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### The Growth Outlook and Rotorua's Economy

*Speech notes to Rotorua Economic Forum*

This afternoon I want to talk about the government's vision for achieving long-term sustained growth in the New Zealand economy, and where regional economies such as Rotorua fit into that.

At the start, it is important to acknowledge that the growth vision has in fact been a reality for the past six years. The economic cycle that has just ended has been one of the most impressive in our recent history, and it has restored our self-confidence after two decades of sluggish performance.

Since 1999, annual growth has averaged 3.9 per cent, which is well above the OECD average of 2.5 per cent. In the year to December 2004 alone, the economy grew by 4.4 per cent.

The New Zealand economy today is around 20 percent larger than it was in 1999, and that has enabled us to do two things:

- It has enabled us to improve the living standards of ordinary households, through creating over 300,000 new jobs, delivering better incomes and improvements to public services like free doctors visits and more accessible childcare.
- And it has enabled us to start investing in the things that will secure our future. Those investments include building up our essential infrastructures, investing in the skills of our workforce, supporting our exporters, and focusing our scientific research on key areas of competitive advantage.

This strong performance has not been a matter of riding the tide of global growth. Quite the opposite, in fact, in that it has occurred despite some challenging international and domestic events, including the burst of the technology bubble in 2000, heightened geopolitical uncertainties following the events of September 11, dry weather conditions and the outbreak of SARS in 2003, and oil prices reaching record levels in nominal terms.

The New Zealand economy showed great resilience through this period, and there is every reason to believe that, just as the period of growth was prolonged, so the current downturn will be relatively short and not particularly severe.

GDP growth is expected to fall from 3.7 percent in the year to March 2005 to 2.1 per cent in the year to March 2006, and will bottom out at 1.0 per cent in the year to March 2007. That is due to a number of factors, including higher interest and exchange rates, lower net migration to New Zealand, slower growth in many of our trading partners, and a forecast decline in our terms of trade, largely due to rising world oil prices.

While those projected growth rates are obviously disappointing, we should take heart from the fact that there was a time, not so long ago, when growth of 2.5 per cent would have been seen as a real achievement, especially near the bottom of the cycle. Moreover, even at the bottom of the cycle, our forecast growth will more or less match the OECD average.

Similarly, while we are forecasting that unemployment will rise slightly as the economy slows over the next few years, our unemployment rate will remain amongst the lowest in the OECD, and in particular lower than Australia's.

The Treasury is forecasting for growth to rebound to 3.3 per cent in the March 2008 year, and our challenge is to make the next economic cycle last longer and deliver more sustained and more diversified growth.

What then are the conditions that will create strong economic growth in our regional economies? The answer is essentially the same as for our national economy.

We need a skilled and motivated workforce; people who want to do their best work in the place they want to live and bring up their families.

We need innovative companies who use advanced skills and knowledge to maintain their competitive edge. As Bill Gates says, we need not only to bring high-quality products and services to the market, but also to be the first to replace our own products with new and more innovative ones.

We need in particular to foster new exporters who will take advantage of strengthened international linkages such as those emerging from the trans-Tasman Single Economic Market and the free trade agreements we are developing with China, the ASEAN nations and Chile.

To achieve these goals we need a broad set of national strategies that are supported in key areas by regional initiatives. There are many threads to this strategy. They include:

- Investment in research and science;
- Development of our venture capital markets;
- Direct support for business, and particularly exporters;
- Investment in infrastructure;
- Trade access;
- Maintaining our high ranking in terms of regulatory compliance costs and ease of doing business; and
- Building up the skills and productivity of our workforce.

I want to touch briefly on several of these. For example, this year's Budget announced a \$100 million increase in research and science funding over the next four years, including \$81 million to support research in key industries and \$16 million to accelerate the commercialisation of research. All told we are spending \$630 million a year on research, science and technology, which is a 65 per cent increase since 1999.

A large portion of this research is aimed at improvements in our land-based industries, such as forestry and farming, which are important pillars of the Rotorua economy.

Meanwhile, the government has made some very real moves to foster a more vibrant venture capital market:

- We have launched the Venture Investment Fund as a means of developing the venture capital market. This year's Budget announced a further injection of capital into the VIF venture capital fund of \$60 million, following promising early results from the Fund's initial rounds of investment;
- Alongside that is the Seed Co-investment Fund, or SCIF, which is a \$40 million initiative for developing early stage capital markets; and
- We are supporting a higher rate of domestic savings through the New Zealand Superannuation Fund and now the KiwiSaver scheme;

In the same vein, this year's Budget put \$64.2 million more into market development assistance, assisting New Zealand firms crack key overseas markets. New Zealand needs to new crop of world-beating exporters, and the first place to look for those are existing small-scale exporters who have established one or more secure markets, but who still have further potential to develop.

We have, for example, a large number of companies who have entered the Australian market, taking advantage of the low barriers to trade that are creating a domestic market of 26 million people. The question is: which of these exporters are ready to take the lessons they have learned in Australia and develop markets in Asia, Europe, and the Americas?

We have recognised that, for a variety of practical reasons, this is often a step beyond their comfort zone. Marketing, production and finance need to move to new level of sophistication, and this involves more specialised management expertise and an ability to address a new set of risks.

We are undertaking to share some of the upfront costs and risks of developing that next set of markets, recognising that the success of beachhead exporters brings benefits that go well beyond those particular companies.

