20 November 2024

Rt Hon Prime Minister Christopher Luxon
c/- Parliament Buildings
Wellington

cc Hon Nicola Willis, Minister of Finance

Tēnā koe e Pirimia,

re: Your Government’s fiscal policy

We write to express our heightening concern at your Government’s approach to fiscal policy, and our alarm at the consequences for the people and communities of New Zealand.

We would welcome the opportunity to discuss in more detail, more directly with you as soon as possible, the immediate and long-lasting harm that your Government’s approach to fiscal policy is creating.

We summarise our concerns below under four headings.

- Reduced current and projected spending is needlessly exacerbating the current recession
- A focus on government debt is far too narrow, as it ignores the impacts on private sector debt and external debt
- The accumulating harm risks a long-lasting hollowing-out of business capacity and capability
- Fiscal policy is in direct conflict with the Government’s stated export target

Fiscal policy is needlessly exacerbating the current recession

Current and projected reductions in government spending appear to be central to the Government's fiscal policy. The economic rationale for this approach is unclear. Rather, there appear to be few considerations outside the short-term impacts. For example, your Government's cancellation of key infrastructure projects and sinking-lid cuts to the public service are powerful contributors to the current severe and prolonged recession. This is substantially worsening the contractionary effects on the economy of the Reserve Bank's use of the Official Cash Rate to contain inflation.

It is important to recognise that even prior to cutting back expenditure, government consumption spending was close to 20% of GDP. This covered spending on health, education, defence, administration, justice, transport, and culture. In addition, deferrals and reductions in projected infrastructure spending has further reduced employment and intensified the economic recession.

There is ample evidence that government spending, including the necessary infrastructure and allied networks, has for many years fallen well short of that required for population growth and demographic changes. The Infrastructure Commission has stated that New Zealand has a $104 billion infrastructure gap at present – and that this picture will significantly worsen given current spending projections.

These accumulating shortfalls put the nation in a poor position to improve its long-run economic resilience and to prepare for future challenges. If nothing is changed now, this under-funding simply passes the burden of adjustments, and investment spending, to future generations.

Failure to correct this course will lead to higher economic scarring, with the costs borne by those with the least ability to pay, as has been demonstrated repeatedly in New Zealand's history. It will also undermine the resilience of the private sector – particularly exporters – and will continue to constrain the capability of firms to scale up.

A focus on government debt ignores impacts on private sector debt and external debt

Similarly, the fiscal policy focus on reducing government debt lacks a clear economic rationale. Irrespective of the debt measure adopted, international comparisons of government debt in comparison to GDP remain in New Zealand's favour. Credit rating agencies continue to view the government's debt situation without concern.

Bluntly, there is no government (or public) debt crisis in New Zealand.

The New Zealand economy's ongoing problem is private sector debt. Importantly, private sector debt is being driven upwards by your Government's fiscal policy in pursuit of surpluses for itself and its aim of rapidly reducing public debt.

Standard economics shows the relationship between public and private sector financial balances. When total domestic saving (both public and private) is insufficient for domestic investment (both private and public), the gap needs to be filled by drawing on foreign funds. The overall current account (or external) deficit is a measure of this gap and requires overseas borrowing or asset sales to foreigners to finance such a deficit. With the banks acting as intermediaries, the resulting increase in liabilities is reflected on both the private and public sectors' balance sheets.

These connections – in particular, between the Government's fiscal stance, the size of the current account deficit, and the consequent size of the nation's external debt – are glaringly missing in documents describing the economic impact of fiscal policy. There is little explanation of how fiscal policy focussed on reducing government spending would reduce New Zealand's external deficit and total external debt. Consequently, fiscal policy is adding to the vulnerability of economic activity and exposing New Zealand to inevitable global shocks.

The accumulating harm risks a long-lasting hollowing-out of business capacity and capability

There appear to be further spending reductions accelerating at this stage of the economic cycle. The negative impact risks undermining retail, hospitality, home improvement sectors, and challenges the heart of rural economies and communities across the nation. Prolonging the current cyclical downturn in this manner means that these costs result from a policy choice, rather than being an economic outcome.

In addition, increasingly worrying is the harm imposed on those households on low or casual wage income or dependent on benefits. The erosion of the already low psychological and financial reserves of the poorest will be hard – and socially and fiscally costly – to repair. We note that the consequent erosion of the tax base will also impair the government's balance sheet.

This long-lasting harm is further evident in the increasing numbers of trained and skilled New Zealanders migrating abroad in search of hope. This is creating skills shortages across the country, particularly in health and education.

The loss of this capacity and capability – in terms of workforce skills, knowledge and expertise alongside investor/owner appetite for equipment, machinery, technology upgrades and expansions – becomes increasingly permanent the longer the downturn is prolonged.

This form of hollowing-out is currently clearly visible in the construction sector, where once again the boom-bust cycle is seeing harm that will impact on the development of the sector for years to come and further undermine critical efforts to expand the housing stock. This will (again) be likely reflected with future infrastructure and housing developments experiencing difficulties in attracting sub-contractors back to the building and construction sector.

The hollowing-out of business capacity and capability includes small-to-medium enterprises (SMEs) across the economy. Many SMEs across regional and metropolitan New Zealand continue to be financed through mortgages on family homes and other informal community networks. The accumulating impact on household sector balance sheets will add unnecessary stress on an already stressed sector of the nation.

Arising from this situation is the long-lasting scar of the loss of entrepreneurial aspiration in our communities as the cyclical downturn is unnecessarily prolonged.

Fiscal policy is in direct conflict with the Government's stated export target

A successful fiscal policy is one that has an economic justification consistent with a clear aspiration. Such aspiration would set the direction to an improvement in New Zealand's external position, and so underpin its ability to confront the climatic, social, and demographic challenges, as well as increasing our ability to withstand global economic shocks.

The Government's stated objective to double the value of exports over the next decade potentially provides direction. However, a focus on lifting export quality and unit values – making clear the target is not simply about increasing quantities – is required. Further, a goal directly targeting net exports (i.e. exports minus imports) would be more consistent with this aspiration, placing value on import competing activities as well as on export expansion.

Importantly though, there is a direct conflict between the current fiscal policy stance and the aspirational export goal. New Zealand's historical reliance on volume-driven commodity growth and mainly low-value exports requires significant structural shifts for the returns from exports to be doubled. Without investment in key infrastructure, resilience building, business capacity and capability, human capital, and entrepreneurial endeavour, the necessary structural shifts will not occur. The current fiscal policy settings undermine the required investments to facilitate such shifts.

Consequently, your Government's aspiration for the export sector will itself continue to be an aspiration due to a short-sighted fiscal policy stance, rather than the attainable goal it could become.

Our request

To reiterate, given the concerns set out above, we would like the opportunity to urgently discuss these matters directly with you.

In the interim, given the urgency of the situation, we request that

- your Government immediately suspend all directions for further reductions to departmental and agency spending and/or further delays in infrastructure spending.
- your Government request further advice from officials, including convening private and community sector advisors, to ensure that Budget 2025 provides a clear economic rationale for fiscal policy that will assist
  - growth in the scale and resilience of the business sector
  - reductions in private sector debt
  - investing in infrastructure
  - strong employment growth in good jobs

  so that the New Zealand economy can be fit for the future needs of the people and communities of New Zealand.

We look forward to hearing from you in due course.

Ngā mihi nui

Signed:

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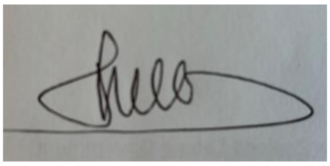

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