TE TAI ŌHANGA
THE TREASURY

Bending two curves: New Zealand’s intertwined economic and fiscal challenges

Keynote address delivered by Iain Rennie, Secretary to the Treasury, to the 2025 New Zealand Economics Forum

Note: The speech as delivered may differ slightly from these notes.

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Introduction

It’s a pleasure to be here, to lay out a perspective from Treasury that contributes to the vigorous public policy debate that this conference has fostered in recent years.

The theme we’ve been reflecting on is unconstrained thinking in constrained times. It might be natural to think that the Treasury is more comfortable living in the second half of this conference theme. Constraints are our bread and butter, some might say, in that we will always say there’s not enough bread and too little butter.

There is always some truth to that, if you take the narrow perspective that economics is about scarcity and finance is about balancing the books. But my conviction is that Treasury can be at its best when we harness that natural caution today in the service of a sense of ambition for tomorrow.

Long-term economic and fiscal issues are intertwined

So I want to talk today about what it means to integrate fiscal and economic advice, with an eye to the long-term horizon. I will lay out the productivity and fiscal sustainability challenges that New Zealand faces. But I will also give you a sense of the broad solutions and policy toolkits that governments will have to contemplate over time to address those issues successfully, in the Treasury’s judgement.

The crux of my message today is that New Zealand needs to bend two curves. One is the long-term economic growth trajectory, which needs to bend upwards to expand our productive capacity and national real incomes. The second is our net public debt trajectory, which needs to bend downwards to rebuild the fiscal buffers that have been a major source of New Zealand’s resilience and ability to respond to shocks over recent decades. These are medium- and long-term challenges, but we need to address them soon.

The reason I'm focussing on addressing economic growth and fiscal sustainability is because these issues are intertwined. Achieving higher productivity means New Zealanders' real incomes will be rising over time, as will our national incomes and our ability to fund effective public services that citizens deserve. Rebuilding our fiscal resilience will be crucial to give ourselves the breathing space to address the long-term sustainability of current revenue and expense settings created by population aging. It will also give us confidence that we can weather the shocks we might be subject to in coming years and continue to invest in the things New Zealanders need.

And I do not believe these issues are in opposition to each other over the longer term. Productivity and fiscal sustainability aren't the only things that matter. However, I believe that a growing economy and a sustainable fiscal position can unlock a positive-sum dynamic in public policy debate, where we can think about different ways to share the burdens and seize the opportunities of a changing world. We know that New Zealand will continue to face the buffeting headwinds of global and domestic changes: technological, geopolitical, distributional, environmental, demographic. The Treasury hasn't lost sight of that broader canvas. That is the unconstrained thinking New Zealand needs. But today, I want to talk about how to confront the issues that might become constraints if they are not addressed.

Like any good independent financial adviser, our job is to advise about both today and tomorrow – balancing our focus between how we tackle today's pressing needs with preparing and planning to meet tomorrow's challenges and opportunities. I see it as a core part of the Treasury's role to be a thought leader, and contribute confidently to the public discussion on these matters. Throughout 2025, you can expect to hear a lot more from us.

