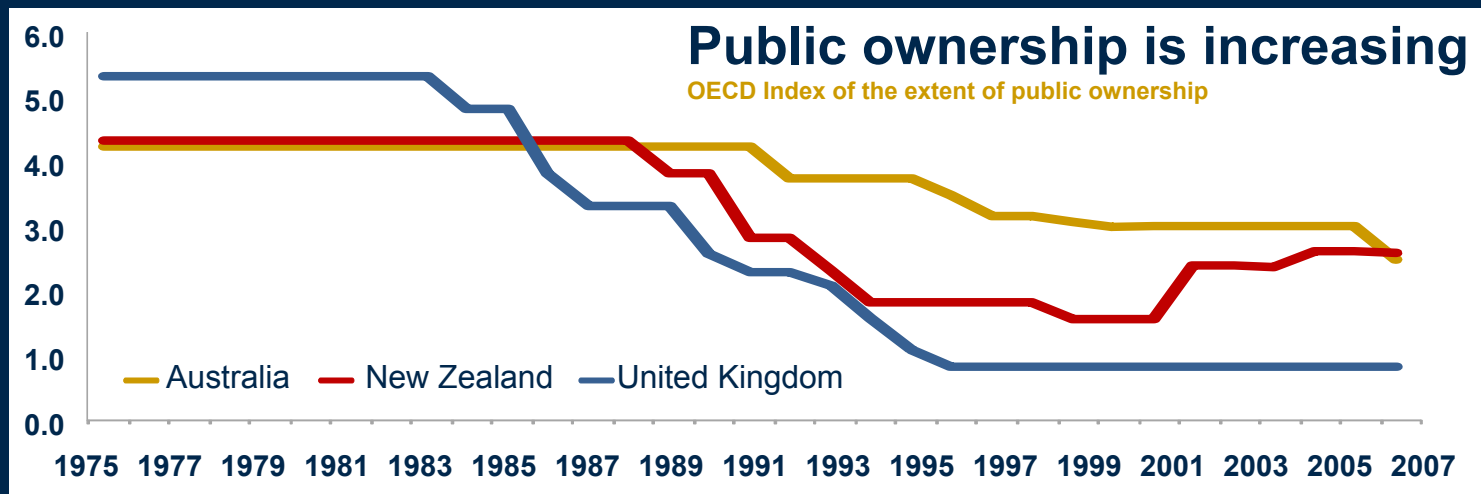
Total tax revenue as a percentage of GDP



Source: OECD

- Total tax take: Relatively high, discourages enterprise and investment
- EMTRs: Discourage participation by working families, reduce rewards
- Tax on capital income: Particularly distortionary, discourages investment
- **Many options if government spending is reduced as recommended, for example:**
 - Align top rates for income / business / trust at 20%
 - Dual tax system: Labour income (e.g. around 25%) and capital income (e.g. around 12.5%)
- Reform Working for Families
- Cost: \$7 billion, funded by spending reductions to 2004/05 levels.

Government as owner of assets



- **Government is often not a good owner:**
- Commercial assets often perform poorly
- Investment in non-commercial assets often has little regard to cost-benefit analysis
- **Recommendations:**
- Sell all commercial assets where there is a competitive market
- Wind up New Zealand Super Fund and use proceeds to repay debt
- Subject all new investments to rigorous transparent cost-benefit and regulatory tests
- Allow exploration for, and potentially mining of, minerals on Crown land

Government as law-maker/regulator

Estimate:

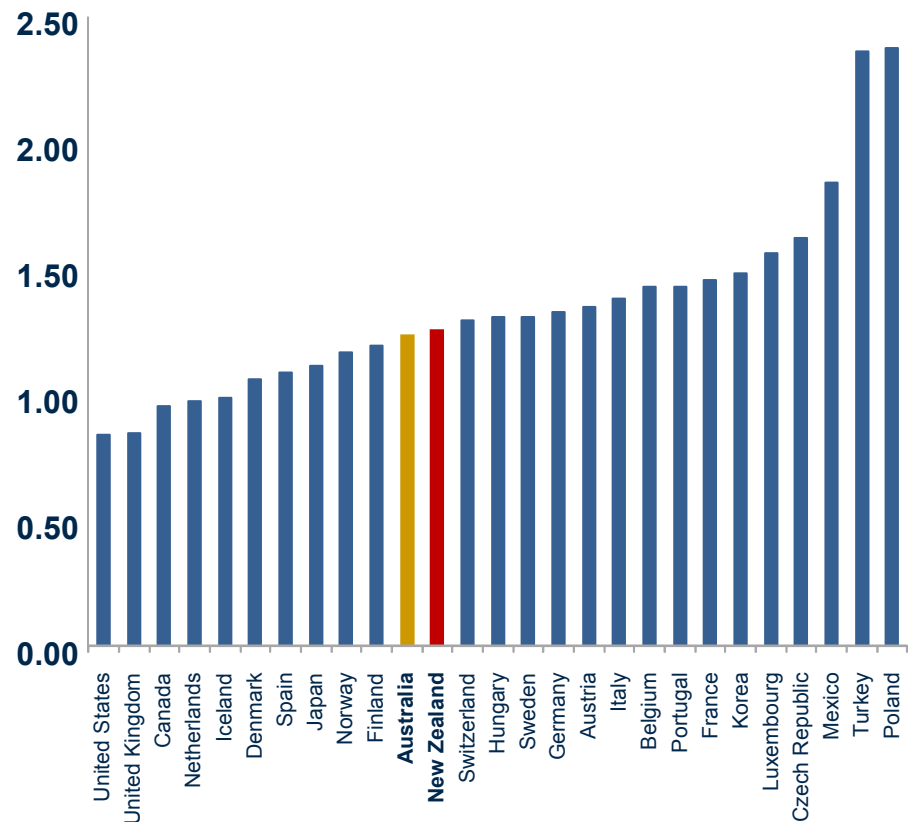
Up to $\frac{1}{3}$ of the income gap could be closed if NZ adopted OECD best practice

