

Executive summary

- *Main findings*
- *Key recommendations*

Main findings

Economic growth has been faster in New Zealand than in most other OECD countries in recent years. Inflation and inflation expectations are well anchored, but the current account has been in sizeable deficit for some time. Strong fiscal and monetary policy frameworks and a healthy financial sector have yielded macroeconomic stability, underpinning growth. Employment is high, in large part thanks to flexible labour markets and ample immigration, business investment is robust, and households and firms are optimistic. Well-being is high, although a considerable income gap with the top half of the OECD remains. However, bottlenecks in housing, urban infrastructure and skills, inequalities in living standards, and rising environmental pressures all pose risks for sustaining growth. The government is moving to deal with these weaknesses.

Removing bottlenecks to sustain the economic expansion. Businesses have reported increasing difficulties in finding skilled labour. However, wage pressures remain subdued thanks to immigration, policies to improve labour market matching (e.g. the Canterbury Skills and Employment Hub which has matched demand and labour supply in the post-earthquake rebuild) and skills training. Rapid population growth and a low responsiveness of supply have led to housing and urban infrastructure constraints. In particular, house prices have risen sharply in Auckland, the largest city, eroding affordability and raising financial-stability risks. Efforts to speed the housing supply response have been made, although community resistance to rezoning and densification may limit development. Environmental regulations also appear to be relatively burdensome for economic activity, including for residential investment. Finally, the foreign debt position, which reflects low private saving, has been large for some time and is an ongoing vulnerability. It calls for a continued solid fiscal position, as New Zealand faces potentially large macroeconomic shocks and longer-run pension and health spending pressures.

Reducing greenhouse gas emissions and water pollution. New Zealand faces difficult climate change challenges because of the high share of its greenhouse gas (GHG) emissions coming from agriculture, where there are few cost-effective abatement possibilities, and because three quarters of electricity already comes from renewable sources, meaning there are fewer potential gains in generation. The effectiveness of the NZ Emissions Trading Scheme, New Zealand's main climate change policy instrument, is being limited by an exemption for biological emissions from agriculture and transitional arrangements that effectively halve the carbon price faced by covered emitters. Water quality in some regions has suffered from the steady expansion of intensive dairy farming. The industry and government have responded, but it is not yet clear if these measures will prove sufficient.

Making economic growth more inclusive. Income inequality, reflecting in part unequal employment prospects, is above the OECD average. Recent welfare reforms facilitate the transition of beneficiaries into employment, but a greater focus is needed on improving the long-term outcomes of the most disadvantaged New Zealanders across the public sector. The government is taking steps to ease shortages of affordable and social housing but will need to go further to make significant headway in rolling back the large increase in the burden of housing costs on low-income households in recent decades. Obesity, cigarette smoking and poor access to health care have contributed to bad health outcomes for some groups. While educational achievement is high, children from disadvantaged backgrounds are less school-ready and more likely to leave school without qualifications. Reforms are underway to increase student attainment by improving the school readiness of these groups, enhancing teaching quality and increasing collaboration across schools.

Key recommendations

Removing bottlenecks to sustain the economic expansion

- Implement fiscal consolidation measures to reduce net debt, as planned, while continuing efforts to improve the well-being of the most vulnerable members of society. Allow the automatic stabilisers to operate fully.
- Provide guidance to regional authorities in the implementation of environmental and planning regulations, including the Resource Management Act. Reduce their economic costs and the scope for vested interests to limit competition or thwart rezoning and development that would be in the wider public interest.
- Implement infrastructure demand management strategies to reduce urban road congestion, notably congestion charging. Consider diversifying revenue sources for infrastructure funding, such as sharing in a revenue base linked to local economic activity or taxing the windfall gains that accrue to landowners from rezoning land for urban use.
- Draw lessons from the Canterbury Skills and Employment Hub (a labour-market matching scheme), trial it elsewhere and, subject to positive results, roll it out country-wide.
- More frequently update immigration skill shortage categories to reduce labour market bottlenecks.

Strengthen policies to reduce GHG emissions and water pollution

- Terminate the transitional arrangements that halve the number of emission permits (and hence their price) needed by emitters in the NZ Emissions Trading Scheme. Develop a strategy to cut agricultural GHG emissions efficiently through a combination of pricing, regulation and R&D.
- Monitor the implementation of the 2014 National Policy Statement for Freshwater Management in regional plans to ensure water quality meets goals. Provide clearer technical guidance for regional councils. Ensure that information on environmental quality is comparable and reliable, in part by passing the Environmental Reporting Bill.

Implement co-ordinated reforms to make economic growth more inclusive

- Complement the recent welfare reform by following up people going off benefit, as planned, to ensure satisfactory outcomes. Strengthen the focus of social spending on lifting the long-term outcomes of the disadvantaged, including by improving coordination across the public sector.
- Raise the supply of social housing for low-income households. Increase targeted housing subsidies for low-income households that are not in social housing.
- Adopt a comprehensive approach to reducing obesity, covering personal actions, factors that influence physical activity and nutritional practices, and improved obesity management through primary care.
- Meet the 98% participation target for early childhood education. Ensure that the education provided is of high quality, includes programmes to enhance the involvement of parents and focuses more on the outcomes of children with disadvantaged backgrounds.



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