

To Whither or Wither ?

Observations on the State of the Economy

(Page numbers refer to the pages of charts in the presentation)

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It is well known that over many decades New Zealand fell from having one of the highest per capita real incomes in the world to being virtually at the bottom of the developed country league table. Moreover, we have a long history of large external imbalances. Today the balance of payments current account deficit stands at the record level of about 9 per cent of national income.

Thus we are living big time off other people's savings and running up a large overseas debt, in this case owed by the private sector rather than (as in the past) by the Government.

This makes us vulnerable to external shocks and suggests a seriously overvalued exchange rate.

This is bad news for exporters but great for importers, at least in the short term. As even the most economically uninformed of us realize, there is a limit to how much one can sponge off the savings of others, and when the time comes for an adjustment to the realities of living within our means, the shock could be severe.

This situation has emerged despite considerable help from better terms of trade (the ratio of export to import prices); the vast improvements over the past decade or so in the overall stance of monetary and fiscal policies; and the resultant lowering of inflation and the pleasing decline in unemployment (although the latter is disconcertingly offset to a significant extent by a large rise in sickness beneficiaries). (See pages 2 to 4 of presentation)

After the extensive deregulation and consequent enhanced adaptability of the business sector in the mid eighties and early nineties, both small and large businesses became more agile and competitive. This contributed greatly to the substantial gains in productivity growth through the period up to 2000. Total productivity grew by 2.3 % annually from 1992 (after the introduction of the Employment Contracts Act) to 2000. During the past 15 years, New Zealand has thus transformed itself from a below average performer to an above average performer with respect to our rate of economic growth. (See page 5)

But closing the gap with other countries requires much more than this. To catch up to the average of the developed countries (the OECD) by 2015 would require annual economic growth of 3.4 % versus the 2.1 % achieved between 1997 and 2006. This looks impossible given current policies. (See pages 6 to 12)

Why is this ?
(See pages 13 to 26)

It is in part because we are in fact starting to go backwards again in relative terms. For example:

1. The Economic Freedom index is now on the decline for NZ after a period of increases. (Page 13)
2. Work stoppages are increasing again. (Page 13)
3. Hours worked per full time employee are going down. (Page 15)
4. Core public servant numbers are growing rapidly after declining through the nineties. (Page 14)

5. Crown spending is forecast to continue at very high levels relative to national income. (Page 15)
6. The overseas deficit is huge and persistent. (Pages 2 & 15 & 17)
7. Infrastructure investment has been falling, as shown by the declining ratios of capital stock to GDP; utilities GDP to economy-wide GDP; and soft investment intentions. (Pages 18 to 20)
8. Surveys show business is worried about high taxes, extensive regulation and the burden of compliance costs. (Pages 21 to 26)
9. Capacity utilization is at record levels (thus constraining future growth). (Page 20)
10. NZ's capital stock growth is lagging other countries; (Page 20)
11. New legislation and regulations are extensive, more than at any time in our history if judged by the number of pages of new laws; (Page 25)
12. The regulatory dilemmas are seen acutely in industries as diverse as electricity, building products, banking, telecommunications and our capital markets; and encompass markets as diverse as those for labour, carbon emissions, and capital. (Pages 27 to 32)

The problems with the plethora of new and extended regulations are multiple. Regulations beget regulations; they override commercial solutions; induce uncertainty; increase compliance costs; divert energy from competitive solutions to rent seeking activity; often concentrate on past problems rather than address future challenges; discourage offshore direct investors; result in company executives spending more time debating with government officials rather than dealing with customers; substitute regulators instead of company managers as decision makers, with few government officials having ever had any real

commercial experience; and generally inhibit business flexibility. (Pages 26 & 33 & 34)

The astonishing growth in the number of Government bureaucrats (Page 14) may be great for Wellington (which has now become the highest income per head town in NZ but sadly and not unrelated the town with one of the country's lowest growth rates), but it is bad news for the nation's economic growth. Productivity growth originates predominantly in the private sector not within the public sector. The former needs to grow to survive; the latter redistributes income rather than creating it.

The essential question is, has productivity (real output per person and per unit of capital) been increasing faster under the more regulatory policies of the past seven years ?
The answer, unfortunately, is no.

Since 2000, annual productivity growth has been just 0.7 %, which is about one third what we achieved between 1992 and 2000, at 2.3 %, and also much less than we recorded during the period some have called that of "the failed policies of the past", 1998 to 2000, when the number was 2.0 %. (Pages 4 & 5)

So how does the scorecard for the past few years look ?
The positives are reasonably sound monetary and overall fiscal policies, and a favourable terms of trade position. The negatives for business have been intrusive and extensive government regulation; high taxes; the growing relative size of government; an infrastructure mess; some weak social policies; a shrinking capital market; and constitutional issues (e.g. the absence of the right of appeal for many regulatory decisions, to say nothing of MMP).

The better growth performance has been driven by the world expansion, good commodity prices, and domestic productivity growth.

Productivity growth is based on stable macro policies (low inflation), reducing size of government, and deregulation (which promotes flexibility and adaptability). (Pages 36 & 37)

But over recent years we have had a larger government sector, extensive government interventions, poor government management of some of their own areas (who believes health or education or roads are well managed ?), huge and growing external imbalances, and multiple violations of property rights. All of these have contributed to the disappointing and sharp decline in productivity growth in New Zealand. This is why the business sector is so worried about the future prospects for New Zealand.

The solutions are complex. They involve much more respect for property rights, greater certainty in the application of the law and the enforceability of contracts, fewer changes in and less intrusive regulatory interventions, and lower taxes allied with a smaller government sector. (Pages 37 & 38)

It would be nice to think the Government and other political parties would appreciate the importance of these considerations rather than feel the need for ever increasing central control over so much of our lives.

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