Submission

By

Business|NZ

To

Finance and Expenditure Committee

On the

Budget Policy Statement 2004

30 January 2004

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BUDGET POLICY STATEMENT 2004

SUBMISSION BY BUSINESS NEW ZEALAND

30 JANUARY 2004

1. Introduction

1.1 Encompassing five regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, Canterbury Manufacturers' Association, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 53-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

1.2 In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

1.3 Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services).

1.4 It is widely acknowledged that consistent, sustainable economic growth well in excess of 4% *per capita*[1] per annum would be required to achieve this goal in the medium term. Responsible fiscal policy has a critical role in fostering sustainable economic growth.

2. Summary of Recommendations

2.1 Business New Zealand is pleased to have the opportunity to comment on the Budget Policy Statement (BPS) 2004. While welcoming the Government's continued commitment to careful fiscal management, we are concerned that spending and the tax burden both remain too high and we consider that more should be done to facilitate higher rates of sustainable economic growth. In particular, Business New Zealand submits that all policies should have a growth promoting focus, with all proposals being rigorously assessed on their positive or negative impacts on growth.

[1] *Per capita* growth is the relevant indicator, as it measures average income levels as the population changes. The importance of distinguishing between nominal and per capita GDP growth is shown by New Zealand's recent experience where although New Zealand GDP grew by 3.8% for the year ended September 2003, our population grew by 1.7%, causing GDP per capita to rise by only 2.1%. Countries such as New Zealand must grow GDP faster just to 'stand still' compared to many OECD countries, which have low or negative population growth.

2.2 Business New Zealand recommends that:

(a) The Government should take a stronger leadership role in championing business success and the importance of successful businesses to the wider public.

(b) The Government should ensure that its policies in all areas have an explicit growth promoting focus, with all proposals being rigorously assessed on their positive or negative impacts on productivity and economic growth.

(c) Officials should develop models to forecast the fiscal and economic impact of changes in tax rates.

(d) The New Zealand Superannuation Fund (NZSF) should be abolished and reference to the NZSF should therefore be removed from the Government's fiscal approach.

(e) The Government's fiscal approach should be amended to provide a target for core Crown expenses of 30% of GDP.

(f) Tax revenue as a proportion of GDP should be reduced and tax rates should be reduced overall.

(g) The Government should, as a priority, reduce the corporate tax rate to 20% by 2010.

(h) The Government's long-term fiscal objectives should be:

- Operating surplus on average over the economic cycle sufficient to ensure consistency with the long-term expenditure and debt objectives.
- Ensure sufficient revenue to meet the operating balance objective.
- Ensure core Crown expenses are held below 30% of GDP on average over the economic cycle.
- Increase net worth consistent with the operating balance objective.
- Manage total debt at prudent levels. In the longer term, gross sovereign-issued debt below 15% of GDP on average over the economic cycle.

(i) The Government's short-term fiscal intentions should contribute to the long-term fiscal objectives recommended above.

(j) The Government should adopt the recommendations made by the OECD in its 2003 Economic Survey of New Zealand.

3. Growth as the Priority

3.1 This is the third BPS that Business New Zealand has submitted on since the organisation was formed in May 2001. In each of its previous submissions (2002 and 2003) Business New Zealand remarked that delivering a strong and growing economy requires the adoption of a balanced, credible growth strategy. The previous submissions also recommended that the Government should ensure that its policies in all areas have an explicit growth promoting focus, with all proposals being assessed on their positive or negative impacts on growth.

3.2 The Government seems to recognise the case for growth and Business New Zealand agrees that economic growth is not an end in itself but the key to lifting the living standards and improving opportunities and security for all New Zealanders.

3.3 The need for growth is particularly urgent when comparing the living standards of Australians with New Zealanders – the fact that the average Australian earns upwards of $200 per week more than the average New Zealander is down to one reason – growth (or a lack of growth in New Zealand's case over a period of many years).

3.4 Business New Zealand welcomed the Governor General's Speech from the Throne on the opening of the 47th Parliament on 27 August 2002 also including the statement:

"My Government sees its most important task as building the conditions for increasing New Zealand's long-term rate of economic growth."

