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**BUILDING INDUSTRY FEDERATION**

**TIME FOR AN ECONOMIC DEBATE**

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## **TIME FOR AN ECONOMIC DEBATE**

Towards the end of last year the *New Zealand Herald* ran a survey of opinion among 120 top chief executives and company chairmen. One of the questions asked was: "Did New Zealand have a growth strategy to sustain business success?" In the *Herald's* words:

The answer was a resounding 'No'. Only three players conceded that there was a strategy – or the beginnings of one.

The *Herald* survey also reported a widely shared view that the government-business dialogue of the past two years was not delivering results.

This is a disturbing situation. The government and the business community are at one in wanting to see New Zealand do better. Those of us who have the privilege of leading business organisations have a duty to represent our members' views effectively. This year business organisations must do a much better job of pointing out the gap between the government's goals and its actions, and press it to adopt a more credible strategy.

The government responded to criticisms of some decisions taken in its first term of office by saying that they were motivated by a desire to redistribute income, not to create wealth. As an aside, this argument was dubious: much of the spending went to better-off groups such as tertiary students (who generally come from better-off families) and wealthier superannuitants rather than people in genuine need. Nevertheless, the government's focus subsequently turned to wealth creation and has remained there. At the opening of the current parliament, the Speech from the Throne indicated that the government:

... sees its most important task as building the conditions for increasing New Zealand's long-term sustainable rate of economic growth.

It has set itself the target of restoring New Zealand to the top half of the Organisation for Economic Cooperation and Development (OECD) income rankings. The minister

of finance has stated that by next year it will be clear whether New Zealand is on track to achieving this goal.

The government clearly has a solid platform to build on. The economic reforms of the 1980s and early 1990s created a much stronger economy. In the 10 years to 2003, the economy grew in real terms by an average of 3.2 percent a year, according to International Monetary Fund (IMF) figures. This was almost a 40 percent improvement on the average of 2.3 percent for the previous decade and above the average for major advanced economies. Employment growth has been high and inflation, interest rates and public debt much lower. The benefits of the reforms to consumers, workers and taxpayers have been chronically undersold. Not everything was done right and important things have still not been done, but talk of the failed policies of the past is clearly nonsense.

As a result of these improvements, the long-term slide in New Zealand's average incomes appears to have been arrested but not yet reversed. New Zealand has not done as well as Australia, which has been a more consistent reformer. Australia has climbed back to 12th position in the OECD rankings, which puts it in the top half, whereas New Zealand is in 21st place. Ireland has done better again, averaging 8 percent annual growth for the decade to this year, and demonstrating what a small country can achieve with sound policies.

A point that needs to be made is that what matters for average incomes is not growth in real gross domestic product (GDP) but in real GDP per person. Only economic growth in excess of population growth – which is averaging about 1 percent a year – raises average incomes. The economy appears to have grown by about 4 percent last year. However, because the population grew by a bit over 1 percent with relatively high levels of immigration, the increase in GDP per head was only around 2.5-3 percent.

The fact is that recent per capita GDP growth is still only middling by OECD standards and the outlook is for it to slip back rather than to increase. A Treasury paper estimated that per capita GDP growth would have to average between 4.6 and 7.4 percent per annum to put New Zealand back into the top half of the OECD in a

decade. That is a huge challenge. It means lifting the growth rate achieved in the last decade to one much closer to Irish levels.

Too many people have become complacent about the economy in the past couple of years. New Zealand has continued to grow at a time when the world economy has been struggling. Helpful factors have been high commodity prices, favourable weather and a low dollar. All of these were bound to change. Exporters are now finding the going tougher and forecasters are projecting somewhat slower growth in the period ahead.

Nevertheless, it is wrong to suggest that the government has just been lucky and that the economy is about to return to the boom and bust cycles of the past. The reality is that we have a much more flexible and resilient economy than we had 15 years ago. The debate is not about whether steps taken by the government will bring growth to a halt. Rather, it is about whether its policies will raise the trend rate of GDP growth from recent levels of about 3 percent a year to the much higher levels it is targeting. Currently there are no signs of this happening.

