SLIP SLIDING AWAY
A Critical View of New Zealand's Economic Policies and Long Term Performance:

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Address to the NZ Institute of Economic Research Annual Meeting, Wellington

20 September, 2000

strategicVALUE limited

1. Introduction:

Some economists, business people and others are deeply concerned about New Zealand's economic position. The concern reflects New Zealand's persistently poor economic performance, over many decades, with no persuasive sign of the basis for an improvement.

The community generally shows no sign of concern. There is no groundswell of community opinion or marches on Parliament demanding better economic policy and more growth, and this is typically reflected in governments' policy priorities – of distributing wealth, rather than encouraging its creation.

Yet the position is already serious and the consequences of this poor performance more evident and constraining.

Consequently, the New Zealand Institute of Economic Research, as part of its public good research programme, is putting a high priority on research on this issue, on how to improve New Zealand's economic performance. Because of the central role of government policy in this question, it is intended to consider the political dimension as well.

Having first joined the Institute as a graduate in 1965 and left after a term as director in 1981, many of the issues in this address are all too familiar. There have been some marked changes for the better in New Zealand's position over recent decades – CER, the freeing up of finance, goods and labour markets, removal of subsidies, reduction in tax rates and so on. Much of this change though was initiated by virtual - coup and not with electoral support. And, regrettably these positive developments have fallen well short of what is needed. The post-1984 changes did not go far enough. Stopping for tea was disastrous, as subsequent progress was limited and increasingly a victim of poor policy design and management and the damage this did to the credibility and acceptance of reform policies.

Thus the trend of poor economic performance and relative decline continues, although the external context is now changed for the better, and this has important implications.

This address now outlines the basis for concern about New Zealand's economic policies and long-term economic performance and discusses a number of related issues. While the focus is long-term, I include brief comment on the current position. Its purpose is to debunk comfortable myths, undermine complacency and encourage a shift in attitudes and policies, towards giving New Zealand a more viable and attractive future.

The Evidence of the Problem – the Persistent Adverse Trends and Present Position: [1]

> **GDP per capita:**

GDP per capita, 1990 prices & exchange rates
US$

	Australia	*USA*	*New Zealand*	*OECD*
1960	8846	12359	8755	8253
1970	12074	15871	10403	12012
1980	14677	18858	11541	14908
1990	17323	22224	12817	18094
1997	19647	24849	13975	19697
% increase	122	101	60	139

Ratio of New Zealand's GDP per capita -
to USA, Australia & OECD

	Australia	*USA*	*OECD*
1960	.99	.71	1.06
1970	.86	.66	.87
1980	.79	.61	.77
1990	.74	.58	.71
1997	.71	.56	.71

Note: Using a purchasing power parity basis makes little difference – it improves the position vis a vis the USA slightly.

In terms of GDP per capita, New Zealand's relative position has persistently deteriorated since 1960. Then it was close to Australia and the OECD average and well below the USA. By 1997, it had declined to about 70% of Australia and the OECD and about 60% of the USA.

> **Exports**

Exports in 1990 prices & exchange rates
US$billion

	Australia	*USA*	*New Zealand*	*OECD*
1960	8.7	104.3	3.4	522.6
1970	19.0	186.4	5.7	1122.6
1980	28.7	357.8	8.3	2002.0
1990	49.6	548.2	11.9	3117.9
1997	89.8	1001.7	17.1	4804.9
% increase	932	860	404	819

Exports per Capita
in 1990 prices and exchange rates
US$

	Australia	*USA*	*New Zealand*	*OECD*
1960	825	577	1426	752
1970	1482	909	2035	1440
1980	1951	1571	2633	2320
1990	2905	2194	3541	3330
1997	4843	3754	4546	4860
% increase	487	551	219	540

New Zealand's export growth has been less than half that of Australia, the USA and the OECD since 1960. This is serious for a small, export dependent economy.

New Zealand's growth in exports per capita has similarly lagged badly. 1990 to 1997 the increase was 28%, compared to 67% for Australia and 71% for the USA.

