NEW ZEALAND BUSINESS ROUNDTABLE

Submission on the 2004 Budget Policy Statement

January 2004

2004 BUDGET POLICY STATEMENT

1. Introduction

1.1 This submission on the Budget Policy Statement 2004 (BPS) is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the NZBR is to contribute to the development of sound public policies that reflect overall New Zealand interests.

1.2 In this submission, section 2 reviews the outlook for economic growth in the light of the government's growth targets. Section 3 comments on the government's fiscal strategy in relation to growth. Section 4 discusses the strengths and weaknesses of the Fiscal Responsibility Act 1994 and the changes proposed to integrate it with the Public Finance Act 1989. Section 5 sets out our conclusions and recommendations.

2. Economic growth

2.1 The BPS states on page 2 that economic growth "remains a top policy priority" of the government. The Speech from the Throne at the opening of the current parliament stated that the government:

> ... sees its most important task as building the conditions for increasing New Zealand's long term sustainable rate of economic growth.[1]

The government has amplified this statement by saying its goal is to see New Zealand attain a level of income per capita in the top half of the member countries of the Organisation for Economic Cooperation and Development (OECD). The minister of finance stated in 2002 that within the next couple of years (ie by mid-2004) it would be clear whether New Zealand is on the right track.[2]

2.2 The economic reforms of the 1980s and early 1990s gave the government a solid platform on which to build. During the last decade (to the calendar year 2002), economic growth averaged 3.6 percent a year in real terms, the seventh fastest rate of growth in the

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[1] Dame Silvia Cartwright, Speech from the Throne, 27 August 2002.
[2] Hon Dr Michael Cullen, *Daily Post*, 25 May 2002.

OECD and a major improvement on New Zealand's previous record. In the same period, per capita incomes grew at an average annual rate of 2.5 percent. This was a little faster than the OECD area as a whole. The OECD's recent economic survey of New Zealand observes that the earlier reforms boosted the economy's sustainable growth rate and its resilience to adverse shocks.[3] The prime minister's description of them as 'failed policies' is clearly without foundation. Rather, it is the government's policies that are failing. The OECD finds that productivity growth has not been lifted sufficiently to move New Zealand up the OECD income rankings. As its report states:

> The slide in relative living standards *vis-à-vis* the OECD average seems to have been arrested, but a further acceleration – necessary if New Zealand is to move back into the top half of the OECD ranking, as the government is intent on doing – is still not in sight.[4]

2.3 The deteriorating growth forecasts in the December 2003 *Economic and Fiscal Update* (2003 DEFU) support this assessment. For example, the forecasts for real gross domestic product (GDP) in table 1.1 point to a 3.1 percent average annual growth rate for New Zealand in the six years 2003-2008. The same table indicates that employment growth (full-time equivalent basis) will average 1.6 percent per annum during the same period. The two figures together imply average labour productivity growth of only 1.6 percent per annum.[5] These projections are well short of the government's growth objectives and the achieved growth rates in the last decade.

2.4 The growth forecasts in the DEFU are in line with expert opinion. In our last BPS submission (January 2003), we documented at some length what appeared to be a general consensus that New Zealand's trend rate of growth in labour productivity is of the order of 1.5 percent per annum. Since the trend growth in the labour force is expected to fall increasingly below 1.5 percent per annum in the medium term, the trend growth rate for GDP is expected to fall

[3] OECD Economic Surveys, New Zealand, December 2003, OECD, Paris.
[4] *Ibid*.
[5] The figures do not reconcile because of rounding errors.

increasingly below 3 percent per annum.[6] Such trend growth rates could well see a widening gap in living standards between New Zealand and better-performing OECD countries, in particular Australia. Economic growth in Australia is likely to average nearer 4 percent per annum in coming years.

2.5 It is clear that the goal of returning New Zealand to the top half of the OECD requires a radical lift in trend growth in labour productivity. The minister of finance acknowledged in the 2001 Budget that raising New Zealand's sustainable economic growth rate from 3 percent a year to 4 percent or more would require something like a doubling of our productivity growth rate.

