

New Zealand Credit and Finance Institute

**Why New Zealand Needs a
Responsible Budget**

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WHY NEW ZEALAND NEEDS A RESPONSIBLE BUDGET

Your letter of invitation asked me to comment on the role of the New Zealand Business Roundtable and its interest in public policy issues, particularly as they relate to business. I shall also say a little about our current preoccupations, the most important of which is the forthcoming budget.

The Business Roundtable arose out of an informal grouping of business executives in the early 1980s who met periodically to discuss issues of common interest. It currently has around 40 members who belong by invitation. Most are the chief executives or chairmen of leading business enterprises, including current and former SOEs. We meet five times a year. There is a regular communication flow from a small Wellington office. Members suggest topics for study and determine our policy approach.

The Business Roundtable is not like some other interest groups which tend to pursue rather narrow and self-interested agendas. Such groups have had the habit of seeking favours from the government on the basis, of course, that acceding to them would advance the national interest. Over the decades governments gave way to much special pleading. Ten years ago we had a maze of subsidies and protection affecting most parts of the economy. These strangled the internationally exposed sectors which were then subsidised to compensate. In addition we had high tax rates because all the concessions and subsidies undermined the tax base.

As you will recall, the cumulative effect of this mismanagement was abysmal economic growth and continuously rising overseas and public debt. Furthermore, by mid-1984, after a two year wage and price freeze, the government deficit was a massive 9 percent of GDP and the financial crisis triggered by the election caused the foreign exchange markets to be closed.

It was this experience that made members of the Business Roundtable appreciate that continuing with the old ways would mean a continuing steady decline for the nation. They realised that the future growth and prosperity of their enterprises required a well-run economy. If you like, this involved an element of self-interest because large businesses cannot grow while operating in an economic backwater. Quite clearly policies that are good for the nation will also in the long run be good for businesses - or at least those businesses that do a good job - even though they may cause short term hardship for some.

This forced us to go back to basics - to analyse why the economy was not performing and to come up with policy ideas to break out of the low growth/high debt trap that New Zealand had slid into over the previous two decades.

The decision was taken at an early stage that we would not comment on issues unless we had first done our homework. Since 1986 I suspect we have commissioned and published more research on a wider range of subjects than any other New Zealand business organisation. We are very open in our operations. Early versions of studies are usually sent to a wide range of national and international specialists for comment.

We have often been attacked as an organisation, but the professional standard of our work is seldom challenged.

We have produced over 50 publications and made many submissions to the government, the opposition and parliamentary committees. Areas covered include the Commerce Act, privatisation, labour market reform, telecommunications, social welfare, education, and immigration. During the next year we expect to publish reports on agricultural marketing, health, housing, central banking and local government.

You may be surprised that we have tackled such a wide range of subjects, including some that many would consider beyond the brief of a business group. There is a very deliberate reason for the broad approach. The economy is not a series of sectors operating without reference to each other. The operation of every sector impinges on others.

Obviously the efficiency of the Cook Strait ferries affects the ability of Canterbury manufacturers and arable farmers to compete in the Auckland market against imports and local suppliers. Much less obvious is the impact that sectors such as education and health have on business.

Resources consumed by these two industries total more than 10 percent of GDP. The issue here is whether we are getting the best value for money for this large outlay. Is the health consumer getting what he or she wants? Are the products of the education system able to make a positive contribution to the workplace and society?

Once you think about this you realise that health and education services are far too important to be left to those in the system who have their own interests and agendas. So many parts of the economy which were supposedly regulated in the national interest were in fact controlled by the providers prior to the recent changes. Health and education are no different. We will continue to take a close interest in how public policy evolves in both areas.

One of our priorities for the next year is local government where there is enormous scope for further efficiency gains. Local authorities account for around 3 percent of GDP and through their regulatory powers influence a great deal more economic activity.

