

New Zealand's Path to Growth

**Address by Simon Carlaw, Chief Executive, Business NZ
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Thank you for this invitation to speak this morning. I welcome and value the opportunity.

Last month, on 15 July, the Deputy Prime Minister addressed you on the topic, 'New Zealand's Path to Growth'. I thought I should do the same. Not only is imitation the sincerest form of flattery, there is much to be said on the subject. I am not sure that Dr Cullen's typically elegant but selective discourse went much further than an incursion into the geography; his crafting of a way forward is a bit like the actual prospect of implementing critical roading infrastructural improvements while the strategy is firmly shaped by the Greens, who don't want any. Nor is it an excuse that governments do something sensible only after they have exhausted all the alternatives. Other countries, almost all now richer than we are, have taken the growth priority more seriously and more consistently.

Like many New Zealanders, I have been struck by what I shall call the Orewa factor. I shall leave to others the subject matter of Don Brash's address last January. The significance of Orewa for me is more its impact on public policy debate in this country.

I believe that the Orewa factor has had two consequences particularly relevant to the issues that I wish to talk to you about this morning. The first is that public policy

debate has reverted in almost every medium to an admission of at least two sides to every issue or argument, and sometimes also to the several other perspectives that attend every complex issue.

There has been a second, and I suspect just as fundamental, outcome that could be especially relevant to the major political parties. The most significant challenges to New Zealanders' collective and individual comfort zones in the second half of last century took place during a couple of short intervals in the mid 1980s and early 1990s. Not surprisingly, their impacts have largely coloured New Zealand politics – and thus public policy – ever since.

What I think of as the politics of “blame and shame” have had too prominent a role as key drivers of our recent political investment in our and our children's futures. If I am at least half right in my assertion that reaction to Orewa marked a watershed through a collective recapture of a capacity for critical debate, there is also an opening for political parties to now move on from the politics of blame and shame to a more positive and constructive framework. This should shape responses to the challenges of the 21st century without baggage from the past limiting the toolkit of options that we should be exploring.

In Business New Zealand's view, there are critical issues concerning New Zealand's infrastructure and competitiveness on which some fresh thinking by all political parties has become imperative. Let me briefly refer to two key recent reports that reiterate why fresh thinking is necessary if we are to avoid what Paul Keating called at the first Knowledge Wave conference “genteel poverty, but poverty nonetheless”.

The first of these reports is the most recent OECD Economic Survey of NZ published last December¹. Its confirmation that the reforms of the 1980's and early 1990's afforded New Zealand a markedly improved economic performance relative to the OECD average has been the subject of some public comment. Its conclusions in this area should also be contrasted with the Government's invitation to the gullible to accord authorship of this growth to policies implemented only since 1999. Climate, exchange rates, commodity prices and immigration are all more relevant.

Also worth noting is the three pages devoted to argument and evidence in favour of maintaining at least the level of labour market flexibility applicable prior to the introduction of the Employment Law Reform Bill now before Select Committee. As an intergovernmental organisation, the OECD is usually gun shy of criticising member government policy. Nevertheless, in the OECD's view, "...recent years have seen a clear trend towards greater rigidities and higher labour costs...cumulatively their impact may be important"².

The OECD concludes that while our average annual rate of growth over the last decade has been a little higher than that of the OECD as a whole "something is missing, as potential output has not been rising fast enough for New Zealand to return to the top half of the OECD rankings, the government's announced objective".

A similar picture is painted in another recent report, again from a familiar, if a little surprising, source: the NZ Treasury. In "NZ Economic Growth: An Analysis of

¹ 'OECD Economic Surveys – New Zealand', December 2003, OECD, Paris

² op cit, pp 97-100; and p.12

Performance and Policy”³, written primarily for an internal audience about the same time as the OECD report, the Treasury reiterates the OECD’s observations about New Zealand's improved growth performance since the early 1990’s⁴.

Again, the reforms of the 80’s and early 90’s are accorded parentage status for this. But, and it is an important but, there is also a note of warning; to move towards a top ten ranking would require an annual per capita growth rate of just over 3%, “...a higher annual average growth rate than New Zealand has achieved over any sustained period at least since the 1960’s”. Note, too, that the Treasury is talking about a per capita growth rate that takes account of population growth. The media and governments are sometimes careless in making the distinction between nominal and per capita rates. For New Zealand, a 3% plus per capita rate equates to a nominal rate in excess of 4%. This places (traditional) 2-2.5% growth rates in perspective, even Dr Cullen’s 3.6% for the year ending March.

