ECONOMIC DEVELOPMENT

Higher Incomes, Better Jobs & More Exports

Our vision

For decades New Zealand has spent more than we have earned as a country. Yet the economic settings for the country have barely moved in response. It is time to acknowledge that substantial change is needed to improve our fortunes.

Under current settings, using National's own projections, every year New Zealand gets poorer. Because we import more than we export (including the money paid to overseas lenders and overseas owners of our assets), each year that hole is plugged by borrowing from overseas and selling more of New Zealand's assets.

What this shows is that substantial structural change is needed to improve our fortunes. We should not simply borrow and hope, nor just sell more of our assets.

Long term, there is only one way out – the export of more goods and services to generate more jobs and income for New Zealand.

To achieve this, our country needs to save more, invest in the export sector and export more. Growth in the breadth of our exports is pivotal for New Zealand. While our traditional export industries remain important, New Zealand desperately needs more exports from new and emerging sectors.

Change nothing and nothing changes.

We need to drive increases in our exports and jobs, and improve our productivity. Labour has the policy mix to make these structural changes to our economy.

Labour's proposed changes to monetary policy, New Zealand's mix of taxes and improved savings will all help our exporters. So too will our Research & Development tax credit.

With the right supports in place, New Zealand will become wealthier.

Labour's economic development policy will increase foreign exchange earnings, grow New Zealand's GDP and jobs, reduce external liabilities and grow domestic capital.

Our plan is designed to address all three of the stages we need to succeed – repaying debt, building equity and stimulating growth.

These steps are needed if we are to own our own future rather than slide further into debt and fall ever further behind Australia.

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Why a capital gains tax will improve the economy

The world's financial authorities say we need a capital gains tax ("CGT"). In addition to the New Zealand Treasury and our Reserve Bank, the IMF and the OECD recommend its adoption.

There are 31 OECD counties with a capital gains tax – including Australia, the USA and the UK.

New Zealand is the odd one out.

We need a CGT to bring about structural improvements to our economy. Our tax system currently favours the speculative sector and penalises the productive export sector.

The OECD and the Treasury both say it is wrong for our tax system to have advantageous tax rules for property investment.

This bias diverts precious investment capital into the speculative sector at the expense of the export sector.

We need to fix this. And a CGT will.

Restructuring the tax system by introducing a capital gains tax (excluding the family home):

- Will allow us to fund other tax cuts and reduce debt without resorting to the sale of our assets.
- Helps our economy grow.

It drives crucial investment capital into the productive export sector. This opens opportunities for the development of the export sector which we so greatly need to improve our economic well-being.

For further information, see http://www.ownourfuture.co.nz/capital-gains-tax.

Savings

To reverse the trend of rising private debt and higher interest rates New Zealand needs to increase private savings. Put simply, New Zealand needs more people saving more.

Australia's higher rate of savings has resulted in higher levels of investment in Australian businesses. Not only has Australian per capita GDP risen to far higher levels than in New Zealand, but their net investment position as a percentage of GDP is markedly better.

Long term problems need long term solutions. Labour believes KiwiSaver should be expanded to provide the basis for a significantly higher private saving rate and additional security in retirement.

> Labour's plan will make KiwiSaver compulsory for every employee aged 18 to 65 from 2014.
>
> Labour will gradually increase employer contributions at a rate of 0.5 per cent a year, from 3 per cent to 7 per cent, over 9 years.

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Labour will retain the current minimum employee contribution of 2 per cent. The $1,000 kick-start will be spread over 5 years. Labour will not make any more changes to the member tax credit.

The rate of increase in savings needs to be moderate. The 0.5% per annum increase in employer contributions that Labour is planning is how savings were improved in Australia. This allows real incomes, after savings are deducted, to increase even while the savings build. The gradual increase avoids cost of living pressures for savers, and also avoids the wider recessionary effect a sudden increase to the rate of savings could cause.

The projected annual increases in private savings, once the universal KiwiSaver reaches maturity, are very substantial. Using the approach adopted by the savings working group, New Zealand's net international investment position improves by 17% of GDP after 20 years.

With more capital available for investment, productivity, profits and wages will increase. NZIER have estimated wages will increase by an additional 7% over 15 years if private savings substantially improve.

