Submission

by

Business NZ

to the

Finance & Expenditure Select Committee

on the

Budget Policy Statement 2002

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BUDGET POLICY STATEMENT 2002

SUBMISSION BY BUSINESS NEW ZEALAND

1 FEBRUARY 2002

1. Introduction

1.1 This submission is made on behalf of Business New Zealand, incorporating regional employers' and manufacturers' organisations. The regional organisations consist of the Employers and Manufacturers Association (Northern), Employers and Manufacturers' Association (Central), Canterbury Manufacturers' Association, Canterbury Employers' Chambers of Commerce, and the Otago-Southland Employers' Association. Business New Zealand represents business and employer interests in all matters affecting those sectors.

1.2 Business New Zealand strongly supports the Fiscal Responsibility Act 1994, as the obligations imposed by the Act on the Government provide for greater accountability and transparency in policy and decision-making. The Act requires that the Government's management of the economy must be consistent with the principles of sound fiscal management, and the greater accountability and transparency provided for by the Act should reduce the risk of significant negative policy surprises.

1.3 One of Business New Zealand's key goals is to see the implementation of policies that would see New Zealand retain a first world national income and to regain a place in the top half of the OECD in per capita GDP terms. This is a goal that is shared by the Government. It is widely acknowledged that consistent, sustainable growth in real GDP per capita of well in excess of 4% per annum (and probably closer to 7-8%) would be required to achieve this goal in the medium term. Continued growth of around 2% (our long-run average) would only continue New Zealand's relative decline.

1.4 The health of the economy also influences the ability of a nation to deliver on the desirable social and environmental outcomes that we all want. First class social services and a clean and healthy environment are possible only in prosperous, first world economies.

1.5 When it was elected, the Labour-Alliance Government undertook a number of policy actions to correct what it perceived to be 'failings' of the 1984-99 period's emphasis on market-driven economic reform. However, while Business New Zealand can understand the Government's wish to re-balance social and economic priorities, we submit that it is now time for the Government to concentrate on building the foundations for a strong and growing economy, without which desirable social and environmental outcomes would be unsustainable.

1.6 Unfortunately, the Budget Policy Statement (BPS) points to a policy direction that, far from spurring the economy onto a higher growth path, merely confirms the low-growth status quo. We submit that maintaining Government spending at a third of GDP, without any consideration of value for money or the deadweight costs of high levels of taxation is insufficient.

2. Business New Zealand's Growth Strategy

2.1 New Zealanders want better health, education, and social services as well as a clean environment. New Zealanders also expect to enjoy material standards of living comparable with those in Australia, Western Europe, and the United States.

2.2 However, we cannot achieve these aspirations unless we better match our incomes to our expectations. New Zealand needs a balanced set of policies that will promote its international competitiveness, foster innovation, and encourage entrepreneurs. To this end, Business New Zealand has developed a package of twenty key priorities that we believe would deliver a more prosperous and sustainable New Zealand. These key priorities are attached as Annex 1.

2.3 Business New Zealand's over-arching key priority is for the formulation of a sustainable development strategy that (a) recognises economic growth as a precursor for social well-being and effective environmental management, and (b) fosters a climate of innovation and competitiveness. Of the other key priorities, three are directly related to fiscal policy:

- Lower tax rates, with a priority of reducing the corporate tax rate in stages to 20% by 2010;

- Reduce the proportion of government spending to GDP to less than 30% by 2005, to be achieved by ensuring that government spending grows at a rate slower than that for GDP; and

- Reduce the level of gross Crown debt to below 15% of GDP by 2010.

2.4 It is against these key policy priorities that Business New Zealand has reviewed the BPS.

3. Specific Comments on the Budget Policy Statement 2002

3.1 Business New Zealand welcomes the opportunity to comment on the BPS, the objective of which is to provide an overview of the Government's approach to the upcoming Budget.

3.2 While we generally agree that the Government is continuing to be a 'careful fiscal manager', we are particularly concerned about the following issues, which must be addressed if we are to have a prosperous economy that can deliver sustainable social and environmental outcomes:

- Projected increases in operating expenses and revenues;
- Projected increase in the level of gross Crown debt;
- Impact of the New Zealand Superannuation Fund; and
- Increased level of Government involvement in commercial activities.

