SUSTAINABILITY – KEY ISSUES FOR NEW ZEALAND

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Introduction:
This speech considers New Zealand's sustainability performance and prospects. The views range from positive to sharply critical and reflect the conference theme – "Ours today, Theirs tomorrow".

"Sustainability" has become a high profile, topical issue, and appropriately so, but its limited populist dimensions tend to dominate public debate. My perspective is broader. It goes beyond a focus on the natural environment and its use and protection, to consider the sustainability of New Zealand as a community, including its economic and social wellbeing.

Maybe environmental issues generally are third order in any real consideration of sustainability. The prime focus needs to be on the economy and its performance, followed by the implications of economic performance and government policy for the social wellbeing of the New Zealand community, and then, the implication of economic and social issues and policy for the environment. It's not that environmental issues are unimportant – they are vital for New Zealand's future, but they do need to be put in context.

Why are my comments critical? Because improvements primarily means identifying and changing the areas of weakness and poor performance. Unless we focus on them, how can we improve them.

A Snapshot of New Zealand:

First, a generally positive view of New Zealand's present position:

September 11 underlined the advantages of living in a small, remote, peaceful and generally un-threatened nation, with a low population density, a very attractive physical environment, and a generally benign climate.

In addition, of some 130 economies covered by the World Bank in its annual reviews, New Zealand has the 21st highest gross national product per capita at US$16,480 (in 1997, the latest data). Australia ranked 16th at US$20,540, with Canada 18th at US $19,290, and the United States 6th at US$28,740. I simply note that some decades ago, New Zealand ranked amongst the top few.

In contrast, China was 81st at US$860, and Bangladesh 116th at US$270. What a privileged position for New Zealand to be in, and more on China later.

A number of indicators from The Social Report 2001, compared a range of trends in New Zealand with those in other countries:

> Life expectancy has improved in New Zealand in recent decades, but it has improved faster in other countries and the level in New Zealand is now lower than in Japan, Australia, Canada and many European countries.

> The rate of youth suicides in New Zealand is the highest in OECD countries.

> New Zealand has a high rate of teenage births compared with other developed countries and was second only to the USA for most of the last decade.

> Participation in earlier childhood education is high in New Zealand, ranking 6th of 28 OECD countries.

> New Zealand ranked 11th of 28 OECD countries in the proportion of the population having at least an upper secondary education, and 14th in the proportion which had completed tertiary qualifications.

> New Zealand's unemployment rate was one of the lowest in the OECD in the mid 1980s, well above average in the early 1990s and is approximately average now.

> Income inequality has increased over the past decade, mainly due to the relatively faster increase in the incomes of high-income earners.

> The proportion of the population receiving low incomes has increased since 1988, with the incidence of low incomes being particularly high for sole parent families, those reliant on benefit income, living in rented accommodation and of Pacific or Maori ethnic groups.

A quarter of households have housing costs greater than 30% of their income, a higher proportion than in 1988.
In terms of environmental indicators, two are used:

> Unacceptable levels of air pollution sometimes occur in localised urban areas, mainly with traffic congestion, but in terms of the ambient concentration of carbon monoxide, air quality is generally good, although urban areas overall are not markedly better than the average of OECD economies.

> In terms of drinking water quality New Zealand's standards are high.

This limited range of indicators, generally those for which country comparisons are available, gives a rather mixed result. Things are pretty reasonable in New Zealand, but we are broadly middle of the pack, and losing ground.

One Firm's Performance:

What about business and sustainability – let me give you a brief snapshot of one firm - Comalco New Zealand, which is probably amongst the better performers:

> After 30 years of operation and some very difficult times, profitability is now tracking consistently in a positive EVA range.

> Net profit after tax was $175 million in 2001.

> Tax paid was $95 million.

> Total smelter aluminium production is now about 330,000 tonnes per annum, compared to 75,000 tpa in the mid 1970s, most of which is exported.

