# Labour's pathway to the future:
# More progressive and more prudent

**Institute of Policy Studies, Thursday, 25 November 2010**

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## INTRODUCTION – TOWARDS A NEW PATHWAY

Professor Jonathan Boston and your team at IPS, ladies and gentlemen, it goes without saying that we meet today under the shadow of sad times.

May I begin my remarks by acknowledging the 29 miners who have perished at Pike River, and their families and friends. Immediately following this seminar I will return to a special session of parliament, which will then lift early as a mark of respect to the miners.

It is also true that we meet in the shadow of uncertain economic times:

- A domestic recovery so faltering that is hardly occurring at all
- The shadows of rising international tensions and instability
- And overdue questioning of the old assumptions that governed economic thinking before the global financial crisis.

Today our country is confronted by the most serious global economic conditions in seventy years.

The world that existed during our last time in government has gone. Who now believes markets are always right, that Wall Street acts in the interests of Main Street, that derivatives spread risk, or that bankers just get a fair day's pay for a fair day's work?

National has no plan for the recovery. Instead of creating a coherent plan for all, they have looked after their mates.

They have cut taxes the country could not afford to cut, failed to increase growth or invest for the future.

Not many Kiwis would say their highest priority would be to spend $9.1 billion more on the highest earning ten per cent of New Zealanders over four years - five times as much as went to the bottom earning half.

Most would want to see families' incomes protected so they can keep paying their bills. Most would want to use this opportunity to strengthen New Zealand for the future, not strip it for the privileges of a few.

National's policies are not socially responsible, nor capable of enduring solutions, nor of stimulating the economy.

The result is exactly what most would expect: stagnant growth and widening gaps. Widening between the rich and everyone else; widening between New Zealand and Australia; and widening gaps between what we need to do and what we are able to do.

So our pathway to recovery and renewal will strongly contrast with National's mismanagement.

Yet it must navigate the same international financial constraints.

And it will inherit their irresponsible tax cuts, the depleted social capital; the privatized Crown assets; the mortgaging of superannuation.

It will inherit National's theft from future generations to buy off the votes and vested interests of today.

So Labour will have no choice but to follow a pathway to recovery that is both more fiscally prudent, more determined to address structural impediments, and more socially progressive than that of the current Government.

We will be more prudent because our fiscal strategy will reduce net debt over the fiscal cycle. Labour is a fiscally responsible party. We proved that during our last term when we reduced net debt to zero, despite Bill English calling for tax cuts that would only have inflated the property bubble.

We will not now go on a spending binge.

Instead, our pathway to recovery will build a stronger capital base so that we own more of our future.

Our pathway will encourage businesses to innovate more and increase the value of our exports.

Our pathway will include higher skill levels and therefore higher earnings for working people.

Labour will chart a new course of innovation, saving, ownership, and investment.

New Zealanders look to Labour to rise to tough challenges.

We always have: in the 1930's when Labour charted the pathway out of the great Depression; in the War years when Labour led us through; in the 70s after Britain joined the European Common Market; in the 80's when we restarted Muldoon's broken economy; and in the last decade when Labour rebuilt our torn social fabric.

Labour is rising to the challenge of change again. We need to because National's passive response to the new global conditions is not working.

In my remarks today I will:

- show that new solutions are required at this time of major economic change, and indicate the three paths open to us
- show that the current National Government is short of ideas, failing to deliver and lacking in fiscal credibility
- outline Labour's bold new pathway that is both more progressive and more prudent
- indicate three major areas of policy change that will underpin this new Labour approach.

## THREE PATHS

The choices we have to make are not unique to us.

Confronted with a stalled economy and the grave global conditions, we have seen developed countries go one of three ways.

The first is to cut their way out. Greece the UK and Ireland are cutting savagely.

Labour won't do that, because our problems are not the same as theirs, and because anyway the social cost is too high and falls too unfairly on too many.

Another option being tried in the US is to print their way out, with quantitative monetary easing lowering interest and exchange rates but risking inflation.

Whatever happens there, that is not a plausible option for New Zealand due to our size and dependence on foreign capital.

The third option is closer to the path Australia has followed successfully out of times of trouble: growing out of the crisis, with a combination of appropriate stimulus and investment.

This is closer to the option New Zealand needs to follow.

The Labour Government in Australia responded to the crisis with direct support for the needy and strong investment in economic infrastructure.

They rolled out fast broadband and created r&d incentives that look a lot like the credits Labour introduced in New Zealand in 2007 and National cancelled in 2008.