3.3 *Operating Expenses and Revenues*

3.3.1 Business New Zealand is concerned at the forecast increase in operating expenses from $39.6 billion for 2001/02 (33.3% of GDP) to $43.8 billion for 2004/05 (32.4% of GDP), *exclusive* of New Zealand Superannuation Fund contributions[1]. This is a 10.6% increase in nominal spending over a three-year period.

3.3.2 As noted above, one of Business New Zealand's key priorities is for the proportion of Government spending to GDP to fall to less than 30% by 2005. High levels of government spending do not lend themselves to a more vibrant and prosperous economy, as the experiences of many OECD economies prove[2]. For example, Ireland has substantially reduced government spending as a percent of GDP from over 50% in the 1980s to less than 30% today, which has helped to encourage and sustain high levels of economic growth and a high standard of living. The Irish are now significantly better off than New Zealanders (both in terms of economic and social indicators), something that would have been unthinkable only 20 years ago.

3.3.3 We consider that achieving the 30% objective would be achievable even without cuts in the nominal level of spending. According to the Government's own predictions for GDP, 30% of GDP at the end of the year 2004/05 would equate to operating expenses of approximately $40.6 billion for that year ($1 billion more than in 2001/02).

3.3.4 However, we do recognise that it would require a level of fiscal discipline not seen for some years. The previous Government made a provision for $2.7 billion for increased expenditure over the period 1999-2003 and, in 2000 the incoming Government increased this to $5.9 billion, much of which was 'front-loaded' in the 2000 and 2001 Budgets. Due to recent spending pressures this 'cap' on new operating spending has now been revised up to $6.1 billion and does not include new capital spending (such as for the recapitalisation of Air New Zealand).

3.3.5 While some new expenditure in key areas (such as health and education) may be acceptable where demographics justify it, we are concerned about the increased levels of operating expenses for the following reasons:

- Most importantly, increased expenditure generally requires higher levels of taxation, particularly if surpluses are to be maintained. The BPS estimates an increase in operating revenues from $40.3 billion for 2001/02 (33.9% of GDP) to $46.6 billion for 2004/05 (34.4% of GDP). This is a substantial 15.6% increase over a three-year period, considerably higher than the projected 10.6% increase in expenditure. Higher levels of taxation have implications for economic growth, particularly through reduced levels of disposable income for individuals and reduced investment for businesses,

[1] Inclusive of New Zealand Superannuation Fund contributions, total expenses and contributions are estimated to be 34% of GDP for the 2004/05 year.
[2] 'How Much Government? The Effects of High Government Spending on Economic Performance', Winton Bates (2001).

as well as through dead-weight losses associated with high levels of taxation.

- Increased expenditure can feed into increased inflationary pressures, thereby causing the Reserve Bank to tighten monetary policy, with the usual flow-on effects of higher interest rates and reduced activity within the wealth and jobs-generating private sector. Responsible fiscal policy should complement, not contradict monetary policy.

- The sustainability of the Government's fiscal policies must be considered. The fiscal projections over the next few years are subject to continued growth in the economy of around 3% per annum, no major unforeseen events, and continued discipline in the face of public and political pressures to increase spending. We consider this to be an optimistic assumption under current policy parameters, but even if we were to accept the 3% growth assumption, new expenditure could easily be allowed to grow above levels currently forecast and rapidly eat into projected surpluses. Unfortunately, recent experience is that New Zealand governments of all persuasion have felt able to significantly increase spending when the operating surplus is projected to be healthy.

- One of the important means of increasing economic growth is increasing the rate of productivity growth. Unfortunately, there appears to be little emphasis on productivity growth in the proposals for increased funding, with most of the focus appearing to be on the redistribution of wealth. Examples of spending that would benefit productivity include education, research and development, and transport and communications[3].

3.3.6 Business New Zealand submits that the Government should encourage growth by more actively containing expenditure to below 30% of GDP and reducing the tax burden by lowering tax rates. In our view a good place to start would be by reducing the rate of corporate tax, which at 33% is now the highest in the Asia-Pacific region and has implications for New Zealand's ongoing international competitiveness. A refocusing of spending on enhancing productivity growth should be a priority.