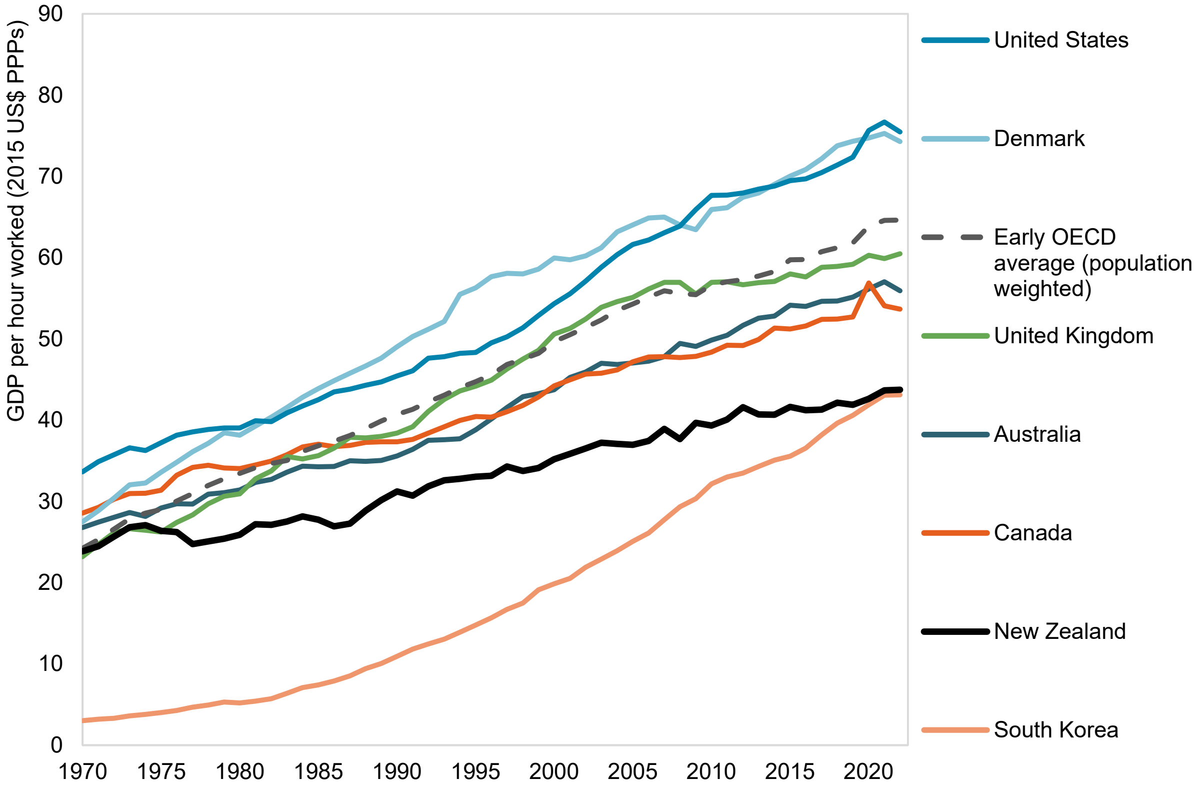
Three of our statutory stewardship documents will expand on the themes I introduce today. In coming months, we'll release the draft of our Long-Term Insights Briefing (LTIB) which will focus on sustainable and resilient fiscal policy over economic cycles. Later in the year our Long-Term Fiscal Statement will explore the implications of ageing and climate change for New Zealand's fiscal sustainability. And towards the end of the year, the Investment Statement will explore issues around the prudent investment and management of our balance sheet. Alongside this, we will continue to promote our research and perspectives on economic performance and policy as we always do, through our programme of speeches and publications.

Bending a curve up: Tackling the growth and productivity challenge

In recent years, most of the developed world has been experiencing a productivity slowdown, from which we have not been exempt.[1] But we also know that the underlying issues in New Zealand are longstanding. Labour productivity first fell significantly behind other advanced economies in the early 1970s and as of 2023, New Zealand was ranked 31st for GDP/hour of the current 38 OECD members.

[1] The Treasury (2024) *The productivity slowdown: implications for the Treasury's forecasts and projection*.

Figure 1: GDP per hour worked, 2015 US Dollars Purchasing Power Parity (PPP)



Source: OECD productivity database.

Note: Early OECD countries are defined as those who joined the OECD prior to 1975. This includes Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan,Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Türkiye, the United Kingdom, and the United States. Ireland and Luxembourg joined the OECD before 1975 but are excluded as outliers due to GDP measurement.

Over a long period of time, the Treasury[2] and many others[3] have diagnosed and analysed the causes of this decline. There are always nuances in how to interpret these matters, and you can’t replay the tape of economic history to test all the grand theories. But on the basis of our longstanding engagement with these debates, we are confident that we understand the basic problems.