Recommendations:

- Consistent application of the principles in the Regulatory Responsibility Bill
- Further reform of RMA; labour law; water rights; tariffs; overseas investment; producer boards
- Establish a New Zealand Productivity Commission

New Zealand is middle-of-the-pack

OECD Product Market Regulation Index, 2008

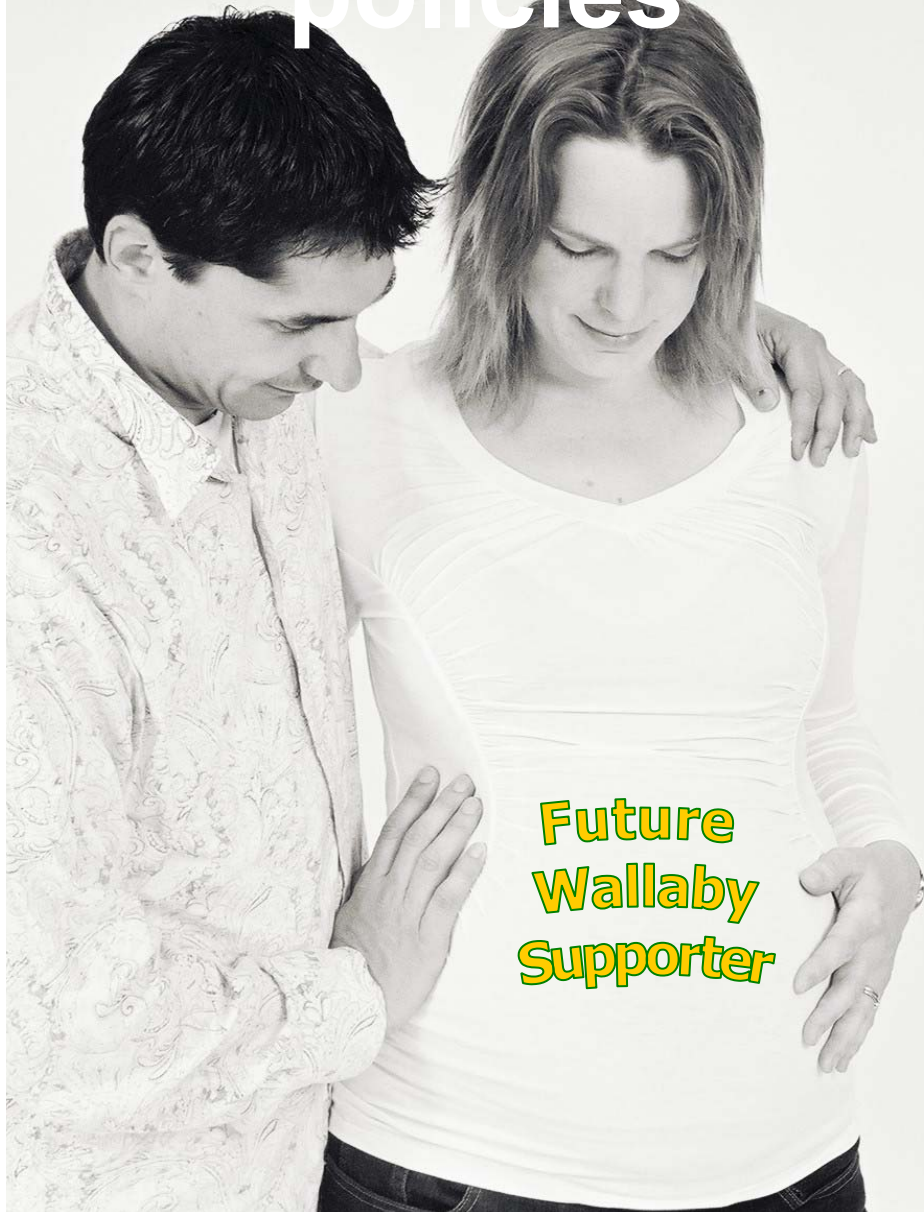


Way forward

- We believe that the policies we are recommending will give us every chance of closing the gap