What does the Treasury see as challenges in the way? It also places emphasis on poor labour productivity growth by comparison with, say, Australia that is in turn linked to poor productive investment flows and a poor accumulation of physical capital. Put simply, a less than satisfactory level of investment in productive capacity and innovation by comparison with the national passion for tax-preferred property speculation.

It is not surprising then that the Treasury identifies measures to increase labour productivity as critical to targeting that 3% per capita growth rate, key among which

³ ‘New Zealand Economic Growth: An Analysis of Performance and Policy’, The Treasury, Wellington, November 2003

⁴ op cit, p.4

must be skill development and enhancement, just like the OECD's concern over our educational outcomes and immigration flows. The Treasury also proposes better benefit and tax interfaces to accelerate the movement from welfare to workplace, on ensuring that there are no adverse impacts on high levels of employment New Zealand has achieved from recent steps that will reduce labour market flexibility and efficiency, the reconsideration of taxation policies that impact on investment, the re-evaluation of the quality of some government expenditure and a questioning of the investment impacts of some major environmental or other policy interventions – the RMA is singled out, as it should - that have a capacity to influence investment decisions.

There are three observations that come to mind from these reports. First, what they say is remarkably similar. Second, what they say is remarkably familiar. And third, what they say is largely “outside government policy”, a fob-off that Business NZ has encountered on a regular basis.

Of course every government comes into office with some ‘no go’ territory that is fundamental; this is now accentuated by MMP arithmetic that has added to the quantum of such baggage. The risk is that both take on a character beyond the political dimension so that, caught in the headlights, the capacity for vision is impaired to the point where confidence withers in the face of criticism that enabled the old Soviet empire to put those finding fault with paradise quite literally and logically into asylums for the insane.

But it should come as no surprise that Business NZ's policy advocacy is very much in this OECD/Treasury territory. Nor, as I argued earlier, should it matter that to make progress virtually every political party is going to have to deal with its past baggage, including that from the politics of 'blame and shame'. What will matter is the subject of a third report that I also want to mention.

As Dr Cullen reported to you, a couple of months ago, the Growth and Innovation Advisory Board (GIAB) released the results of some major research into community attitudes towards business and economic growth⁵. This was prompted in part by an Industry NZ study last year that suggested most New Zealanders saw business as a 'necessary evil'. I hope that it was also prompted by the knowledge that without any community buy-in to the case for accelerated growth and its connections to, say, the length of hospital waiting lists, any serious political prioritisation for growth policies will reflect this ambiguity in the community. In short, it will also remain half-hearted.

The GIAB research makes it very clear that community attitudes towards business and growth are the subjects of major caveats, that talk of growth, of the OECD, and of unflattering comparisons with others are turn-offs. Even comparisons with Australia fall into the "burning plank" category that conflicts with a community perception that despite the numbers, New Zealanders enjoy something pretty special here. 'Big business' and particularly foreign owned big business is no-go territory. There are, however, some very strong Kiwi values that go to the heart of what we severally think makes us distinctive in a big and distant world. Link those values to

⁵ see www.giab.govt.nz/reports.html, Research Summary 19 April 2004

'business' or 'growth', and attitudes towards business and growth, to business success and opportunities, and their relationships to lifestyles, become very positive.

This is an important and critical finding. The challenge for those of us in business or politics that wish to advance the policy proposals reiterated in the OECD and Treasury reports must thus be to proceed by harnessing those Kiwi values so that growth is portrayed as an outcome of Kiwi values, not a threat to them. The language we use must focus on enhancing our quality of life, on the impact of legislation on families and their lifestyles, and on the development of Kiwi businesses. These will rank their success not in terms of 'profit' or 'wealth creation' but to factors such as Kiwi determination and ingenuity, of winning against the odds, and of enabling 'something to be put back' into the community. Mainland Cheese, Hubbards and the Warehouse are heard; others clearly are not.

This is critical stuff for political parties that want to go forward to shape New Zealand's future, not react to it, because New Zealand is still in option time. As one of my colleagues has put it, New Zealand can either be part of the solution in the South West Pacific or be part of the problem⁶. Don Brash was pilloried last week for saying just this to an Australian audience.

There are two familiar and critical sets of issues for which there are still no satisfactory answers if New Zealand is to close the OECD or Australian gaps – our infrastructure and our global competitiveness. Both require fresh thinking. Neither will be adequately dealt to by ad hoc reaction, intervention and certainly not by

⁶ see 'The Five Pillars of Economic Reform', address by Peter Townsend, Chief Executive, Canterbury Employers Chamber of Commerce, Christchurch 2003.

ideology. Nor can they credibly be left to some sort of political default option that simply says, 'if enacted we'll repeal'. New Zealand is too small, too thin in the wallet to afford three or six yearly policy pendulums that generate only pay-back baggage, arguably of the kind that we are experiencing with labour market policies. We need to be smarter than that. Responses to these issues will also wallow unless they are approached on a strategic and integrated basis.

