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ROTARY CLUB OF WANGANUI

AGENDA 2002: AN ELECTION WITH VISION

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Arguably the most important commitment the government has made is to restore New Zealand to the top half of the Organisation for Economic Cooperation and Development (OECD) income rankings. It has set store on keeping its word. At election time this year the main focus of the economic debate should be on whether the government is delivering on this commitment.

Past governments have made similar commitments but failed to live up to them. The Bolger-Birch government set a goal of achieving an average annual growth rate of 3.5-5 percent for the period to 2010. However, it never seriously put in the hard yards needed to achieve this goal, and neither it nor the subsequent coalition government ever looked like reaching it.

It is easy to be cynical about such lip-service commitments. But the price we pay for cynicism is to tolerate ongoing economic under-performance. This year the media, business organisations and others must hold political parties accountable for their record and their programmes in relation to goals of faster economic growth.

The Treasury has estimated that to achieve the government's goal of restoring New Zealand to the top half of the OECD ladder over 10 years, real per capita gross domestic product (GDP) would need to grow at an annual rate of 4.6 to 7.4 percent, depending on the measure of GDP that is used. The National Party has committed itself to an annual growth target of 6 percent. The ACT and New Zealand First parties have similar goals. Thus most political parties are seeking major improvements to New Zealand's present economic performance. In doing so they are clearly reflecting the aspirations of most New Zealanders for faster increases in living standards.

The government acknowledged in the 2001 budget that "our medium-term growth path is not sufficient to improve our relative standing among the developed nations of the world". But is it on track to improving that outlook? Regrettably, no. The December 2001 Economic and Fiscal Update (DEFU) suggests that over the current parliamentary term, total economic growth in New Zealand will only match that of other OECD countries. The DEFU projections for future years (averaging between 2

and 3 percent a year) show no signs of improvement. This contrasts with the 10 years to 2001 when, according to International Monetary Fund (IMF) figures, New Zealand's average growth rate at 3.1 per cent was slightly above the advanced country average of 2.8 percent, and the five years to 1996 when New Zealand averaged 4 percent annual growth. Our performance is deteriorating, not improving.

This may come as a surprise to some. Many economic commentators have seen the last three years as relatively buoyant. Growth was 5.5 percent in calendar 1999 and has averaged around 2.5 percent in the subsequent two years. But as the minister of finance noted in the budget, New Zealand has been experiencing the most benign combination of circumstances seen for many years. They include a strong world economy in that period, high commodity prices, favourable weather and a low dollar, all of which have boosted farming and some other export industries. None of these circumstances is likely to last.

Projections suggest that the economy may grow by around 2 percent this year – more than many other countries given the current international slowdown, but only two-thirds of Australia's projected growth of over 3 percent. Moreover, the balance of payments deficit is still over 3 percent of GDP at a time of modest growth, and external debt levels remain high. The improved competitiveness position is largely due to the weak currency, which has meant cuts in real wages. The unemployment rate seems stuck in the 5-6 percent range, contrary to the prime minister's goal of getting it down to 3 percent. Welfare dependency remains a major problem. There is little evidence to suggest that New Zealand is on its way to becoming a top OECD country. Last year *The Australian's* international editor, Paul Kelly, expressed the view that New Zealand faces "pervasive economic decline". Such opinions are much more common in the Australian media than our own.

It is pleasing that the government (and other political parties) are recognising that New Zealand needs to do better. There is no reason why we could not achieve much faster growth. In the decade to 2001, two other small economies, Ireland and Singapore, achieved growth rates of over 7 percent, according to IMF figures. Some recent Treasury work puts New Zealand's under-performance down to problems of size and distance. This defeatism is implausible – New Zealand was no bigger or closer to its main markets when it was one of the world's highest income countries.

As Glenn Withers of the Australian National University told a Business New Zealand conference at the end of last year:

Australia and New Zealand were once global nations for which the tyranny of distance meant little. International capital flowed freely, tariffs and minimum wages were few, and regulation minimal.

What went wrong for both countries, Withers noted, was a shift from open, liberal policies to a century of protectionism and welfare statism. This bred a culture of dependence which focused on redistribution, not wealth creation. Only in the last two decades have both countries started to discard this legacy.

In its first year of office the government's emphasis was again on redistribution, with moves such as the increase in the top income tax rate and increased assistance to superannuitants and tertiary students – in the last two cases benefiting better-off groups rather than the disadvantaged. However, its subsequent declared focus, which business organisations have welcomed, has been on wealth creation. The problem is that a credible and coherent strategy, in line with contemporary economic thinking and the directions of successful countries, has not yet emerged. In the budget last year, the government described its strategy in the following terms:

- building the future capability of the economy by creating an economy which supports entrepreneurship and excellence
- building the base of business through a network of incubator supports, technology fellowships and enterprise award programmes
- attracting enterprises with high growth potential by introducing business growth and greenfields investment services
- assisting specific sectors to develop expansion strategies in partnership with the Government; and
- a "smart government" component that expands the role of the Industrial Supplies Office and attracts and coordinates major events.

This, to be frank, is not a strategy. Nor is talk about a 'new economy' or a 'knowledge economy'. Many of New Zealand's strengths are in 'old economy' industries. Key requirements for the development of innovative, high technology industries are high levels of economic freedom – low taxes, unrestrictive labour laws, light regulation –

and rigorous, competitive education. The government is not currently taking New Zealand in these directions.

This is not to deny that there have been a number of developments that have been welcomed by the Business Roundtable and other business organisations. The government's monetary policy review rejected misguided proposals to change the Reserve Bank Act. Its tax review served a similar purpose in rejecting ideas for new taxes, but it is disappointing that its arguments for a lower, flatter tax structure were quickly dismissed. The government's commitment to stick to its spending allocations – even though they can be criticised as excessive – has been important for financial market confidence. It has held the line in the debate on genetic modification, and it also deserves credit for the deregulation of two of the three monopoly producer boards, moves on immigration and its free trade initiatives.