The problems some local authority bus companies have had in winning contracts under the new competitive arrangements have exposed gross inefficiencies in their operations. The position with port companies was the same. They have made great strides towards achieving international standards of efficiency, but still have a long way to go. Similar gains have yet to be made in many electricity distribution companies.

In addition to radically upgrading their efficiency, terminating inappropriate activities and eliminating differential rating which penalises business, we believe it is important that the regulatory role of local councils is also reviewed so that unnecessary costs are not imposed on commerce. The approach we take when analysing laws and regulations imposed by either central or local government is that the benefits must be clearly shown to outweigh the costs.

Within the next six weeks the government will deliver its first and probably most important budget. The previous government had instituted reforms in many key areas but had stalled on the labour market and failed to control government expenditure. The result of this policy imbalance was to squeeze the internationally competing sectors of the economy. The policy mix undoubtedly cost thousands of jobs.

As the numbers out of work grew, so did those on our relatively generous social welfare system. At present the ratio of beneficiaries (including GRI) to full time workers is approximately 2 to 3. Welfare payments exceed the amount spent on health and education. They cost more than the government collects in income tax. We spend 13 percent of GDP on welfare compared with 7 percent in Australia. The system is clearly out of control.

The projected fiscal deficit for 1991/92, as estimated last December prior to the welfare cuts, was \$2.1 billion rising to \$5.2 billion in 1993/4. That was unsustainable and would have added to our already large debt burden. Every week action was delayed would have meant the problem got worse.

The steps announced on 19 December to cut benefits and reform the labour market have produced major benefits. Interest rates are down nearly 5 percent since last October, inflation and inflation expectations are lower, the competitiveness of industry has improved, business confidence has lifted a little and we can at least see a glimmer of light at the end of a rather long tunnel.

If the government is able to cut its expenditure and increase the efficiency of all government services, the recovery will gather strength. In 1992 it seems likely to be helped by an upturn in the international economy. But we must keep sober. Farming is having one of its worst years on record. Previous signs of optimism over the last 3 years have been dashed by governments that found fiscal decisions too tough. The government's goal is to balance the budget in 1993/94. It is sobering to recognise that even that difficult target is not enough. We must work to achieve genuine budget surpluses in order to repay a stock of public debt which, despite asset sales, remains well above the OECD average.

There are some who think the prescription we support is too harsh on many people. The reality is that the sort of policies promoted by the Business Roundtable are not only in line with sound OECD practice but will also produce better results for the average person. For people who are less advantaged the cruellest policies are those that do not reflect reality. They will be the real victims of any further postponement of difficult decisions, reliance on more borrowing, or tax increases. We support as a priority welfare targeted to the genuinely needy and policies aimed at helping people out of welfare-dependent life styles, but policies which increase the number of people in this group are clearly irresponsible. Hence we must urgently apply ourselves to creating an economy of growth with increasing employment opportunities.

I find it amazing that some people still think the answer to the government's financial problem lies in increasing taxes. Central government taxation already amounts to around 37 percent of GDP. When you add local authority rates the total comes to around 40 percent. On top of that we have a gap between spending and revenue of

another 3 percent. Increasing tax rates would snuff out private sector recovery just as the GST increase did in 1989. Company tax revenue is down by a third on last year's budget estimates. To haul the economy out of recession the private sector must have greater access to cash flows, not less.

An increase in tax rates would send the worst possible signal to the business community and international investors. It would suggest the government had given up the struggle before it had even started and that the New Zealand political system is incapable of getting its fiscal house in order.

The minister of finance is right in saying that the government must grasp the nettle on spending. This is not an easy exercise. Many governments have tackled the area and made little progress. The bureaucracy has plenty of self-defence mechanisms to ensure that ministers "do not go too far."

Rather than simply wielding an axe, the government should analyse its functions and reduce them to an essential core. Anything that is not absolutely necessary, or is something that the private sector can do better, should be cast off.

