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NEW ZEALAND
BusinessROUNDTABLE
PROMOTING POLICIES FOR A BETTER NEW ZEALAND

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Dear Dr Brash

2025 TASKFORCE: INVITATION TO HAVE YOUR SAY

Introduction

The Business Roundtable appreciates the opportunity to contribute to the thinking of your Taskforce.

We strongly support the government's goal of bridging the income gap with Australia by 2025. In our view this is achievable but only with outstanding economic management.

Economic research points to the quality and consistency of a country's institutions and policies as the key determinant of income per capita.[1] They influence economic freedom and the environment for entrepreneurship. This matters more than factors such as a country's size, location and natural resources. We believe the main reason for Australia's relatively good performance since the mid-1980s is the improvement in its institutions and policies and, at least until recently, the consistency with which they have been maintained. The National-ACT Confidence and Supply Agreement recognises the need for significant improvements to New Zealand's institutions and policies. Greater respect for property rights and the rule of law is particularly important in this context.

By contrast, we do not think Australia's performance can be put down primarily to its mineral resources as some have suggested.[2] Other countries (and pre-reform Australia) have had similar endowments but lagging economic performance. In any case, New Zealand can only offset any such natural advantages with superior policies.

New Zealand adopted similar reforms to Australia's from the mid-1980s. They led to greatly improved economic performance in the 1990s. However, unlike in Australia, the momentum of reform was not maintained from the mid-1990s on, and policy reversals and a focus on income redistribution rather than wealth creation this decade have undermined productivity and economic growth.[3] Perhaps the best indicator of the deterioration is the decline in multifactor productivity growth (in the measured sector of the economy) from an average annual rate of 2.1 percent in 1992-2000 to just 0.6 percent in 2000-08. Moreover, Australia is no standout performer, and we should not contemplate harmonisation with Australian policies willy nilly. We should draw on the best of Australian policies and the best of the rest of the world (and indeed seek to improve on them).

The Taskforce is asked to investigate the reasons for the recent deterioration in performance. We believe the prime cause is the expansion of government (central and local) in respect of spending, taxation, ownership of enterprises, and regulation. This has crowded out private sector activity and self-reliance in the community and reduced international competitiveness and productivity. The National-ACT Confidence and Supply Agreement expresses a commitment to limited government – government limited to its proper role – and greater economic freedom in relation to achieving the 2025 goal.

We see the need for structural adjustment in the economy to reduce external borrowing and debt (by shifting resources into export and import-competing activities) and to raise productivity growth in the private and public sectors as key issues for the Taskforce. However, they are not the only ones: per capita income growth, which is the Taskforce's remit, is not only a matter of productivity growth. It can also be facilitated by increased labour utilisation (for which labour market flexibility and tightly controlled public welfare policies are relevant) and additional investment. An important point for the Taskforce to emphasise is that government policies in all major areas (eg energy, transport, climate change) must be consistent with the much higher trend growth rate that the government aims to achieve. Growth policies also need to have regard to other goals such as fairness and environmental quality.

General approach

We think a good starting point for the Taskforce is the 2009 OECD Economic Survey of New Zealand and earlier reports. Although we have sometimes been critical of reports by the OECD, it reflects conventional, non-ideological, well-accepted economic thinking in its member countries. It cannot be regarded as radical or 'leading edge': many of New Zealand's important economic reforms (such as the Reserve Bank Act 1989) were not part of OECD thinking at the time. Adoption of the OECD's recommendations would not be sufficient to bridge the income gap, however; the Taskforce will need to go beyond them.[4]

Another benefit of using the OECD as a starting point is that its work is quite comprehensive, as the Taskforce's must be, and it focuses on the major areas of economic and social policy where policy changes can make a difference. The Taskforce must do the same: there is no point in 'sweating the small stuff'. Its report needs to have the scale and depth of similar past exercises such as the report of the 1976 Holmes taskforce, *New Zealand at the Turning Point*, the Treasury's 1984 *Economic Management* and the OECD surveys.

Key recommendations of the OECD can be grouped under the following headings. The views are those of the OECD unless otherwise indicated.

– ***Monetary policy and banking***

New Zealand's monetary policy framework is sound. Inflation expectations should be anchored around the middle of the target range (1-3%). (We think this might be too high to reflect price stability and recommend a statistical investigation of CPI 'drift' and a re-centering of the PTA range.) The wholesale and retail guarantees should be removed. Land supply controls should be eased.

Our research to date does not support an alternative monetary framework (eg adopting another currency) or the need for 'supplementary instruments' such as a capital gains or land tax.[5]

– ***Fiscal policy***

Budget deficits should be reined in to reduce borrowing and public debt, there should be a legislated cap on government spending growth (note the useful discussion on p46 of the 2009 report), low quality spending (eg interest-free student loans and KiwiSaver subsidies) should be cut and contributions to the Cullen Fund should be suspended.

