Submission

By

Business|NZ

To

Finance and Expenditure Committee

On the

Budget Policy Statement 2003

3 February 2003

PO Box 1925
Wellington
Ph: 04 496 6555
Fax: 04 496 6550

BUDGET POLICY STATEMENT 2003

SUBMISSION BY BUSINESS NEW ZEALAND

3 FEBRUARY 2003

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 49-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) 2003. While welcoming the Government's continued commitment to careful fiscal management, we are concerned that the tax burden remains 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 3.9% for the year ended September 2002, our population grew by 1.6%, causing GDP per capita to rise by only 2.3%. 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 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 growth;

(b) Officials should develop dynamic models to forecast the fiscal and economic impact of changes in tax rates;

(c) The New Zealand Superannuation Fund should be abolished;

(d) The Government's intention to 'make tax treatment of superannuation more equitable' should be a high priority;

(e) The Government should maintain budget surpluses through exercising firm control over operating spending while reducing tax rates, particularly the company tax rate;

(f) The target for core Crown expenses (plus NZSF contributions) should be reduced from 35% of GDP to 30% of GDP;

(g) The Government should lower tax rates, with a priority on reducing the company tax rate for all businesses over time from 33% to 20%;

(h) The target for gross sovereign issue debt should be reduced from 30% of GDP on average over the economic cycle to 15% of GDP by 2010;

(i) Increasing net worth should be achieved through reducing debt rather than building on NZSF assets; and

(j) The Government should legislate for a Regulatory Responsibility Act to complement the Fiscal Responsibility Act 1994.

3. Growth as *the* Priority

3.1 Delivering a strong and growing economy, which can sustain a socially cohesive society, requires the adoption of a balanced, credible growth strategy. The Government's *Growth and Innovation Framework (GIF)* is a useful strategy statement in that it sets a goal of lifting New Zealand's OECD ranking and identifies the importance of innovation as a growth driver. However, we consider that the Government's primary focus on encouraging innovation in three 'chosen' sectors[2] is insufficient on its own to lift New Zealand onto a higher path of sustainable economic growth.

3.2 The 2002 Budget continued along much the same theme as the GIF strategy in focussing on innovation. While the Budget was fiscally prudent and had a number of useful initiatives (particularly in research, education and skills development, and broadband roll-out), we are concerned about the abolition of the fiscal cap and the impact of the Super Fund on future spending pressures. As a result, it is now unlikely that the level of government spending as a proportion of GDP will fall to below 30% in the short to medium term (this is important as the level of government spending generally provides the best overall measure of the tax burden).

3.3 Business New Zealand warmly welcomed the statement in the Governor General's Speech from the Throne, on the opening of the 47th Parliament on 27 August 2002, which said:

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

3.4 While Business New Zealand is pleased that the Government is talking about the need for a higher rate of economic growth, there has been little evidence to date that it is moving to implement or prioritise a credible growth strategy and policy direction that would spur the economy onto such a higher growth path. To date, a number of key policy decisions have at best merely confirmed the low-growth status quo or at worst have been in the wrong direction and damaged New Zealand's growth potential.

3.5 We also note the results of a recent survey of business leaders carried out by the New Zealand Herald, which found that only 5% of respondents thought the Government had a credible strategy for economic growth[3].

3.6 Meanwhile, the OECD in its 2002 review of New Zealand said that policies in all areas must have a growth promoting focus if higher living standards are to be achieved[4]. The OECD commented that there is often a conflict between growth promoting policies and initiatives and those that seek primarily to regulate activity and/or redistribute income. We agree with this assessment.

---

[2] The three sectors identified in the GIF as being of high priority are biotechnology, creative industries, and information and communication technology.
[3] *New Zealand Herald*, 'What our Chief Executives Think', 29 November 2002.
[4] *OECD Economic Survey of New Zealand*, OECD May 2002.

3.7 Business New Zealand submits that it is now time for the Government to focus on building the foundations for a strong and growing economy, without which desirable social and environmental outcomes would not be possible. For growth to truly become a priority, there must be 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.

3.8 *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 growth.*

4. Business New Zealand Growth Strategy

4.1 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.

4.2 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.