Can anyone explain to me, for example, why the government is still supporting a Trade Union Education Authority? The organisation should prove its worth by openly competing with other educational groups and raising its own income, not rely on the taxpayer. Having determined what is appropriate for the government to do, the next question is the efficiency of the operation. As far as is possible the public sector must face disciplines that ensure its employees produce services in the most efficient manner. Wherever possible the role of providing services should be separated from the financing role and made contestable. The indications are that something like this sort of approach is at last being followed.

The government has taken a lot of criticism, including from some in its own ranks, about the steps that have been taken and those that are foreshadowed for the budget. It needs to be pointed out that some of these same critics were saying just a few months ago that the administration's monetary policy was the cause of high interest rates which were strangling the economy, and calling for the Governor of the Reserve Bank to be sacked. Where are these critics of monetary policy today? They are silent because they have been proven wrong.

The Reserve Bank had previously carried the burden of controlling inflation because the government was unable to control its own expenditure. Once it showed it was prepared to start taking tough and unpopular decisions, the markets responded strongly. Interest rate reductions can at least be sustained if the minister of finance is given the support she deserves. If not, rates will surely rise again.

It was interesting that at the recent enterprise conference in Wellington there were few calls for kick starts to the economy, artificial devaluations or changes to monetary policy. There was a general consensus in support of the Porter study's conclusions about international competitiveness and of the government's broad directions. This is very encouraging. The most obvious threat to this, as one financial analyst recently noted, is now the National Party caucus. This may yet torpedo the government's fiscal resolve,

thereby producing a higher risk, higher interest rate and slower growth environment than is beginning to look possible.

I believe some commentators and politicians have taken to a very selective reading of the National Party manifesto. Nation's Economic Vision released last year said that by the end of its first term a National government would achieve "a fall in the share of government expenditure and taxation as a percentage of Gross Domestic Product". It went on to say "National will reduce the government's claim on the community's savings by lowering the tax burden and eliminating the government's need to borrow. This will encourage lower interest rates and higher levels of investment". And later it said "National will attack the root cause of rising taxes by checking and then reducing the share of government spending to national income."

Those commitments are unambiguous and should be honoured, not just because they were promised by all National candidates who stood for election but because they are the only way to remove the obstacles to economic growth. Other promises of a more specific nature such as those on superannuation must be subservient to the basic policy. If one abandons core principles one is lost. A tough budget is needed to stop our generation from continuing to pile up debt which will have to be repaid by our children. Far too much inter-generational robbery has already gone on. It must be stopped.

Critics of changes planned by the government should address how the basic policy goals can be sustained. To be credible they must come up with constructive, real world answers.

In the Business Roundtable's view, there is a fundamental conflict between National's economic goals and the range of commitments relating to superannuation. We made this view known before the election. In our view there is scope to reduce the level of GRI without causing hardship to those who are wholly dependent on it; there should be an income and assets test; the age for qualifying for the GRI should be increased more rapidly than proposed to at least 65 years; and the proposed tax concession cannot be afforded. While these decisions are difficult, the alternative is an economy a few years down the track which has been abandoned by the energetic and the enterprising on whom the retired generation depends. An aging population in a stagnant economy is not an attractive prospect. We support the government's objective to create a certain and sustainable environment for superannuation and take it off the political agenda.

The framers of the budget are going to have to make choices. Do they want an economy that will grow under a less oppressive tax burden, create jobs and reduce the number of beneficiaries - the economic vision on which they were elected? Or do they want more of the stagnation and mediocrity that resulted from taking soft options in the past?

To conclude, the 1991 budget is the most important this administration will deliver in its first term. The steps that have been taken so far to deal with the financial crisis which it inherited are correct and courageous. The critics have been proven wrong about monetary policy. They will also be proven wrong about fiscal policy if the government delivers a tough and responsible budget with a forward programme which will eliminate the deficit without increasing taxes. On budget night it will only take a

few hours, at most, for analysts and investors around the world to ascertain whether the government has taken the necessary action. If it fails to make the grade it will have sold the electorate short.