> The lost time injury frequency rate is currently 0.82, compared with about 5.0 in the mid 1990s. The business is committed to achieving zero and is working systematically towards this goal.

> Since 1997:

> Total freshwater use is down by 25%.
> Total liquid discharge is down by 33%.
> Total solid discharges are down by 73%.
> Greenhouse gas emissions are down by 15%, and by 38% since 1990.
> Specific gaseous emissions i.e. fluorides, are down by 94%.

> Since 1990 energy use per tonne of metal produced is down by 9%.

These trends reflect the values of the business rather than the effect of regulations. They also reflect a willingness to commit some $80 million in the mid 1990s to environmental upgrades, when the plant was already fully complying with its permit and license conditions, but it was considered inappropriate to upgrade key aspects of the smelter's production facilities, without also upgrading key areas of its environmental control systems.

The smelter has not had a permit or licence violation since 1997 and recently received the Southland Regional Council Award to industry for environmental performance. In addition, it is a Five Star safety site and the smelter's general manager Tom Campbell, received the 2001 award for the most committed smelter leader in Australasia on safety performance.

I suggest that this is a very encouraging picture, from a sustainability view point, but it's not new, it has just got better over time with continuous improvement, while those critical underlying values have also evolved.
Now, after those anecdotal perspectives, we need to take a rather more focussed view of the Nation's performance, which starts to get to the heart of what sustainability is all about.

Economic Trends:

Since about 1950 New Zealand's average annual rate of economic growth, measured in terms of real GDP per capita in constant US dollars, has averaged about half the OECD average and about half of Australia's. This relatively poor performance has been persistent in every decade. The data here is to 1997, but it is not evident that the foundation has been laid for a sustained improvement. There are some years of better performance, but these are offset by years of poor performance.

As a result of this slow rate of economic growth New Zealand's GDP per capita in 1997 had fallen to only some 70% of Australia's and the OECD average, after being the same in 1960 (this OECD data is slightly different from the World Bank numbers data above, reflecting a different measurement basis).

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 and 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

Source: OECD, NZIER

There has been an even worse performance in exports and productivity. Total exports have consistently grown at less than half the OECD and Australia's average growth rate, and the productivity comparison is slightly worse.

Exports per Capita
In 1990 prices and exchange rate
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

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
1997	197	183	139	258
% increase	97	83	39	158

Source: OECD, NZIER

Exports are generally acknowledged to be the growth engine of the New Zealand economy so, if our export growth has been slow, it's not surprising that our overall economic growth rate has also been slow.
And, if the rate of growth of productivity per capita is the principle determinant of the economic well-being of New Zealanders, it's not surprising that our slow rate of productivity growth has led to relatively low rates of income growth.

Does slow economic growth matter?

Yes. It really does, and this goes to the heart of the sustainability issue:

The rate of growth of real GDP per capita is the basic determinant of material living standards in the community. 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, both 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.

Thus, New Zealand's poor growth performance underlines why these services are failing to perform at an acceptable standard now, why such services are often better overseas and why economic performance is now the prime determinant of sustainability for New Zealand.

Now we need to look more closely at a number of other important aspects of context and performance.

Globalisation:

Globalisation is real, is continuing and is a vital contextual element in considering New Zealand's sustainability. It reflects the reduced cost of communication and trade between nations, the lowering of barriers and the desire to grow trade, communications and living standards.

While globalisation is generally good, increasing potential living standards for all nations, the World Development Report notes "the globalisation of trade, finance, and information flows is intensifying competition, raising the danger that the poorest countries and communities will fall behind more rapidly than ever before". Note that this is a danger, not a probability.

Globalisation is creating increased opportunity for New Zealand, for trade in goods and services, as well as increased opportunity for New Zealanders to benefit from their knowledge and skills.

Globalisation also imposes a powerful discipline on economies and governments. Markets are more open and transparent, and quicker to judge whether a nation's policies and prospects are generally positive or negative, and to react accordingly. The Asian economic crisis of the late 1990s and the current Argentine problems are good examples of this, where markets imposed a severe discipline because of what are seen to be inadequate government policies and poor economic performance.