3.4 *Gross Crown Debt*

3.4.1 While the BPS predicts that net Crown debt will fall over the forecast period, the level of gross Crown debt will actually rise, from $37.1 billion for 2001/02 (31.2% of GDP) to $42.3 billion for 2004/05 (31.3% of GDP), an increase of 14% over the three-year period. This is mainly due to contributions having to be found for the New Zealand Superannuation Fund, new investment in hospitals, schools, prisons, and transport, re-equipping the defence force, and the recapitalisation of Air New Zealand.

3.4.2 Business New Zealand is very concerned about the increasing level of Crown debt, particularly if the new borrowing is necessary to meet contributions to

[3] Refer to 'The Driving Forces of Economic Growth: Panel Data Evidence for OECD Countries', OECD Economic Studies No. 33, 2001/02 (p 18-19) for a discussion on 'productive spending'.

the New Zealand Superannuation Fund and increased Government involvement in commercial activities (both issues discussed further below).

3.4.3 Higher levels of Crown debt would result in increased finance costs for the Government (money that could be spent on other priorities and/or returned to taxpayers through lower tax rates[4]) and have the down-stream impact of increasing interest rates through the Government competing with private sector borrowers for scarce capital. High levels of debt can also lead to credit downgrades, which in turn can result in higher interest rates through higher country risk premiums.

3.4.4 While New Zealand's current level of public debt, and consequently debt-servicing costs, are relatively modest compared to some OECD countries, the country's overall level of indebtedness is high (due mainly to high and increasing levels of household borrowing). At a time when world financial markets are nervous about possible 'Argentina' style debt defaults, it would seem prudent for the Government to be cautious about increased borrowing and not seek to be a contributor to New Zealand's already high overall level of indebtedness.

3.4.5 Therefore, Business New Zealand submits that the Government should be looking to reduce the proportion of gross Crown debt from its existing level of 31.2% to less than 15% of GDP by 2010.

3.5 *New Zealand Superannuation Fund*

3.5.1 Business New Zealand is unconvinced about the value or sustainability of the New Zealand Superannuation Fund, particularly if it results in a higher level of gross Crown debt. The Fund does not address a number of long-standing, unresolved economic and social issues arising from the provision of retirement income.

3.5.2 Business New Zealand is particularly concerned about re-linking the entitlement of New Zealand Superannuation to 65% of the net average weekly wage. The cost in the first year of re-linking superannuation to the net average weekly wage was estimated to be $200 million[5], and it is likely to increase further as the gap between inflation-adjusted superannuation and wage-adjusted superannuation widens. Re-linking New Zealand Superannuation to 65% of the net average wage was therefore a major blow to the scheme's sustainability.

3.5.3 Total operating expenses and New Zealand Superannuation Fund contributions are estimated to reach 34% of GDP by 2004/05, up from 33.4% for the 2000/01 year. Therefore, having to make substantial contributions to the Fund will make it more difficult to get the level of total government spending down to the important benchmark of 30% of GDP.

[4] Finance costs have fallen from around $4 billion for the year ended 30 June 1993 to $2.5 billion for the year ended 30 June 2001. However, over the period to 2005 there is not expected to be any further decline in finance costs, which would reduce options for new spending or tax cuts.
[5] Budget Economic & Fiscal Update 2000 (15 June 2000) p 36.

3.5.4 Business New Zealand is also concerned about the scheme's sustainability in that there is no guarantee that future governments will not raid the Fund for additional spending or tax cuts. The lack of a political consensus on the Fund indicates that this is a definite possibility.

3.5.5 Business New Zealand submits that the previous scheme would have been sustainable if the following options had been pursued:

- Reducing gross Crown debt, so reducing debt-servicing costs and thereby increasing the level of expenditure that could be committed to funding superannuation;

- Reducing tax levels and removing barriers relating to the taxation of investment income to encourage a higher level of personal saving and business investment;

- Focusing Government expenditure on areas that will provide a higher level of economic growth (whereas the requirement to make substantial annual contributions to the Fund will reduce future spending options); and

- Policies focussed on increasing the level of economic growth and labour force participation, so increasing the size of the economic 'pie' that may be redistributed.