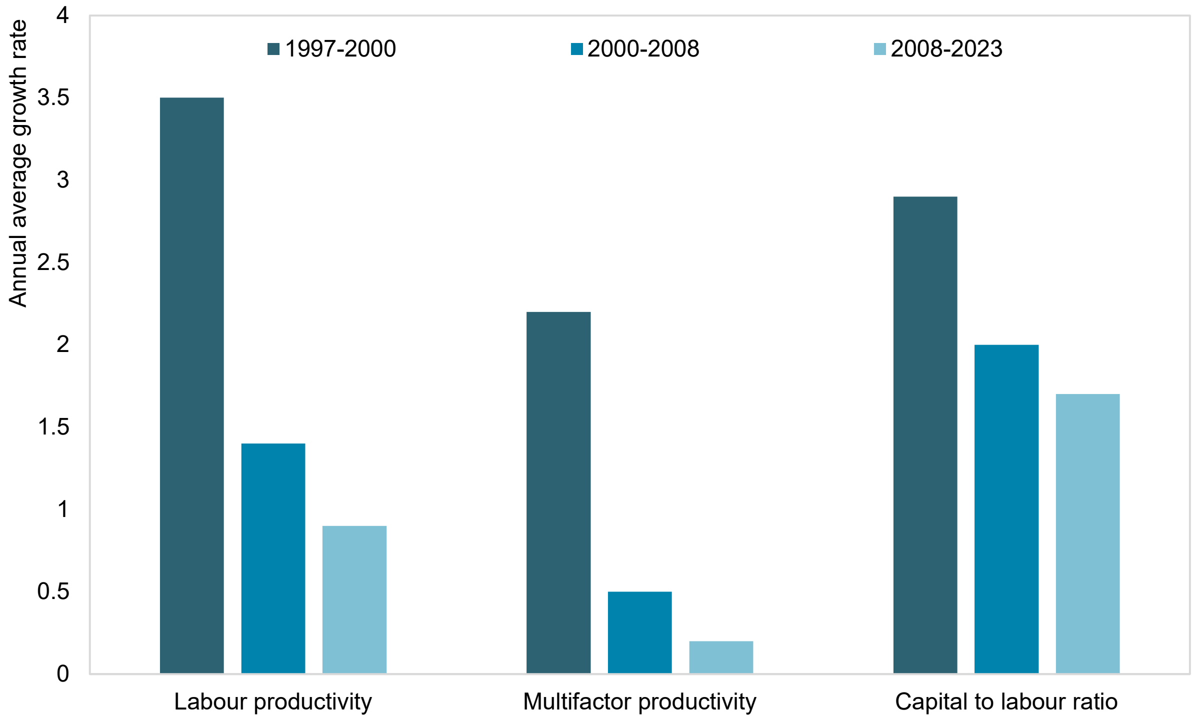
This understanding can be summarised well by applying a core economic framework known in the parlance as a ‘growth accounting framework’. To simplify this (with apologies to any growth theorists in the room!) the framework emphasises the supply side potential of the economy, and underlines that productivity growth emerges from the decisions firms and households make about how they efficiently use, invest in, and combine their capital goods and human capabilities. In the economic equations, these factors are referred to in shorthand: K – capital; L – labour; and MFP – multifactor productivity.

[2] For a selection of previous Treasury research and perspectives, see: The Treasury (2014) *Holding on and letting go: Opportunities and challenges for New Zealand’s economic performance*; Janssen, Galt and Bollinger (2022). *New Zealand’s Productivity Performance: Taking a Broader View*; The Treasury (2023); Galt (2023). *Examining New Zealand’s increased rate of income growth between the late 1990s and 2019;* The Treasury (2023). *Briefing to the Incoming Minister of Finance 2023.*

[3] For other perspectives, see: Productivity Commission (2023). *Productivity by the numbers*; OECD (2024) *OECD Economic Surveys: New Zealand*; Conway (2025). *Beyond the Cycle: Growth and interest rates in the long run.*

So applying this framework, what do we know? New Zealand's performance on these measures over the last three decades strongly suggests that slowing labour productivity growth is likely to reflect declines in the growth of the capital to labour ratio (capital intensity), and slowing growth in MFP and the ability to diffuse new innovations across the economy.[4] And while human capability has been a historical strength for New Zealand in our level of labour force participation and the skills of our people, there are some signs that these trends may be beginning to reverse.[5]

Figure 2: Sources of New Zealand productivity growth since 1997



Source: Stats NZ Productivity Statistics 1978-2023 measured sector.