3.5 The Government's Growth and Innovation Framework (GIF) sets a goal of lifting New Zealand's OECD ranking and identifies a number of policy ingredients for growth, including an open and competitive economy, macro-economic stability, global connectedness, and the role of skills, talent and innovation. Business New Zealand agrees and we welcome the comment in this year's BPS that "economic growth remains a top policy priority"[2].

3.6 The Minister of Finance has correctly pointed out that achieving the increased rates of GDP growth required to return New Zealand to the top half of the OECD needs a substantial increase in the rate of productivity growth. While recent official studies have shown that total factor productivity growth increased dramatically in the 1993-2002 period compared to the 1970s and 1980s, much more progress is required[3].

3.7 Business New Zealand has therefore supported Government policies that we consider would improve productivity, such as those on skills development (e.g., industry training initiatives), talent (e.g., improvements to immigration policy), and global connectedness (e.g., trade negotiations). We have also

[2] Budget Policy Statement 2004, page 2.
[3] *Productivity in New Zealand*, New Zealand Treasury Working Paper 03/06, June 2003.

welcomed the Government undertaking policy work on small business issues, infrastructure development, and improving workplace productivity.

3.8 However, Business New Zealand is concerned about a growing inconsistency between the Government's stated goals for economic growth and the policies being pursued in a number of other critical areas that will, if anything, reduce growth rates for productivity and ultimately GDP.

3.9 Many of the most significant policy changes have been to the labour market, with a number of significant amendments to legislation on health and safety in employment, holidays, and employment relations having either been passed or being considered over the past 12-18 months. Furthermore, pay equity is firmly back on the Government agenda and the minimum wage has been increased substantially every year. These changes will add cost and reduce flexibility in the labour market. Indeed, the OECD remarked in its most recent report on New Zealand that the trend toward a more rigid labour market "is not consistent with the Government's goal of raising per capita incomes"[4].

3.10 There have been a number of other recent policy changes Business New Zealand also considers to be inconsistent with growth goals. Some examples include:

- The Local Government Act 2002;
- Ratification of Kyoto Protocol;
- Supreme Court Act 2003;
- The Land Transport Management Act 2003; and
- The proposed Border Security Fee.

3.11 Meanwhile, there are areas where Business New Zealand considers the status quo to be unsupportive of a higher rate of economic growth. These include a lack of political will in an MMP environment to reform the Resource Management Act and an ideological predisposition to maintain tax rates at levels that are becoming increasingly uncompetitive compared to other countries seeking to attract talented migrants and foreign direct investment.

3.12 A specific example of inconsistency between the Government's rhetoric and its deeds is the area of small business policy. The Business New Zealand – KPMG Compliance Cost Survey showed that the smaller the business the higher the compliance costs per employee[5]. However, although the Government is putting considerable effort in 'connecting' with the small business community (e.g., the establishment of a Small Business Advisory Group and the upcoming Small Business Day road shows), the reality is that the anti-growth policies referred to above have hit and will hit small and medium sized businesses particularly hard.

3.13 Business New Zealand suspects that much of the Government's ambivalence about growth promoting policies is a reflection of public opinion. For example, a survey undertaken in 2003 by BRC Marketing and Social Research on

[4] *OECD Economic Surveys – New Zealand*, OECD, December 2003, page 12.
[5] *Business New Zealand – KPMG Compliance Cost Survey 2003*, August 2003.

behalf of Industry New Zealand found negativity towards and little understanding of the need for growth, with many New Zealanders failing to identify either the role business plays in creating a strong economy or why economic growth matters to their quality of life.

3.14 These disturbing findings reinforce the need for greater promotion of the growth message to all New Zealanders. The business community has been active in this regard but Business New Zealand submits that the Government also has a responsibility to take a stronger leadership role in championing business success and the importance of successful businesses to the wider public.