Education and skills training are also important areas for investment. So, for example, the government has this year:

- Provided additional funding of \$34.4 million to expand the number of Modern Apprentices to 14,000 by the end of 2008;
- Given a further boost to industry training of \$15.6 million, now that we have surpassed our initial goal of getting 150,000 people into work-based training by the end of 2005; and
- Funded new initiatives costing \$33.5 million in improving the literacy, numeracy and language skills of the workforce, aimed at making many of our lower skilled workers more productive.

These initiatives sit alongside a broader set of tertiary education reforms. Like many developed nations, New Zealand has in the last couple of decades turned tertiary education from a somewhat elitist activity engaged in by ten or twenty percent of each population cohort into a central focus for the majority of young people leaving the school sector. We have markedly improved our participation rates, including amongst Maori, where they had been traditionally rather low.

However, a rising tide such as this can hide some fairly low quality delivery, and the funding system we currently have leaves it largely to the tertiary provider and the students to determine who will acquire precisely what skills. That has meant in some cases a mismatch between the skills being taught and those in demand in the labour market.

It has also discouraged tertiary providers from thinking about how they form a network of provision to serve their communities, and instead encouraged them into wasteful duplication and away from collaboration.

The funding reforms that are underway are designed to bring a stronger quality element into the picture, and to ensure that employers have a more prominent role in providing guidance to the system. Quality is, after all, a matter of fitness for purpose, and a key purpose of tertiary education is to enable students to boost the productivity of regional businesses.

We will also strengthen incentives for institutions to form a network of provision that is user and employer focused, with each institution making a distinctive contribution within that network.

The new funding system requires institutions to engage with employers on detailed three year plans. That dialogue will focus on the precise skill sets and competencies that regional employers are looking for in new graduates.

Innovative companies with skilled workers need world class infrastructure, and we know that as a nation we let that slip badly during the 1990s. After six years playing catch up I think it is fair to say we have recovered the lost ground, but of course our population has grown and expectations are higher.

We need to continue the programme of investment that has seen a significant boost to the level of annual expenditure on key assets in the energy and transport sectors. For example, we have more than doubled expenditure on land transport, and this year's Budget committed an extra \$1.3 billion over the next five years to guarantee the State Highway programme and accelerate some critical roading projects. While the major metropolitan areas get a large share of this expenditure, a number of important regional projects will also be fast-tracked.

Finally, regarding regulatory efficiency, we rank at or near the top of most comparisons of the regulatory environment for business. Anyone who has tried to do business in Europe, the US or even Australia, can attest to that fact.

Not that we are resting on our laurels. The key focus of the Business Tax Review released recently is to ensure that our tax system for business supports productivity growth in areas such as research and development. While some critics have labelled it tepid, I would like to remind business that the review is the most significant examination of corporate tax rules in nearly twenty years and in total the measures amount to nearly two billion dollars. We can't afford all of them, but we are still determined to make significant changes.

Importantly, the options go well beyond simplistic notions that the headline company tax rate is the primary determinant of international competitiveness. We need to find the right mix of measures, including the appropriate company tax rate, that gives us the best bang for our buck in terms of lifting productivity and competitiveness.

In the same vein, we are strengthening the business environment through the ongoing progress towards a single economic market with Australia. What we are creating is an environment in which businesses need not face any additional regulatory hurdles from expanding their business across borders than they would if expanding domestically. That means reducing the impact of our common border, reducing duplication in our regulatory systems, and supporting business to take advantage of the increasing openness in trans-Tasman markets.

These are the national initiatives for creating sustained growth. But what of the regional framework?

First of all, it is encouraging to see that there are a very large number of sub-national economic development strategies. Rotorua's Bright Economy strategy is a good example of the benefits that arise merely from bringing regional players together and identifying where future growth is likely to come from within the region.

As you will be aware, key actions from the strategy include:

- Promotion and interaction of tourism and retail sectors;
- Re-development and enhancement of the city's central business district;
- Further development of destination marketing, including the attraction of visitors, skilled workers, residents and businesses;
- Development of value-added forestry and wood processing in the region; and
- Development of the physical and economic linkages with surrounding areas, especially Tauranga (which is one of the country's fastest growing regions in terms of population, investment, and trade infrastructure).

The opportunities in forestry have been recognised in the wood processing centre of excellence, which received \$2 million of regional development funding. The project is a collaboration between the Forest Industries Training and Education Council, Waiariki Institute of Technology and the University of Auckland. The Centre currently offers 3 programmes aimed at improving skill levels within the wood industry, and it establishes Rotorua as an attractive location for those wanting to trial innovative ideas in wood processing.

Recent OECD research suggests that the most value is added in regional development strategies by this kind of initiative that builds up the capability of regional economies in the crucial areas that underpin business growth.

The experience is that regional growth strategies that focus on 'thinking big' by heavy investment in large sunk assets, or that get into long-term subsidies that prevent adjustment to economic change, have a particularly high failure rate. The most effective strategies are those that strengthen a region's capability to identify opportunities for growth and to marshal their joint resources in areas such as marketing and venture capital.

Maintaining this depth of capability is the major challenge to a regional economy, and we need to ensure that our regional development programmes address this need. While it is tempting to see bricks and mortar as a sign of a healthy economy, the real dynamism of a regional economy lies within its business networks, and its ability to get business, local government and the community working collaboratively.

That is something that regional business leaders have told us, and it is a message we are taking very seriously.

Thank you.