Note: Labour productivity growth comprises growth in MFP and growth in the capital-to-labour ratio weighted by the capital factor share. Productivity statistics by growth cycle are published Stats NZ. A growth cycle is the span of years between adjacent peaks in economic growth.

This is only the barest summary of a complex reality, and today I don't want to dwell on diagnosis.

As you heard yesterday, the Government already has a significant economic reform programme underway. There are a number of focus areas in that plan which do tackle some of the deep productivity challenges, and successful implementation of the Government's programme is critical. In particular I would point to: effective resource management reform; refocussing the science sector; and lifting educational performance.

[4] The Treasury (2024). *The productivity slowdown: implications for the Treasury's forecasts and projection*

[5] The Treasury's Wellbeing Report, highlighted that New Zealand is one in a group of OECD countries in which the proficiency of our children in reading, science and mathematics has declined over the last 10 years, as measured by the OECD's Programme for International Student Assessment or PISA. The Treasury (2022), *Te Tai Waiora: Wellbeing in Aotearoa New Zealand 2022.*

What I want to highlight today are four areas where Treasury thinks further focus is warranted, and where a sustained improvement in the quality of the policy environment could really make an impact over the long term. Across these, there are a range of economic policy toolkits that the Government will need to consider.

Private Investment and Capital Intensity

New Zealand's low capital intensity is a key driver of our poor productivity performance. New Zealand has much lower levels of capital per worker than OECD peers we compare ourselves to. Increasing this ratio would mean workers can use more, and better, technology and tools to do their jobs, which will increase productivity. While investment has been on an upward trajectory since 2007, it has not kept pace with the expanding workforce.

A cause of this is likely to include New Zealand's high cost of capital which is in part due to relatively high tax rates on businesses, including on inbound investment, and high interest rates. Our taxation of investment is also uneven, which distorts investment choices. Such economic settings can discourage the acquisition of productivity-enhancing assets like machinery and equipment. This suggests that the policy responses are likely to include those that create an environment more conducive to firms making these investments. This could be through the structure of business taxation, savings policy, and regulatory frameworks that keep pace with business changes and create certainty for investment in emerging sectors.

Connections to the world

New Zealand, being small and remote, faces unique economic challenges including limited domestic competition, difficulties in scaling up businesses, and poor connections to global markets. These factors hinder the country's capacity to attract foreign direct investment (FDI), which is crucial for bridging the gap between national savings and investment needs—particularly important for improving capital intensity and addressing infrastructure deficits.

New Zealand's FDI stock is below the OECD average—38% compared to 50% in 2022—indicating room for growth through policy reform. During the late 1990s, New Zealand's FDI peaked at 59% of GDP, surpassing the OECD median at that time. Since then, New Zealand has experienced a decline in FDI growth, with an annual decrease of 0.5%, while the OECD's FDI has grown by 4% per annum.

Restrictive regulatory frameworks, such as the Overseas Investment Act 2005, may partially explain New Zealand's low levels of FDI. However, the consistent flat rate of FDI across various investment types since the early 2000s suggests that reforming the OIA alone may not be enough. Attracting significant foreign investment requires creating a favourable investment environment, which includes competitive tax settings, a positive general business climate, and an available skilled workforce.

Innovation and the diffusion of new technology

The development and adoption of new ideas and technologies is a driver of growth. Yet New Zealand business spend on R&D is low compared to our peers, and we could do better at commercialising new inventions. Additionally, New Zealand firms on average tend to be slow to adopt new ideas and technologies from overseas. While there are some highly innovative pockets of the New Zealand economy, these can struggle to reach critical mass. The challenge for policy is working out how best to multiply, broaden, and deepen those pockets of innovation.

