ECONOMIC POLICY

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Freeing up growth and fixing the books

Bryce Wilkinson



THE NEW ZEALAND INITIATIVE

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The New Zealand Initiative is an independent public policy think tank supported by chief executives of major New Zealand businesses. We believe in evidence-based policy and are committed to developing policies that work for all New Zealanders. Our mission is to help build a better, stronger New Zealand. We are taking the initiative to promote a prosperous, free and fair society with a competitive, open and dynamic economy. We develop and contribute bold ideas that will have a profound, positive, long-term impact.

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Executive Summary

Two problems with a common remedy

New Zealand faces two linked problems. Incomes are well below Australia's, and the public finances are on a path that Treasury's long-term projections show to be unsustainable.

On the OECD's measure, Australia's net national income per head was about 30% above New Zealand's in 2024. That is a missing NZ$20,000 per person, or roughly $105 billion a year. Estimates of the gap range from 12% to 37% depending on the measure, but every measure reviewed in this report puts New Zealand behind. The gap narrowed after 2005, has widened again since 2019, and young New Zealanders continue to leave for Australia.

The shortfall is not one of effort. New Zealand employs as large a share of its working-age population as Australia does, and on more questionable official figures New Zealanders work more hours per head.

The major gap lies in labour productivity, meaning what each hour of work has to work with and how well it is used. Between 1995 and 2025, labour productivity rose 64% in Australia's market sector against 49% in New Zealand's former measured sector. Capital intensity rose 101% against 83%, and multifactor productivity, the efficiency with which capital and labour are combined, rose 22% against 15%. New Zealand's multifactor productivity has fallen sharply since 2021.

The fiscal problem compounds the productivity problem. The OECD forecasts general government spending in New Zealand at 42.9% of GDP in 2026, against 39.8% in Australia and 7.3 percentage points above New Zealand's own ratio in 2017. Core Crown spending in 2024 ended 5.8 percentage points of GDP above what Budget 2018 had planned, while core Crown tax revenue rose by only 1.5 points. Net core Crown debt rose from 19.5% of GDP in 2018 to 41.7% in 2024 and is forecast to peak at about 44%. Moody's and Fitch now both have New Zealand on negative outlook.

Both problems have the same remedy. Faster income growth lifts tax revenue and eases the debt burden, provided governments do not raise spending in step with it. Faster growth combined with firmer spending discipline is the least painful route to fiscal repair.

The report's focus

This report does not dwell on things no government can change, such as New Zealand's distance from markets, its geography or its small population. Those factors may help explain a lower level of productivity, but they cannot explain why productivity growth has slowed, and New Zealand was once more prosperous relative to other countries than it is today. The report asks what governments could most usefully do better.

Governments have two broad levers. They spend, funded by taxes and borrowing, and they regulate. Regulation compels people to spend money on what government wants done. It works like a tax-and-spend programme, except that the costs are unmeasured and unbudgeted.

Governments use both levers intensively, but how well they do that depends on the quality of the institutional checks that test spending and regulation for value for money and for respect for individual rights, including property rights.

New Zealand can and should do better

On the surface, New Zealand does well. It ranks at or near the top of the world for institutional quality. It is third in the Fraser Institute's economic freedom index and fourth equal in Transparency International's Corruption Perceptions Index.

The critical point to consider is that New Zealand's productivity performance does not match those rankings. Such indexes cannot capture everything that matters, a point the 2025 Taskforce also made. A law that looks permissive on paper may frustrate commercial flexibility, adjustment and resilience in practice. Such aspects are harder for international organisations to assess, country by country.

General government commands about half of national disposable income. In the year to March 2024 its current and capital cash spending totalled $175 billion. Of this total, 61% went on transfer payments and only 20% on collective services such as defence, police and the courts.

The last Controller and Auditor-General's assessment of the quality of central government spending scrutiny was telling. He assessed that it was "hard if not impossible" to see the combined effect of some $180 billion of expenditure, and that budget performance measures are so poor that "Parliament does not get the performance information it needs to effectively scrutinise how public money will be spent".

Parliamentarians cannot be expected to take well-informed decisions on spending of that scale when they cannot see what it achieves. These findings come from Parliament's own independent auditor, not from a hostile critic.

The weakness shows plainly in infrastructure. Te Waihanga reports that New Zealand has spent around 5.8% of GDP a year on infrastructure over the past 20 years, among the highest rates in the OECD, yet it ranks in the bottom 10% of high-income countries for infrastructure efficiency. New Zealand's difficulty lies in its ability to spend well, not in the amount it spends. In each of the last five Budgets, half or fewer of the infrastructure bids that Treasury assessed had been through a complete business case.