Of course, Australia's success is built on a generation of strong savings.

## NATIONAL'S RECORD - 1. NO NEW IDEAS

The comparison with the National Government is stark.

Like a possum blinded by the headlights of the global recession, they appear unable to grow their way out like Australia; unwilling to spend their way out like America; or even to cut their way out like Britain.

They simply seem to have no coherent new ideas at all.

They claim to have a "six point plan", but no one outside the Beehive could tell you what it was.

And even if they had, to quote the New Zealand Institute, a goal is not a strategy.

The Government has tried gimmicks, like their cycle-way to nowhere and the Jobs Summit that created no jobs.

They have passed tax cuts that went overwhelmingly to the highest earning ten per cent of New Zealanders.

They have cut into skills and research and development.

Their infrastructure investment is a fraudulent combination of re-announced spending and reallocated expenditure. They have announced the Kopu Bridge eleven times, and are spending billions on a holiday highway north of Auckland so their mates get to their baches faster - but there is no new money for it; only money that has been taken away from other road projects.

But they have no new thinking. No vision of an integrated transport system. No preparation for a low carbon future or the risk of future oil shocks.

Nothing that could help increase Auckland productivity through trains that get people to work more quickly, take cars off the road, and enable all transport to be more effective.

Instead of putting us on a path to a stronger future, they have put us on a low growth path.

Rather than building a better New Zealand, they have created two New Zealands.

By looking out for the few and not the many, they have left most people with less of a stake: less secure, and more fearful.

They have shrunk the revenue base, and failed to increase growth or invest for the future.

When we needed skills, they cut early childhood education, closed the gates of universities, and failed to take the opportunity of the recession to invest in training.

They are failing to make sure our environment is maintained for its own sake and as our great economic advantage, a reason for the world to buy our things and not someone else's.

## 2. NO CATCH-UP TO AUSTRALIA

Standard and Poor's reminded us this week, our economy is under-diversified.

We don't create enough value from our strong underlying resource base to become the country we aspire to be.

In fact we're falling further behind the countries we like to compare ourselves to.

Consider this: In 1974 New Zealand enjoyed parity with Australia in real GDP per capita (measured on purchasing power parity.)

By 1999 we were 34 per cent behind, after twenty five years in which National governed for eighteen.

During the first six years of the last Labour-led government, the gap in real per capita GDP closed to under 30 per cent.

To be fair it widened again in our last term in office, to end up close to where we started - the first government in decades to leave office with the real per capita GDP gap with Australia about the same as it was when we started.

National made its number one economic pledge a promise to close that gap with Australia.

But in the last two years it has widened again. After two years of National, Australia's real per capita GDP is now 37.4 per cent - wider than it has ever been.

Using the figures tabled by John Key in parliament, the gap in average wages has widened since National took office from $133.60 to $175.43 - or by $42 a week.

The gap is not growing only because Australia is performing well.

It's growing because things in New Zealand are getting worse, not better.

Median wages have dropped $9 over the last year. They have dropped nineteen per cent for Pacific people.

With our recovery stalled it is no wonder that Standard & Poor's put our economy on negative credit watch.

They are clearly worried that when the growth figures are released next month, they will again show the National Government's performance trailing its own forecasts.

### 3. NO FISCAL CREDIBILITY

National talks the talk of fiscal prudence, but do they walk the walk?

They say they will cut gross debt to below 20% of GDP, but because they have indulged themselves with grossly irresponsible tax cuts, they are keeping it at 35% until at least 2014.

They say they will reduce government spending as a share of the economy from 35% to 27% by 2024, but it will stay above 34% until just after the next election.

They say they will keep new spending to $1.1~billion each year, but automatic cost inflation in health, education and welfare will eat up almost all of it, leaving them nothing for new ideas or new jobs.

They said they would resume superannuation pre-funding when the books return to surplus in 2016, but it is not in the Budget until at least 2020.

They said the 2010 Budget would be fiscally neutral, but it opened up a $1.1 billion extra hole in 4 years; and $9 billion extra debt in a decade.

They said they would not raise GST to fund a deficit, but raised it anyway.

They decried borrowing $250 million a week to keep the economy going, but then gave rich folks big tax cuts, reduced revenue and upped the borrowing to $300 million a week.

The truth is - the only way they can get the numbers to add up is to massively cut government services and privatise assets if they get a second term.