While increasing opportunity, globalisation also increases competition. In New Zealand's front yard - the Asia-Pacific region, China has a manufacturing cost structure which is about 1/10th of New Zealand's, and there are a number of other low cost economies including Bangladesh, India and Pakistan, Thailand, Malaysia and Taiwan.

New Zealand will not survive selling cheap goods in competition with China, domestically or overseas. It has to move up the economic scale, making more high value products and with more added value per employee. This is happening, but not enough.

This has direct implications for the less skilled and qualified in New Zealand.

Export Performance:

According to a recent NZ Institute of Economic Research study:

> New Zealand's relatively slow economic growth over recent decades can largely be attributed to slow export growth.

> The slow export growth has been largely due to the composition of New Zealand's exports. In most product groups New Zealand's export growth has been similar to world import growth. New Zealand's exports though, are largely in commodity groups that have shown relatively slow world import growth.

In 1976 resource based goods and primary products accounted for 45% of world trade, low technology goods 21% and high and medium technology goods 33%. By 1996 the resource based and primary products share had fallen to 24% and medium and high technology goods had increased to 55%. New Zealand's exports have been concentrated in the slow-growing market segments, and we have not been sufficiently innovative in these industries in increasing market share or value added per employee.

There is another key linkage between New Zealand's exports and the well-being of the community.

According to the Institute, New Zealand's export growth tends to benefit relatively more the less qualified and less skilled workers, as the export industries employ relatively more people in these vulnerable categories – people with low educational qualifications and skill, people in the regions, and Maori and women are often more heavily represented. Therefore the rate and structure of export growth also has potentially substantial implications for [illegible] and social well-being in New Zealand.

Education, Knowledge and Development:

According to New Zealand's 2001 Social Report "… in 1997 almost half the adult population had literacy levels below those required to meet the demands of everyday life (as measured by the International Adult Literacy Survey)". Further, a recent OECD report on New Zealand concluded that New Zealand, once amongst the OECD's top performers in education has, in the last three decades, been outstripped by other countries, although there have been recent signs of improvement.

The overall picture is that older New Zealanders were fairly well educated by OECD standards. Now younger New Zealanders (15 – 25 age groups) are in the middle of the pack, which has the potential to constrain New Zealand's growth. While there was a wide-spread of outcomes between the best and worse performers, the statistics showed that a third of New Zealand students left school with only basic or no qualifications.

Significantly, a recent World Development Report notes that "… economies are built not merely through the accumulation of physical capital and human skill, but on a foundation of information, learning and adaptation. Because knowledge matters, understanding how people and societies acquire and use it – and why they sometimes fail to do so – is essential to improving people's lives, and especially the lives of the poorest".

The Report concludes that "… knowledge is at the core of all our development efforts".

While there is considerable debate about the exact contribution of knowledge to economic growth, some studies indicate that as much as 70%, of growth is not related to the accumulation of physical capital, and that a substantial part of that 70% or so, is related to the accumulation of knowledge in a community and to doing things smarter.

While the level of education and knowledge in a community has a direct influence on its productivity, it also influences what it produces, as it is generally difficult to produce more sophisticated, higher technology products without the requisite capability in an educated workforce and knowledgeable community.

Spending on R & D has a direct influence on the development of technology and on the benefits of owning rather than having to acquire technology. High-income economies generally have a high rate of investment in R & D and low income economies a low rate of investment.

New Zealand has a low rate of investment in R & D, together with an over reliance on government investment and a relatively weak private sector contribution, probably reflecting the implications of the tax system.

These issues are all relevant to New Zealand's poor performance on exports because New Zealand's exports are principally in goods with a low level of transformation and sophistication, which is also the slowest growing segment of world trade.

It also explains why our exports to Japan have fallen from about 1% of Japan's imports to about 0.4% over the last 2 decades.