Regulation receives even less scrutiny than spending. The Productivity Commission concluded in 2014 that the regulatory system is "as significant as the tax and spending systems" in its effect on New Zealanders. Some 200 regulatory regimes employ more than 10,000 regulatory workers, yet the Commission found that "surprisingly little information exists about regulation and its effects" and described the system as marked by "surprising complacency". The regulators of banks, financial markets, insurers and commerce operate with inadequate oversight and questionable governance arrangements. Nothing comparable to the annual Budget reviews the stock of regulation.

Property rights are weakly protected. Lew Evans and Neil Quigley, with Kevin Counsell, found New Zealand to be "distinguished by having among the weakest protection of private rights in the OECD". The Bill of Rights Act 1990 does not protect property, and no general law requires addressing the issue of compensation when regulation impairs its value less than severely. The cost of an adverse regulatory decision therefore falls on owners, and the regulator has only a weak incentive to assess that cost accurately and to put weight on it.

The Resource Management Act shows what results. Chris Bishop, the Minister for Infrastructure and RMA Reform, has called it a "handbrake on growth and opportunity". He has pointed to three years to approve housing developments, eight years to consent a wind farm and nearly a decade to extend a port. Sapere estimated direct infrastructure consenting costs at $1.29 billion a year, rising to 15.9% of the budget

for projects under $200,000. The larger cost is unseen and unmeasured, it is the investment and innovation that do not happen because approval is too slow, too uncertain or too expensive.

What governments do can make a difference

The gap with Australia is not fixed. It has widened and narrowed over the past half-century as world events and domestic policy changed, and New Zealand's own record shows how much government policy can matter.

The reforms that began in 1984 and continued into the 1990s imposed real costs, and those costs unavoidably fell unevenly. But labour productivity growth picked up quickly, and the strongest productivity growth cycles of the past half-century came in the 15 years to March 2000. Arthur Grimes and Shine Wu found that New Zealand had the slowest growth in real adjusted national income per head of 22 OECD countries between 1970 and 1994, and the seventh fastest between 1994 and 2018. Material living standards rose 51% over those 24 years. Good export prices helped and the reforms were not the only factor, but the difference between the two periods is marked. Reform was not the project of one side of politics. A Labour government began it in 1984 and a National government continued it after 1990.

Spending restraint has also gone hand in hand with good times. Government spending fell from about 36% of GDP to 29% by the early 2000s. Real GDP grew by an average of 3.8% a year from 1993 to 2003, the country's best sustained performance in decades, and net core Crown debt fell to 5.4% of GDP by 2008.

Spending growth restraint while GDP grows has proven to be politically feasible in reducing the spending burden relative to incomes. Abroad, Sweden, Norway and Canada reduced public spending by around 15% of GDP between 1992 and 2007, largely by holding real spending steady while their economies grew. At home, farming has prospered without the subsidies removed in the late 1980s, painful as their removal was for farmers at the time.

Change is happening now too. The 2023-2026 government has done its best to reform the RMA and to improve the teaching of literacy and numeracy in schools. The fast-track approval for the Port of Auckland took 66 working days from the convening of the expert panel. Politicians who set out to achieve better outcomes can justifiably hope to be elected.

What governments could do

Governments have three ways of restoring fiscal surpluses. They could raise taxes, but at a 39% marginal rate each extra dollar of revenue imposes deadweight costs of roughly 15 to 24 cents, and far more for the self-employed, so higher taxes risk slowing growth further. They could hold spending growth below the growth of the economy and wait for revenue to catch up, which is roughly the current strategy and leaves the public finances exposed to the next shock. Or they could strengthen the institutions that test spending and regulation for value for money. This report favours the third course. It is a sensible course whatever the state of the public accounts.

The report puts forward six options. The first is a fiscal council that reports directly to Parliament rather than to a minister. The second is firmer disciplines on how prudent debt levels are set, so that the government of the day cannot simply choose whatever level suits it and leave no buffer for bad times. The third, building on the Public Finance Amendment Act 2026, is to bring enough transparency to time-limited spending to stop it understating future costs. The fourth is to bring compensation for regulatory takings to the fore, including in the RMA replacement legislation and the Regulatory Standards Act.

The fifth is structures that give non-partisan momentum to rolling zero-base reviews of major spending programmes and restrictive regulations. The sixth is to give ministers the power to direct their agencies and to get timely, relevant information from them.