2.6 A recent Treasury working paper, using new estimates of the capital stock produced by Statistics New Zealand, confirmed earlier findings that productivity growth in New Zealand markedly improved after 1993.[7] In particular, average multi-factor productivity growth increased from 0.09 percent per annum in 1988-1993 to 1.32 percent per annum in 1993-2002. Welcome though this hard-won improvement was, it is small relative to the task of doubling current productivity growth.

2.7 There are no signs of further improvements in productivity under current policies. To the contrary, there is every likelihood that average growth rates will fall. A recent decision that is clearly productivity-reducing is the staged introduction of an additional week's statutory minimum annual leave. The first order effect could be to lower annual labour productivity for the affected workers by two percent. Lower production could also lower capital productivity in the short term. Other measures that conflict with the growth objective include higher tax rates, the refusal (without parallel in the OECD) to privatise state-owned enterprises, other proposed changes to employment laws, the ratification of the Kyoto Protocol, the refusal to

[6] The Treasury's long-term forecasts assume an underlying growth rate in labour productivity of 1.5 percent per annum. In its base case, labour force growth falls increasingly below 1 percent per annum after 2010-11.

[7] Melleny Black, Melody Guy and Nathan McLellan, *Productivity in New Zealand 1998 to 2002*, New Zealand Treasury Working Paper, 03/06, June 2003.

make major changes to the Resource Management Act, redistributive welfare policies, and the general bias against greater private sector involvement in health and education.

2.8 The latest OECD report on New Zealand canvassed a number of ways in which the government might raise productivity growth. These included eliminating tariffs, reducing business regulation, welfare reform to improve work incentives, freeing up the labour market, addressing RMA problems, reducing tax rates,[8] addressing infrastructural bottlenecks and abandoning policies based on 'picking winners'. Earlier OECD surveys also stressed the importance of obtaining greater value for money from government spending.

2.9 Such suggestions would be widely supported in the business sector. Surveys of business leaders have routinely found that the overwhelming majority do not think the government has a credible growth strategy.

2.10 In summary, long-term forecasts point to no further improvement in trend per capita growth and the likelihood of a declining trend for GDP growth. The time the minister of finance set for himself to establish a higher growth path (mid-2004) is nearly up. Realistically, New Zealand can expect to fall further behind on current policies. The implication is that without major changes the goal of getting into the top half of the OECD is unattainable. We submit that the time has come for the government to accept the OECD's judgment that its policies have failed – that an acceleration of the trend growth rate is "not in sight" – and urgently reassess them.

3. Fiscal outlook

3.1 The BPS raises planned new spending for 2004-05 and beyond from \$1.1 billion to \$2.1 billion in the first year, rising to \$3.3 billion in future

[8] We do not agree with the OECD's suggestion that the focus should be primarily on lowering the company tax rate. In our view it would be better to lower the top personal rate and align it with the company rate and then progressively lower both.

years.[9] Increased spending of $2.1 billion represents 1.5 percent of GDP, or 60 percent of the 2.5 percent increase in real GDP forecast for fiscal year 2005. For fiscal year 2006 new plus forecast operating spending in real terms rises to 62 percent of the forecast increase in real GDP and for fiscal years 2007 and 2008 it is expected to account for over 100 percent of the increase in real GDP. In other words, the government is appropriating for itself a large and growing proportion of the benefits of economic growth, leaving relatively little scope for increases in after-tax private incomes. In addition, forecasts of capital spending have been increased by $500 million, to a total of $2.2 billion spread over the next four years, plus the legislatively required New Zealand Superannuation Fund contributions.

3.2 It is difficult to avoid the impression that the government is planning to spend more merely because it has more money to spend, and is opposed to giving surplus revenue back to taxpayers. For example, comparing the latest BPS with the forecasts in Budget 2003, revenue from levies based on the Crown's sovereign power is now forecast to be higher by $5.8 billion cumulatively in the three years to 2005-07, and forecast core Crown operating spending has been lifted by $5.4 billion.[10] The rate of increase exceeds that of population growth and (CPI) inflation. The sum of new operating spending for the 2004 Budget and forecast new operating spending has been lifted cumulatively by $4.3 billion. It is difficult to believe that something has changed to make all these spending plans more desirable than they were a year earlier. The economic welfare loss from an additional $1 billion of taxes is substantial at current marginal rates of tax. Government expenditure must be remarkably productive if it is to offset this negative effect on growth. The focus on government spending as a ratio of GDP is leading the government to spend the 'growth dividend' just because the tax revenue keeps rolling in.