Incomes:

The average annual income for all people aged 15 and over was about $23,000 in 2000, while the median income was $17,680, showing the relatively skewed distribution towards higher income earners.

More significantly in this context is the variation in average annual incomes according to the highest qualification that people hold:

	$000
No qualification	16
School certificate	20
Vocational or trade qualification	28
Bachelor or higher degree	41

This data reflects the view that higher levels of training and qualification are consistent with higher productivity and therefore higher remuneration, and has serious implications for a society with a high proportion of poorly trained and educated citizens, particularly in terms of the exposure of people with little or no qualifications to the effect of global competition, and the risk that the more skilled and qualified represent the more mobile element in the work force. Reflecting the relatively rapid rises in the incomes of the top 20% of income earners in recent years, the disposable income of a household at the 80th percentile was 3.2 times higher than the income of a household at the 20th percentile in 1998, compared with a ratio of 2.7% in 1988.

The incomes of the bottom 20% of earners have remained approximately constant since 1988, and incomes of the middle 60% have been relatively stable, with some increase in recent years.

The challenge here is to improve education standards and upgrade skills, and the incentives for citizens to upgrade their own capability because a serious challenge for New Zealand economy, and especially the less skilled and qualified, is the competitive pressure from really low cost economies, such as China.

While Mexico's average hourly manufacturing wage is US$2.00 per hour, China's is only a tenth of that level at about US$0.22 per hour, or about NZ$0.50 per hour.

While New Zealand consumers can benefit from cheap imported goods, producers and employees face a tough challenge, made more serious by the increasing on-costs and disincentives to employing labour in New Zealand.

Savings and Foreign Debt:

An important consequence of low-income levels in New Zealand is the low rate of savings, and household's net savings are now negative.

With low domestic savings New Zealand is dependent on foreign savings, via foreign capital inflows, to finance public and private sector investment and periodically, current consumption as well.

There are a number of risks in this area, which relate directly to New Zealand's sustainability.

For foreign savers to be willing to provide funds to New Zealand, New Zealand must continue to be attractive to them. Attractiveness is determined by the whole mix of factors including government policy, the treatment of foreign investment - both by tax and regulation, the overall performance of the economy and social and political trends. On the one hand, this is a positive influence as it encourages governments to keep policies within bounds, which are broadly acceptable to the international financial community and institutions.

On the other hand though there is a risk that governments pursue paths based on political ideology and national sovereignty, without due regard to the consequences in international markets, which has led to serious difficulties for many economies – of which the Argentine is the most recent and notable – its policies have led to the collapse of its financial system and much of the economy.

A real challenge to New Zealand's sustainability is the persistent, long-term deficit on its external Current Account with the rest of the world. Since the early 1970s the current account deficit as a percentage of GDP has averaged about 5%, and foreign capital inflows are required to offset this deficit, either in the form of debt or equity.

According to Statistics New Zealand, in 1975 New Zealand's cumulative current account deficit was less than $10 billion, but by 2001 it had increased to about $80 billion, and net foreign indebtedness was $88 billion, 80% of GDP. That is one of the worst positions in the developed world. Most mature and developed economies in Europe and North America are either net lenders to the rest of the world or have a net debt position of only 20% - 30% of GDP. Even Australia, with a history of persistent current account deficits, is only half as dependent on foreign capital as New Zealand is. It is notable that the position deteriorated dramatically, in terms of household savings, in the mid 1990s and New Zealand now has the lowest rate of household savings in the OECD.

One reason for low savings can be high wealth levels but this is unlikely in New Zealand, as its net financial wealth to income ratio is low by international standards – and only about a quarter of Australia's in 2001. Between 1995 and 2001 Australia's household net financial wealth to income ratio increased by 48%, broadly in line with the rest of the developed world, whereas New Zealand's ratio declined by 38% - a very unsatisfactory situation.