3.6 *Government Involvement in Commercial Activities*

3.6.1 Business New Zealand submits that the Government should justify its ownership of and involvement in commercial activities and that the onus should be on it to prove that public ownership is clearly in the public good. This holds both for existing State Owned Enterprises and State activities, as well as any new initiatives.

3.6.2 We are concerned about the Government's recent moves into commercial activities, particularly Kiwi Bank and Air New Zealand. The clear onus must be on the Government to now develop and deliver strategies for these interventions, including performance criteria and exit strategies.

3.6.3 We also submit that the Government's continued refusal to consider any further asset privatisation reduces options not only in terms of the lost revenue that such sales may provide, but also possible efficiency gains that could be made from the full or partial private ownership of some existing State Owned Enterprises. We submit that the Government should regularly assess and justify its ownership of such businesses and that if it cannot adequately do so, it should consider divesting itself of them. This is simply sound business practice and prudent asset management.

4. Regulatory Burden

4.1 While not directly a fiscal issue, Business New Zealand is also very concerned about the continuing moves to increase the regulatory burden and therefore the costs of compliance, particularly in the labour market and environmental areas. We consider that this trend is unsustainable and will inevitably reduce New Zealand's growth potential. In particular, we point to:

- The Health and Safety in Employment Amendment Bill 2001 currently before the House, which will significantly and punitively increase costs for employers but produce little gain in workplace safety;

- The proposal for the early ratification of the Kyoto Protocol before our major trading partners commit and before there is an adequate understanding of the policy options and the economic and social implications of ratification; and

- The failure to enact amendments to either the Resource Management Act 1991 or the Hazardous Substances and New Organisms Act 1996, amendments that would assist in easing business compliance costs and reducing barriers to economic development.

4.2 Although Regulatory Impact Statements are now supposed to accompany policy proposals and legislation, they often seem to be an afterthought and lack rigorous (or any) analysis. For example, we are particularly disappointed with the quality of the Regulatory Impact Statement that accompanied the Local Government Bill 2001. Therefore, we repeat the business community's longstanding advocacy for a Regulatory Responsibility Act, which would be complementary to the Fiscal Responsibility Act 1994 and provide greater rigour to the analysis of regulatory and compliance cost implications.

5. Conclusion

5.1 Business New Zealand is strongly supportive of the Fiscal Responsibility Act 1994 and welcomes the opportunity to comment on the Budget Policy Statement 2002. While we generally agree that the Government is continuing to be a 'careful fiscal manager' we are concerned about the following issues, which we submit must be addressed in order to ensure we have a prosperous economy that can deliver sustainable social and environmental outcomes:

- Projected increases in operating expenses and revenues;
- Projected increase in the level of gross Crown debt;
- Impact of the New Zealand Superannuation Fund; and
- Increased level of Government involvement in commercial activities.

5.2 We are also very concerned about the growth implications of an increased regulatory burden particularly in the labour market and the environment. We consider that there is a strong case for a Regulatory Responsibility Act.

6. Recommendations

6.1 Business New Zealand recommends that the Government take more decisive action to:

- Lower tax rates, with a priority of reducing the corporate tax rate in stages to 20% by 2010;

- Reduce the proportion of government spending (including New Zealand Superannuation Fund contributions) to GDP to less than 30% by 2005, to be achieved by ensuring that government spending grows at a rate slower than that for GDP;

- Reduce the level of gross Crown debt to below 15% of GDP by 2010;

- Refocus government spending on areas that would improve productivity rather than redistribute wealth;

- Address the long-term sustainability of New Zealand Superannuation (by implementing the actions described in paragraph 3.5.5); and

- Assess and justify its involvement in commercial undertakings and its ownership of State Owned Enterprises.