Evidence suggests that New Zealand has poor innovation outcomes relative to the countries we compare ourselves to. Our most productive “frontier firms” were less than half as productive as the frontier firms of other Small Advanced Economies in 2016.[6] Competition is one of several factors that can contribute to lifting innovation.

Regulation and the competitive environment

New Zealand is geographically remote with small, highly concentrated markets. Our markets are often subject to weak competitive discipline and prices are high by international standards. Competitiveness requires good competition law and enforcement, but it goes much broader than that. Broader policy and regulatory settings could further business dynamism and productivity in the economy.

Improving market and infrastructure settings and maintaining up-to-date and well-performing regulatory systems can give firms more confidence to invest, innovate and grow. Regulatory systems that are clear, stable, proportionate, and well implemented create certainty for businesses, encouraging investment and innovation. Overly restrictive regulation, or regulation that is poorly designed and implemented, can create unnecessary costs and be a barrier to new firms wanting to enter a market.

Bending our productivity growth curve upwards is an ambitious goal and an effort that will need ongoing focus and adjustment. New Zealand is blessed with fantastic human capability, business acumen, and natural resources. Our challenge is to help the country work smarter, and there is no reason why this isn’t an appropriate aspiration for New Zealand.

Bending a curve down: Rebuilding fiscal resilience and closing the structural deficit

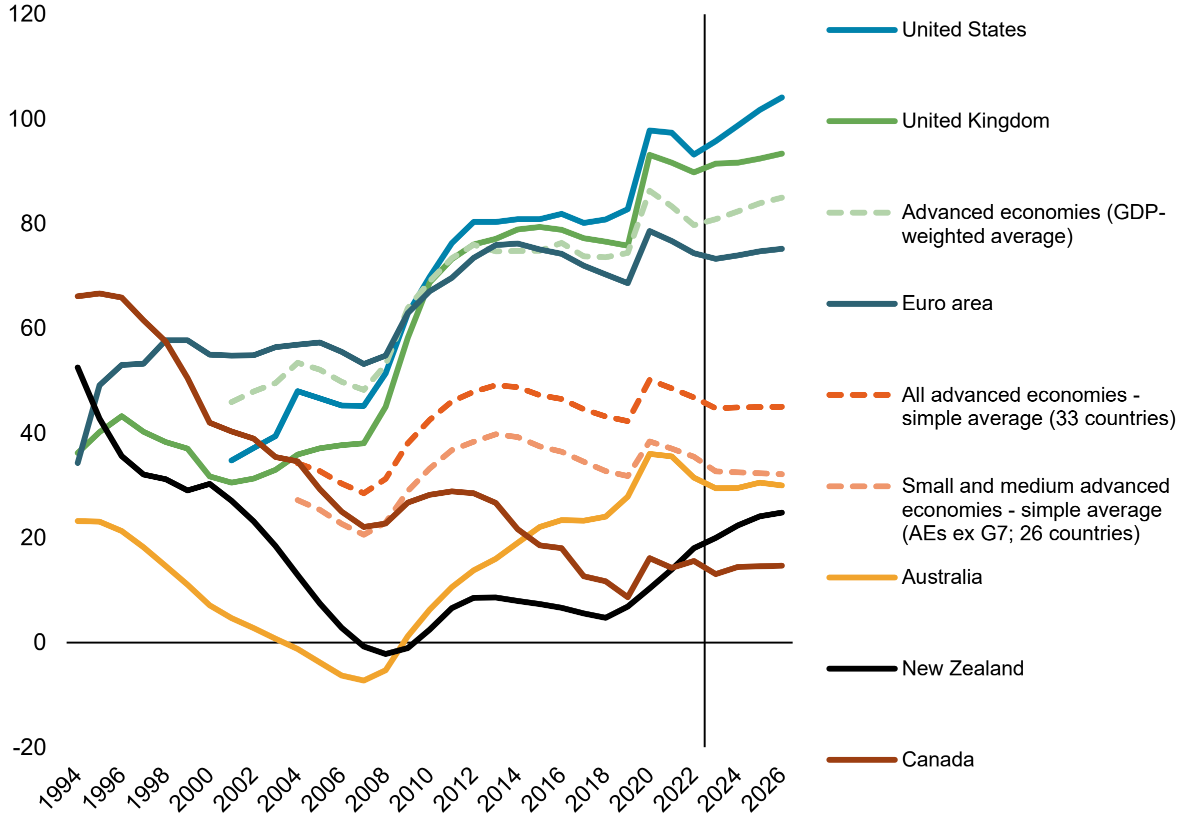
Moving then from economic policy to fiscal policy, and the curves we need to bend downwards. New Zealand has had a strong track record of fiscal discipline since the 1990s, with debt levels falling significantly since the reforms were made to the fiscal institutional framework. New Zealand’s debt levels remain well below the historically elevated levels seen in major economies such as the United States, United Kingdom and Euro Area.