For more information, see http://www.ownourfuture.co.nz/savings.

Monetary Policy

Changing our monetary policy is one way we can help encourage investment in the productive exporting businesses.

A volatile New Zealand dollar and persistently high interest rates are causing structural problems for our economy.

Currently, the New Zealand dollar is one of the ten most traded currencies in the world. This heavy trading is reflected in a highly volatile currency which makes doing business more difficult for our exporters. Our exporters have to plan for the value of the dollar changing at great speed and little predictability. When our exchange rate surges, it undermines the competitiveness of our prices in destination markets. When the exchange rate falls, the price of inputs like fuel can soar unexpectedly.

Our current policy is not well designed to produce a stable and competitive exchange rate, nor to keep interest rates as low as possible. In fact, it often operates the other way round.

Labour will reform monetary policy to ensure our exporters are not undermined by extreme exchange fluctuations, including by:

- Introducing a 15 per cent capital gains tax
- Introducing universal KiwiSaver
- Broadening the objectives of the Reserve Bank Act
- Ensuring the interests of exporters are represented on the Reserve Bank Board
- Taking pressure off the official cash rate through complementary monetary and prudential policy tools, and

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- Encouraging more selective Reserve Bank interventions to impose costs on currency speculation.

Currently the sole focus of the objectives of the Reserve Bank Act is on the maintenance of price stability – or inflation. We agree with the approach taken by Australia that recognises that along with inflation control, employment, economic prosperity, and the health of the export sector are at least as important.

For further information, see http://www.ownourfuture.co.nz/monetary-policy.

Research and Development tax credit

Countries similar in size to New Zealand like Finland, Singapore, Denmark and Israel put substantial emphasis on increasing R&D done by businesses. They receive significant government support.

Although Kiwis are an inventive people, our low level of business expenditure is a drag on New Zealand's ability to innovate and grow. Treasury had previously argued that the tax credit was a more effective means of incentivising business R&D than discretionary grants, as they are more driven by business and reach many more firms. Yet National axed the policy and introduced a system of grants less than half the value of a tax credit.

> Labour will introduce a Research & Development (R&D) tax credit at the rate of 12.5%, to lift New Zealand's lagging R&D expenditure by encouraging businesses to research and innovate.

This policy is estimated to stimulate approximately $1.5 billion p.a. of additional research and development spending by industry. This will assist the growth of our export sector and bring new jobs and export earnings for New Zealand.

Just as important, a tax credit policy, unlike a government handout, will promote a shift in business culture to think and plan strategically to the R&D spend.

Funding will be provided through the savings through charging the agricultural sector 10% of their agricultural emissions, a move that will also stimulate innovative changes in the wider export economy as well as encourage innovation and productivity increases in the agricultural sector.

We will also cancel any further grants through National's three programmes, although those grants that have already been awarded will continue to be paid.

New Zealand firms that conduct eligible R&D activities in New Zealand will qualify for a tax credit on all eligible R&D expenditure. To qualify for the R&D tax credit, a firm will need to control the R&D project, bear the financial risk of it, and have effective ownership over the project results.

Industry Targeting for Export Growth

Many successful Asian economies use the power of the State and state owned organisations to coordinate and encourage success in identified sectors.

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Japan's Ministry of International Trade and Industry is perhaps the best known example of industry targeting, having successfully supported the growth of the auto industry through a range of initiatives.

New Zealand has successfully taken this approach in agriculture. Our research institutions, and our Ministries of Agriculture, Economic Development and Foreign Affairs and Trade have cooperated with private sector farmers, processors and marketers to improve productivity, develop new products and processes, and access trade opportunities. These steps have enabled New Zealand to ensure a good share of the value chain accrues to New Zealand.

This approach should be extended to other sectors of the economy.

It is clear New Zealand cannot catch up with other wealthier countries and overcome our long term current account deficit without increasing the breadth of our exports. We cannot succeed from agriculture alone.

Industry targeting proposes that the Government identifies industries which we have a comparative advantage in and/or are seen as having high growth potential and then supports growth and investment in these industries.

Industry targeting is favoured in many successful Asian economies.