3.15 *Recommendation: Business New Zealand recommends that the Government should take a stronger leadership role in championing business success and the importance of successful businesses to the wider public.*

3.16 Business New Zealand also reiterates the recommendation made in its previous BPS submissions, that it is time the Government focused on building the foundations for a strong and growing economy, without which New Zealand will not be able to sustain existing standards of living. For growth to truly become a priority, there must be a change in direction, which means a greater and more concerted focus on improving the quality of government spending, a reduction in the burden of taxation on the productive sector, and a more proactive addressing of business compliance costs.

3.17 *Recommendation: Business New Zealand recommends that the Government should ensure that its policies in all areas have an explicit growth promoting focus, with all proposals being rigorously assessed on their positive or negative impacts on productivity and economic growth.*

4. Business New Zealand Growth Strategy

4.1 In December 2001 Business New Zealand released its *Changing Gear* growth strategy, against which we assess all policy and legislation. A copy is attached as Annex 1 to this submission.

4.2 Even after almost five years of relatively strong economic growth, the goal of improving New Zealand's OECD ranking requires 'stretch'. Associated with *Changing Gear*, Business New Zealand has been monitoring a series of indicators tracking progress towards medium and longer-term goals. Although there have been some improvements since 2001 in some areas (e.g., most notably the reduction in Crown debt as a percentage of GDP and the number of participants in formal industry training), most indicators have remained static or have slipped.

4.3 The key Changing Gear growth priorities with direct relevance to this submission are:

Priority	Goal	Progress
Priority 2	Lower tax rates, with a priority of reducing the corporate tax rate in stages to 20% by 2010.	Tax rates have not been reduced. While Government has signalled some tax relief for low-middle income families in the 2004 Budget, it remains resistant to reducing the corporate tax rate, for example.
Priority 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.	Core Crown expenses (plus NZSF contributions) as a percent of GDP has risen from 31.5% for 2000/01 to 33.3% for 2002/03. Table 1 of the Budget Policy Statement forecasts this proportion to remain relatively stable at around 32.5% in years to 2007/08.
Priority 4	Reduce the level of gross Crown debt to below 15% of GDP by 2010.	Gross sovereign-issued debt as a percent of GDP has fallen from 31.6% of GDP for 2000/01 to 28.0% for 2002/03. Table 1 of the Budget Policy Statement forecasts the proportion to fall steadily to 20.4% by 2007/08.

4.4 Business New Zealand therefore finds that only one of its three fiscal policy key priorities is on target. While the progress toward reducing debt is encouraging, it is disappointing that tax rates are likely to remain at high levels and that Government spending is likely to remain higher than we would consider conducive of a higher rate of economic growth.

5. Fiscal Responsibility Act

5.1 Responsible fiscal policy plays a critical role in fostering sustainable economic growth. Business New Zealand therefore strongly supports the principles underpinning the Fiscal Responsibility Act 1994 and the obligations it imposes on Governments that provide for greater accountability and transparency in policy and decision-making. The Act requires the Government's management of the economy to be consistent with the principles of sound fiscal management, while the greater levels of accountability and transparency should reduce the risk of significant fiscal policy surprises.

5.2 Business New Zealand understands that a recently introduced Public Finance (State Sector Management) Bill will repeal the Fiscal Responsibility Act, but integrate its provisions into the Public Finance Act 1989. Business New Zealand has not yet had the opportunity to consider this proposal in detail, but we would be concerned if it were to result in any weakening of the existing fiscal policy framework, including the opportunity to submit on a BPS.

6. Forecasting

6.1 Business New Zealand continues to submit that officials should develop dynamic models to forecast the fiscal and economic impacts of changes in fiscal policy (e.g., tax rates or spending levels).

6.2 Business New Zealand made such a recommendation to last year's BPS. However, while the 'Ready Reckoner' on Treasury's website provides a basic indication of the immediate fiscal impacts of tax rate changes it does not allow for second order macroeconomic effects on growth and employment. Nor can it even model impacts on the operating balance (it can only model immediate change to gross revenue in response to a change in tax rates, not the flow-on impact on government spending).

