This article was first published in the *Dominion Post* on 20 July 2009

Its Record in Catching Australia Will Define the Key Government

Shortly the government is expected to set up an advisory group to report on how to achieve its goal of lifting New Zealand's per capita income levels to those of Australia by 2025.

Former Reserve Bank governor Don Brash is tipped to be named as chairman.

The goal is the counterpart to the Labour government's "top priority" economic goal of getting New Zealand back into the top half of the OECD. Initially it aimed to do so by 2010 but later any target date was dropped.

If Labour was ever serious about its stated goal, it had no programme to achieve it; indeed its failed policies were negative for growth overall. New Zealand dropped a further rung on its watch.

There are several interesting aspects of the new government's goal.

Firstly, it is more challenging. Australia was in 19th place in the OECD rankings in the early 1990s and has now climbed to 12th place.

And New Zealand may be chasing a moving target. Our counterpart organisation the Business Council of Australia wants to see Australia among the top 5 OECD countries by 2012.

Secondly, the government has set a firm date of 2025 for achieving its goal.

Thirdly, the advisory group is to report annually on progress.

This will make it harder for the government to make empty claims about being 'on track', as ministers in the previous government routinely did when asked.

Can the target be met? In my view it is challenging but feasible. For 100 years to the 1970s New Zealand's living standards roughly matched Australia's.

Assuming Australia maintains its recent trend growth rates in GDP per capita, it would require New Zealand to return to the rates of labour productivity growth achieved in the 1990s, and improve on them.

Increased workforce participation would also help.

Hong Kong and Singapore, and Ireland in the 1990s, have demonstrated that small countries that manage their affairs well can grow rapidly.

The Confidence and Supply Agreement between National and ACT states that "Both parties recognise that achieving [the 2025] goal will require significant improvements in New Zealand institutions and policies."

It adds that "Their joint commitment to limited government – government limited to its proper role – and greater economic freedom will need to be consistently adhered to."

This is a promising start. The quality of institutions and policies is far more important than factors such as natural resources in determining prosperity. Australia's economic performance was deteriorating before the Hawke-Keating reforms and improved well before the recent mining boom.

It is not hard to list superior institutions and policies in Australia. It is ahead of New Zealand in many rankings of economic freedom and international competitiveness.

A key difference is the size of government. Despite the federal, state and local government layers, total government expenditure in Australia is around 35% of GDP compared with 45% in New Zealand.

Shrinking the income gap requires smaller government in New Zealand (which would facilitate moves to a lower and flatter tax structure).

Australian governments, both Liberal and Labor, have continued to exit commercial activities. The Queensland Labor government has recently announced a $16 billion sale programme including motorways, the Port of Brisbane and rail assets.

There is much more private sector involvement in infrastructure in Australia.

Possibly New Zealand retains a more flexible labour market overall than Australia. However, the government's 90-day trial period for small employers is much more limited than Australia's 12 month period for small employers and 6 month period for large firms.

Australia typically scores above New Zealand for education performance. There is more choice and competition in its education system, with around a third of secondary students attending private schools.

The Rudd government has recently announced an increase in the pension age to 67, a move that our government has ruled out. Australian welfare rules are typically tighter than New Zealand's.

Of course, not all the differences are in Australia's favour, and recently the Rudd government has made backward moves, such as a massive increase in government spending and re-regulation of the labour market.

And Australia is no standout. In many ways Hong Kong and Singapore, with small governments and essentially flat tax regimes, are better models.

New Zealand needs spending, tax, regulatory and social policies of the highest quality. As Bill English has said, "you need to do 200 things to raise productivity."

At present, New Zealand is not on a path to close the income gap. Treasury's assumption is for trend labour productivity growth of 1.5%, less than half the necessary rate.

The *Herald's* recent Mood of the Boardroom survey revealed support for the government's directions but a view that it was in cruise control.

The income gap won't be closed without far-reaching reform.

Some will complain that the necessary agenda will reflect the principles of earlier reforms. But their merits are now widely accepted and controversy is largely limited to academic debate about whether they were too fast or too slow, or in the wrong order.

The damage of recent economic mismanagement won't be repaired this parliamentary term. But by the time of the next election it should be apparent whether the Key government is on track to achieving the goal that will define its success or failure.

Roger Kerr (rkerr@nzbr.org.nz) is the executive director of the New Zealand Business Roundtable.