Related to industry targeting is **clustering**. That is, enhancing competitiveness of an industry by clustering competing businesses together to create economies of scale for suppliers and for those businesses themselves as the sector strives to compete internationally. The Government has a role in creating the right environment for industries to cluster.

Government procurement also plays an important role in overseas economies by providing support for new businesses seeking to build consumer and investor confidence. The economic growth benefits of using government procurement to help New Zealand companies have for too long been ignored in New Zealand. Cost is, of course, highly relevant, but should not be the only consideration. Labour's policy on improved government procurement is set out at http://www.ownourfuture.co.nz/procurementpolicy.

In some cases, **local infrastructure** developments are needed to unlock regional development opportunities as a means to build prosperity. For example, the upgrade of a wharf at Opotiki is a prerequisite to the development of the aquaculture industry in that area, including processing to provide local employment in an area with high unemployment and deprivation.

In the case of New Zealand's iron sands, **government to government relationships** should be used to broker relationships between China and New Zealand under our free trade agreement to match the required capital and demand for steel with our iron sand and energy resources.

In the case of our fishing industry, **co-operation between government and Iwi** is needed to increase the New Zealand content in the value chain.

The table overleaf provides examples of industries for targeting.

Labour will make greater use of industry targeting and clustering sectors in economic development policy.

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Labour will work with industries, including local industries, and councils to identify regional infrastructure blockages which if overcome will provide economic growth in exported related fields.

Sector	Current Position	Prescription
Niche Manufacturing and services	• **Material, with high value jobs, and growing**	**Lift performance and grow aggressively to grow the depth and breadth of our exports.**
Energy	• Current SOE structure increases administrative costs and largely ignores the potential to grow export revenues from renewables expertise.	Give the three SOEs the mandate to increase their focus on overseas earnings by selling expertise in renewable energy technologies. Joint Ventures and subsidiaries to be encouraged within limits to protect the parent company from undue levels of risk.
Minerals	• Potential opportunities but economic attractiveness depends on margin available to New Zealanders.	Grow selectively. Joint Ventures for largest projects (eg iron sands) using our energy resources for smelting.
ICT	• ICT infrastructure underpins growth of innovation sector.	Convergence of the telecommunications, ICT and broadcasting sector in order to build innovative export sector.
Fishing/aquaculture	• Increasingly fishing and processing is contracted to overseas firms.	Increase New Zealand participation in all parts of the value chain.
Agriculture/forestry	• A large part of New Zealand's export revenue • Little available land for expansion • Potential for intensification but environmental issues must be managed well. • Potential for increased value-add but requires successful innovation.	Increase value per hectare and per worker. Focus on associating manufacturing, milling machines & farming systems. Develop environmental services and technologies (clean tech)
Tourism	• Useful to provide jobs for low skilled people • Tourism labour productivity is much lower than Australia's overall average.	Increase value and quality and improve productivity.

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For more information on Labour's approach to energy, ICT, fisheries, agriculture, forestry and tourism, see our policies in those areas at http://www.ownourfuture.co.nz/.

Unleashing the Growth Potential of New Zealand's Energy Sector

National is proposing sale of half New Zealand's energy SOEs. This would transfer wealth and public assets from the population as a whole to a minority and, ultimately, the international investment community.

Labour does not accept the justification used, which is that the sale of these assets is needed to create investment opportunities for private investors. This justification represents a negative view of the capability of NZ's private enterprise to grow businesses suitable to invest in. Labour does not accept that for the investment community to thrive it has to trade what the government has created.

We believe that the way to grow our businesses, jobs and investment opportunities is to make structural changes to the economy through the changes to tax policy, savings, monetary policy and R&D we have described above.

Selling the SOEs is wrong. New Zealanders lose both the future dividends and the potential that lies in these companies to assist in the growth of our economy.

Labour believes that rather than selling our SOEs, we should utilise these companies to drive growth.

The world needs clean energy technologies. International demand is burgeoning for both environmental and energy security reasons.

We have world leading expertise in many existing renewable electricity technologies – geothermal, wind and hydro. We also have expertise in energy efficiency, planning, engineering and project management. We have niche capabilities in biofuels, and other new energy technologies. Much of this capability lies in our energy SOEs, CRIs and universities which are owned collectively by New Zealanders.