6.3 Business New Zealand remains concerned that until such second order macroeconomic and fiscal effects are able to be modelled it remains all too easy for officials and Ministers to discredit any proposals for tax rate reductions on the grounds that they may put significant revenue at risk when the reality might be somewhat different.

6.4 *Recommendation: Business New Zealand recommends that officials should develop models to forecast the fiscal and economic impact of changes in tax rates.*

COMMENTS ON BUDGET POLICY STATEMENT 2004

The remainder of this submission comments specifically on the content of the Budget Policy Statement 2004.

7. Economic Outlook

7.1 Since the December 1998 quarter, the New Zealand economy has grown strongly, with nominal GDP growth averaging almost 3.8% per annum, or almost 2.8% per annum per capita[6]. This is a significant improvement on growth rates recorded in the 1970s and 1980s and should be an indication that the reforms of the 1980s and 1990s have been beneficial in providing a solid underpinning for higher growth rates and therefore improved living standards.

7.2 However, even ongoing annual GDP per capita growth of 2.8% is unlikely to be sufficient to improve New Zealand's OECD ranking in the medium term, an observation shared by the OECD in its most recent report on New Zealand[7]. This is a reflection of the large gap between the lower income OECD countries (including New Zealand) and those with middle and high incomes. To illustrate, New Zealand's GDP per capita is 84% of the OECD average and while GDP per capita of New Zealand (21st) and Spain (20th) are almost identical, the GDP per capita of the 19th ranked country (Germany) is *higher* than the OECD average.

7.3 Business New Zealand considers that a sustained annual per capita growth rate of around 4% is required if New Zealand is to make progress up the OECD rankings in the medium term – a significant 'stretch' on the status quo.

[6] According to Statistics NZ, GDP growth over the 20 quarters since December 1998 has averaged 0.94% per quarter, or 3.76% per annum. Over the same period, population growth has averaged 0.25% per quarter, or 1% per annum.
[7] *OECD Economic Surveys – New Zealand*, OECD, December 2003.

7.4 However, the Economic Outlook contained in this year's BPS provides little encouragement that there will be any such stretch on existing per capita growth rates. On the contrary, longer-term forecasts suggest that GDP growth will stabilise at around 3% per annum. Net migration is also assumed to fall, meaning that population growth will fall back to under 1% per annum. Taken together these factors imply a GDP per capita growth rate of around 2% per annum into the medium term.

7.5 Business New Zealand does not dispute the economic forecasts underpinning the BPS – they appear to be consistent with most other forecasters and with our own assessments of the economic and business environments. Our main concern is that a GDP per capita growth rate of 2% per annum will not be sufficient to close the gap in living standards with the OECD average let alone countries New Zealanders like to compare themselves with, most notably Australia.

7.6 The forecasts contained in the Economic Outlook provide further evidence of a need for the Government to ensure that its policies in all areas have an explicit productivity and growth promoting focus.

8. Fiscal Outlook

8.1 The strong economy over the past few years has been the main factor behind OBERAC ('operating balance excluding revaluation and accounting policy changes') increasing from virtually zero in 1999 to 4.3% of GDP for 2002/03. While the BPS predicts that OBERAC will fall slightly in 2003/04, it is nevertheless forecast to remain at around 3.7% of GDP in the out-years to 2007/08. These are significant improvements on the forecasts made at the time of the 2003 Budget.

8.2 For the year ended 30 June 2003, core Crown expenses plus New Zealand Superannuation Fund (NZSF) contributions were $42.95 billion, or 33.3% of GDP. By 2007/08, core Crown expenses plus NZSF contributions are forecast to rise to $54.28 billion, or 32.5% of GDP – a 26.4% increase in nominal terms.

8.3 The Government has been careful to portray itself as a 'prudent and careful fiscal manager' (despite core Crown expenses plus NZSF contributions having increased 24% since 1999/2000 and despite a further forecast 26% increase to 2007/08). As mentioned above, the strongly performing economy has helped the Government in this respect by providing it with large increases in revenue to cover its substantial spending increases. While its restraint in responding to calls to increase spending by even greater amounts has been admirable, the Government has still overseen a large increase in spending, at least some of which is of dubious or unproven value.