- But this will require determined and consistent political leadership over successive governments
- We take great heart from the Prime Minister's reaction to Alan Bollard's comment that we should be content with the crumbs from Australia's table:
- No, we want the entrée, the main course and the dessert!

Keep 2009

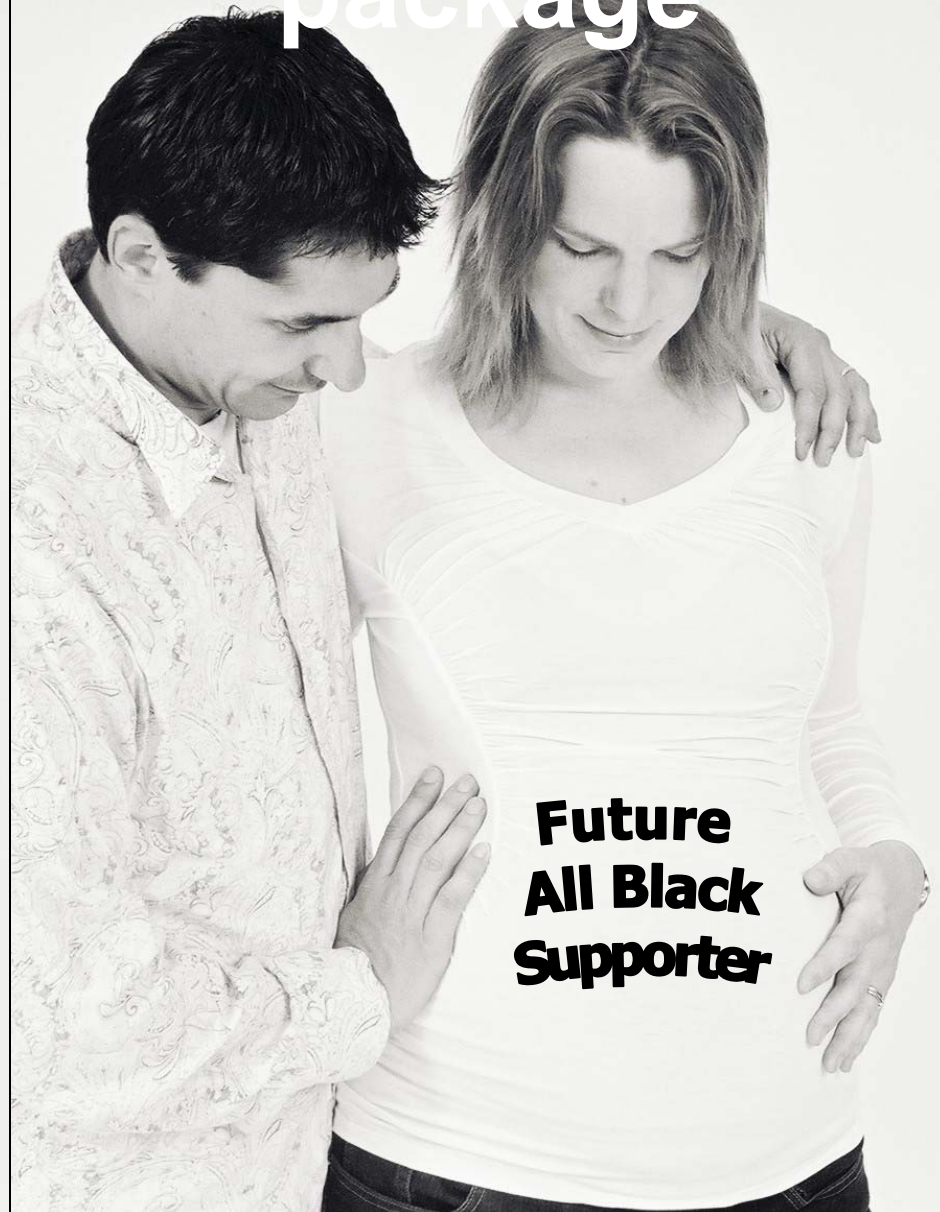
policies



**Future
Wallaby
Supporter**

Adopt 2025

package



**Future
All Black
Supporter**

New Zealand's Real GDP per capita divided by Australia's real GDP per capita (PPP exchange rate)