> **Government Revenue:**

Government (Central, Regional & Local)
Total Tax Revenues
% of GDP

	Australia	*USA*	*New Zealand*	*OECD*
1965	22	25	25	26
1970	23	28	27	29
1980	27	28	33	33
1990	29	28	38	36
1997	30	30	36	37
Average 1980-1997	29	28	35	35

Compared to Australia and the USA the government revenue take in New Zealand, as a proportion of GDP, is high.

> **Productivity:**

Real GDP per total employees
1960 = 100

	Australia	*USA*	*New Zealand*	*OECD*
1960	100	100	100	100
1970	132	126	111	151
1980	144	137	115	185
1990	160	156	132	222
1999	197	183	139	258
% increase	97	83	39	158

New Zealand's productivity growth, broadly measured, has been relatively very poor – less than half Australia's and the USA's and a quarter of the OECD average, since 1960.

1990 to 1999 New Zealand's increase was 5% - a third of the USA and the OECD average and close to a quarter of Australia's average increase.

> **Savings:**

Net Savings - % of National Disposable Income

	Australia	*USA*	*New Zealand*	*OECD*
1960	13	12	15	16
1970	14	10	13	17
1980	8	9	12	12
1990	3	5	6	11
1997	6	7	6	12

New Zealand's net savings rate is not out of line with Australia and the USA, but is low by OECD standards.

> **Investment:**

Gross Fixed Capital Formation
1990 prices and exchange rates
US$ billions

	Australia	*USA*	*New Zealand*	*OECD*
1960	24	392	3.7	1150
1970	42	581	5.4	2149
1980	52	776	5.6	2754
1990	67	932	8.2	3682
1997	88	1315	11.7	4236
% increase	276	235	215	268

Investment % of GDP

	Australia	*USA*	*New Zealand*	*OECD*
1960	24.8	17.9	21.2	21.2
1970	25.9	17.9	22.8	24.1
1980	24.1	20.2	20.7	23.5
1990	22.7	16.8	19.1	21.7
1997	21.3	17.4	19.9	21.8

While New Zealand's aggregate investment performance appears reasonable in relative terms, there are well known underlying qualitative problems, including:

- the undue focus on housing investment.
- the persistently low returns on investment in the primary sector
- the lack of competitiveness in many New Zealand businesses, reflected in recently published EVA data
- the disproportionate role of the public sector

What does this data show?

- New Zealand's overall economic growth performance, in terms of real GDP per capita, has been poor.
- its performance in the vital areas of export and productivity growth has been weak.
- these are persistent long-term trends over several decades.
- post 1990 data shows a continuing, serious relative deterioration, especially in exports and productivity.

3. Does slow economic growth matter:

Yes, it really does!

The rate of growth of real GDP per capita is the basic determinant of material living standards, which is the key ingredient in overall community living standards. Yes, social and environmental conditions are important. Yes, economic growth must be on a sustainable basis. Yes, there are measurement problems.

But, as New Zealand's rate of real GDP per capita growth persistently lags well behind that of Australia and other OECD economies, so the ability of the New Zealand community to afford goods and services is reduced, compared to these other countries; the capacity for private consumption – houses, clothing, food, cars, entertainment, travel, sports, recreation, etc, and the capacity to provide and afford typically public sector services such as health, education, welfare, justice, defence, conservation, etc services.

New Zealand's poor growth performance partly explains why these services are failing to perform at an acceptable standard now and why such services are often better overseas, even though health and education spending has outstripped economic growth since 1990.

However, the problem has been compounded in recent years by the increasing difficulty in designing, implementing and managing public sector policies and processes efficiently and effectively. The failures are all too frequent and evident, to the point where poor process is undermining the ability to make change.

The following table shows spending per capita on a range of public sector services in New Zealand, and what that level of expenditure would have been if New Zealand's economic growth had kept pace with Australia's since 1960, assuming that the same proportion of national income would still have been spent on these services. This is a simple but strong indication of what poor economic performance means to the New Zealand community.

Expenditure per Capita NZ$
2000

	Expenditure	***Potential (1)***
Health	1794	2586
Education	1647	2374
Social Security & Welfare	3366	4851
Law & Order	400	576

(1) If New Zealand's growth rate had matched Australia's. Note that Australia's growth rate was below the OECD average.

Think of the potential benefit of another $700 per capita, an increase of 43%, in annual education expenditure.