These options are not a complete programme. The problems they address run across health, education, welfare, superannuation, infrastructure, taxation and regulation, which is why the 2025 Taskforce in 2009 and 2010 made so many recommendations, and why The New Zealand Initiative has made many more since. Progress needs to be made on all of those fronts.

The six options matter because they would make such progress easier to achieve and harder to reverse. The Taskforce was wound up, the Productivity Commission was abolished, and the Natural and Built Environment Act 2023 was repealed within months of its passage. Reforms that one government adopts, another can undo.

New Zealanders could be appreciably more prosperous if governments that command half the national income focused much more on value for money in what they own, tax, spend and regulate. Achieving that will take voter support and political courage, but the country has done it before, and the rewards from faster compounding growth are large.

SECTION 1

Introduction

This report is about the best way of meeting New Zealanders' needs for more income to spend.

The need is palpable. New Zealanders want incomes that keep ahead of the cost of living, warmer, drier and more affordable houses, shorter waits for elective surgery, safer neighbourhoods, swimmable rivers and beaches, and less bureaucratic spending incompetence.

Opinion polls show a widespread concern that the cost of living is too high relative to incomes. The daily pressure on governments to channel more of the national income in favour of one need or another is relentless.

The demands on government vastly outstrip its income. Inadequate spending disciplines make it too easy for politicians to spend to excess, and so, governments borrow.

Government borrowing is an abstract thing, until a day of reckoning arrives. Its deficit spending boosts household incomes, but the debt is not visible to householders. It does not show up on their monthly bank or credit card statement. Yet, the burden of such debt will fall on householders sooner or later.

Debt to fund current spending is not a free lunch; it is deferred taxation.

The future burden only becomes apparent insidiously. Government interest payments on the public debt creep up as a proportion of the tax take. Less of each tax dollar is left to fund what the public expects, demands even, from government.[1]

Governments that succumb to the pressure to keep borrowing grow the problem. The Fiscal Responsibility Act 1994 aimed to help governments resist that pressure.

The Act arose because governments that had to tackle the 1984 currency and public debt crisis and its aftermath wanted the public to never have to go through that experience again. The Act required future governments to declare levels for a prudent level of public debt and to demonstrate that their tax and spending intentions were prudent in that respect.

That Act allowed big operating spending increases as long as they were credibly funded. Well, that was its hope. It started well. The 1999-2008 government took the key provisions into the Public Finance Act, unchanged.

Unfortunately, the 2017-2023 government found a loophole. It realised it could announce a new government spending programme of a permanent nature, but only authorise time-limited funding for it. That meant Treasury's fiscal projections had to assume funding would terminate unless there was a clear government authority or intent to continue with it. That exclusion made its future spending projections lower than they were likely to be.

Documents released after the change in government show that the previous government's recourse to this strategy was significant. A Treasury report to its new Minister in December 2023 listed 22 time-limited funded programmes. Its report was published in redacted form that deleted that quantum of that spending. However, the Minister later put the indicative cost of continuing with 20 of the time-limited

programmes, each costing more than or close to $50 million had a indicative cumulative "cost of $7.2 billion over the forecast period".[2]

The effect was to give the public an overly optimistic assessment of the future path for fiscal deficits and the public debt. This loophole needed to be addressed. The Public Finance Amendment Act 2026, in force from 1 July 2026, now requires Treasury to categorise the specific fiscal risks in its economic and fiscal updates, a practice that already identifies time-limited funding. Whether disclosure alone will change behaviour remains to be seen.[3]

A related problem is that each government's assessment of what is a prudent level has no firm anchor. The natural bias is towards sanctioning whatever level of debt Treasury is projecting under current policies.

Governments are reluctant to take action on growing public debt because they fear higher unemployment and a voter backlash if they curb spending or raise tax rates. The alternative is to borrow and hope. An incumbent government can hope that by the time corrective action is unavoidable, the blame will fall on those taking that action.

Whereas an incumbent government has this "pass-the-parcel" or "kick-the-can-down-the-road" option, indebted households do not. Households have a stronger incentive than governments to take effective action if their debt grows.

The most positive way out of the current dual cost of living and government deficit spending difficulties is more national income, and greater government spending restraint. More income will increase tax revenues and ease the public debt problem.[4] But it will only do so if governments do not increase spending in lockstep with rising revenues. As things stand, this looks like their default option.[5]

But how can higher income per capita be achieved? Governments have no button to push that reads "for faster income growth, press here".

Some, the author included, point to heavy taxation to fund poor quality spending and too much unnecessary red tape. The opposing case is that some more prosperous countries have bigger tax burdens and New Zealand's red tape cannot be seriously bad because New Zealand scores at the top end of the world ladder for economic freedom. So why cannot New Zealand be more prosperous with higher taxes and spending?