Why do the overwhelming majority of respondents to the *Heralds* survey believe the government lacks a credible growth strategy?

I suggest a first reason is that the government has done little to educate the public about the magnitude of the task implied by its ambitious goals. The minister of finance has acknowledged that to meet them our productivity growth rate would need to more than double. That is a radical change which would require radical changes in attitudes, policy and business performance. Yet the government's description of its strategic approach is policy incrementalism, which can't possibly do the job.

Secondly, New Zealand's recent economic directions are out of line with those of successful countries and the advice of mainstream organisations such as the OECD. They have been urging New Zealand to follow the continuing worldwide trend towards policies of economic liberalisation. As a recent Business Roundtable study put it, New Zealand has been losing sight of the lodestar of economic freedom. To do better than other countries requires superior, truly first class, public policies.

Thirdly, the majority of the policy changes made by the government have been anti-growth rather than pro-growth. Early moves included the increase in planned government spending, the lift in the top tax rate, more restrictive employment legislation, the removal of competition for accident insurance and the tariff freeze. More recently we have seen a trend to renationalisation, heavier regulation of business, expansion of the scope of local government and planned tax increases under the Kyoto Protocol. This year government spending is set to rise by a further \$1 billion and business will be confronted by further regulations, more costly employment legislation including the Holidays Act, and the removal of the opportunity to take commercial law cases to the Privy Council.

In addition, as comments in response to the *Herald's* survey emphasised, development barriers such as the Resource Management Act and infrastructure are not being effectively addressed, property rights are being undermined in a number of areas, and welfare dependency and skill shortages are a drag on the economy. The consistent themes of the survey were too much government intervention and a poor understanding of business needs.

It is true that there have been some pro-growth initiatives for which the government deserves credit, but they have been swamped by initiatives harmful to growth. The government still seems to be putting income redistribution ahead of wealth creation. It is talking about cutting taxes on lower income groups and boosting family assistance rather than cutting high marginal tax rates and taxes on capital income which would do most to boost economic growth. Similarly, the government's current transport bill downgrades economic efficiency in the transport sector as a priority objective, which will impact on resource allocation and growth. The government cannot keep saying one thing and doing another and look credible to business and investors.

There is no reason why New Zealand could not be doing a great deal better. Our size and geography are no great handicap. New Zealand managers measure up to their counterparts abroad in creating value added in their firms. Many New Zealand firms

are succeeding internationally. Statistics New Zealand has found that New Zealand ranks highly for innovation.

Instead the main handicaps are things governments have control over. Economic research in recent years is pointing increasingly to the conclusion that the central factor in economic growth is better institutions and more limited government. As a rule, governments cannot create wealth or expand the economy. Only the private sector can do that. Governments can, however, hinder economic growth through excessive spending, high marginal tax rates and over-regulation. The government's share of GDP must be rolled back and regulatory burdens on business lifted if the private sector is to expand and New Zealand become a dynamic and high-income country.

A recent *Australian Financial Review* editorial made the point that:

Australians have reason to feel good about their country's economy. The painful reforms of the past two decades have given us a more flexible, dynamic and diverse economy, one better able to take advantage of opportunities wherever they occur ... This should give us the confidence to tackle the further reforms needed to cement those gains.

The Business Roundtable has been making similar points about New Zealand. For several years we have been concerned that New Zealand has been losing ground relative to countries that have persisted with economic reforms, and more recently has been heading in some wrong directions. Other business organisations have been saying much the same thing. Some business people have been trying to get the message across privately to the government but have become disillusioned with their lack of success. The business community is running out of patience with the failure of the government-business dialogue to produce substantive outcomes. This year people in business must speak out more clearly in public about the need for an effective growth strategy to deliver the fair, clean, safe and prosperous society we all want.