The three most critical elements of the infrastructural package are learning and skills development, transport and energy.

There can be little debate over the learning outcome – a literate and numerate population competent to acquire workplace skills and knowledge to the best of their ability on an on-going basis. At least 15% of the graduates of compulsory education according to the Government's latest figures emerge without any formal qualification and place at risk future learning potential. Given the ethnic composition of this percentage and that Maori and Pacific Island people are predicted to make up 25% of the working age population in 2021, this will get worse unless we do better.

Perhaps this is because learning and skills development policies are traditionally hijacked by patch protection, a focus on property and asset management, and the collective assertions of the education unions. It is also unsurprising that we have not integrated population policy, especially immigration policies, into debate over the framework of our educational infrastructure given the reality that New Zealand will always 'leak' offshore a percentage of those emerging from learning and frequently experience skill shortages that exceed domestic supply.

In one sense these are distractions. The spotlight needs to sit not on school funding, zoning or the NCEA but on the immediate challenge of improving the skill levels of managers and employees already in the workforce. This requires a vertically integrated package of institutions and learning processes that involves all post compulsory providers, the ITO's and modern apprenticeships in a supply chain that extends from foundation/literacy skills to management and leadership skills on a common access and funding base. The case for a professional careers advisory service, independent of providers, to assist with good learning and career choices is as compelling as the need to encourage the Tertiary Education Commission into action – not irrelevancy – perhaps by restructuring membership of the Commission so that user representatives always exceed those of providers, and by placing its large bureaucracy at least at arms length. If we don't, we run the real risk of submerging learning in our education system in a sea of qualifications.

The OECD has correctly identified transport and energy infrastructure as two of our most serious bottlenecks. For transport, the core national strategy is flawed and it should not be a surprise that so is the Land Transport Management Act. There is simply no room for ideology or muddled thinking that produces Orwellian obstacles in the way of overdue roading development while putting taxpayers at risk of huge liabilities through their involuntary ownership of a clapped-out rail track network, or by selling snake-oil about public transport capabilities. Barriers to private investment and partnership in roading (or rail) development must be removed. And inflation-linked taxation increases attached to the price of petrol are inefficient and ineffective; far better to recover costs according to use of the roading network so that more accurate signals are better targeted.

Issues relating to energy infrastructure compare in some respects to those applicable in education – excessive state participation, a gamut of regulation from light to heavy-handed, and a preoccupation with patch protection.

The National Energy Efficiency and Conservation strategy and a few windmills will not address the looming electricity shortfall. Nor will ideological mantras that give credence to the value of the Kyoto Protocol. First, there needs to be a national debate on how we allocate water and an intelligent process for doing so. Clearly the Waitaki fiasco has shown that the RMA ‘first in, first served’ approach is inadequate; any doubts should be dispelled by the huge costs and uncertainties of the re-consent process for existing generation plant. Nor can much credence be extended to the fiction that Transpower can solve on its own the shortcomings of the national distribution grid. Responses to these issues must inform a broad national strategy intended to secure supply and transmission into the future.

While cost increases are one tool of demand management, price volatility is not. New Zealand’s traditional energy competitive advantage has gone. Already, exporters with production on both sides of the Tasman report more competitive and cheaper supply offers to their Australian plants for longer contracts. There are other obvious questions for which business is seeking answers. They include what the role of coal will be and why the economy should risk slipping into a dependence on expensive, imported gas for electricity generation. And we must also find credible answers as to why a regulatory and advisory bureaucracy of the size and cost that is emerging is necessary.

Last, let me touch on competitiveness issues. There are five I consider critical: the labour market, local government efficiency, the RMA, climate change and taxation, in no particular order. I will not spend a lot of time on the labour market. There is clear evidence of a cumulative series of changes that have reduced labour market flexibility, raised compliance costs, and increased the risks of creating new jobs; I note in passing simply significant annual increases in minimum wage levels, the near perfect botch made by the Select Committee's interventions in rendering the Holidays Act impenetrable as well as mandating an extra week's leave, and the Employment Relations Law Reform Bill that attacks existing workplace freedoms by seeking to enshrine collective agreements and Multi Employer Collective Agreements at their pinnacle. Do not be lulled by warm and fuzzy noises about 'decent work', work/life balance or the curious economics of pay equity. The intent is to rebuild union membership and to entrench their influence which, outside the public sector, clearly need a helping hand.