3.3 As we stated in last year's submission, up to a certain level, government spending can improve economic performance and social

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[9] See the BPS, pp 5, 36-37 and 109 for new operating spending intentions.

[10] These statistics are calculated from pages 108 and 109 in Budget 2003 and pages 92 and 93 in the BPS.

cohesion by ensuring the provision of public goods and access to social services, including a welfare safety net. But spending is only justified where it provides value for money. The OECD has amply documented deficiencies in the quality of government spending in New Zealand. Base spending, 95 percent of the total, is not properly reviewed. It seems to be easier for governments to increase spending than to stop unjustified spending. Resources need to be shifted from the public sector to the private sector and transfer payments reduced if wealth is to be created and the economy is to grow faster. Greater emphasis on wealth creation implies less emphasis on wealth redistribution.

3.4 In the past year two papers published by New Zealand economists have served to reinforce this theme.[11] The author of one of these papers, Arthur Grimes, correctly observes that the overall size of government in New Zealand is smaller than in many European countries and infers that this is positive for New Zealand's rate of growth relative to the OECD average. However, this level of spending is still too high to achieve fast growth. Extensive scrutiny of the OECD's database has established that it is implausible that New Zealand could achieve per capita economic growth of 4 percent per annum or more for a decade with total government outlays (central plus local government) at around 40 percent of GDP on the OECD's measure.[12] The latest OECD statistics for government spending outlays as a percentage of GDP indicate that New Zealand's spending ratio is projected to be 39.9 percent for 2004 and 2005.

3.5 Our submission last year also emphasised the importance, for any given level of expenditure, of improving the efficiency of the tax system. For tax policy to make the greatest possible contribution to growth, the McLeod Tax Review recommended reducing the highest effective marginal tax rates. High personal tax rates, high effective

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11 Arthur Grimes, 'Economic Growth and the Size and Structure of Government: Implications for New Zealand', *New Zealand Economic Papers*, Vol 37(1), June 2003, pp 151-174; and Norman Gemmell and Richard Kneller, *Fiscal Policy, Growth and Convergence in Europe*, New Zealand Treasury Working Paper, 03/14, June 2003.

12 Roger Kerr, 'Memo to Dr Cullen: Big Government Harms Growth', New Zealand Business Roundtable, 25 September 2002.

rates resulting from the tax/benefit interface, and high taxes on capital income are among the most damaging to the economy.

3.6 From a growth perspective, the McLeod Review found that the move to increase the top personal tax rate to 39 percent was a mistake. Deadweight costs were increased, and the tax code and tax administration were made more complex. In addition, many firms faced higher labour costs as they were forced to increase wages and salaries to attract and retain internationally mobile workers, and New Zealand suffered a 'brain drain' which may resume when international conditions improve. Both the McLeod Review and the OECD have recommended that New Zealand should adopt a lower, flatter tax structure, and the top personal rate should be lowered and aligned with the company rate. There is much less merit in reducing the company rate alone; among other things, the owners of most small businesses and farmers are primarily affected by the personal rate. In the context of the international tax regime, the tax burden on inbound investment should be reduced and a cap should be placed on the total tax liability of any individual. We submit that these and other recommendations of the McLeod Review should be revisited by the government.

3.7 Instead of foreshadowing a growth-oriented approach to future tax policy, the government has signalled tax cuts and/or increased family assistance to low or middle income earners. Taxes were cut for these groups twice in the 1990s. They were motivated by income redistribution, not wealth creation (economic growth) goals. The minister of finance is correct to argue that these tax cuts did little to improve growth. But this is because of the form they took; that argument is not relevant to cuts in high marginal rates, which should be the focus of the government's tax policy if it is serious about its growth objective. Seemingly it is not: the renewed emphasis on income redistribution further calls into question the government's stated "top priority" goal.

