Rt Hon John Key

Prime Minister

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Speech

EMBARGOED UNTIL DELIVERY

Our Economic Challenge Trusts Stadium, Henderson Ladies and Gentlemen. This year is about building a brighter future for New Zealanders and their families. That is only possible if we lift the country's economic performance, and by doing so deliver the jobs, higher incomes and better living standards New Zealanders aspire to and deserve. That means making responsible decisions now, as the economy picks up, to increase national savings and reduce the country's debt. In less than two weeks, on the first day of Parliament, I will deliver a Statement which sets out our full programme of action for the year, across all the different areas of government. But today I want to concentrate solely on the economy, because our economic performance is the most important challenge facing New Zealand. The good news on the economy is that 2011 is expected to be a better year than 2010. Treasury is predicting growth in excess of 3 per cent this year, together with higher wages and falling unemployment. As in 2010, there will no doubt be bumps in the road. But regardless of what unfolds, it is important to look through the quarter-to-quarter economic figures and focus on the longer-term challenge. That challenge is to build a lasting recovery based on savings, exports and productive investment. New Zealand has been through a recession and a global financial crisis. We have a chance, now the economy is gathering steam again, to build a solid platform for future growth. If we get this right the possibilities are exciting. Our trade is rapidly shifting towards Asia, which is growing much faster than our traditional markets in Europe and the United States. New Zealand is a food-producing country and world demand for food is rising. Global prices for dairy, forestry, meat and other commodities are high. We have a genuine competitive advantage in agriculture and other primary sectors. We have world-class firms engaged in high-tech manufacturing, software, film and other industries. These are great opportunities for New Zealand. But as a country we have to reach out and grasp those opportunities or we risk missing the boat. The way for New Zealand to get ahead is to sell more to the rest of the world. That means making some changes. Growth over the last decade was built on all the wrong things – debt, consumption, and government spending. People borrowed heavily to buy houses and farms, property prices soared and New Zealanders felt wealthier as a result. They spent a lot on consumer goods, which led to a bubble of economic activity. The Labour Government thought this bubble, and the tax revenue it generated, would go on forever and spent up large on permanent new spending programmes. The Government's spending increased by more than 50 per cent in just six years. High government and private sector consumption generated inflationary pressures, pushing up interest rates and discouraging productive investment. High interest rates in turn led to an over-valued exchange rate which smothered the internationally-competitive sectors of the economy, like agriculture, horticulture and manufacturing. Our exporters found it hard to sell their products at competitive prices overseas because of the high value of the dollar. The internationally-competitive sectors of the economy actually went into recession in 2004, and experienced a 10 per cent drop in output over the next five years. In contrast, the domestically-focused side of the economy grew strongly. Since 2004, almost 60 per cent of new jobs have been in heavily government-dominated sectors. As a country we imported far more than we exported, leaving a gaping balance of payments deficit that persisted for year after year. All this could never be a solid basis for growth. Subsequent events proved that very clearly. By the time the National-led Government came into office at the end of 2008 the economy was deep in recession, and inflation was the highest it had been in 18 years. The Government's books had been left in a mess, with Treasury projecting no end to budget deficits and government debt spiralling out of control. As an incoming government, we moved quickly to steady the ship, help the economy through the recession and set a credible path back to surplus. Even so, when we tally up everything the Government is spending this year, we still need to borrow $300 million a week on average to pay the bills. In the worst of the recession, running a budget deficit was the right thing to do, as it gave much-needed support to the economy. Now, as the economy recovers, borrowing $300 million a week is unaffordable and is holding the economy back. It is crowding out our internationally-competitive sectors of the economy, keeping the exchange rate high, and tying up resources that could be better used elsewhere in the economy. And this borrowing will, of course, have to be repaid in future years, with interest. Annual interest payments on our debt will, in four years time, cost more than spending on the Police, defence and early childhood education combined. Rising government debt adds to New Zealand's total indebtedness to the rest of the world. Through decades of under-saving, over-spending and over-borrowing, the public and private sectors have together built up a net foreign debt equivalent to 85 per cent of GDP. That makes us heavily reliant on overseas lenders who can at any time decide that we are just too much of a risk. And if we can't raise money overseas, or can only do so at a high price, we face the risk of a protracted recession, with a significant loss of jobs and a fall in the value of everyone's homes, businesses and farms. To put it in context, the only other developed countries with a foreign debt the size of ours are Greece, Portugal, Spain and Ireland. That is very uneasy company indeed. And it is precisely the difficulties those countries are in that has led to Standard and Poor's putting New Zealand on negative outlook. So as the economy picks up, it is crucially important that our growth is not based, as it was in the 2000s, on debt, consumption and government spending but instead is built on the solid foundation of