4.3 In December 2001 Business New Zealand released its *Changing Gear* growth strategy and we assess all policy and legislation on consistency with the growth strategy. A copy is attached as Annex 1 to this submission. Those key growth priorities with direct relevance to this submission include:

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

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.*

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

5. Fiscal Policy and Economic Growth

5.1 Responsible fiscal policy plays a critical role in fostering sustainable economic growth. Business New Zealand therefore strongly supports the Fiscal Responsibility Act 1994 and the obligations imposed by the Act on the Government as they 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.

6. Economic Outlook

6.1 Since the December 1998 quarter, the New Zealand economy has grown relatively strongly, with nominal GDP growth averaging 3.6% per annum and real GDP per capita averaging 2.7% per annum[5]. This four-year period has been one of New Zealand's longest sustained economic expansions in recent times, and Business New Zealand considers that it is evidence that the reforms of 1980s and 1990s have been beneficial in providing a solid underpinning for higher growth rates.

6.2 However, there was also a combination of favourable external factors (notably relatively high commodity prices, good growing conditions, and generally low exchange and interest rates), which resulted in New Zealand experiencing particularly strong export growth in 2000/01, boosting incomes and stimulating domestic demand. Unfortunately, these external factors are now considerably less favourable than they were previously, and this has been translated into a weakening export performance since late 2001. Conventional wisdom suggests that this should sooner or later impact upon domestic demand.

6.3 To date, the domestic economy has been cushioned though by strong population growth of 1.6% in the year ended September 2002[6], with the main contributors being higher inwards migration and lower outwards migration. Population growth has helped underpin the domestic economy, through strong retail and housing sales, at a time of external weakness, but it is also very important for long-term economic growth prospects by increasing the supply of labour. If migration inflows fall in 2003, this is likely to impact upon domestic demand and dampen economic growth prospects.

6.4 Taking all these factors into account, the consensus among economists and financial markets (a view which seems to be shared by Treasury forecasts in its December Update) is that New Zealand's GDP growth rate will probably peak in the March 2003 quarter at around 4% and then fall away to between 2-3% by the end of the year (i.e., only 1-2% when translated into per-capita GDP growth), with much depending on the performance of the international economy and geo-political developments.

6.5 It is significant that unlike previous slowdowns there are as yet few if any credible forecasts of a 'bust' – the 1980s and 1990s reforms should be given more credit for improving New Zealand's economic fundamentals and lifting overall economic performance.

6.6 However, Business New Zealand submits that any lower growth scenario will make it difficult to achieve a higher OECD ranking in the medium term and adds urgency to the need for the Government to ensure that its policies in all areas have an explicit growth promoting focus and at the very least 'do no harm'.

---

[5] Seasonally adjusted GDP chain-volume series expressed in 1995/96 prices and National Population Estimates, Statistics NZ. Since December 1998, nominal GDP growth has averaged around 0.9% per quarter (3.6% annualised), and population growth has averaged around 0.2% per quarter (0.9% annualised).

[6] National Population Estimates, Statistics NZ.

7. Forecasting

7.1 Economic forecasts form the basis for the Government's estimates for fiscal-outturns and judgements for spending intentions for the 2003 Budget and beyond. Therefore they are very important tools for the conduct of both fiscal and monetary policy.

7.2 Business New Zealand has been concerned, however, with a lack of dynamic modelling to forecast 'flow-on' revenue and expenditure impacts resulting from increases or reductions in tax rates. We are concerned that officials make assumptions based on a static forecasting model, which cannot model the dynamic impacts of a lower tax rate on increased economic activity caused by higher investment, employment, etc that in turn leads to higher tax revenues from company tax, personal income tax and GST.

7.3 In 2001, Business New Zealand and EMA (Northern) contracted economic forecaster Infometrics to model the economic and fiscal impacts of a 20% company tax rate. Treasury responded by criticising some of the assumptions behind the Infometrics model, but offered no alternative. While we accept that developing a credible dynamic model could be difficult, our view is that until dynamic effects are properly modelled it will remain too easy for officials and Ministers to discredit any proposals for tax rate reductions on the grounds that they might 'put significant revenue at risk', when the reality may be somewhat different.

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

8. Specific Comments on the Budget Policy Statement 2003

8.1 Business New Zealand welcomes the opportunity to comment on the Budget Policy Statement (BPS) 2003, the objective of which is to provide an overview of the Government's approach to the upcoming Budget.