We strongly support a legislated cap on government spending and taxation, which the government is to consider next year.[6] The aim should be to shrink the government spending share of the economy (currently 46.4 percent on the OECD's measure, up from 37.6 in 2002) to under 30 percent over a number of years. This would be a major boost to growth.[7]

The government has set tight parameters for spending in forthcoming budgets. These are imperative to facilitate resource-switching to tradeables, improve value for money and motivate public sector efficiencies. Achieving them will require a searching reassessment of programmes and entities and public service (machinery of government) reform. The quality of management in the public sector is a major issue. The development and execution of an ambitious programme of reform will not occur without management at the top of the critical departments being upgraded and strengthened.

– ***Government ownership***

The OECD criticised recent renationalisations and recommends divestment of state-owned enterprises, particularly in energy and transport. It recommends similar moves for ports.

Our research indicates the potential gains from such moves could be in excess of 1 percent of GDP annually.[8] The taskforce should assess evidence about privatisation and address misconceptions. Options for policy changes in this area, ranging from trade sales to floats and share giveaways, could be considered. The potential of moves in this area for strengthening New Zealand's capital markets is a relevant factor. A fresh look at housing and the state's role in it would also be valuable, given its significance in the economy.

– ***Tax policy***

The OECD believes the company, personal, trust and PIE rates should be reduced and aligned, and Working for Families should be redesigned.

We concur, and support the 2001 McLeod Tax Review's recommendation of a lower and flatter income tax structure, and the government's medium-term goal of uniform top rates of 30 percent. In the longer run, New Zealand needs to think more in terms of the (essentially flat) Hong Kong and Singapore tax structures (with rates of 20 percent or below) to achieve rapid growth. The two main tax bases (income and GST) should be retained and we see no need for new taxes.

– ***Local government***

The 2009 report recommends that legislation should focus councils on their core public good roles, apply a cap on spending because of weak democratic accountability, and eliminate the business rate differential (see pp 46-47).

We agree that councils have expanded well beyond their proper roles, which should be respecified and constrained in legislation.[9]

– ***Regulation***

The OECD states that much poor quality regulation has been introduced in recent years and should be reviewed. It advocates, among other things, changes to the Resource Management Act, the introduction of tradeable water rights, not moving ahead of other countries with climate change policies, the elimination of FDI screening, and scrapping the Telecommunications Service Obligation.

We hope the Taskforce will strongly support the concept of a Regulatory Responsibility Act with compensation for regulatory takings.[10] New Zealand's ranking for product market regulation has slipped in recent years and we believe barriers to competition like the kiwifruit export monopoly should be removed. We recommend a review of the Commerce Act (starting with its objectives) by an expert group and moves to full free trade as a natural concomitant of the free trade agreement with China.

– ***Employment law***

In recent reports the OECD has criticised the re-regulation of the labour market which is an extremely important area (labour costs account for some 60 percent of total production costs in the economy).[11] Employment relations should be essentially voluntary and based on normal contract law, as is the case in the high-growth Asian countries with which New Zealand increasingly competes.

– ***ACC***

ACC should be opened up to private sector competition.

We support this proposal for all accounts, and in the longer term we support a review of the no-fault regime.[12]

– ***New Zealand Superannuation***

The OECD recommends NZS benefits should be linked to the CPI, not wages, and that the qualifying age should be raised to 67 and indexed for life expectancy.

Other issues

In addition to reforms under the above headings, we recommend the Taskforce should investigate the following important areas which have not been covered in depth in recent OECD reports:

– ***Infrastructure***

The essential issues here concern the role of the government with respect to ownership, regulation and funding. Most infrastructure industries are or could be operated by the private sector. In the case of roading and water, New Zealand should move to more commercial governance structures with efficient pricing mechanisms, and more private sector participation.[13] Rigorous cost benefit analysis should be applied to non-commercial projects such as broadband to avoid the waste of resources associated with Think Big and earlier hydro projects.

– ***Education***

We believe there is enormous scope to improve New Zealand’s education performance, particularly for groups such as Maori and Pacific students. At the school level we support greater choice and competition (as in Australia) with all schools (state, integrated, independent) being funded on the same basis (as in Sweden and the Netherlands) and the supply side of the education system should be made freer and more flexible.[14]

At the tertiary level we favour more autonomy for institutions (including self-ownership, reforms to governance arrangements, the removal of interest rate subsidies from student loans (as recently advocated by the Confederation of British Industry), and lower tuition subsidies related to the assessed ‘public good’ element of higher education courses.[15]

– ***Welfare***

We support a public safety net for those who are unable to support themselves and cannot be assisted by their families or voluntary organisations. However, current welfare policies have large fiscal costs and unduly encourage welfare dependency with corrosive social effects. More restrictive rules, drawing on policies that have reduced welfare dependency in countries such as Australia and, more particularly, the United States, Singapore and Hong Kong, should be adopted.[16] Currently, much spending is on middle class welfare, with recipients being largely those who paid taxes in the first place.[17] Policies should be more closely targeted to those in genuine need, and include mutual obligations on the part of beneficiaries to become self-sufficient wherever possible.