Local Government is another sector favoured by significant new legislation. This legislation remains flawed. Local Government assets exceed the value of all listed public companies. Rates have increased at over twice the rate of inflation – 10.4% in the last twelve months – over the last decade. 270,000 business ratepayers pay over half this bill that is set to increase as local government competes to take up the challenge of tackling the cultural and other needs of its communities that are so much more politically rewarding than core public goods. Rates are a driver of inflation. Why should such property taxes continue to be a major funding mechanism? Is low voter turn-out and lower participation in community consultation really an adequate check on the quality of local government expenditure?

The RMA. Why is it apparently beyond our national wit to seriously and effectively address the Act's deficiencies? Yes, the court process is now arguably more efficient. But it has also been amended to pick winners in the energy sector and it has proved itself deficient over water rights. Both the OECD and Treasury agree that its shortcomings and uncertainties still deter investment. The current tune-up of the Act should not simply deliver another version of the National Development Act. There is no case for returning to the fiction that any combination of Ministers and bureaucrats know best. Or that large – usually taxpayer-funded projects – should have a fast-track denied others whose cumulative or special character may be equally critical to the economy. Perhaps the best thing to come out of the current exercise is a dawning realisation that there needs to be an on-going debate on key resource use, for water for example, that requires tradable rights as an effective allocative mechanism. Because, like fisheries, the devil will be in the detail, this cannot be dealt to in the timeframe made available by the Government.

On climate change it sometimes seems that Russian opinion counts for more than any outside the Government. Calls for caution in locking New Zealand ever more firmly into the jaws of this hugely expensive but flawed agreement are hardly deafening. They should be. Kyoto is a complete nonsense. It cannot and will not achieve value. Its negative competitive impacts become ever more apparent and a fraction of those costs could underwrite valuable climate change research that could more effectively address national, regional and international concerns. Why not say so?

Nor need I dwell on taxation. You know that we now have the highest tax burden of all non-European OECD countries and that New Zealand is about the only OECD country where taxes of all kinds are trending up, not down. It seems apparent to most political parties that taxation is now an integral part of global competition for investment. The most recent New Zealand response is a new \$20 million border tax on traders while exporters were promised a helping hand in the Budget. This defies logic. Surely it is clear that our taxation needs to be more attractive than our Tasman neighbours simply in order to stay competitive? Or that growing the economy, not taxing in order to pay into the Cullen Super Fund, is a more sustainable funding mechanism for this looming liability.

I have suggested this morning that there is now a rare opportunity to take a fresh look at some critical but unfinished business, much of it 'outside Government policy'. This unfinished business comprises key growth issues that business must ensure is in the mainstream of every party's advocacy going into the next election. They are not just those that business would use to talk up its book, for business to win and for the wider community to do the paying. These are issues that will determine whether we can secure the wealth that in turn would underpin Kiwi values and lifestyles into the future.

I have also suggested to you that the growth message of itself will not repay the effort of the strategic and integrated policy development that it demands. Nor will it be worth the risks of putting aside past baggage or of being fresh and bold.

Antennae out there in towns and cities across New Zealand simply do not pick up messages broadcast in frequencies that are outside the parameters of values that are strongly held and strongly defended. If New Zealand is to close up the gaps that separate us from the top half of the OECD, even level pegging with other low middle income countries such as Slovenia, much less Australia, the messages need to be made in new terms and language. Business New Zealand intends to take up this challenge. We could use some help.

Irrespective of the fortuitous growth we have recently enjoyed, New Zealand has been steadily storing up economic mushrooms that will certainly poke through the surface one day. The cost of central and local government has shot up. Bureaucracy is burgeoning, perhaps the one unequivocal growth achievement. Unfortunately, more is no better in this territory than the huge funding increases directed to health and education outcomes and social transfer payments, including superannuation.

New Zealand is no closer to matching the Australian magnet for our skills or its capacity to offer bigger jobs and the pay that goes with it. We seem determined to replicate their labour market inflexibility while surrendering our traditional comparative advantage in energy costs. Ideology as much as science determines our transport, environmental and climate change barriers to investment. Immigration is polarised and politicised. We need to get smarter in addressing the skill shortcomings of a rapidly browning school population and workforce. We need successful Maori in business and Maori business to come out of the closet, to acknowledge that what hurts business growth, hurts Maori as least as much.

I doubt that New Zealand can chart a sustainable accelerated growth path while regulation, legislation and high taxation act as barriers. The path to growth needs to be a broad one with room for everyone. There should be few rest stops because too much time has already been frittered away and others are travelling faster. While we cannot do much about our economic geography or even our size in the medium term, we can't blame anyone else for the quality of the health, education, environment and social systems that we will bequeath our grandchildren and their children.