8.4 The improved fiscal outlook contained in the latest forecasts has provided encouragement for the Government to deliver a 'social dividend' to low and middle-income earners. While this intention is worthy, Business New Zealand considers there to be scope for tax relief for all New Zealanders, including businesses – particularly if the proportion of Government spending as a proportion of GDP were contained to below 30%.

9. Government's Fiscal Approach

9.1 The Government's fiscal approach is to run operating surpluses on average across the cycle sufficient to meet NZSF contributions while meeting capital pressures and priorities, and managing debt at prudent levels.

9.2 Business New Zealand agrees with this broad approach, with the main exception being the NZSF. We continue to hold the view that the previous scheme would have been sustainable had options been more actively pursued to:

- Adjust entitlements to the scheme to make it more affordable in the longer term (linking entitlements to changes in the average wage rather than the earlier inflation-adjustment was a move in the opposite direction);
- Reduce gross Crown debt, so reducing debt servicing costs and freeing up expenditure for other purposes;
- Reduce tax rates and remove barriers relating to the taxation of investment income, so encouraging higher levels of personal saving and business investment;
- Focus government expenditure on areas that will provide a higher level of economic growth (whereas the requirement to make substantial NZSF contributions reduces future spending options); and
- Implement policies focussed on increasing economic growth and labour force participation, so increasing the size of the economic pie that may be redistributed.

9.3 Business New Zealand remains concerned that the NZSF reduces options for both tax cuts and new expenditure. We are also concerned that it is causing a growing sense of complacency among the public about future levels of publicly provided retirement income and as a result is discouraging individuals from saving for their retirement. As in our previous BPS submissions, we submit that the NZSF should be abolished.

9.4 *Recommendation: Business New Zealand recommends that the NZSF should be abolished and reference to the NZSF should therefore be removed from the Government's fiscal approach.*

9.5 Because of the Government's intention to continue to run operating surpluses, expenditure levels will determine the amount of tax revenue required. According to a recent OECD report New Zealand now has the highest tax burden of non-European OECD countries[8]. This has significant implications for New Zealand's international competitiveness and its attractiveness as a destination for foreign direct investment and talented migrants.

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[8] *Tax Policy: Recent Trends and Reforms in OECD Countries*, OECD November 2003. Table 1 on page 12 of the report shows that New Zealand's total tax revenue as a percent of GDP has risen to 34.9% in 2002, similar to the OECD average, but overtaking Canada as the non-European OECD country with the highest tax burden.

9.6 Business New Zealand therefore submits that there should be an emphasis added to the Government's fiscal approach aimed at targeting core Crown expenses to be reduced to below 30% of GDP. This will in turn enable a reduction in the amount of tax revenue required as a percent of GDP.

9.7 It is important to recognise that setting a target for core Crown expenses of 30% of GDP would not necessarily result in cuts to the quantum of existing expenditure. We submit that such a target would be achievable simply by ensuring that spending increases at a rate slower than that of GDP and that existing spending is assessed to ensure that it delivers value for money and contributes to a growing economy[9].

9.8 To illustrate, if the growth forecasts in the BPS are achieved, meeting a spending target of 30% of GDP would result in core Crown expenses of $50.02 billion for the 2007/08 year[10]. While this would be around $4.26 billion less than the BPS forecast for that year, it would still amount to a 16.5% increase in spending on 2002/03. Abolishing the NZSF, as recommended above, would make the 30% of GDP target even easier to achieve by eliminating the need to make NZSF contributions of over $2 billion per annum.

9.9 *Recommendation: Business New Zealand recommends that the Government's fiscal approach should be amended to provide a target for core Crown expenses of 30% of GDP.*

9.10 An expenditure target of 30% of GDP would enable a reduction in the amount of revenue required – much needed considering New Zealand's high tax burden relative to non-European OECD countries. Business New Zealand advocates a lower tax burden and lower tax rates overall.