– ***Immigration***

We supported the liberalisation of New Zealand's immigration policies and consider it could be taken further. We favour introducing on a pilot basis a settlement fee or an auction system for a defined category and quota of immigrants.[18] The net outmigration of skilled, educated young New Zealanders needs to be reversed. This will be an increasing problem if Australia continues to outperform New Zealand, which it is likely to do without significant changes to New Zealand institutions and policies.

– ***Innovation***

We see innovation as what happens when economic policy settings are sound and conducive to entrepreneurial freedom and where market competition prevails. Innovation does not generally call for government intervention; indeed intervention (eg in the form of statutory monopolies like ACC and the kiwifruit export monopoly) often stifles innovation. We believe there is a relevant government role in relation to higher education (see above) and basic (public good) science, but not in relation to private R & D. We think the Taskforce could examine ways of strengthening links between CRIs and the private sector, and of improving incentives for CRI performance. (A study of CSL, a $20 billion Australian biotechnology company that resulted from the privatisation of the Commonwealth Serum Laboratories, could provide useful lessons.)

Constitutional issues

We are critical of the MMP electoral system on democratic grounds. In addition, research suggests it is conducive to the expansion of government (which is also New Zealand's experience) and to lower quality decision making. Australia's electoral arrangements are generally superior. We recommend the Taskforce addresses this issue.[19]

We would be pleased to elaborate on any of these points and supply any of the articles and reports listed in the endnotes that may be of interest to the Taskforce.

Conclusion

The overriding point we would make to the Taskforce is that its recommendations must constitute in sum a credible programme for achieving the 2025 goal. Previous government efforts such as the Knowledge Wave were long on talk and short on substance and results. The OECD has itself said that New Zealand needs to go beyond best practice in every policy area. Australia will not be standing still and its trend growth rate is higher than New Zealand's (indicating that without far-reaching reforms the income gap is more likely to widen than narrow). We suggest the Taskforce should draw on sound research and evidence-based analysis, undertake modelling or other analysis to test whether its recommendations are quantitatively sufficient to meet the government's goals, and establish a scorecard or similar metrics against which it can measure and report on progress towards the 2025 goal in its subsequent reports.

We have no objection to posting this submission on the Taskforce website and I am happy to be the point of contact for any inquiries.

Yours sincerely

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Endnotes

1 *Public Policy: An Introduction* p1 fn1.
2 Good Institutions and Policies, Not Mining, Account for Australia's Prosperity (article).
3 *Losing Sight of the Lodestar of Economic Freedom: A Report Card on New Zealand's Economic Reforms; Why Have Kiwis Not Become Tigers?*
4 OECD Report Falls Short of Necessary Growth Strategy (article).
5 *Monetary Arrangements for New Zealand*.
6 *Restraining Leviathan.*
7 *How Much Government? The Effects of High Government Spending on Economic Growth.*
8 *The Changing Balance between the Public and Private Sectors.*
9 *Democracy and Performance: A Manifesto for Local Government; Local Government and the Provision of Public Goods* (Local Government Forum).
10 *Constraining Government Regulation.*
11 *Towards Full Employment in New Zealand; Power in Employment Relations: Is there an Imbalance?*
12 *Accident Compensation: Options for Reform.*
13 *Options for the Reform of Roading in New Zealand; Reform of the Water Industry.*
14 *Education Matters: Government, Markets and New Zealand Schools* (Education Forum)*; School Choice: The Three Essential Elements and Several Policy Options* (Education Forum); *A New Deal: Making Education Work for all New Zealanders* (Education Forum).
15 *Who Should Pay? Tuition Fees and Tertiary Education Financing in New Zealand (*Education Forum).
16 *From Welfare State to Civil Society; Towards Personal Independence and Prosperity: Income Support for Persons of Working Age in New Zealand; Equity as a Social Goal; Family Matters: Family Breakdown and its Consequences; Maori and Welfare.*
17 *Middle Class Welfare*.
18 *Populate or Languish: Rethinking New Zealand's Immigration Policy.*
19 *An Analysis of Proposals for Constitutional Change in New Zealand.*

All these items are available on the New Zealand Business Roundtable website, www.nzbr.org.nz