And even then, how they will pay for current levels of superannuation without pre-funding or doubling the tax burden on our kids is a mystery to everyone - including the Treasury and the Retirement Commission.

New Zealand cannot afford the fiscal irresponsibility of giving massive tax cuts to top earners.

We can’t keep going down the path National is plotting.

Passive government that cuts the size of the state instead of investing in real structural change is stalling the recovery, not helping it.

## LABOUR'S NEW ECONOMIC PATHWAY

Because of National's wasteful tax cuts there won't be huge pockets of money to spend when the next Labour government takes office.

We know we can't just tax and spend our way out of a hole.
Instead of massive extra spending, we will have to reform the fundamentals of our economy.

We will do what it takes to put the economy back on a better pathway, one that is more progressive and more prudent:

- one where we together, all of us - the many and not just the few - accumulate assets and not debt.

- One where we all have a stake in our economy and a beautiful country through a better job and better skills.

- And, unlike National, who trust only the rich to handle assets and savings and wealth, we are prepared to trust ordinary New Zealanders to hold a stake in their own future.

We will do what it takes for Kiwis to have access to capital so we can invest here, for ideas to be worked up and innovated here, for us to hold stakes in our smart companies and keep them here, and provide opportunities for our children that will give them the choice to stay here.

We are prepared to invest what it takes to keep us clean and green, in children, in infrastructure that will make the many more productive, not help the few go on holiday.

So today we are committing to making bold changes to our economy, to put it on a path that is both more progressive and more prudent.

To where we can all can grow our capital base and own our own future; where we can innovate more and export more.

To increase the skills and therefore the earnings of working people; and grow the stake and savings of New Zealanders in our own future.

That's why I am saying the next Labour Government will be both more progressive and more prudent.

Instead of being fiscally looser, we will be more active economic managers.

The way you get to recovery of the type I'm talking about is through deeper partnerships and much more aggressive use of the capital account.

We will reduce net debt.

But we will not shrink the ability of the state to lead change in partnership with business and the community.

In the balance of my remarks today I want to give you a sense of what the policy map looks like that will guide us on this new pathway.

Individual policies will be announced in more detail as appropriate nearer the election.

## THE NEW PATHWAY: MAP AND WAYPOINTS

### 1: BUILDING A STRONG EXPORT ECONOMY.

At the core of Labour's plan there will be an active economic development partnership between government, business and the community to grow good jobs, high incomes and more exports.

We will unlock opportunities to move New Zealand companies up the global value chain, and unlock potential across specific sectors and regions.

Take the example of Denmark, roughly similar in population to New Zealand, but smaller in land area.

It has added more value to its agricultural base, and developed much higher value niche manufacturing and service industries.

We are top in milk powder. Denmark makes ridiculously expensive butter and cheese.

We are great at exporting raw logs. They are number one in furniture design.

We have abundant renewable hydro power. They are the world's leading exporters of wind farm turbines.

Finland went one better and turned a forestry company into the world's number one mobile phone manufacturer, Nokia.

At the heart of these small, primary sector-based Scandinavian economies was an overriding commitment to innovation.

Finland spends around 3% of GDP on R&D; New Zealand less than 1%.

We need more Gallagher's and Icebreakers, more Via Lactia's and Fisher and Paykel Healthcare's.

We simply cannot expand bulk commodity production enough, or guarantee commodity prices high enough, to lift GDP per capita to the levels we aspire to.

But neither should we presume that there is a false choice between our primary endowments and our innovation strengths.

Innovation means improving the efficiency of processes as well as creating new products and services.

Partnership means creating the environment and incentives for the private sector to invest, such as by restoring R&D tax credits, and more.

It means getting dialogue going between government and business leaders; listening hard to unlock potential and knock over roadblocks in high potential sectors and regions.

Investing in clean technology is a likely example. Leveraging forestry investment through the benefits of a low carbon future is another.

Both would support our international branding as a premium producer that is clean, green and clever.

We will seamlessly and powerfully link innovation and strategic economic development

We can build new regional partnerships between business, Iwi, local and central government and economic development agencies, from aquaculture in Opotiki to broadband in Balclutha.

We can ensure there is a proper, nurturing growth pipeline for small and medium business development.  We can expand the use of incubators, venture investment funds and beach-heads to assist start-ups to take ideas to market, and market to the world.

We can implement a comprehensive skills strategy that brings back apprenticeships and encourages lifelong learning to enhance the productivity of workers and the profitability of workplaces.