savings, exports and productive investment. The National-led Government was elected in late 2008 to build that stronger growth. We have made considerable progress already with our six-point plan for a stronger economy. As part of that plan we undertook the biggest reforms of the tax system in 25 years to increase the incentives to work hard, save and invest; and to remove distortions and clamp down on loopholes. Importantly, we designed these tax changes so that they won't result in extra government borrowing across the forecast period. We hauled back new budget spending allowances and reduced the size of the bureaucracy. We invested in much-needed infrastructure, to unblock the arteries of the economy. We have progressed an ambitious free trade agenda. And we introduced a number of regulatory changes to make it easier to do business. But structural change in the economy does not happen overnight. It is a bit like turning a super-tanker around. New Zealand's economic imbalances have built up over several decades, so it will take more than a year or two to fix them. It will take a number of years and considerable effort. In our first Budget, in 2009, the Government's focus was on getting through the recession in as good a shape as possible. In last year's Budget, we concentrated on reforming the tax system. This year the theme of the Budget will be savings and investment. The Government agrees with the Savings Working Group, in its interim report, that New Zealand as a whole needs to save more, spend less and reduce our reliance on foreign debt. Over the last year or so, New Zealand households, businesses and farms have begun to save more, spend less and borrow less as a proportion of their incomes. This is an encouraging change of behaviour but needs to be cemented in for the long term. And government needs to stop pushing the other way. The Savings Working Group is due to present its report to the Government in a few weeks. We will consider this very carefully, including ideas around tax, KiwiSaver, and investment products. The Government has already made tax changes that are pro-savings. We remain conscious, however, that effective tax rates on some forms of savings remain very high. The Government is also interested in ideas that increase participation in KiwiSaver and raise national savings, but which don't result in an ongoing and unaffordable fiscal cost, which again would have to be borrowed. And in terms of investment opportunities, the Government is interested in the Working Group's thoughts on how to expand the range of investment opportunities available to New Zealand savers. It would be better for both investors and the economy as a whole if people had the confidence to save more and invest in a wider range of assets, not just in property. These are all areas where the Government may be able to influence the level or allocation of private sector savings. But a point which has been made to us very clearly, by the Savings Working Group and others, is that the government is itself a crucial part of the national savings equation. The government simply has to get its finances in order if New Zealand is to achieve a long-term improvement in its economic prospects. Therefore I am announcing today that the Government intends to borrow less in the future than is currently forecast. That is going to involve action on two fronts – on the operating side and on the capital side of the Government's spending. First, in terms of operating spending, the Government has decided to run a tighter fiscal policy than has previously been indicated. When we are borrowing $300 million a week, have an overvalued exchange rate, and face the prospect of a credit rating downgrade, the Government believes it should be spending less and therefore borrowing less. I have therefore challenged my Ministers to balance the books more quickly. Government spending will continue to increase each year in dollar terms, but at a slower pace than the rest of the economy. As the first step in reducing spending growth, we will run a tighter Budget this year than was indicated in the Budget Policy Statement in December. Currently we have a new spending allowance of $1.1 billion each year, compared to Labour's average of $2.8 billion a year over its last five budgets. Our plan is to reduce that new spending allowance in Budget 2011 even further, to around $800 to $900 million. Nonetheless, this year's Budget will continue to prioritise new spending to health and education in particular, and to initiatives that promote economic growth. At the moment, Treasury is projecting the budget to return to a meaningful surplus in 2015/16. With a tighter Budget this year, and assuming revenue stays on track, the budget will in fact return to a meaningful surplus a year earlier, in 2014/15. In addition, until we get back into surplus, we are going to allocate any upward revenue surprises to further reducing the deficit. Throughout this year, we are also going to consider longer-term sources of savings. In particular, the Government is determined to reduce the costs of running its own business. That process has started, but the public sector is still a long way from being a lean and efficient organisation. Crucially, this year there will be no room at all for extravagant election promises. We are going to campaign on being responsible managers of the economy, who make the right decisions to build a platform for future growth. Any party that wants to ramp up spending is being economically irresponsible. The only way to spend more money is to borrow it or to raise taxes. Borrowing more would lift our debt to dangerous levels, while raising taxes would snuff out the recovery and send even more Kiwis overseas. In terms of capital spending, the Government is committed to building assets that will help create a stronger economy and deliver better public services. In December, the Government released its first Investment Statement which shows what we own, how much it is worth, and how much we expect to spend on buying new assets in the future. The Investment Statement shows that the government, on behalf of taxpayers, owns $220 billion of assets across a whole range of social, financial and commercial investments – everything