9.11 *Recommendation: Business New Zealand recommends that tax revenue as a proportion of GDP should be reduced and that tax rates should be reduced overall.*

9.12 While advocating for a lower tax burden and lower tax rates overall, Business New Zealand's priority is the reduction of the corporate tax rate to 20% by 2010. A lower corporate tax rate would be beneficial for international competitiveness and would help attract the foreign direct investment as well as the talented and skilled migrants the Government wishes to attract. Unfortunately though, New Zealand's 33% corporate tax rate is defying a consistent international trend of reducing corporate tax rates and as a result it is becoming increasingly uncompetitive, particularly against that of Australia[11].

9.13 *Recommendation: Business New Zealand recommends that the Government should, as a priority, reduce the corporate tax rate to 20% by 2010.*

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[9] A key problem for New Zealand, as illustrated by Arthur Grimes' study *Economic Growth and the Size and Structure of Government: Implications for New Zealand* (New Zealand Economic Papers, Volume 37(1), June 2003, is that its structures of both government spending and taxation are likely to be detrimental to its economic performance. Too much government spending is redistributive rather than productive.

[10] Assumes nominal GDP of $166.7 billion as forecast in Table 2.9 (page 44) of the BPS 2004.

[11] Please refer to *KPMG Corporate Tax Rate Survey*, January 2003 for more detail on how New Zealand's corporate tax rate compares internationally.

10. Long Term Fiscal Objectives

10.1 The Government's long-term fiscal objectives are unchanged:

- Operating surplus on average over the economic cycle sufficient to meet the requirements for contributions to the NZSF and ensure consistency with the long-term debt objective.
- Ensure sufficient revenue to meet the operating balance objective.
- Ensure expenses are consistent with the operating balance objective.
- Increase net worth consistent with the operating balance objective.
- Manage total debt at prudent levels. In the longer term, gross sovereign-issued debt below 30% of GDP on average over the economic cycle.

10.2 As discussed above, Business New Zealand broadly agrees with the Government's fiscal approach, with the exception that we believe the NZSF should be abolished. We also consider that there should be an expenditure target of 30% of GDP.

10.3 Consequently, Business New Zealand submits that the long-term fiscal objectives should also be amended to take these factors into account. We also agree with the comment in the BPS that the long-term target for gross sovereign-issued debt could be lowered. Business New Zealand submits that this target should be reduced from 30% of GDP to 15% of GDP.

10.4 *Recommendation: Business New Zealand recommends that the Government's long-term fiscal objectives should be:*

- *Operating surplus on average over the economic cycle sufficient to ensure consistency with the long-term expenditure and debt objectives.*
- *Ensure sufficient revenue to meet the operating balance objective.*
- *Ensure core Crown expenses are held below 30% of GDP on average over the economic cycle.*
- *Increase net worth consistent with the operating balance objective.*
- *Manage total debt a prudent levels. In the longer term, gross sovereign-issued debt below 15% of GDP on average over the economic cycle.*

11. Short-Term Fiscal Intentions

11.1 Business New Zealand submits that the Government's short-term fiscal intentions should contribute to the long-term fiscal objectives recommended above.

11.2 *Recommendation: Business New Zealand recommends that the Government's short-term fiscal intentions should contribute to the long-term fiscal objectives recommended above.*

12. Fiscal and Monetary Policy Risks

12.1 Business New Zealand agrees with the comment in the BPS (page 6) that there are constraints on the degree to which spending can be increased (or taxes cut) at a time when the economy is operating close to capacity. Too much additional fiscal stimulus can add to tensions on monetary policy and the current account. However, despite recognising this risk, the Government appears committed to increase spending by at least 26% in the years to 2007/08.

12.2 The BPS also expresses caution about assumptions of future revenue levels that might not come to fruition if economic growth falls by more than expected. On page 6 it warns, "too often, both in our history and abroad, we have seen so-called structural fiscal surpluses disappear very quickly".