The current focus of SOEs is almost exclusively on producing domestic electricity. This largely ignores the potential export earnings which can be generated through better utilising this skill and capital base.

> Under Labour the energy SOEs will not be sold but will be encouraged to grow new subsidiaries to develop products and services for export. New subsidiaries will be able to raise private sector capital, including from KiwiSaver institutions.

New subsidiary boards will be formed to ensure the experienced and hard-nosed private sector entrepreneurial skills of those risking their own money are brought to bear. Products will include high value componentry for mature technologies used by those SOEs as well as new technologies.

The parent SOEs will be protected from sale and from unaffordable failures by limits on their exposure to increased risks at the subsidiary level. Given that the energy SOEs are multi-billion dollar enterprises, these limits will still allow the considerable muscle of these enterprises to power progress in this sector.

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The alternative proposed by National – the sale of SOEs - is a backward looking vision that will see these New Zealand owned jewels privatised to overseas owners over time, with their export potential ignored.

Overcoming Capital Constraints to Build More Export Firms

We need to remove impediments blocking the growth of innovative companies with export potential.

We also need to do all we can to help them remain in New Zealand, so New Zealand can share the future financial benefits of their success and keep some of the employment which flows from these successes in New Zealand.

While there are capital constraints on small enterprises in their earliest stages of development, these are less of an impediment than the capital constraints at the point of expansion into overseas markets. There is a relatively vibrant 'angel' or very early investors sector willing to put in the region of $250,000 – $2 million into businesses with exciting ideas. Often a significant share of this comes from friends and family.

However, once businesses need around $2 million or more of capital in order to take their business to the next level and develop offshore markets, this level of investment is difficult to attract. The NZ Venture Investment Fund helps, in partnership with private venture capital funds, but insufficient private capital is attracted to the venture capital sector to meet the demands of promising companies. Companies of this size often also find international capital difficult to obtain, and frequently end up selling to a foreign investor that recognises the value in the idea.

The New Zealand Institute estimates that around $1.8 billion per annum of investment funding would be required to fund the internationalising of businesses of this kind, and that investment of this kind has in recent years averaged less than 10% of this. [1]

The New Zealand Institute proposes a number of options for leveraging greater overseas and New Zealand investment capital for businesses wanting to internationalise.

They suggest that as part of eligibility for NZVIF, support from an international venture capital partner should be secured, perhaps at a minimum investment level of 20%. They note that there may need to be inducements for participation by such partners.

The Institute also recommends steps to increase funding from domestic investors. They propose entitling venture or angel investors to a deduction of 20% of their investment against other income at the time of investment. Further, if the capital in a business invested in by the fund is lost, investors would then be entitled to an additional 50% deduction.

Eligibility for deductions would only be available for businesses that are pre-classified as 'innovation-based and internationally focused' via an official approval process. A time limit, a maximum deductible amount and change of control protections would be required.

[1] Rick Boven, Catherine Harland and Lillian Grace, *Plugging the gap: An internationalisation strategy,* New Zealand Institute Discussion Paper 2010/2, December 2010.

The New Zealand Institute points out the provision of tax and other fiscal incentives for start-up businesses is not uncommon internationally, as shown in the table below:

Tax and other fiscal policies incentivizing investment in start-up and growing international business							
Incentive policies identified as present	**Canada**	**Denmark**	**Israel**	**Netherlands**	**Singapore**	**United Kingdom**	**United States**
Capital loss deductibility	✔	✔		✔		✔	✔
Capital gains – annual exemptions, tax free provision of 100% or for a portion of gain		✔				✔	✔
Other investor, angel or entrepreneur incentives e.g. grants, reduced tax rates, tax deductions, tax credits	✔		✔	✔	✔	✔	

Source: New Zealand Institute, *Plugging the gap*

Labour believes further stimulation of this sector is in New Zealand's economic interest. The NZVIF already provides some support, which we believe ought to continue. In our view serious consideration should be given to some of the solutions proposed by the New Zealand Institute.