Without accelerated economic growth, New Zealand's relative economic decline will have increasingly serious consequences. Politically attractive policies become unsustainable and New Zealand's capacity to provide goods and services to its community will steadily decline compared to Australia and other first world countries.

4. The Changing Global Context:

Globalisation is a real, dynamic and generally positive force. It has reduced barriers amongst countries and markets and led to a much greater degree of openness, integration and efficiency in many markets.

This is overwhelmingly a good thing, especially for small, trade dependent economy, such as New Zealand's. It is increasing potential living standards. It is giving developing economies access to markets for their goods and access to capital for investment. It is providing a strong incentive to national economies, to be more disciplined, transparent and effective in their policies.

I can recall past discussions, which regretted New Zealand was not a listed company, with its poor performance reflected in its share price.

Well, with globalisation this has changed and New Zealand's performance is now rated by the markets, especially the currency, debt and migration markets, explicitly and continuously.

Thus, globalisation provides a very different context now for economies and their economic policies – there is much more intensive scrutiny, a much greater requirement to perform consistently and a much greater exposure to penalties for failure to perform.

Given this changed context how is New Zealand being rated by markets?

- non-residents now held less than 40% of government stock compared with over 60% 1996-1998.

- foreign institution ownership of the New Zealand equity markets has fallen from 36% to 31% in 2 years.

- the NZ dollar has weakened some 37% against the US dollar since the mid 1990's. It is down 15% against the Australian dollar, 28% against the Yen and 30% against the pound.

- there is a significant net migration loss, some 10,000 in the last year and an average of about 1900 annual loss since 1970.

There are other important aspects of context.

New Zealand's physical resource endowment gives it a strong base for producing primary sector commodity and other products and tourism. A recent Australian study ranks New Zealand's per capita resource endowment well ahead of Australia's.

Yes, New Zealand is small and remote. That's not new. But, it is a good reason to be more innovative in offsetting disadvantages and exploiting advantages, for developing trade alliances and getting closer to Australia.

There are a remarkable number of examples of successful business developments in New Zealand – based on R & D and innovation and entrepreneurship. World-class success stories. But these are relatively isolated islands in the wider economy and we urgently need more.

There is nothing inherently wrong with commodity businesses - but it is essential to recognise their implications. An average performance typically earns a mediocre return, as a price taker with substantial exposure to uncertainty and volatility. In contrast, a superior performance through continuous improvement, R & D, innovation, etc, which provide the basis for differentiating in terms of product characteristics, service, cost and so on, gives the potential for good returns.

As New Zealand is increasingly understanding, it does not have a monopoly in its main export commodities, in meat, wool, dairy, forestry, fishing, aluminium, coal, horticulture, iron sands and so on, and prices and returns are increasingly influenced by strong competition, by production growth in low cost economies and by competitor innovation.

In this competitive context, investment in innovation and superior performance is the route to better returns, including superior returns to labour, and the policy framework needs to support such investment.

Some used to have a vision of New Zealand being a high productivity, high-income economy. "The Switzerland of the South Pacific" was a popular phrase. The reality is though that we are not taking the necessary steps to achieve this, and are actually losing ground. There are islands of excellent performance but, in general, we are not providing the policy base for achieving the better performance and better returns. There is little support for R & D and innovation. There is much reduced government support for productive industry generally.

It is disappointing that there is no credible and persuasive vision. There is no credible and persuasive strategic view of what might be and how to really make progress. There hasn't been one, to the best of my knowledge, since the early 1980's and then it was only a passing phase.

There is a particular risk now that pursuit of social and environmental objectives, without a realistic focus on economic growth, will further undermine the economy, thwarting the social and environmental policies and leaving the whole community worse off.

Even Europe seems to be finally learning that its high tax – high government spending, highly interventionist policies are counterproductive.

"prompted by the effects of the Euro globalisation and shrinking deficits, Euro zone governments are suddenly engaged in a round of historic tax cutting.

"The changes, which go into effect next year, are expected to attract more investment, heighten corporate competitiveness and fuel economic growth.

"The measures are proof that tax competition is under way in the Euro zone.
There is a question of national competitiveness to be addressed – L. Fabius, Finance Minister, France.

"The large Euro economies are now playing catch-up to the smaller ones – Ireland and the Netherlands, which moved some years ago.