3.8 A sustainable reduction in the tax burden to foster economic growth requires progressively reducing the share of government spending in the economy. The key to such a reduction is, in the first instance, to keep the rate of increase in government spending lower than the growth rate of the economy. In addition, there are many avenues for achieving reductions in current spending including:

– general growth-oriented policies and labour market reforms to reduce spending on the unemployed;

– welfare reforms along US lines (eg time limited benefits, work tests and more vigorous efforts to place beneficiaries in employment);

– reductions in middle class welfare (spending on superannuation, education and health that benefits better-off groups);

– privatisation, and the scrapping of the New Zealand Superannuation Fund, which would generate lower debt servicing costs;[13] and

– reducing spending on private goods, including business subsidies.

3.9 Reductions in government spending on non-traded goods and services would also help support monetary policy and lower the real exchange rate. The minister of finance has correctly stated that the government is “not without options” to reduce current pressures on exporters, yet he has failed to address this option. Other measures which would help ease these pressures, which threaten to slow the economy down, are listed in a statement attached as Annex I.

3.10 Instead of applying most or all of the increases in tax revenue generated by economic growth to spending increases, we believe

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13 A study by Phil Barry, *The Changing Balance Between the Public and Private Sectors*, New Zealand Business Roundtable, 2002, also found that privatisation of state-owned enterprises could raise national income by around $1 billion on an ongoing basis.

the government should emulate the successful approach of Dutch (left-of-centre) governments in the 1990s, namely to announce that all dividends in the form of higher revenue growth will be distributed in the form of regular income tax cuts. Many of the dividends of Ireland's economic reforms were also applied to tax reductions.

4. Proposed changes to the Fiscal Responsibility Act

4.1 This year marks the tenth anniversary of the passage of the Fiscal Responsibility Act 1994 (FRA). The Public Finance (State Sector Management) Bill will both repeal the FRA and integrate its provisions into the Public Finance Act 1989. This integration will be accompanied by changes that are intended to make the Fiscal Strategy Report (that accompanies each budget) the main vehicle for setting out high-level fiscal strategy. The focus of the BPS is to be narrowed so that it is more on the priorities for the coming budget and less on high-level fiscal strategy issues.

4.2 The FRA has served New Zealand well in some important respects. The focus on fiscal prudence has paid dividends, as evidenced by the sustained operating balance surpluses, improvements in Crown net worth and, most recently, the Triple-A credit rating for Crown foreign currency debt. These are major achievements given the erratic course of fiscal policy in the 1970s and early 1980s.

4.3 Another virtue has been greater transparency. An incoming government faces less risk of unpleasant fiscal surprises. The system of improving accountability by requiring the minister of finance and the secretary to the Treasury to sign a statement of responsibility appears to have worked well.

4.4 On the other hand, a material disappointment is the failure of the BPS process to engage the government in effective debate with the public and parliament about the value for money of government spending and the link between budget policy and economic growth. For example, business organisations have been saying since the mid-1990s that successive governments have not had credible strategies for achieving their targets for economic growth. No effective engagement on that point has occurred and, as predicted, the growth aspirations have not been achieved. Another disappointment has been the tendency for governments to fail to meet their long-term expenditure targets established under the FRA or to take remedial action.

4.5 The proposed changes to the FRA, outlined above, do not address our concerns about the failure to align fiscal priorities with economic growth priorities and to improve the quality of spending. Indeed, they may make it even harder to achieve a meaningful debate on fiscal policy. First, there seems to be a risk that future BPSs will not provide a coherent basis for assessing the consistency of the pending budget with longer-term fiscal and economic growth objectives. Secondly, discussions about longer-term fiscal strategy are largely academic when they are too late to affect the latest budget and too early to impact materially on the next one.

4.6 In respect of our concern about poor scrutiny of expenditure, the key problem appears to be a lack of political will. Assessing value for money is not rocket science. It is simply a matter of demanding convincing answers to basic questions. For example, a report from the OECD secretariat recently commended the following questions for evaluating value for money:

OECD proposals for evaluating value for money

1. Does the programme still serve a clearly defined public purpose that matters?
2. Is this an appropriate role for government?
3. Would we establish the programme today if it did not already exist?
4. Is it desirable to maintain it at its current level?
5. Can it be delivered more effectively or efficiently? Have there been changes (in the service environment, infrastructure, technology, etc.) since the programme's inception that would now permit an alternative means of achieving its objective with greater economy, efficiency, or effectiveness?

Sources: Canadian Office of the Auditor General and Finance Canada.