That is a fair question and the debate over this point is a thread that runs through this report, starting with section 4 on the vast empirical economic literature on the sources of the prosperity of nations.

But for now, there is a more pragmatic observation to make. It is that central government's role in the economy is so large and intrusive that there is much that it can do for better or for worse in respect of the allocation and use of resources in New Zealand.

If large and intrusive government is what New Zealanders want, require it at least to focus more on excelling in the quality of its spending, regulation and government-owned operations. Below are some illustrations of its reach, for better or for worse:

- General government spends over 50% of national disposable income with an inadequate focus on what is being achieved by that spending.[6]
- Central government has a near monopoly over skill attainment through state education and the regulation of technical education, and the results are troubling.

- It runs a costly monopoly state accident insurer when competitive provision has worked in the past and it monopolises the provision of major hospital services which it funds from taxes and rations by queues. It can be a funder without being a provider, but if it is to be a provider it needs to get better.
- A small army of regulators regulate the banks, financial markets, insurers and commerce, with inadequate oversight, questionable governance arrangements and sometimes evidence of in-house turmoil and dubious competence.
- Its environmental, safety and land use regulation is a red tape nightmare that confounds environmentalists and the public's need for better quality infrastructure and affordable housing alike. No one can be sure what they can do with their property until they get a resource consent. The costs and delays of getting that consent are prohibitive in some cases. Long-standing common law use rights in property barely exist. The right to compensation from a private person for loss from an infringement of a legal right is routinely denied if the infringer is government.
- It limits capital formation through taxes, undue restrictions on foreign direct investment, red tape delays and uncertainties to obtain resource consents. It regulates corporate activity intensively and dubiously through diverse regulators.
- It spends on infrastructure very poorly (see below).
- It is undermining the clarity and predictability of the rule of law in many ways, of which the wanton ban on offshore oil and gas exploration was symptomatic.

One starting point for assessing what governments might do better is to benchmark New Zealand against other prosperous countries and ask what the differences teach.

Section 2 does that with respect to differences in incomes and consumption per capita. On the OECD's measures Australians have about 30% more income per head than New Zealanders and about an eighth more consumption per head. Many young adult New Zealanders have understandably left for Australia. More will follow if such gaps remain.

Such gaps are a symptom, not a cause. New Zealand employs much the same proportion of its population aged 15 to 64 as Australia, with both of us at the top end of the OECD in this respect.[7] So that is not a contributing factor. On the official OECD statistics, hours worked per person employed in New Zealand are also at about the OECD average, and higher than Australia, but Treasury has published reasons for thinking these estimates are too high and hours worked per worker could be higher in Australia.[8]

With that qualification, the diagnostic growth accounting finger using official statistics points at New Zealand's relative shortfall in labour productivity as the major contributor to the inadequate income that is behind the current cost of living concern. (This finding is silent as to its cause.)

Official measures of the productivity gap make it greater than the income gap because they assess New Zealanders to be working more hours per head of population. That shortfall also shows up as lower wage earnings per worker for New Zealanders.

Capital per worker matters for labour productivity, regardless of the measurement issue. A labourer shifts more earth with a bulldozer than with a shovel. As section 3 documents, the Australian worker is on any measure operating more bulldozer. The quality of capital infrastructure also matters. The productivity of

road freight depends on the quality of the road network.

Skills matter for the same reason: a skilled worker can use more complex machines and get paid more; literacy and numeracy are fundamental.

Prosperity is not just about labour productivity. The efficiency with which capital and natural resources are used also matters.

The quality of the husbandry of land, water, fish stocks and minerals is very important. Wasteful over-use or under-use leaves New Zealanders worse off than they need to be. The Resource Management Act (RMA) has inflicted both types of waste on New Zealanders.

Innovation is vital. Across history, human ingenuity and curiosity appear to be the unbounded resource, although progress is often hard-won, double-edged and can be lost.

Technological and other innovations can lift the productivity of both capital and labour. Their driver is competition. Wars provide an extreme example of the competitive spur to innovate. Of course this is not to commend war. Peaceful innovation is the goal and the freedom to innovate and compete is fundamental.

This report focuses on government's influence over productivity growth. It does not detour into things no government can do much about – such as our geographic location, natural resources or smallish population.

The argument of this report is simple. Freeing up New Zealanders to lift their productivity is achievable given enough political will, and it is also the best way to ease the current pressures. It is also the least painful route to fiscal repair, so long as spending discipline is strengthened rather than relaxed.