8.2 While generally agreeing that the Government is continuing to be a careful 'fiscal manager', Business New Zealand is concerned about a number of issues that must be urgently addressed if New Zealand's economy is to grow to the extent required to achieve the Government's goal of moving New Zealand back into the top-half of the OECD in terms of per capita income, particularly when the prospects for growth are becoming less favourable. In particular, we are concerned that Government spending and revenue as proportions of GDP are forecast to remain at levels that will require a continued high tax burden, so stifling our economic growth prospects.

8.3 The remainder of this submission comments specifically on these issues.

9. Government's Fiscal Policy Approach

9.1 With one notable exception, Business New Zealand agrees with the broad principles behind the Government's fiscal policy approach, which is to:

- Run operating surpluses on average across the economic cycle sufficient to meet New Zealand Superannuation Fund (NZSF) contributions;
- Meet capital pressures and priorities; and
- Manage debt at prudent levels.

9.2 The exception is the NZSF, where we remain unconvinced about its value and sustainability. Our view is 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 levels 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 particularly concerned about the potential for gross Crown debt to increase in order to fund NZSF contributions, which are forecast to reach around 1.6% of GDP per annum by 2006. The NZSF reduces options both for tax cuts and new expenditure, options that might be less risky than investing large sums of taxpayers' money in volatile equity markets. As in our submission to BPS 2002, we submit that the NZSF should be abolished.

9.4 *Recommendation: Business New Zealand recommends that the NZSF should be abolished.*

9.5 On the positive side, Business New Zealand is encouraged that the Government has signalled in the BPS that it intends to 'make tax treatment of superannuation more equitable'. We eagerly await developments in this area and hope that consensus can be reached on this important issue.

9.6 *Recommendation: Business New Zealand recommends that the Government's intention to 'make tax treatment of superannuation more equitable' should be a high priority.*

10. Fiscal Targets

Operating Balance Target

10.1 The Government's target is for an operating surplus to be sufficient over the economic cycle to meet NZSF contributions and be consistent with the long-term debt objective. According to the BPS forecasts, the Government should not have any difficulty achieving this target.

10.2 However, Business New Zealand is concerned that the requirement to meet NZSF contributions (forecast to reach 1.6% of GDP per annum by 2006) reduces options for reduced tax rates or other growth-enhancing spending alternatives, particularly if weaker economic conditions cause surpluses to be less than forecast in out-years.

10.3 We also note that the forecast surpluses grow steadily, reaching 3.5% of GDP by 2006. Even allowing for NZSF contributions this would be a large surplus by New Zealand standards. In the past when similarly large surpluses have been forecast (notably in the mid-1990s), Governments of all persuasion have been quick to relax and increase spending. Business New Zealand would be most concerned if these positive forecasts were to result in operating spending as a percent of GDP to rise.

10.4 If the Government is to consider reducing the operating balance, Business New Zealand submits that the priority should be on reducing tax rates. If the BPS forecasts are to be believed it seems likely that a lower company tax rate and lower personal income tax rates for all could be achieved without seriously compromising the operating balance, even when continuing to make NZSF contributions. There is more discussion on lower tax rates below under 'Revenue Target'.

10.5 *Recommendation: Business New Zealand recommends that the Government should maintain budget surpluses through exercising firm control over operating spending while reducing tax rates, particularly the company tax rate.*

Spending Target

10.6 The Government's spending target is for core Crown expenses (plus NZSF contributions) to average around 35% of GDP. According to BPS 2003, core Crown expenses *plus* NZSF contributions are forecast to rise from an actual 31.5% of GDP in 2002 to 32.4% in 2003 before tracking downwards to 31.6% in 2007.

10.7 In light of this forecast, it is difficult to understand why the Government has set its target for its expenses target at 35%, unless it is to give it room to significantly increase spending in out-years. Business New Zealand submits that core Crown expenses as a percent of GDP should be targeted to fall below 30% by 2005 by ensuring that spending grows at a rate slower than that of GDP. This does not imply a reduction in nominal spending.

10.8 *Recommendation: Business New Zealand recommends that the target for core Crown expenses (plus NZSF contributions) should be reduced from 35% of to 30% of GDP.*

Revenue Target

10.9 The Government's revenue target is for tax-to-GDP to remain at 'around current levels' (i.e., 33% if using core Crown revenue, or 42% if using total Crown revenue). According to BPS 2003, tax-to-GDP is forecast to increase over the period, despite no change in tax rates being signalled. Again, we consider this target to be set too high, and in the light of large surpluses that are forecast (even when taking account of NZSF contributions), Business New Zealand submits that tax rates should be reduced.