We can better use global broadband technology so Kiwi entrepreneurs can play to win in global value chains.  When Toronto Airport's baggage handling systems can be run out of a factory control center in Glen Eden, there is no reason Dubai's education system cannot be managed out of Wellington.

We can leverage our unique lifestyle advantages: selling consulting services from fishing boats in the Hauraki Gulf or ski chalets in Central Otago.

Crucially in a capital constrained fiscal environment, we will better leverage the Crown's balance sheet in new and innovative ways.

We can expand public-private partnerships for new transport infrastructure.  The project scale must be right and the PPP benefits must outweigh any increase in cost of capital, but that leaves plenty of scope for win-wins .

We can unleash State Owned Enterprises to create and grow new subsidiaries with private partners and shareholders, without diluting the taxpayer's equity, or wholly or partially privatizing the SOE.

We've already seen a huge example of success in the government's creation of Kiwibank: that investment has increased the value of NZ Post far beyond the value of the initial investment.

There must be serious conversations with Maori owners of substantial assets about leveraging that asset base to build a brighter future - such as in regions where large scale forests can be planted, and help create a lower carbon future.

We can partner with Iwi and community groups to provide social housing; or with the New Zealand Superannuation Fund as a cornerstone investor in long term local growth opportunities.

Such Crown partnership investments need not increase net debt. If the government invests in a growing asset like a forest, that asset appears on both sides of the Crown balance sheet, and need not increase net debt; but does increase net worth.

We can turn old models of Government participation in economic development on their head by using equity rather than grants; private sector exports rather than bureaucrats, and rigorous performance measures rather than public sector doubletalk.

And Labour has already withdrawn from the now moribund consensus on monetary policy. We will reform the Reserve Bank Act and the Policy Targets Agreement.

We would retain the operational independence of the Reserve Bank and the current 1-3% inflation target, but broaden its objectives to include external balance and growth, including exchange rate conditions for Kiwi exporters.

We would broaden the monetary tool set to explicitly include complementary monetary instruments like a counter-cyclical core assets ratio and consideration of an inbound transactions tax.

## 2: OWNING OUR OWN FUTURE: GROWING SAVINGS AND CAPITAL

Growing the real economy is only half the story: we must also own enough of it to enjoy the benefits.

Without reform of the savings and capital side of our national account, we cannot address the triple challenge laid out this week by Standard and Poor's: to fix our savings gap, to turn around growing (mainly private) net international liabilities, and to close the current account deficit through a more diversified economy.

National claims that their stuttering, fragile 'recovery' is a triumph of 'saving'. Actually it is a tragedy of shrinking household income.

Ask any median wage-earning family at the supermarket how their great new saving plan is going.

They're struggling to make ends meet as it is, with prices rising faster than their wages.

In contrast, Australia's compulsory savings scheme is widely regarded as providing a trillion dollar deep pool of savings - some of which is used to buy up New Zealand.

Labour is committed to leading the savings debate. In 2011 we will have the leading savings policy.

Labour will restore pre-funding of NZ Super. That won't increase net debt because it matches assets to liabilities.

We have been doing a lot of work in this area and we have a clear idea of what will work. But with the Savings Working Group reporting in the New Year, we will do due diligence on its report before releasing our own policy.

But underneath our policy is a conclusion that the government will not be in any fiscal position to bankroll the investment we need alone.

It will take partnerships, and therefore a key role for the government will be to help to create an environment where we save more as a country. Kiwisaver is an example we can build on.

Institutional reform also has an important part to play.

New Zealand has, on the whole, benefitted from a strong and stable banking sector.

But the flip side of our trans-Tasman banking anchor is the annual drain of financial sector profits to its 95% foreign parents.

Each year that drain is far larger than the combined profits of all the companies listed on the New Zealand stock exchange. It does not assist our current account balance, or the accumulation of long term domestic capital adequacy from local sources.

Labour will over time build Kiwibank into a full service, full-scale domestic banking institution. We want to retain more banking profits in New Zealand.

We will work with the sector to ensure that there are adequate, accessible business banking facilities available in New Zealand to suit all stages of the client business life cycle.

We will put the government's own banking arrangements up for a transparent tendering process to ensure fairness and value for New Zealand taxpayers.

Labour would resume prefunding contributions to the New Zealand Superannuation Fund. The average return on the fund is higher than the Crown's cost of borrowing, despite having suffered the immediate effects of the worst financial crisis in 70 years.