Europe's tax to GDP ratio remains excessive, compared to the USA's 31% (OECD data), but it is now recognising the competitive disadvantage and responding."

AFR 2 September, 2000.

Significantly, this is raising the bar for New Zealand, in terms of developing a competitive policy environment.

5. The Importance of Government Policies:

The role of governments is to create a policy environment within which business, in all sectors and in all forms, can create economic wealth. The policy framework will also deal with social and environmental issues and the distribution of wealth.

In a competitive global environment, government policies must be competitive – they must provide the basis for business to be competitive on a sufficient scale to produce the economic wealth and jobs that the community needs.

Where government policies are uncompetitive then the development of economic activity and employment will be inadequate and the community generally will suffer the consequences.

In a global market context capital and labour at the margin can move relatively freely and will orient to countries where prospects are better and policies more competitive.

The message of the last Manufacturer's Export Conference on New Zealand's position was clear and sobering – unless there is a marked improvement in the quality of New Zealand's policy, across a wide range of areas, such as taxation, education, R & D, new export market and exporter development assistance etc, it would be increasingly difficult for existing exporters to continue to operate from New Zealand. A number spoke about their emotional link with New Zealand but indicated they were faced with a near term decision about whether they shifted more or all of their operation overseas, because their New Zealand base was no longer competitive, and they identified a range of policy-related reasons for this.

6. Business:

Business, in all sectors and in all shapes and sizes, is the engine of the economy. It is the generator of economic growth and national wealth.

Business is fundamentally about risk and uncertainty. It is about judgement, often supported by analysis but with a significant degree of residual uncertainty about which judgement needs to be exercised. For most businesses, it involves uncertainty and risk extending some years into the future. In large, commodity-based businesses – such as New Zealand relies on, this may be 10 to 20 years or more for example with tree planting, pasture development, R & D, or investing in large processing facilities.

Therefore, business confidence is not just about today or today's markets and data. It is about the future and judgements about how events will unfold some years ahead, including how New Zealand's policy environment will unfold.

If business confidence has been undermined then business will behave accordingly, typically reducing its exposure to risk, particularly to additional risk. In the market context, that judgement needs to be quick and astute as markets punish behaviour considered inappropriate or out of touch.

It is not surprising that business confidence has fallen in New Zealand recently. The new Government has made a number of policy changes. The fact that the electorate may have voted for them does not mean that business or investors consider these policies to be appropriate and attractive, and as more detail of the policies became evident, the less attractive they appeared to be for business, which was already unhappy with what it saw as an uncompetitive policy environment before the election.

The emphasis on distributing rather than creating economic wealth, on social rather than economic objectives, all gave business cause to pause and review its position. The negative implications of this assessment were compounded by what was perceived to be a lack of effective consultation and a lack of understanding of business and its vital role as the engine of the economy, through putting its own resources on the line.

This issue is not simply one of short-term significance. Rather, it relates to the fundamental problems referred to in this address. In an era of open and transparent markets, there is high priority on having a competitive set of policies. To the extent that policies are judged to be uncompetitive, markets will react accordingly. And, that is what has been happening in New Zealand recently.

There is also a very real risk that business now just gets on with business. Attitudes are quite different to the 1980's. Business is much more pragmatic and realistic. It's not generally sitting around waiting for governments. It's much less committed to participating in the policy debate – though it will seek to protect value in existing activities. It has learnt that the return from committing resources to the policy debate can be poor and that it is difficult to achieve much.

So businesses these days, it seems to me, are much less committed to influencing New Zealand's policies and much more focussed on developing where business returns are potentially greatest, allowing for the relative competitiveness of government' policies in different locations.

Reflecting this, New Zealand businesses are now more international in their thinking and activities. Other than those based on New Zealand resources, they are also much more mobile.

In parallel, there has been a substantial cut back in executive roles in established business in New Zealand and some loss of decision making authority offshore, with the risk that New Zealand becomes more of a "branch office" location for foreign owned businesses.

These job losses should be offset by growth elsewhere, but why is New Zealand not being more successful in the relocation of regional share service and similar activities. This is an important issue as New Zealand should be in a strong competitive position.

7. The Social Perspective:

If economic performance is substantially determined by the policy framework, do we simply blame politicians for our economic woes?