10.10 While advocating lower tax rates overall, Business New Zealand's view is that the company tax rate should be reduced as a priority. We submit that a steady reduction in the company tax rate to around 20% in the medium term would be beneficial for international competitiveness and business investment, while not impacting detrimentally on the Government's overall fiscal position[7].

10.11 Maintaining New Zealand's international competitiveness is behind Business New Zealand's calls for a lower company tax rate. In August 2002 the Australian Treasurer released a consultation paper reviewing its international taxation arrangements. KPMG Australia described the direction of the paper as 'pro investment, pro-growth, and pro-business' although it also noted that more reform would be needed to 'catapult Australia to regional competitive leadership'[8]. Australia has also reduced its company tax rate over the past few years from 36% to 30%, a rate that is now lower than New Zealand's. Meanwhile, Singapore is cutting personal and company tax rates to a maximum of 20% because it fears becoming unattractive as an investment location[9].

10.12 The contrast with New Zealand could hardly be starker. While it is true that New Zealand does not have the high additional payroll taxes that are a feature of many other OECD countries, the headline rate of company tax is nevertheless an important consideration for investors. In this respect, New Zealand fares poorly. Whereas in 1988 a 33% company tax rate was highly competitive, the advantage has been steadily eroded over time, so much so that by 2002 New Zealand's company tax rate is now higher not only than almost all Asia-Pacific countries, but also the averages for the OECD and even the EU[10]. The international trends are clearly working against New Zealand retaining a 33% company tax rate.

10.13 The Government should also be very careful about comparing New Zealand's tax burden with the OECD average or individual European countries. Our major trading partners and competitors for investment are mainly in the Asia-Pacific region. These countries generally have significantly lower tax rates and tax burdens than New Zealand.

---

[7] This view is backed up by Business New Zealand's 2002 election survey, which found that 69% of members supported reducing the corporate tax rate to 20% by 2010, with 23% opposed (most of those opposed wanted the rate cut to 20% by earlier than 2010 or to a lower rate by 2010).
[8] *International Tax Review*, KPMG Australia advisory note, August 2002.
[9] *Lifting Our Act Means Growth Must Come First*, by Dr Murray Horn, NZ Herald, 29 November 2002.
[10] *KPMG Corporate Tax Rate Survey*, January 2002.

10.14 Business New Zealand is confident that reducing the rate of company tax would not result in significant revenue loss to the Government simply because company tax is primarily a withholding tax. That is, income tax paid by companies is attributed to shareholders in so far as profits are distributed as dividends. Shareholders can use the associated imputation credits to reduce their personal tax payments, but the tax paid by companies on their behalf is seen as the individual's tax liability.

10.15 Dividends attract imputation credits, but these would be worth less if the company tax rate were cut, so leaving shareholders to pay more personal income tax at whatever their marginal rate. Reducing the company tax rate should therefore increase the revenue collected from personal income tax.

10.16 The only leakage would be for those situations where imputation credits are not being utilised, most notably non-resident shareholders. However, we note that our relatively high company tax rate provides a significant disincentive to declare taxable profit in New Zealand. Reducing our company tax rate to be more competitive with other Asia-Pacific countries should reverse this disincentive and result in substantially more income being declared here – more than offsetting any short-term revenue loss from a lower company tax rate.

10.17 Furthermore, if companies receive a tax cut, they are more likely to 'save' the cut by investing in new plant and equipment, which should in turn increase their future potential output – surely a potent lever to lifting New Zealand's rate of sustainable economic growth. Also, the business sector is already a significant source of 'savings' in the economy and we believe that reducing the company tax rate would increase these savings further, so helping to lift overall national savings.

10.18 A further argument in favour of reducing the company tax rate is the consequential relief in provisional tax payments, particularly for small-medium sized enterprises in their start-up stages. We are aware of many cases where small companies have made a profit in their first year of business but then struggle with their cash flow to make what can be relatively large provisional tax payments in relation to the size of their business and then being liable for penalty tax. While we are aware and welcome the IRD investigating ways to better align provisional tax payments with income patterns, compliance for small business would be made easier if the company tax rate was 20% as opposed to 33%.