The bottom line is that New Zealand is now highly dependent on foreign capital, with all the risk and potential consequences that go with that, and without a significant increase in net exports of goods and services the position will continue to deteriorate. There is currently no sign of this shift occurring, or of policy shifts that will cause such a shift and the latest Budget expenditure commitments, capital plus operating, take central government into a cash negative position.

Fiscal and Related Issues:

The IMF and OECD, amongst others, have warned that New Zealand's level of government expenditure, at about 40% of GDP, is too high, that a flatter, lower tax structure is needed for personal taxation, with the top rate aligned with the company rate, which is now the highest in the Asia – Pacific region and needs to be lowered.
This view is supported by New Zealand tax specialists and business, but is generally unpopular with the New Zealand community, which prefers increased government expenditure on education, health and welfare, even at the expense of even the higher taxes. Given the skewed income distribution in New Zealand I expect that the average income earner is advocating this position on the basis that taxation on the average income will not be increased and that citizens on higher incomes will be happy to pay the additional tax, rather than pursuing more attractive opportunities off-shore, or through increased leisure time.

One view is that the government acts within the boundaries of a social compact, the compact reflecting the communities' willingness to pay tax, at particular rates at particular income levels, given the use to which the tax revenue is put. If tax rates become too high then the compact is at risk. If the level or structure of expenditure is unacceptable, then the compact is also at risk.

This is an important area where globalisation has significantly altered the rules for governments, particularly as a high proportion of tax revenue is paid by a small proportion of individual tax payers who have relatively high incomes, and these high tax paying individuals are typically amongst the most competitive in a global labour market and the most mobile and willing to relocate to increase their income or avoid an unacceptable tax impost.

To underline the significance of this issue, Treasury forecasts for the current tax year indicate that:

> 79% of personal income tax payers will have an annual income of $40,000 dollars or less (55% will be under $20,000), and will pay only 35% of personal tax receipts, an average of $2,800 per taxpayer.

> 13% of taxpayers with incomes over $50,000 will pay 52% of personal income taxes.

> The top 4% of taxpayers, with incomes over $80,000, will pay 31% of personal income taxes, an average of $46,000 tax per taxpayer.

Similarly, companies have considerable scope to relocate and restructure their activities, within legal and ethical bounds, to avoid unacceptable taxation provisions.

It is a critical role of government to create a competitive policy environment, within which business can create economic wealth for the whole community. If the policy environment is not competitive then the performance of the economy will suffer. If taxes or government expenditure are too high, this will inhibit growth prospects and encourage adverse market trends.

There was a strong message in last year's Budget. Of $2,178 million of new fiscal commitments:

> 73% went to health and welfare.

> 16% to education.

> 5% to "Moving Forward" –research, science, technology, etc., of which less than 1% went directly to encouraging growth by business – the community wealth creators.

This is typical of New Zealand governments, and there are strong grounds for concluding that poor policies have been a key part of New Zealand's difficulties.

New Zealand Values:

Values and attitudes have an important impact on economic policy and performance. There have been a series of insightful studies on the values and attitudes of New Zealanders by Webster and Perry of Massy University.
Key 1992 conclusions were:

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

> Many years of sheltered if modest affluence may have prevented much of the thrust of competitive inventiveness.

> The attitudes of the past characterise all levels of the workforce.

> 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 New Zealand economy.

The position has improved a bit in subsequent surveys but New Zealand still faces a major difficulty in addressing its economic problems and improving its economic performance, because many New Zealanders have no interest in or understanding of the importance of these issues, and their attitudes are inconsistent with making the necessary changes.

This perspective is underlined by a recent National Business Review – Compaq poll (May, 2002) in which over 90% of respondents were satisfied with the community as a place to live and with their personal life. The only area of significant dissatisfaction was the 25% of $15-25,000 income earners who were unhappy.

Implications for the Sustainability of the Natural Environment:

It needs to be made quite explicit that New Zealand's environment performance now is increasingly constrained by its poor economic performance, limiting the scope and timing of improvements.

