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## **Economic Challenges for the New Government**

The economic story of the last 10 years is easily told.

The Labour-led government came into office at the end of 1999 when the economy was recovering strongly from the shallow recession induced by the Asian crises. In the year to March 2000 the economy grew by 4.7%.

It also inherited a generally sound economic framework created by the economic reforms of the 1980s and early 1990s, even though the previous National-New Zealand First government had allowed government spending to take off and had become more interventionist.

In the first half of this decade, the economy continued to perform well, assisted by generally buoyant world economic conditions, high terms of trade, reasonable control over government spending in Labour's first term, and what turned out to be excessively loose monetary policy from 2003 on.

Former finance minister Michael Cullen was correct to claim that per capita incomes grew slightly faster in New Zealand than in Australia up to 2005.

However, by that time a raft of anti-growth initiatives in areas such as tax, employment law, network industry regulation, competition and securities law, environmental policy and others, coupled with mushrooming government spending, were beginning to take their toll.

From 2006 on, per capita income growth in New Zealand fell below that of Australia and is projected to remain lower for at least an 8-year period, according to the latest IMF forecasts.

Labour productivity growth, which averaged close to 3% per annum in the 1990s, fell to 1.1% on average in the period 2000-07, and multifactor productivity growth also slumped.

The Business Roundtable pointed out repeatedly that the Labour-led government's anti-growth policies and focus on income redistribution made its goal of getting New Zealand back into the top half of the OECD income range unachievable. Unfortunately that assessment proved to be correct.

Other economic problems have mounted. Dr Cullen misdiagnosed the balance of payments deficit as a savings problem rather than a loss of international competitiveness, and for the last four years of his watch the deficits were larger than those he inherited.

The economy entered recession at the beginning of this year, well before the world financial crisis hit it.

As one of New Zealand's most senior businessmen put it to me recently, "I don't know whether National realise the mess they are inheriting, and the severity of the recession.

"All the fiscal surpluses have been eroded and turned into serious deficits; the external deficit is one of the highest in the western world and leaves us at risk of a brick wall on offshore borrowing; inflation at 5% is the highest in many years; and wage pressures are severe at a time when unemployment is rising rapidly.

"Pervasive regulations have strangled many businesses; the stock exchange has largely dwindled into insignificance; the deposit guarantee scheme is distorting debt markets; public sector numbers have ballooned; and management of the health and education sectors is woeful.

"Business people have seen this crisis developing. The mystery is why media commentators have been so slow to grasp it."

The National-ACT Confidence and Supply Agreement recognises the seriousness of the immediate economic risks and the dire productivity trend. It acknowledges the need for significant changes in institutions and policies to cope with the problems.

Under the heading of 'joint aspirations', the parties have committed themselves to the goal of closing the income gap with Australia by 2025

which, they said, “will require a sustained lift in New Zealand’s productivity growth rate to 3% a year or more.”

The government must be held accountable for achieving its goals. It has recognised the need for more limited government and greater economic freedom in order to unleash faster productivity growth.

A promising sign is that it plans to set up a task force to make recommendations on a credible policy programme, and to report annually on whether the quality of institutions and policies is improving and whether New Zealand is on track to meet the 2025 goal.

The Agreement also envisages steps to strengthen New Zealand’s fiscal and regulatory constitutions. The government spending share of the economy will have to fall well below its current level (42% of GDP compared with 33% in Australia) to facilitate rapid growth.

The many other serious impediments to productivity growth in New Zealand will have to be decisively addressed.

Given the extent of the current difficulties, a quantum leap in New Zealand’s performance cannot be expected within three years.

But it will not take long to see whether the government is headed in the right direction, just as it did not take long to see that the previous government was headed in the wrong one.

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