In our view capital loss deductibility, which shares risk by sharing losses following failure, is more important than exemption from capital gains taxes, which investors in successful entities are able to pay.

Review of Tax on Overseas Royalties

Some intellectual property (IP) based ventures are incentivised by New Zealand's current tax laws to leave New Zealand and locate themselves in lower tax jurisdictions. IP can and does easily move with the domicile of the IP owning company (unlike real assets like land and other hard assets like plant). Reducing tax rates on overseas income from IP may in practice increase New Zealand tax revenue as well as encourage these companies to remain domiciled in New Zealand.

Labour will explore the following ideas for leveraging future capital as part of its economic development strategy, including:

- Requiring support from an international venture capital as part of eligibility for NZVIF.
- Entitling domestic venture or angel investors to a deduction of 20% of their investment against other income at the time of investment, and an additional 50% deduction be allowed if capital is lost.
- Whether a concessional tax rate should be introduced for overseas royalty income of companies based in New Zealand.

Labour will investigate the potential costs of these options and any difficulties that might result as part of the requirement for an overseas investor to access VIF funding, and report back by the end of 2012.

NZ Venture Investment Fund (NZVIF)

The government should continue to support the NZVIF programme through further underwriting. This will enable NZVIF to reinvest returns as the funds it has invested exit their investment companies and distribute returns to investors.

In August 2010, the government provided a $40 million underwrite for the Venture Capital programme to leverage more private investment. This underwrite enables NZVIF to make new investment commitments up to a total of $200m. Officials have advised that it is unlikely that the $40m will be drawn upon.

> Labour will continue to support NZVIF with a view to providing additional underwriting as the pool of ventures expands, and broadening access to VIF through a variety of means.

Reducing Compliance Costs for Capital Raising

As a consequence of a need for increased regulation of finance companies that were masquerading at low risk when they were higher risk, New Zealand has increased the regulation of offers of security to the public. This has led to increase costs for all capital raising, not just for finance companies.

Labour has said all along that while additional regulation of debt security was necessary, equity offerings have been over-regulated in the process. This increases the cost of capital and is a serious barrier to small to medium sized businesses expanding in export markets.

> Labour will reduce compliance costs for equity offerings, which openly describe the risk of loss of investment, by simplifying prospectus and audit requirements. (See Labour's Commerce and Small Business policy for more information.)

Cooperation between Crown Funded Research and Export Industries

Supporting the policy initiatives outlined above, Labour also wants to see greater cooperation between publicly funded bodies and targeted export industries.

Tax funded bodies which have applied science relevance, such as CRIs and Centres of Research Excellence, could have a greater expectation placed on them to collaborate more closely and more often with industry. See Labour's Research, Science & Technology policy for more information.

Pipelines for Business Growth

The discussion above talks about opportunities to grow the innovative sector, through opening up opportunities to access to capital, and to targeting industries and sectors to grow export orientated business.

However there is an intermediate step required to help small and medium sized enterprises (SMEs) and entrepreneurs to tap into both the R&D and infrastructure being progressed as part of the government's sector/industry targeting, and the capital required to expand.

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Small businesses have identified that in addition to access to capital and R&D facilities, governance arrangements and market intelligence are some of the biggest barriers to business growth.

Providing start-up companies with access to an appropriate range of mentoring/training is an important step in identifying those companies that have high growth potential. Those that wish to take up the opportunity will be referred to incubator support programmes like the Escalator programme (abandoned by the current government) and/or be able to access specific or generic market development assistance.

These will be access points to angel investor networks, venture capital funding and the stair-casing opportunity provided by the NZX.

In addition there will be succession planning support for business owners, who wish to consider the range of options for their own retirement from active business life, while potentially retaining an interest in the business. Early support could have a significant impact on the "hollowing out" effect that has become prevalent.

If we are to own our own future, we need a mechanism for ensuring that all options are explored before final decisions are taken.

> Labour will establish a "Pipeline for Business Growth Taskforce", modelled on the Capital Markets Development Taskforce, with a requirement to report in 6 months with recommendations for the pipeline framework, which will connect the training, the R&D, the capital and the market development opportunities so that we can facilitate the advancement of high growth potential businesses.

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