However, public debt as a percentage of GDP in New Zealand has risen from its low in 2008 to near the average levels of debt seen in other small and medium-sized developed nations (figure 3). In simple terms, one could say that it is not true that New Zealand is a high debt country; we aren’t a very low debt country anymore either.

[6] New Zealand Productivity Commission (2021) New Zealand firms: Reaching for the frontier. Final report.

Why has this happened? The short answer is that we have gone through several decades of successive shocks, and successive Governments have used the Crown fiscal headroom to help New Zealand respond and bounce back. So debt levels have ratcheted upwards following the Global Financial Crisis in 2008, the Canterbury Earthquakes and COVID-19. The overall fiscal cost of the earthquakes and the pandemic alone have been estimated at approximately 10% and 20% of GDP, respectively.[7] And, although there have been efforts to repair the resulting fiscal deficits, the long-term average for the operating balance has reduced significantly over this period.

Figure 3: General Government net debt (IMF measure, % of GDP)



Source: International Monetary Fund, World Economic Outlook Database, October 2024.

Though we will never be able to predict specific shocks, our fiscal strategy should expect that we will confront major shocks of some form. A reasonable starting point is that the fiscal cost of future shocks will be broadly in line with recent history, resulting in a fiscal cost of 10% of GDP per decade.[8] There is always a matter of judgement on what the prudent level of debt is, and how to balance that against prudent investment. But the Treasury's clear view is that fiscal consolidation is required to build resilience against the shocks and cycles we are likely to face in future decades.

[7] See note 24 to the 2017 Budget Economic and Fiscal Update, which has been updated to reflect the latest estimates of the cost to the Earthquake Commission. The IMF has estimated that New Zealand's discretionary response to COVID-19 equated to 21.3% of GDP, primarily because of additional spending and foregone revenue, see IMF (2021), *Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic*.

[8] There are some areas where structural changes may increase future risk, including the impacts of climate change and an evolving geopolitical environment. The forthcoming LTIB will include in-depth analysis of the shocks and cycles that New Zealand will face in the future, and how they might compare to historical experience.

The Treasury's view is informed by chronic pressures on the sustainability of public finances, in addition to the pressure from acute shocks. As set out by the Treasury in successive Long-term Fiscal Statements, an ageing population is projected to result in substantial increases in expenditure on superannuation and healthcare, if current policy settings are maintained. In addition, increased expenditure is likely required to address New Zealand's long-standing infrastructure deficits, and to ensure that the stock of assets is well maintained.

Ultimately, this requires a period of sustained operating surpluses over the medium-term. New Zealand is currently running a structural operating deficit of more than 2% of GDP. This means that, after stripping out the effects of economic shocks and the business cycle, the underlying trends in operating expenditure exceed incoming revenue. The Treasury estimates that the Government has been in structural deficit since 2019/20, and at the Half Year Economic and Fiscal Update (HYEFU) we forecast that this situation will continue until 2028/29.

So this is a problem. Our public debt right now is not troublingly high, but action is needed to address structural deficits and respond to medium-term fiscal pressures associated with an ageing population.