The OECD report suggested that an outcome-based review of social assistance would probably offer the greatest gains. It advocated a focus on welfare administration, benefit levels, the use of market mechanisms and recourse to user charges to limit demand, and noted the benefits of competition, choice and diversity.

4.7 The report also argued that the excessive fragmentation of New Zealand's public service impedes resource reallocation and effectiveness. In 2000 in New Zealand there were around 800 separate appropriations for outputs, spread across 78 Votes. In contrast, Australia and Sweden have the equivalent of 27 Votes or broad categories of spending.

4.8 A complete summary of the OECD's recommendations is contained in the box in Annex II. It is a long list and represents a major programme.

4.9 We believe there is much to commend in the OECD's recommendations, but they do not address the fundamental problem of poor incentives facing government decision makers. In the private sector it is widely acknowledged that it is undesirable to leave managers with free cash flows to spend. Excess cash should be removed from managers so that the burden of proof lies on them to establish that any proposals to spend shareholders' money are justified. Exactly the same problems occur when fixed tax rates applied to increasing incomes give politicians more discretionary money to spend. Here the danger is that politicians will spend money to promote their own interests, or the interests of their parties or supporters, rather than the interests of taxpayers at large.

4.10 In last year's submission we drew attention to a large number of initiatives among state governments in the United States to shift the burden of proof for spending taxpayers' money back on to politicians. Around 26 states have adopted some form of tax and expenditure limitations. Constraints that limit government spending to the inflation rate and population growth and mandate immediate rebates of government surpluses appear to have been most effective.[14] States

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[14] Michael New, 'Limiting Government through Direct Democracy: The Case of Tax and Expenditure Limitations', *Policy Analysis*, Cato Institute, 13 December 2001.

are generally required to put any proposals for spending in excess of these limits to the public in the form of a referendum. We commend the idea of a thoroughgoing review of the Fiscal Responsibility Act with a view to increasing the focus on value for money considerations. In particular, the review should encompass the case for introducing some form of tax and expenditure limitations, with strict criteria for authorising and correcting any departures from them. Further features could be a prohibition on subsidies to businesses, along the lines of the constitution of the US state of Georgia, and rules that would direct the government to its prime role of ensuring the provision of public goods and a social safety net.

4.11 We believe that similar disciplines should be imposed on regulatory decisions.[15] Regulations can be as unconstitutional as taxes. Here the principle of compensation for regulatory takings, funded where possible by the beneficiaries of those takings, could improve the incentives of politicians and those lobbying for a regulation to better balance its benefits and costs. We were pleased that two parties contesting the 2002 general election favoured consideration of a Regulatory Responsibility Act and would like to see other parties show a willingness to examine the idea in an open-minded way.

5. Conclusions and recommendations

5.1 The government's policies for economic growth are not achieving its stated goals. This is now undeniable. An urgent reassessment is called for. Consistent with the OECD's thinking, we submit that more credible measures that would enhance New Zealand's growth prospects would include:

- restoring the goal of reducing Crown operating expenses to below 30 percent of GDP;
- moving towards more uniform rates of income tax at a lower level, with a maximum of 25 percent being a medium-term goal;

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15 See *Constraining Government Regulation*, New Zealand Business Roundtable, December 2001.

- reducing the top personal rate and aligning it with the company tax rate;

- undertaking a thoroughgoing review of the value for money being obtained from major spending programmes, focusing on the gap between what is being achieved by government spending in major areas and desired outcomes;

- setting up expert task forces to undertake a fundamental review of the major regulations that the ministerial review of business compliance costs found were imposing the greatest costs on businesses; and

- privatising government entities that supply private goods and services.

5.2 We also urge the Committee to recommend to the government a review of options for improving the quality of government spending, including options for restraining tendencies to simply spend the 'growth dividend'. We suggest this takes the form of a review of the Fiscal Responsibility Act which would include examination of the case for tax and expenditure limitations.

5.3 We recommend that the government investigates the idea of a Regulatory Responsibility Act.

5.4 We continue to believe that the New Zealand Superannuation Fund should be wound up and the proceeds used to repay debt.