from hospitals, roads, prisons, schools and Police stations to the Super Fund, electricity companies and coal mining operations. We also expect to acquire $33 billion of net new assets over the next five years, including new schools, operating theatres, ultra-fast broadband and major investments in our state highways and other transport infrastructure. That is a considerable spend by any reckoning. At the margin there are two ways we can acquire new assets – either we can borrow more or we can change the mix of assets we own. As I have said, the government can't keep building up debt forever. As a country we have to fund more of our own future. So we need to look at where we can change the mix of assets we own – identifying where new assets are most needed and where we have more money invested than we absolutely need to. The greatest scope to change the mix of assets lies with the government's portfolio of commercial assets. In particular, the sort of mixed-ownership model under which Air New Zealand operates – where the government owns most of the company but there is a minority of outside equity – gives the best of both worlds. Under this model, the government has a controlling stake in what is a crucial piece of transport infrastructure and guarantees that it will be majority New Zealand owned. But by not owning 100 percent of the airline, the government also has capital free to invest in other assets. This model could be extended to more of the government's commercial assets. As well as freeing up capital, there are three other potential benefits of a mixed ownership model. The first is that it broadens the pool of investments for New Zealand savers, either directly themselves, or through investment funds such as KiwiSaver. New, quality listings on the stock exchange would give "mum and dad" investors the option of putting their savings into large and proven companies, rather than relying, as is so often the case, on property investments. The second is that the company reaps the benefits of sharper commercial disciplines, more transparency and greater external oversight. Under the mixed ownership model Air New Zealand has been a creative and innovative company and a model corporate citizen. It has also offered some very competitive prices for air travel. I am convinced that Air New Zealand would not be run as well, nor provide as good a service to customers, if it was owned 100 percent by the government. And the third potential benefit is the opportunity for the companies involved to obtain more capital to grow further, without depending entirely on a cash-strapped government to support them. For all these reasons, the Government has asked Treasury for advice on the merits and viability of extending the mixed ownership model to four other state-owned companies – Mighty River Power, Meridian, Genesis and Solid Energy. In each case, the government would retain majority ownership and control, and the freed-up capital would be used to purchase other public assets, thereby reducing the government's need to borrow. The Government has also asked Treasury for advice on the merits and viability of reducing the government's shareholding in Air New Zealand, again while retaining a majority stake. Only the companies I have just mentioned will be considered for a mixed ownership model. But the Government will continue to look for commercial arrangements in other areas where private involvement can help drive performance, in the way we have been doing with public-private partnerships, for example. I can see a strong appetite from New Zealand investors for participation in a mixed ownership model. Between KiwiSaver, other managed funds, iwi, mum and dad investors and the government's own investment arms – including the Super Fund – there is a very substantial capacity to invest in quality New Zealand assets. We would envisage these groups being at the front of the queue in any offering, and taking the majority of any stake that was offered. In particular, I think it would be great if Kiwi mums and dads had more of a stake in the New Zealand economy by owning shares in good Kiwi companies. That, in my view, would be progress towards building a better savings and investment culture in New Zealand. Ownership by New Zealand investors would of course be on top of the government's majority stake, which is held on behalf of all New Zealanders. That majority stake would always ensure New Zealand control for the benefit of New Zealanders. As far as possible, without compromising commercial sensitivities, the Government will publicly release the advice we receive from Treasury. We have always been clear that if there was to be any change to our policy on state-owned assets in any way, we would seek the support of New Zealanders at an election, and that is exactly what we will do. Our final policy will be decided prior to this year's election, and we will seek a mandate from the electorate before proceeding with any change. The mixed-ownership model presents the possibility of real benefits for New Zealanders. But let me be clear – we will only proceed with a mixed ownership model if it meets the following tests: ·
the Government would have to maintain a majority controlling stake by owning more than 50 per cent of the company; · New Zealand investors would have to be at the front of the queue for shareholdings, and we would have to be confident of widespread and substantial New Zealand share ownership; · the companies involved would have to present good opportunities for investors; · the capital freed up would have to be used on behalf of taxpayers to fund new public assets and thereby reduce the pressure on the Government to borrow; and · the Government would have to be satisfied that industry-specific regulations adequately protected New Zealand consumers. In particular, I want to stress that the Government is interested in what works, not in following any particular ideology. Governments of all stripes, all around the world, regularly consider the mix of assets they own and whether they are deployed in the right places. That is what we are doing as well. I want to finish by emphasising the importance of getting the New Zealand economy back on a solid and durable growth path. We got off that path in the mid-2000s, and doing so has proven very harmful. Getting back on the growth path again means playing to our true strengths – allowing our export industries to start expanding again, and not tying up resources in less-efficient, domestically-focused government sectors. Increasing national savings is key to supporting this shift. That is why the theme of this year's Budget is going to be savings and investment. We recognise that New Zealand's high level of foreign debt is our biggest vulnerability. We have asked the Savings Working Group to consider policy options to increase national savings. But the Government is already committed to playing its part. We have to increase our own savings and reduce public sector debt. That is why the Government is going to reduce growth in its spending, get back to surplus faster than previously indicated and look to better allocate its assets across competing uses. As I said at the outset of this speech, New Zealand has some great opportunities to get ahead again and have a more prosperous future. But to do so we have to give our internationally-competitive sectors the platform to succeed. This Government is prepared to do that. We will take the steps required to build stronger growth, and build that brighter future for New Zealanders. New Zealanders deserve nothing less. Media contact: Kevin Taylor 027 600 5619 (in Wellington) Lesley Hamilton 027 490 1345 (with Prime Minister)