10.19 Overall, we submit that higher business investment and subsequent economic activity generated by a cut in the company tax rate would ultimately result in higher taxable incomes (both corporate and personal). Increased job growth would also reduce transfer payments, so reducing Government expenses.

10.20 *Recommendation: Business New Zealand recommends that the Government should lower tax rates, with a priority on reducing the company tax rate for all businesses over time from 33% to 20%.*

Debt Target

10.21 The Government's debt target is for gross sovereign issue debt to be below 30% of GDP on average over the economic cycle and for net debt (including NZSF assets) to fall towards 0% of GDP by 2010. This contrasts with Business New Zealand's target of gross debt falling to 15% of GDP by 2010.

10.22 The Government appears to be making reasonable progress with its debt targets, although it rightly points out that deviations in the operating balance would have significant impacts on debt. Gross sovereign issue debt is forecast to fall from 29.6% of GDP in 2002 to 24.5% in 2006, although we note that the nominal amount is forecast to remain unchanged in absolute terms (at around $36 billion).

10.23 Business New Zealand submits that failing to reduce the absolute level of debt could be risky, particularly if actual surpluses in out-years are less than forecast. Rather than investing up to 1.6% of GDP per annum in the NZSF, the Government should instead put priority on reducing gross debt in absolute terms, to around 15% of GDP by 2010.

10.24 *Recommendation: Business New Zealand recommends that the target for gross sovereign issue debt should be reduced from 30% of GDP on average over the economic cycle to 15% of GDP by 2010.*

Net Worth Target

10.25 Business New Zealand is comfortable with the Government's target for net worth (that it should increase consistent with the operating balance objective), and we agree that there should be a focus on quality investment. However, we disagree that the target should be achieved through building on NZSF assets rather than reducing debt for the reasons expressed above.

10.26 *Recommendation: Business New Zealand recommends that increasing net worth should be achieved through reducing debt rather than building on NZSF assets.*

11. New Fiscal Management Approach

11.1 In the 2002 Budget the Government announced it would be using a new fiscal management approach. Rather than setting a three-year spending limit, the Government has decided to manage spending through greater focus on and regular view of the operating balance and gross-debt tracks.

11.2 While Business New Zealand accepts that this approach would appear to be prudent, we are concerned that abolishing the 'fiscal cap' could potentially weaken fiscal discipline. We will be watching closely to ensure that the absence of a spending limit does not result in spending rising as a percent of GDP.

12. Budget Policies and Priorities for 2003

12.1 Business New Zealand notes that the Government plans to put in place around $1 billion in new operating spending in 2003 and out-years. 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 additional spending has been earmarked without any indication that it will be of high quality or consistent with a growth promoting focus. That the Government does not intend to increase new spending by much more than what was indicated in the Pre-Election Update (despite a healthier operating balance than earlier forecast) is of only small comfort.

12.2 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.

12.3 We also note that the Government's forecasts for new capital spending remain unchanged from the Pre-Election Update. While we strongly agree that increased investment in infrastructure, 'particularly roading', must be a high priority, Business New Zealand is deeply concerned that the Land Transport Management Bill (currently at Select Committee stage) will result in significant delays in significant infrastructure projects, a lower quality of spending and possibly even a lower quantum of spending on roading, as non-roading initiatives gain a high priority. Problems with the RMA are also causing significant concern with regard to future energy supply and particularly hydro-generation capacity.

12.4 The BPS sets out the following broad priorities for the 2003 Budget:

- Higher living standards for all through growth and innovation;
- Supporting a productive and cohesive society;
- Reducing crime and the impacts of crime; and
- Investing in the future.

12.5 It would be impossible for anyone to disagree with the importance of these broad priorities – they are all laudable objectives. However, while agreeing that they are all 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. Regulatory Burden

13.1 While not directly a fiscal issue, Business New Zealand remains 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. Attached, as Annex 2, is an assessment of where compliance and business costs have increased over the recent years due to Government policy.

13.2 Although Regulatory Impact Statements must now accompany policy proposals and legislation, our experience to date has been disappointing – the statements often seem to be an afterthought and lack rigorous (or any) analysis. For example, we were particularly disappointed with the quality of the statements that accompanied the recently passed Local Government and Health & Safety in Employment Amendment Bills. We therefore 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.

13.3 *Recommendation: Business New Zealand recommends that the Government should legislate for 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.

Annex 2

Fostering Growth or Costing Business?