5.5 We believe that the proposed changes to the BPS could make it harder to promote informed debate about whether longer-term fiscal strategy is consistent with longer-term economic growth objectives. In our view, it is more logical for public contributions to debates about longer-term fiscal strategy to be sought in advance of budgetary decisions rather than afterwards. We recommend that the select committee considering the Public Finance (State Sector Management) Bill addresses this issue.

ANNEX I

NZBR MEDIA RELEASE

Exchange Rate: What Treasury and the Reserve Bank Should Tell the Minister of Finance

“There is a raft of competitiveness-improving measures which the Treasury and the Reserve Bank should identify in response to Dr Cullen’s request for advice on how to reduce exchange-rate pressures on exporters”, the executive director of the New Zealand Business Roundtable, Roger Kerr, said today.

“These do not include intervention in the foreign exchange market, as the minister of finance has correctly acknowledged. Nor do they include interest rate cuts, capital controls or, in present circumstances, alternative exchange rate regimes. Such measures would be ineffective and harmful, and the government’s advisers should make this clear.”

Mr Kerr said that the best thing that the Reserve Bank can do to help exporters is to keep inflation under control. Inevitably, this means cycles in interest rates and exchange rates which firms trading internationally have to manage like any other business risk.

“Nevertheless, maintaining international competitiveness and the health of the export sector is vital for a small, open economy like New Zealand”, Mr Kerr said. “This requires not just a focus on the current value of the dollar but on broader dimensions of price and non-price competitiveness, including productivity, quality and service delivery. Firms must take responsibility for many of these factors.

“But the government also has an important role to play in creating a competitive environment for business. New Zealand has been going backwards in this regard. The 1995 World Economic Forum/IMD World Competitiveness Report found that “New Zealand, in 8th position this year, continues to be impressive with its remarkable comeback from 18th position in 1991”, and noted that “New Zealand has an outstanding result in *Government* (3rd)”. Since then, New Zealand has slipped back to 18th position (2003) in the comparable survey, and the quality of government management is also well down.”

Recently, the government had announced further reductions on tariffs, which would help exporters as tariffs are a tax on exports. But much more was needed to improve New Zealand’s international competitiveness.

Mr Kerr said that the real exchange rate which affects exporters can be expressed as the ratio of international to domestic unit costs. Competitiveness would be improved by measures to enhance efficiency and reduce costs in the domestic sector of the economy. In particular, better fiscal and regulatory policies would help support monetary policy. Key options include:

- *Lower central and local government spending* Most government spending is on domestic goods and services, and increased demand puts pressure on prices and costs. Much public spending is also wasteful, inefficient and poorly targeted. Pre-election spending increases would further undermine competitiveness.

- *Reverse galloping state regulation* Businesses are being hit with higher compliance costs across the board, and intervention in industries such as telecommunications, electricity and transport is adding to costs and discouraging investment and innovation.

- *Improve infrastructure* The poor performance of central and local government-dominated industries such as roading and water is creating excessive costs for business. There needs to be greater private sector participation in these industries. Obstacles to investment such as the Resource Management Act and Kyoto Protocol commitments should be tackled.

- *Reduce employment restrictions* Labour costs represent around half total production costs, on average. Pushing the dollar down – assuming this could be done without increasing inflation and triggering monetary tightening – would be equivalent to cutting real wages. Equally, firms should be taking account of the higher purchasing power of the dollar in wage bargaining. However, the more desirable focus should be on raising productivity. The government's drive to increase unionisation and collective bargaining, and to legislate for more holidays, will simply add to unit costs and reduce productivity.

- *Increase competition* Monopoly areas of the economy such as accident insurance should be opened up to competition, and there is scope for much greater private sector provision in areas such as health, education and prison services.

- *Cut taxes* The government is raising excessive amounts of revenue. Tax reductions focused on raising efficiency would take pressure off wages and increase savings. They should include a reversal of the increase in the top tax rate, which increased the cost to firms of internationally mobile employees, as recommended by the McLeod Tax Review.

Such measures would have both short- and longer-term benefits for competitiveness. Skill upgrading through introducing greater choice, competition and autonomy into the government-dominated education sector would have important long-term effects.

"The minister of finance is absolutely right to say that he is "not entirely without options" to assist the export sector and producers more generally", Mr Kerr said.

"The OECD is likely to highlight most of the above options for improving competitiveness and economic growth in its forthcoming report on New Zealand, which will focus on medium-term economic policy.

