

The State of the Nation

Some Notes on an Economic Overview

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It is well known that over many decades New Zealand fell from having one of the highest per capita real incomes in the world to being virtually at the bottom of the developed country league table. Moreover, we have a long history of large external imbalances. Today the balance of payments current account deficit stands at the record level of about nine per cent of national income.

Thus we are living in a major way off other people's savings and running up a large overseas debt, in this case owed by the private sector rather than (as in the past) by the Government.

This makes us potentially vulnerable to external shocks and suggests a seriously overvalued exchange rate.

This is bad news for exporters but great for importers, at least in the short term. As even the most economically uninformed of us realize, there is a limit to how much one can rely on the savings of others. When the time comes for an adjustment to the realities of living within our means, the shock could be severe.

This situation has emerged despite considerable help from better terms of trade (the ratio of export to import prices); the vast improvements over the past decade or so in the overall stance of monetary and fiscal policies; the resultant lowering of inflation; and the pleasing decline in unemployment (although the latter is disconcertingly offset to a significant extent by a large rise in sickness beneficiaries).

After the extensive deregulation and consequent enhanced adaptability of the business sector in the mid eighties and early nineties, both small and large businesses became more agile and competitive. This contributed greatly to the substantial gains in productivity growth through the period up to 2000. Total productivity grew by 2.5 % annually from 1992 (after the introduction of the Employment Contracts Act) to 2000. During the past 15 years, New Zealand thus transformed itself from a below average performer to an above average performer with respect to our rate of economic growth.

But closing the gap with other countries requires much more than this. To catch up to the average of the developed countries (the OECD) by 2015 would require annual per capita economic growth of 3.4 % versus the 2.1 % achieved between 1997 and 2006. This looks impossible given current policies.

Why is this ?

It is in part because we are in fact starting to go backwards again in relative terms. For example:

1. The Economic Freedom index is now on the decline for NZ after a period of increases.
2. Work stoppages are increasing again.
3. Hours worked per full time employee are going down.
4. Core public servant numbers are growing rapidly after declining through the nineties.
5. Crown spending is forecast to continue at very high levels relative to national income.
6. The overseas deficit is huge and persistent, the 3rd worst in the OECD.

7. Infrastructure investment has been falling, as shown by the declining ratios of capital stock to GDP; utilities GDP to economy-wide GDP; and soft investment intentions (but with some improvement in the latter over the past year).
8. Surveys show business is worried about high taxes, extensive regulation and the burden of compliance costs.
9. Capacity utilization is at record levels (thus constraining future growth).
10. NZ's capital stock growth is lagging other countries;
11. New legislation and regulations are extensive, more than at any time in our history if judged by the number of pages of laws passed.
12. Some major new Government sponsored investments are failing to cover their costs of capital, and are thus not adding economic value.

New and extensive regulations are seen in every walk of life: local bodies, resource management, employment, more central control of numerous activities, securities and accounting and takeovers and governance for the corporate world, climate change and competition, and in many industries including notably banking, electricity and telecommunications.

The problems with the plethora of new regulations are multiple. Regulations beget regulations; they override commercial solutions; induce uncertainty; increase compliance costs; divert energy from competitive solutions to rent seeking activity; often concentrate on past problems rather than address future challenges; discourage offshore direct investors; result in company executives spending more time debating with government officials rather than dealing with customers; substitute regulators instead of company managers as decision makers, with few government officials having ever had any real commercial experience; and generally inhibit business flexibility.

The growth in the number of Government bureaucrats may be great for Wellington (which has now become the highest income town in NZ), but it is bad news for the nation's growth. Productivity growth originates in the private sector not within the public sector. The former needs to grow to survive; the latter redistributes income rather than creating it.

The essential question is, has productivity (real output per person and per unit of capital combined) been increasing faster under the more regulatory policies of the past seven years ? The answer, sadly, is no.

Since 2000, annual productivity growth has been just 1.1 %, which is less than half what we achieved between 1992 and 2000, at 2.5 %, and also much less than we recorded during the period some have called that of "the failed policies of the past", 1998 to 2000, when the number was 2.1 %.

So how does the scorecard for the past few years look ? The positives are reasonably sound monetary and overall fiscal policies, and a favourable terms of trade position. The negatives for business have been intrusive and extensive government regulation; high taxes; the growing size of government; an infrastructure mess; some weak social policies; a shrinking capital market; and constitutional issues (e.g. the absence of the right of appeal for many regulatory decisions, to say nothing of MMP).

The better growth performance has been driven by the world expansion, good commodity prices, and domestic productivity growth.

In assessing productivity, the state of the labour market is important as too is the cost of capital relative to labour. For example, relative to Australia, the cost of capital in NZ looks high.

Productivity growth is based on stable macro policies (low inflation), reducing size of government, and deregulation (which promotes flexibility).

But over recent years we have had a larger government sector, extensive government interventions, poor government management of some of their own areas (who believes health or education or roads are well managed ?), huge and growing external imbalances, and multiple violations of property rights. All of these have contributed to the disappointing and sharp decline in productivity growth in New Zealand.

This is why the business sector is so worried about the future prospects for New Zealand.

The solutions are complex. They involve much more respect for property rights, greater certainty in the application of the law and the enforceability of contracts, fewer changes in and less intrusive regulatory interventions, and lower taxes allied with a smaller government sector.

It would be nice to think the Government and other political parties would appreciate the importance of these considerations rather than feel the need for increasingly centralized control over so much of our lives.

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