Careful consideration must be given to investing, as responsible opportunities permit, a greater share of the Funds financial assets in New Zealand.

Labour has announced its foreign direct investment policy. We warmly welcome beneficial inbound FDI on a non-discriminatory basis as to source.

However Labour will ensure that the presumption on all land sales over five hectares, and on strategic monopoly network infrastructure, is reversed to require a net national benefit to be demonstrated.

FDI matters, but so does the quality of that investment.

And if New Zealanders are to own their own slice of the Kiwi dream, then they cannot be priced out of the market for their own land.

If New Zealand is to enjoy the benefits of its strong resource endowment, we must retain control of those fundamental assets.

A healthy financial sector will not be possible unless the Government plays its part to ensure a prudent and healthy financial position.

Labour is committed to Fiscal responsibility and sustainability.

We will establish a credible set of fiscal targets that the Labour government sticks with.

Labour will reduce net Crown debt, including the assets of the New Zealand Superannuation Fund, over time across the business cycle. We will maintain and gradually reduce gross debt at prudent levels.

And we will help prepare for the retirements of the baby-boomer generation by resuming contributions to the NZ Superannuation Fund.

Labour’s new pathway will be a prudent as well as a progressive one.

Sustainability encompasses respect for our long term financial environment as well as our natural one.

## 3. HELPING KIWI’S GET AHEAD

The ultimate test for Labour’s economic policy is whether it benefits everyday New Zealanders, both in the near and longer terms.

All New Zealanders will benefit from a Labour Government that enjoys the stability and confidence of financial markets.

Owning our own future means increasing our stake in our own financial future and ensuring that stake-holding is broadly spread.

And we will make sure that everyone carries their fair share of the responsibility.

How can anyone call National’s policies a success when poor families in Auckland are paying more than 50% of their income for a basic roof over their heads?

Everyone has a responsibility to do their bit for our country - and that’s why we will take some pressure off our fiscal future by taking a new look at major avenues for tax avoidance.

The National Government received advice to crack down on avoidance through trusts and loss attributing qualifying companies (LAQC’s) - and let the opportunity slip this year, because it would have affected their mates.

This is a highly technical area that I don't have time to explore in depth, but I am clear that we need to take the pressure off hard working families by broadening the tax base to reduce avoidance and distortions, as well as to reduce environmental and other externalities.

If avenues for avoidance of responsibility are reduced, and if everyone pays their fair share, then that may well give us opportunities over time to reduce the overall tax paid by low and middle income earners.

But it is a priority to reduce the burden on those families in the short term - that's why we're pledging to axe the GST on fresh fruit and vegetables, and to reduce the pace of power price increases.

The real test of policy is whether the benefits are fairly shared. We need to help Kiwi Families get ahead.

## CONCLUSION

The National Government has left us with a stalled recovery.

We need to make a strong change in direction, but we won't have much fiscal room to move.

Therefore Labour will make strong changes in other areas:

- Stronger use of the capital account and partnerships.

- Stronger commitment to economic development, innovation, skills; research, science and technology.

- Monetary policy that is less volatile and therefore more supportive of exporters.

- Making sure we own our own future.

Ensuring everyone pays their fair share.

We know we will have to build our future prosperity within tight fiscal constraints.

These have been made worse by the retrenchment of the current government and its failure to address the long term fiscal outlook.

But we will reduce net debt over the fiscal cycle.

Yet without strong leadership from government, our private sector will continue to suffer from the tyranny of scale and distance, combined with capital scarcity and progressive loss of ownership and control.

Bold and innovative solutions will be required to turn New Zealand's economy around.

These must combine

- sound macroeconomic management,

- a comprehensive economic development and innovation strategy,

- structural solutions to our local savings and investment deficits,

- and a determination to deliver tangible benefits to all New Zealanders on an equitable basis.

We have seen where the old approach gets us, debt, hollowing out, rising inequalities, loss of economic control, bubbles and unproductive investments, low wages.

We have rejected that in favour of a new approach that is both more progressive and more prudent than the status quo.

We are choosing a new pathway, and once we are heading down it, a lot of things will seem different.

We know what the main landmarks on it are: but we will need to work with communities, iwi and businesses; the finance sector, international and local investors to grow it.

It makes the most of markets, makes sure that we end up with all us having a stake in them, and in the economy they generate.

It is a pathway to an economy renews the Kiwi dream: somewhere ordinary Kiwi's can own our own future; can grow, can be proud of, and build a real stake in.