"The Treasury and the Reserve Bank also have a duty to the taxpaying public to offer independent and professional advice, and any competent response to the minister of finance's request must include such options, as well as others.

"The only real question is: Will the minister of finance accept such advice?", Mr Kerr concluded.

24 November 2003

ANNEX II

Box 9. **Summary of OECD Working Paper Recommendations for New Zealand**
New Zealand's public spending framework is in reasonably good shape. Even so, there is room for further changes in order to build on the gains that have already been made and to raise the quality of expenditure even higher.

Continue to improve the machinery of public management

- *Better evaluation*. Undertake comprehensive and regular evaluation of baseline expenditure.
- *A greater focus on outcomes*, but not at the expense of a clear specification of outputs. Combine this with more evaluation of effectiveness and value-for-money. Ensure that programme goals are specific, measurable, achievable, relevant, and timed (SMART), and make a central agency responsible for quality control in this area. Use sunset clauses on programmes. Push the Statements of Intent throughout the public sector.
- *Reduce fragmentation and boost strategic management*: Re-instate the more useful parts of the *Key Results Areas*. Ensure that there is flexibility for appropriations to become less fragmented. Institute a policy that, within limits, each minister can "keep" any savings if they are allocated to some other part of his or her portfolio, subject to approval from Cabinet. Push ahead with networks across agencies, and supplement with ministerial teams. Re-start the CE reforms, clarify the role of each, and bring under the wings of a department where there is no strong reason for the extra degree of separation. Resist combining policy shops with delivery arms, but consider creating larger policy Chancelleries.
- *Use multi-year appropriations where possible, and use of other appropriation modes such as per-unit pricing.*

Raise the effectiveness of social spending

- Focus on more active social support, with an emphasis on employment placement. Keep training programmes limited and focussed on those most likely to benefit. Reduce the level of unemployment assistance for long duration spells, combined with more active policies as they approach the cut-off point. Broaden, and enforce, work requirements, including for 55-65 year-olds. Consider more use of in-work benefits, address METR problems where they exist, and tidy up supplementary benefits. Consider more childcare resources for beneficiaries.

Make greater use of market mechanisms

- Encourage contracting out. Expand the range of user-charges as a way to manage demand. Introduce road-pricing mechanisms for all road users. Remove the incentive for user charges to be set at too high a level.
- Encourage competition in the education system, but carefully manage its side effects by giving greater management assistance to schools that need it. Increase management flexibility over schools' budgets.
- Re-introduce full competition in tertiary education. Re-instate the level playing field between PTEs and public institutions. Push ahead with TEAC's recommendations on separating funding for research and teaching, and take steps to steer enrolments into priority areas. Control costs by maintaining open access but with greater private co-payment if necessary, rather than restricting entry.
- Encourage choice and competition in the health sector by allowing patients to transfer their entitlements to private health plans, and by avoiding geographic restrictions on access care. Encourage DHBs to purchase from providers other than "their" hospital. Push ahead quickly with plans for primary care reform.
- Introduce competition to all forms of accident insurance.

Continue to strengthen top-down spending control

- Long-term objectives should have a specific timeframe and be ranked so that the binding restraint is clear. The objectives should cover core Crown and CEs.
- Retain the provisions framework.
- Bring capital decision-making more closely into the Budget process. Tie the capital provision explicitly to the debt target, use it as a spending cap rather than a forecast, and give it more public prominence. Use public-private partnerships wherever appropriate and possible. Fund new capital pressures by partial or full privatisations of non-core assets (SOEs and Crown entities).
- Maintain fixed departmental baselines as an incentive to search for efficiencies, at least until a comprehensive alternative mechanism is in place.

Fill in the holes in the proposed local government reforms

- Legislate principles of appropriate activities for local government to undertake. Legislate a top-down spending framework, such as a local FRA, and consider more binding fiscal rules such as spending caps. Encourage economically efficient funding mechanisms such as user-charges and differential rates. Rethink whether the power of general competence is required for regional government.

Source: David Rae, "Next Steps for Public Spending in New Zealand: The Pursuit of Effectiveness", Economics Department Working Papers No 337, Organisation of Economic Cooperation and Development (OECD), 2 August 2002.