Growth will be the number one priority for the Business Roundtable this year, and I believe for other business organisations as well. We see a need to promote better

public understanding about why people's aspirations for more jobs, higher incomes, better health and education services and less welfare dependency all hinge in one way or another on economic growth. Growth is not everything but it makes a lot of other things easier, including taking care of the environment. Recently, Michael Cullen was asked in the House whether he was aware that New Zealand spent less on roads than many other OECD countries. He replied correctly:

New Zealand spends less on roading, on health, on education, on law and order, and on a large number of things, than do a number of other OECD countries. Unfortunately, that is what being in the bottom half of the OECD means.

We want to reach out to other constituencies that share our aims. For example, we want to forge closer links with the small business sector, given our belief that the needs of small and large businesses are much the same. A recent Ministry of Economic Development study found that, contrary to conventional wisdom, the relative costs of complying with government regulations are just as great for large businesses as small ones. Also compliance costs are only part of the story – in many cases the problem is the regulations themselves.

We have embarked on a study of the economic and social performance of Maori and how it might be enhanced, given the important role Maori occupy in business and society. We want to recognise and promote the role of women in business. And we shall be seeking to engage with educationists and parents on ways of improving an education system which is still too centralised, bureaucratic and unresponsive to the needs of those it should be serving. We shall be publishing a major study on education in the near future, as well as one on the family which we see as central to many of New Zealand's welfare problems.

Many commentators observed that in the election campaign last year there was no real economic debate. This did not serve the country well. The 2001 Budget had made the point that New Zealand was experiencing the most benign combination of circumstances seen for many years. This should not have lulled the country into a false sense of security. Times will get tougher again. There are always shocks in economic life – war in the Middle East this year may be one of them. New Zealand is

not as immune to them as it might be – our level of foreign debt, for example, is high. Important questions about the path New Zealand is on need to be debated, and no one has a monopoly of wisdom on them.

To pose such questions is not to be anti-government. The government's economic goals are laudable. Economic reform is never easy. The prime minister deserves credit for using political capital to facilitate the adoption of genetic modification, a technology vital to New Zealand's future. Other necessary reforms are equally challenging, and governments need support in making them.

More broadly, we need a strong public and political consensus on policies for economic success, of the kind that has been achieved in countries like the United States, Australia and Ireland. Changes of government don't lead to fundamental changes in direction in those countries. The government has implicitly acknowledged that most of New Zealand's structural reforms were sound by leaving them largely in place. The public, too, has generally accepted that reality. The problem as business sees it is that too many of the subsequent changes have been directionally wrong – they are weakening rather than strengthening the economic framework when what we need are new initiatives that will take the country forward. The risk is not that the sky will fall in but that our economic performance will suffer death by a thousand cuts, moving us away from, rather than towards, the government's goal of achieving faster growth. And just as the benefits of better economic policies can take years to materialise, many of the costs of policy mistakes only show up with a long lag.

The minister of finance is right to implicitly acknowledge that by 2004 it should be possible to judge whether the government's policies are lifting New Zealand's sustainable growth rate. Five years is enough time for an economic strategy to make a difference.

Going forward, the media and others should therefore be reviewing whether there is evidence of an improving growth outlook. They should be pressing the government to explain more explicitly why it thinks the advice it is receiving from the OECD and the IMF is wrong. They should be asking it to respond to Business New Zealand's

calculation that a medium-sized company is now facing an extra \$44,000 a year in costs because of government policies, and to the Business Roundtable's contention that New Zealand cannot hope to achieve sustained per capita GDP growth of 4 percent or more with total government spending – central plus local – equal to about 40 percent of the economy. They should be asking the Growth and Innovation Advisory Board to put forward for public scrutiny the advice it is giving on how the government can meet its goals. They should be interviewing respected independent economic experts for their views on the merits of competing arguments.

In a democratic society, at the end of the day, it is for voters to decide the policies they want their governments to follow. Judging by the pro-growth stances of most political parties, New Zealanders want to enjoy greater economic success. The relevant debate is therefore about the policies that will achieve that goal. To help the public make informed decisions, it is time for business, the media and political parties to engage more vigorously in that economic debate.