The current Government has committed to concrete steps to address structural deficits. This will involve ongoing and significant reprioritisation of spending to maintain expenditure within forecast operating allowances. The Treasury will support the Government to implement this strategy, as part of our core role in leading the Budget process across Government. And of course it is critical that this reprioritisation supports more efficient delivery of public services over the long-term.

But what I want to emphasise today is that based on what we know about the longer-term trends and experience from other countries, simply limiting spending growth in the short term and delivering existing services more efficiently will not be enough. Achieving medium-term fiscal sustainability will require choices by successive governments, which looks at the underlying policy settings that are the sources of growing cost pressures and transfer spending, or considers more sustainable ways to fund them.

Past consolidations have tended to require sustained effort; and have typically required a mix of policy measures to increase revenue, reform transfers and subsidies, promote efficient use of the Government balance sheet, and reduce government consumption. Consistent with the lessons learned from past consolidations, the Treasury's focus is on ensuring that the consolidation has an enduring impact on fiscal sustainability, while supporting long-run economic performance.[9]

This will require integrated fiscal and economic strategy advice that considers how different consolidation options will impact on long-run economic performance, and how to manage situations where levers to bend the economic curve, such as changes to tax settings or to increase public investment, could have an impact on our ability to bend the fiscal curve. Keeping visibility of the intertwined economic and fiscal challenges is necessary to ensure that policy is coherent and well-aligned.

[9] For an overview of the lessons learned from past consolidations, see IMF (2023). *Fiscal Consolidations: Taking Stock of the Success Factors, Impact, Design.*

Table 1: Outcomes from historical fiscal consolidations

Factor	Conclusion
Scale	On average consolidations reduced expenditure by almost 6% of GDP, supported by specific expenditure measures announced during the consolidation period equating to almost 8% of GDP.
Pace	Typically, consolidation happened at a rate of 0.7% of GDP per annum over a 9-year period.
Measures	The average consolidation relied on a mix of measures to increase revenue (39%), reform transfers and subsidies (32%), and reduce government consumption (29%).
Context	Fiscal consolidations are much more likely to be successful when the economic environment is supportive, as was the case during the post-GFC consolidation in New Zealand.

Fiscal consolidations reviewed were those motivated by a desire to reduce budget deficits and/or debt, and include the New Zealand post-GFC consolidation, Australia (1993-1997), Belgium (1981-2007), Canada (1985-1997 and 2010-2015), Finland (1992-1998), United Kingdom (1993-1998 and 2009-2020), Sweden (1993-2001), Denmark (2009-2015) and Finland (2010-2015).

Governments over time will differ in their priorities across the relative balance of expenditure changes, revenue reform, and use of the Crown's balance sheet.

The trade-offs are complex – for example, decreasing expenditure can risk decline in service quality and/or large distributional impacts on affected groups, while measures to increase revenue can negatively impact long-run economic performance. So it is right for the broader public to understand what those are and for views to differ on how to tackle them across the political spectrum.

Through its stewardship work, the Treasury has a core role in informing that debate. New Zealand needs a secure understanding of the scale of the challenge and the options that will need to be on the table. The choices aren't easy. However, inaction itself is a choice. And the cost of inaction is it tightens the policy constraints over time. This can mean that the trade-offs become sharper and the adjustments more drastic than need to be.

Concluding remarks

I've focused today on the Treasury perspectives, trying to be open about the way we see the world and contribute to a debate about unconstrained thinking. But of course, we will always have a primary responsibility to serve the Government of the day. When it gets down to specifics, you can be assured that our policy advice to Ministers will be free and frank, but also that we will support the implementation of their decisions and priorities.

Governments need to make progress in the here and now. Our job is to advise them on which pathways are the best to start walking down. We do think hard about a coherent programme, drawing on evidence and judgment but also remain mindful of the uncertain connections between policy changes and policy outcomes when you look out over the horizon. Over time governments will choose to stride faster or slower down those paths. The important thing is to keep taking those steps and maintain momentum across a broad front of economic and fiscal policy frameworks.