12.3 In response to these notes of caution, Business New Zealand submits that the Government should do more to keep its spending under firm control, including ensuring that it gets good value for money from both existing and new spending. Adopting a spending target of 30% of GDP and ensuring that any new spending proposals are tested on the basis of quality and consistency with growth goals would help address concerns about uncertainty over future revenue levels and mitigate tensions between fiscal and monetary policy, while enabling a reduction in tax rates.

13. Budget Policies and Priorities for 2004

13.1 Business New Zealand notes that the Government plans to put in place around $1 billion in new operating spending in 2004 and out-years and increase spending by at least 26% in the years to 2007/08. We would prefer the Government to put its priority on tax rate reduction and getting more value from existing spending. We are concerned that new spending has been earmarked without any indication that it will be of high quality or consistent with a growth promoting focus.

13.2 We urge the Government to keep its operating spending under firm control, with any new spending proposals tested on the basis of quality and consistency with the goal of lifting New Zealand's rate of sustainable economic growth.

13.3 The BPS sets out the following broad priorities for the 2004 Budget:

- Lifting New Zealand's economic performance through growth and innovation;
- Improving opportunities and security for all New Zealanders;
- Building a strong public sector; and
- Capital expenditure in areas such as education, correction, housing, defence, and transport.

13.4 It would be nearly impossible for anyone to disagree with the importance of these broad priorities – they are all laudable objectives. However, while agreeing that they are desirable and worthy of the Government's attention, Business New Zealand is not convinced that the Government's approach is leading New Zealand in the right direction. In our view, we have yet to see the explicit growth promoting focus to all areas of policy that is needed to improve living standards to the extent necessary to catch up with the top-half of the OECD (let alone the top 10).

13.5 In particular, Business New Zealand notes that the OECD in its recent report on New Zealand[12] observed that past macroeconomic and structural reforms have contributed to stronger levels of economic growth but not enough to lift GDP per capita into the top half of the OECD. We agree that the key challenge is to boost productivity and that there are a number of residual weaknesses in fundamentals that need to be addressed if ambitions for higher levels of productivity and economic growth are to be realised. Some key points worth re-stating:

- The most promising strategy is to strengthen global linkages.
- There should be further regulatory harmonisation with Australia and other countries.
- The corporate tax rate should be reduced for domestic as well as foreign investors to help attract more foreign direct investment.
- There is still too much overlap and fragmentation of enterprise support and trade promotion programmes.
- The tax regime for research and development needs to be simplified.
- The Government should refrain from ‘picking winners’, with the film industry subsidy ‘representing an unfortunate precedent’.
- Regulatory reforms are needed to unblock infrastructure bottlenecks, especially in transport and electricity.
- Resource management processes need to be improved, with more weight placed on national interests.
- Immigration brings benefits and policy should be focused on attracting skilled migrants.
- Public and private tertiary education providers should be treated equally.
- The difference between incomes from welfare and work needs to be increased, with financial incentives combined with stricter eligibility and enforcement of the work test.
- Labour market flexibility should be preserved, with the report pointedly observing that recent changes have not been consistent with the Government’s goal of increasing per-capita incomes.
- Public spending discipline should be maintained and the Government should be cautious about new spending obligations.
- The privatisation process should be resumed.
- The end of the policy of pre-announcing three-year caps on new spending removed a visible constraint on spending pressures and the Government needs to find effective replacements.
- Strengthen fiscal management at local government level.
- There should be a greater reliance on economic/market instruments for environmental management.

13.6 *Recommendation: Business New Zealand recommends that the Government should adopt the recommendations made by the OECD in its 2003 Economic Survey of New Zealand.*

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[12] *OECD Economic Surveys – New Zealand*, OECD, December 2003.

14. Conclusion

14.1 While welcoming the Government's continued commitment to careful fiscal management, Business New Zealand is concerned that spending levels and the tax burden both remain too high – and are being signalled for further increases. We consider that more should be done to facilitate higher rates of productivity and economic growth. In particular, Business New Zealand submits that all policies should have a growth promoting focus, with all proposals being rigorously assessed first and foremost on their positive or negative impacts on productivity and economic growth.