At one level - yes. They should be providing astute leadership, rising about political expediency. Putting that view to one site though, politicians are elected, every three years, by the community. The present Government, for example, has generally implemented the policies it campaigned and won the election on.

So, what is the influence of social factors on policy and on the prospect of a decisive improvement, in New Zealand's economic policy performance?

History gives only modest grounds for optimism. Post 1984 was promising, but stalled a long way from the home strait.

A key reason seems to be attitudes in the New Zealand community.

A 1989 study (updated in 1992 and 1998) by Webster and Perry of Massey University, "Can New Zealand Rise to the Competitive Productivity Challenge – A Special Report on Cultural Factors in Economic Activities in New Zealand" is insightful:

New Zealand values in 1992 – the key conclusions were:

- The cultural environment is an important explanatory factor in economic performance.

- There is every reason to believe that many New Zealanders are still dependent, rather than innovative and autonomous.

- The many years of sheltered, if modest affluence may have prevented much of a thrust of competitive inventiveness.

- The attitudes of the past characterise all levels of the work force.

- Hard work and competition are not particularly popular, - equity and prosperity are preferred.

- Most New Zealanders believe that poverty and need are more likely to arise from bad luck or injustice than from the inadequacy of individuals.

- The different cultures of work in New Zealand must be taken seriously, as revealing that a major paradigm shift in New Zealand is needed if there is to be a more viable future economy.

The 1989 results had been even more negative, about attitudes in New Zealand about work, competitiveness, innovation and so on but there are more positive signs in the 1998 results, of a shift towards more acceptance of the importance of competitiveness.

But, for New Zealand to prosper economically it seems that there must be a major shift in community attitudes and a transformation of the culture of work.

Post-1984 was an attempt to achieve by leadership what could not be done democratically. While attitudes were changed by the processes, it wasn't enough and progress stalled, increasingly hampered by the poor quality of key aspects of the change process.

Meanwhile it seems that there isn't a decisive or effective constituency in New Zealand for increased growth and living standards. No one is demonstrating for it, and few seem fussed by the lack of it. The fruits are desired, but not the hard effort of creating the economic wealth in the first place.

8. Why the Title:

I expect that few community leaders set out to reduce the community's economic wealth potential and growth. It's not planned. It just happens.

I expect it happens because there is no real strategy, no real sense of what needs to be done.

Yes there are policy agendas and budgets, over the years, at all levels of government, but mostly oriented to spending, not economic growth or wealth creation. And, if they focus on the latter, they are typically more political and superficial rather than a real working prescription – there's nothing really systematic, or determined.

As a community, though we shouldn't be surprised, if we don't collectively value economic growth, or the hard work, competition and risk taking to achieve it.

If we rather take it for granted.

With globalisation it's different now though. Its like being listed and judged by the markets.

After decades of poor policies and performance, the chickens are coming home to roost.

Its never too late, but the politics seem to win out every time – well almost, and the slide continues.

New Zealand's collective prosperity, slip sliding away.

Concluding Remarks:

New Zealand's leaders, political and other, need to be much more passionate, committed and persuasive about the need for stronger economic growth.

Through leadership, New Zealand's economic growth performance must be improved, preferably supported by attitude changes in the community.

Business attitudes were fundamentally changed for the better in the 1980's. Now its time for the rest of the community. There are some positive signs, but it needs strong leadership and committed process management, NOW, to make a difference.

There is already an undue dependency on public funding in the New Zealand community. This is forecast to increase. There are also gaps to be closed.

This, in the context of an increasingly competitive global economy, an uncompetitive New Zealand policy framework and highly mobile people and capital.

While Australia's growth rate tracks at twice New Zealand's New Zealand's problems simply compound, in areas such as social services, in defence capability, in conservation resources, and in living standards generally.

Conclusions:

- Economic growth is critical
- New Zealand's growth performance must be improved, decisively
- Because of its importance it should be the top priority
- There needs to be a clear and persuasive explanation of this to the community
- The alternative, of business as usual and present trends means further relative decline in community services and living standards, higher taxes and an increasing exodus of people and capital is unacceptable
- Strong leadership will be needed, particularly given community attitudes and the need to change them
- Given the relative decline to date, decisive action is needed now.