

## **OECD Report on New Zealand a Curate's Egg**

The latest OECD report on New Zealand, out last week, attracted little media attention. This is unsurprising. It didn't contain much that was original or insightful.

But at least the OECD avoided major delusions like the statement in its 2005 survey that New Zealand was "on track towards achieving the Government's longer-term objective of lifting GDP per person back into the top half of the OECD."

Nevertheless, the report has political overtones.

Numerically, the OECD is dominated by its European members and reflects their sensitivities. You will look in vain in OECD reports for any acknowledgement that the big welfare state model is broken. It holds up Sweden as an exemplar for fiscal management, yet government spending in Sweden accounts for almost 55% of GDP!

The OECD has never engaged with the factual proposition, endorsed by the 2025 Taskforce, that no country is likely to achieve sustained fast growth with government spending at New Zealand's level of over 40% of the economy. The dynamic non-OECD countries with much smaller government (like many in Asia) are not on the OECD's radar.

Local politics also enters the equation. The report is drawn up in close consultation with the Treasury and the Reserve Bank. Without analysis of contrary views, it reflects the attachment of officials to things such as the savings analysis of New Zealand's external liabilities and to measures such as a capital gains tax, a land tax and a Nordic dual income tax.

The shift from a balance of trade surplus to a deficit and the build-up of foreign debt during the past decade owes more to the loss of international competitiveness than any 'savings deficiency'. Evidence for this view is the stagnation of the tradeable sector of the economy while non-tradeables

production grew rapidly. This imbalance would not be expected if the problem were savings.

Treasury's infatuation with a capital gains tax is flogging a dead horse. It won't happen politically, and any theoretical advantages of such a tax are outweighed by the practical problems.

Moreover, such a tax would not necessarily moderate house price increases. Theory suggests that the main impact would be one-off, and the effect could be the opposite if owners withheld houses from the market. Australia has a (partial) capital gains tax yet house price increases there have been faster than in New Zealand.

The best of the four chapters in the report deals with regulation. Government officials have been complacent about regulatory trends in New Zealand. They oppose the Regulatory Standards Bill (RSB) which seeks to strengthen regulatory disciplines.

The OECD makes it clear that the quality of product market regulation in New Zealand has deteriorated, absolutely and relatively. It would likely have reached the same conclusion if it had examined labour and capital market regulation as well. The report assessed New Zealand to be in the bottom third of OECD countries in terms of barriers to entrepreneurship. It supports a "suitably refined" RSB.

Strangely, the report fails to examine whether its recommendations would achieve the government's priority goal of catching up to Australian income levels by 2025. (They wouldn't.)

Nevertheless, the recommendations of the OECD and the 2025 Taskforce have much in common.

A short list includes (besides an RSB) a legislated cap on government spending, welfare reform, increasing the eligibility age for NZ Super and linking it to the CPI, cutting KiwiSaver subsidies, reforming student loan arrangements, flattening income tax rates, moving towards privatisation, introducing congestion charging, relaxing land use regulations, establishing tradeable water rights, abolishing remaining tariffs, liberalising foreign

investment rules (which are now restrictive by OECD standards), opening ACC to competition and removing Zespri's monopoly on kiwifruit exports.

This overlap makes it abundantly clear that it is absurd to regard the 2025 Taskforce's prescription as extreme or unorthodox. The OECD is utterly mainstream – or even a laggard in recognising the lessons for prosperity in the world today.

The OECD does summon the courage to criticise some of the government's policies, such as its investment in broadband (which, shamefully, was never subjected to a cost benefit analysis) and the retention of the 'Kiwi share' in Telecom.

Overall, the report has some salutary messages for New Zealand. It notes that there has been no growth in the economy for around four years, with the global financial crisis coming on top of the economic mismanagement of the previous government. It suggests that the current account deficit could blow out to a worrying 6% of GDP in 2012 and calls for structural reforms.

It rightly argues that the government should be reducing its fiscal deficit faster as the best way to reduce external vulnerabilities and lift national savings.

But it falls short of a programme for transforming New Zealand into a dynamic, fast-growing economy. In this regard the 2025 Taskforce has done a better job.

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