6.2 More specifically, Business New Zealand also recommends that:

- The New Zealand Superannuation Fund should be abolished;

- The level of New Zealand Superannuation entitlements should be linked only to changes in the Consumer Price Index;

- The ‘Kiwi Bank’ should not proceed;

- The Health and Safety in Employment Amendment Bill 2001 should not proceed;

- Ratification of the Kyoto Protocol should not proceed until (a) our major trading partners have committed to doing so and (b) there is a greater understanding of policy measures and the economic and social implications of ratification;

- Amendments to the Resource Management Act 1991 and the Hazardous Substances and New Organisms Act 1996 should be enacted as a high priority; and

- Consideration should be given to a Regulatory Responsibility Act to complement the Fiscal Responsibility Act 1994.

Annex A

BUSINESS NEW ZEALAND'S 20 KEY GROWTH STRATEGY PRIORITIES

All New Zealanders want higher incomes, better social services, and a clean environment. However, we simply will not achieve these important outcomes without a strong, vibrant, growing economy. We need a balanced set of policies that will promote our international competitiveness, foster innovation and encourage entrepreneurs to do great things for New Zealand. While by no means an exhaustive list, we believe that the implementation of the package of key priorities listed below would go a long way to delivering a better New Zealand for us all.

Policy Integration – Economic/Environmental/Social

1. Formulate a sustainable development strategy that (a) recognises economic growth as a precursor for social well-being and effective environmental management, and (b) fosters a climate of innovation and competitiveness.

Economic Fundamentals

Fiscal and Monetary Policy

2. Lower tax rates, with a priority of reducing the corporate tax rate in stages to 20% by 2010.

3. Reduce the proportion of government spending to GDP to less than 30% by 2005, to be achieved by ensuring that government spending grows at a rate slower than that for GDP.

4. Reduce the level of gross Crown debt to below 15% of GDP by 2010.

5. Pursue the adoption of a common currency with Australia.

Microeconomic Reform

6. Reduce business compliance costs, particularly for the SME sector, using both economy-wide and SME-targeted approaches to rationalising and improving the quality of business regulation, with particular emphasis on taxation issues and the Resource Management Act.

7. Improve the efficiency and effectiveness of local government, with a view of reducing local government spending to less than 3% of GDP by 2005.

Infrastructure

8. Increase investment in transport infrastructure, with an emphasis on eliminating those roading constraints that are impeding economic growth and development.

9. Improve New Zealand's broadband penetration rate to among the top 10 of OECD countries by 2005.

Trade and Exports

10. Pursue policies that would encourage export growth and increased trade, including the negotiation of a free trade agreement with the United States by 2005.

Innovation

11. Increase and improve linkages between research and commercialisation of ideas, and increase the amount of private sector funded research and development to the current OECD average of 1.5% of GDP by 2010.

12. Ensure that the regulatory framework is innovation-friendly and encourages the use of technology.

Human Capital

Education and Skills Development

13. Increase skill levels in the current workforce, by increasing the numbers of people involved in formal industry training from 80,000 to 160,000 per annum, and significantly increase the number of people with industry skill standards, by 2005.

14. Eliminate ‘very poor’ literacy and numeracy in the population (i.e., reduce the number of people with IALS Level 1 literacy to fewer than a statistical margin of 5%), by 2010.

15. Improve the outcomes of compulsory education, so that all completing compulsory education achieve basic literacy and numeracy standards, and attain at least NCEA Level 1, by 2005.

16. Improve the relevance of post-compulsory education, by more rigorous quality assurance, greater partnership with business, and a greater proportion of learning taking place within industry and on-the-job, by 2005.

Labour Market

17. Maintain the focus on the individual enterprise and ensure the flexibility necessary to promote employment growth, particularly in the SME sector, by recognising the need to respect freely bargained agreement terms and conditions whose integrity is respected by third parties.

Population Policy

18. Increase the number and proportion of highly skilled, talented, and motivated immigrants with good English language skills so that the ratio of working age to retired age population returns to 1990 levels by 2010.

Business Excellence

19. Develop a Best Practice Management and Governance Demonstration Project, delivered by business and industry associations with support from central government; and promote best practice and sector co-operation through key supply chain linkages.

20. Promote positive public attitudes towards wealth creation, business success and entrepreneurship.