Over the last decade Central Government has spent about 0.24% of GDP on Votes, Conservation and Environment, equating to $257 million in 2001/02.

If the New Zealand economy had grown at the OECD average rate since 1960, 0.24% of GDP would have been $362 million, an increase of 40% and $102 million. What a difference that would make.

With lower incomes, a higher proportion is spent on necessities. If New Zealand becomes more affluent, the willingness and ability to spend on the natural environment will increase both in direct spending and in achieving superior environmental outcomes from infrastructure and other investment and operating activities.

Conclusion and Prospects:

New Zealand's relatively poor economic performance undermines the sustainable quality of life for the average citizen in New Zealand, and the ability of New Zealand to invest to protect and improve the sustainability of its environment. The adverse trends have been in place for a number of decades now and there has been little sign of governments recognising the fundamental problems, or committing to real improvement.

This is a daunting history. The present Government has espoused the need for New Zealand to become a more innovative, knowledge-based economy, with an economic performance which returns it to the top half of OECD economies (by when is not stated).

This is admirable, but a recent Treasury paper estimated that in order to reach the top half of the OECD economies, real GDP per capita would have to increase at an annual rate of between 4.6% and 7.4% per annum, depending on the measurement base used, and assuming other OECD economies continue to grow at their average rates of the last three decades. Allowing for population growth indicates a required growth rate of the order of 6% per annum, requiring a more than doubling in the long-term rate of growth of productivity, which is a formidable challenge and one not yet targeted effectively in policy.

For example, of new spending and capital commitments in the latest budget, to be spent out to 2005/06, the shares were:

> "Health" 59%.

> "Building Public Sector Capability" – Education, Conservation, Police, Courts, Justice, IRD etc. 18%.

> “Developing a Modern Cohesive Society” – Transport, Welfare, Broadcasting etc. 20%.

> “Strengthening Security” 1%; and

> “Supporting Growth and Innovation”, the economic growth oriented components 2%.

This does not suggest economic growth as a priority.

The 2% equates to $140 million.

In comparison, for example, other commitments were:

	$million
Air New Zealand	1035
Auckland Rail	91
Paid parental leave	163
Health	4543
Land transport strategy	785
IRD	149

A continuation of the low savings rate puts continued reliance on foreign capital, but the level of foreign direct investment in New Zealand has fallen sharply in the recent past, by more than 70%, suggesting that there needs to be a more competitive and attractive policy environment, with lower taxes.

The position has been exacerbated by a lack of government vision and effective leadership on economic issues over the years, with occasional, brief exceptions. The lack of a clear and coherent vision has made it more difficult for the community to understand the critical nature of the issues that must be addressed, and to support the necessary changes.

Given the significance of economic policy and the rate of economic growth in all of this, I continue to be mystified that there are not a continual series of protests in the grounds of Parliament or elsewhere, by citizens outraged that the rate of economic growth is so slow and advocating the need to do better. Perhaps there is a role for Rotary here.

As a result, with continued slow growth, New Zealand will walk a tight rope, managing a steady deterioration in the quality and quantity of personal consumption of both public and private sector goods and services compared with other developed economies, and particularly Australia because of its close proximity and relationship with New Zealand, and New Zealand’s ability to pursue social or environmental objectives – or indeed any objectives not directly oriented to improving its economic performance, will be restricted by its economic capacity, reinforced by the discipline of global markets and the mobility of labour and capital.

It will require strong leadership to make the necessary changes, because the attitudes and values of the New Zealand community are focussed elsewhere, on equality, on avoiding change and competition, and on gaining an increased share of the cake from the government.

All of this highlights the critical role of the community members who are the real wealth creators, and the potentially serious consequences of not supporting them in their endeavours, to actually grow the cake. These people are the foundation for New Zealand’s sustainability, and lets remember that 86% of New Zealand businesses employ 5 or fewer people. We are not talking about the big end of town here.