On the other side of the ledger, however, have been backward moves such as those on tax, ACC, employment law, business regulation, nationalisation, education, health and welfare. The government has made little progress with the Resource Management Act and other business compliance costs. Government operating and capital spending limits are under pressure with health board deficits and the ill-conceived superannuation fund. Initiatives in the pipeline that would be damaging to business include ratification of the Kyoto Protocol, expanded roles and powers for local government, and further employment law changes covering health and safety, redundancy provisions and parental leave. The upshot is that New Zealand's growth outlook has become weaker, not stronger – recent Treasury forecasts have consistently been too optimistic and no economists to my knowledge foresee the kind of growth rates that the government is targeting.

What does New Zealand have to do to achieve a better economic performance? The answer is pretty clear from our experience and that of many other countries over the last two decades. Economic success is not dependent on abundant natural resources. It isn't much affected by size and distance. In today's global economy it isn't solely dependent on the quality of local business skills, provided there are no barriers to outside involvement. Far more important than these factors are countries' own policies and institutions, such as their laws and systems of government.

Today's most successful countries are, in general, those that have avoided or moved away from failed policies of protectionism, import substitution, Keynesianism, central planning in its various forms and extensive state welfare, and towards a freer, open and competitive economic environment. They have fostered – not just talked about – a climate of enterprise rather than state dependency. They are also characterised by good democratic systems and respect for property rights, contracts and the rule of law.

Thus the relatively strong position of countries like the United States, the United Kingdom, Ireland and Australia today owes much to market-oriented economic reforms that began in the 1980s. Thanks to its reforms New Zealand is also far better placed than it was prior to 1984. Yet for almost a decade New Zealand has made little further progress while other countries have continued with policies such as deregulation, privatisation, smaller government, cutting high taxes, greater competition in health and education and welfare reform. Like physical fitness, economic fitness has to be maintained. There is no point in going to the gym once every 10 years. You have to keep on keeping on. New Zealand no longer stands out from OECD norms in terms of the overall configuration of its policies. It also has the handicap of MMP. Unsurprisingly, its performance is now no better than the OECD average.

Leading countries such as the United States are continuing to move forward – the Bush administration is reducing taxes, implementing further education and welfare policy changes and lightening burdens on businesses. The Irish economy grew by around 6 percent last year and is projected to record around 5 percent growth in 2002. If it is returned at this year's elections, the Irish government is likely to continue with privatisation and tax reductions. Australia is also likely to continue on a steady reformist path both at the federal level and at the state level, where Labor governments are mostly in power. As prime minister John Howard said following his re-election:

There is some reform fatigue, but if you continue to argue the national benefits, you can still take people with you. We don't want to lapse into the status quo.

Business organisations in Australia are pressing for ongoing change. Earlier this month the Australian Chamber of Commerce and Industry called for more moves in a

free-market and smaller government direction. It argued for cuts in government spending, rolling back red tape, deregulation of the labour market (especially unfair dismissal laws) and no ratification of the Kyoto Protocol by Australia pending study of its economic impact.

Most business organisations in New Zealand have a broadly similar agenda. Last year the Business Roundtable published work on the impact of high government spending on economic growth. One basic finding was that New Zealand has virtually no chance of achieving sustained per capita income growth of 4 percent or more with government spending (central plus local) equal to around 40 percent of the economy as at present. Any credible growth strategy has to target levels of 30 percent or below as found in countries like the United States, Ireland, Singapore and Hong Kong. We have advocated getting all income tax rates (personal and company) down to a maximum of 25 percent. Also last year we published, along with other business organisations, a major study on constraining government regulation which, among other things, floated the idea of a Regulatory Responsibility Act.

Government spending (both central and local), taxation and business regulation will be major election policy issues for us this year. Other priorities will be employment law, small business growth, education and welfare (including the family), on which we shall be releasing major studies. Shortly we shall be publishing a study on Tasmania which illustrates the risks for a small, remote economy of persisting with bad policies and institutions.

Next month the government will be announcing a package of initiatives to advance its 'economic innovation' agenda. It is to be hoped that it picks up ideas that Reserve Bank governor Don Brash put forward at the Knowledge Wave conference and the representations of business organisations. Raising income levels to the top half of the OECD requires major changes to fiscal, regulatory and social policies. Tinkering and small-scale industry and science policies won't do. Whatever view one takes of initiatives such as Industry New Zealand, the Kiwibank and export credit schemes, they are simply peripheral – as of the end of last year the export credit insurance fund had received just one application. The government's dialogue with business over the past 15 months will have been fruitless if the package lacks substance and if ongoing representations on Kyoto, local government, health and safety and other legislative proposals are not heeded.

Anyone in touch with New Zealand business and international investment markets knows that New Zealand has lost ground relative to its achievements in the early to mid-1990s. Late last year, the chief financial officer of Telecom was reported as saying:

We've lost our share of air-time [in the international investment community]. They can't even get their heads around bothering to allocate resources.

Polls indicate that many business leaders are critical of the government's directions but also feel the National Party is not offering ambitious and credible alternatives. The country desperately needs an election with vision. A strong, growing economy with vibrant, robust businesses is fundamental to the country's quality of life and a strong society. Without it we will not meet the challenges of raising personal incomes, job creation, attracting new investment, retention of our best and brightest, security for an ageing population and environmental improvement. It will be up to everyone this year – the media, community groups, business organisations and others – to insist that a Tasmanian scenario for New Zealand is simply one that cannot be tolerated.