Growth and innovation are high on the list of the Government's key objectives - but Government actions seem to be standing in the way of those objectives.

A year ago Business NZ analysed compliance and other costs resulting from Government decisions at that point in time, in an effort to answer the question: How much is Government costing business?

That analysis indicated that a mid-sized business would, as a result of actions by the then Labour-Alliance Government, pay an extra $26,000 during 1999-2002. Much of this amount derived from additional labour costs stemming from the Employment Relations Act and other employment-related initiatives.

Since then, significant new legislation impacting on business has been passed, including the Local Government Act and the Health & Safety in Employment Amendment Act, and the Kyoto Protocol has been ratified.

Now the analysis has been repeated in order to estimate Government-generated business cost increases and decreases for 2003.

The process was again to take a mid-sized service company (20 employees, annual turnover $4 million, annual wage and salary bill $727,900) and estimate tax-related, transport, power, environment-related and labour costs resulting from Government decisions.

This time around the big costs were again labour-related, with energy costs also significant.

The biggest single cost will come from an increase in the statutory annual holiday allowance, from three to four weeks (the current makeup of Parliament makes it reasonably likely that this will be accepted). It would mean those currently on four weeks' leave would likely claim for five weeks to maintain relativities, and for the purposes of our average mid-sized company, would add an extra 2% per year on the wage bill – a cost of around $14,000 for a full year.

New holidays legislation expected early in 2003 is likely to require time and a half to be paid for staff working statutory holidays as well as a paid day's leave. That will add an extra 1% on the wage bill for a full year - around $7,000.

The recently passed Health & Safety in Employment Amendment Act will impose costs including those arising from the need to self-insure against contingent liability for health and safety claims (around $7,000) and to get advice and training on required policies and procedures (around $2,000).

The Employment Relations Act will engender time costs resulting from increased union involvement in collective bargaining (around $1,000) and staff replacement costs for 'employment relations education' training granted under the ERA (around $600).

Other labour-related imposts include the increase in the minimum wage, increasing payroll costs by around $1,500 and parental leave replacement costs (recruitment and training) of around $500.

Other costs omitted from our analysis include a possible industry training tax; possible restrictions on selling a business or contracting out part of it, which could require contingency provision for substantial redundancy payouts; and pay equity policies that could also impose substantial costs.

After labour-related costs, energy costs loom large. Many small and medium sized businesses saw their power bills increase 50% during the winter of 2001 and now can't get a firm quote from suppliers for coming contract periods given uncertainty over gas supply for new thermal generation and uncertainty stemming from the difficulty of gaining hydro power re-consents under the Resource Management Act. A 10% increase in power costs was conservatively estimated for 2003, giving our mid-sized company an additional power cost of $6,000. This is quite apart from Kyoto-inflicted costs sitting a little further out on the horizon.

Improving application of the Resource Management Act is certainly an area where the Government could reduce costs to business. With a resource consent application under way e.g. to expand business premises, an average business could spend otherwise productive time dealing with objections from competitors and others at a cost of around $1,000.

The recently passed Local Government Act will add costs in a different way. Instead of helping to bring down rates (which have increased at twice the rate of inflation for the last decade) this Act will encourage local bodies to get involved in more activities, with fewer checks and balances. This is bound to result in higher rates. Our medium-sized company can expect its rates bill to increase by around 6% in 2003, an increase of around $900.

Other costs include new import fees (additional cost around $500), an increase in the petrol excise tax (additional cost around $80), increased road user charges for light commercial vehicles (additional cost around $100), an increase in the ACC component of the annual motor vehicle licence fee (additional cost $44), and a petrol tax increase (additional cost around $56).

The time costs of dealing with many government departments (IRD, Statistics NZ and others) have not been added.

A few Government actions will reduce costs. The average ACC employer residual claims levy will reduce by 4 cents per $100 payroll in 2003, saving our average company $290. And a medium sized business could access an apprenticeship subsidy, worth around $1,800.

In total, a conservative estimate of additional costs faced by a medium-sized company resulting from current Government policies, came to more than $43,000 for the calendar year 2003.

(The full analysis can be seen under 'The Great NZ 7-Day Service Company Revisited' on www.businessnz.org.nz.)

Cost increases of this magnitude, stemming directly from Government decisions, are a real burden on business. Action for growth – not just talk - is overdue.