The report proceeds as follows. Section 2 sets out the income and consumption gaps with Australia and other prosperous countries on the main measures. There is no single authoritative measure of 'the gap'. Section 3 explains in more detail why for New Zealand, the productivity gap is commonly greater than the income gap. It sets out the scale and composition of that productivity gap. Section 4 examines what the evidence finds drives productivity growth. Sections 5 and 6 trace the growth of government spending since the 1960s and document the inattention to its quality. Section 7 treats the regulatory burden as quasi-fiscal policy that escapes the fiscal accounts. Section 8 addresses what constitutes prudent public debt, how it should be measured, and whether current fiscal targets and projections are adequate to reach it, before section 9 draws the threads together.

SECTION 2

The Income and Consumption Gaps

New Zealand has been losing citizens to Australia, and the higher incomes in Australia are surely seductive. This section documents the gaps for a range of indicators.

The most cited measure of the income gap is GDP per capita. It measures domestic production, the income received from that production and the amounts of that income spent and saved. Reader alert: some of that income belongs to overseas investors. Where that portion is large, and it is very large in Ireland, GDP will overstate the income accruing to locals. National income per capita, net of capital consumption, is a better measure of the actual income of residents in such cases.[9]

There is a second reader alert: there are many ways of estimating such gaps, and no single authoritative measure. Several major official institutions have databases that allow gaps to be assessed and compared. They include the IMF, the World Bank, the OECD, country-specific official statistical offices and central banks, particularly the Federal Reserve Bank of St. Louis's FRED database.

The research for this report has found many problems of errors and discontinuities in the time series being used for New Zealand across these databases. The implication for readers is that estimates of gaps vary so greatly across these sources that meaning is lost unless the source of any gap is cited in detail. People need to know the institutional source, the nature of the measure, and the time period.

Unsurprisingly given the scope for confusion and error, leading research institutions have developed databases that provide more authoritative time series for use by researchers in academia and elsewhere. This report draws on two of these databases – the Conference Board time series[10] and the Penn World Table[11] series.

Table 1. Recent income and consumption gaps with other countries and groups

	Australia	Canada	Ireland	United Kingdom	United States	Euro area (20 countries)	OECD (26 countries)
Average GDP per capita gap 2023-25	34%	18%	151%	12%	54%	18%	16%
Average individual consumption per capita gap 2021-2023	12%	4%	-10%	6%	45%	0%	3%

Source: OECD Data Explorer, Downloaded, 29 July 2026, Annual per capita GDP and consumption per capita, current prices converted to US$ using current PPPs. Note that this consumption measure includes government transfers in kind.

Table 1 defers to the prevalent usage. It taps into the OECD's database to compare the gaps in New Zealand's GDP per capita and consumption per capita in current prices with five countries of Anglo-Saxon institutional heritage and two larger Europe-embracing regions.

The income and consumption gaps are particularly relevant to any New Zealander thinking of emigrating for material standard of living reasons.

Ireland is an outlier in the table, its GDP per capita being 151% higher than New Zealand's on average over 2023-2025 while its individual consumption per capita was 10% lower on average on the latest 2021-2023 statistics.[12] Ireland's GDP income comparison is best ignored in this context as it is swollen by the magnitude of the foreign direct investment in Ireland given its attractive tax system and access to European markets. It is not an accurate indicator of the standard of living in Irish households.

Australia is an impressive performer on these measures, except when compared to the US.

The gaps with Australia on these measures were 34% on an income basis, averaged over 2023 to 2025, and 12% on a consumption basis, averaged over 2021 to 2023, each measured at the purchasing power parities of the year.

Consumption-based comparisons consistently show a smaller gap than income-based ones. Arthur Grimes and Sean Hyland built an index of household material wellbeing from consumer durables that households report in the OECD's PISA surveys, for 40 countries between 2000 and 2012. New Zealand, with the other Anglo-Saxon settler countries, sits near the top of that index in every survey year, and above the level its national income per capita would predict.[13] Treasury sees Grimes as arguing that this is evidence that New Zealand has high household consumption levels, although also high consumption inequality.[14]

Similar statistics published by the World Bank and the Penn World Table (PWT) also show substantial gaps using GDP per capita.

The degree to which estimates of the income gap with Australia depend on the measure is illustrated by the numbers in Appendix 1. The recent gap varies from 12% to 37% depending on which of the eight measures is selected.

The 12% gap is the lowest by far. It is from the World Bank's estimate of "adjusted net national income per capita" for each country in 2021. That measure nets out depreciation and resource depletion, which likely reduces Australia's income measure more given its larger capital-intensive resource sector.[15]

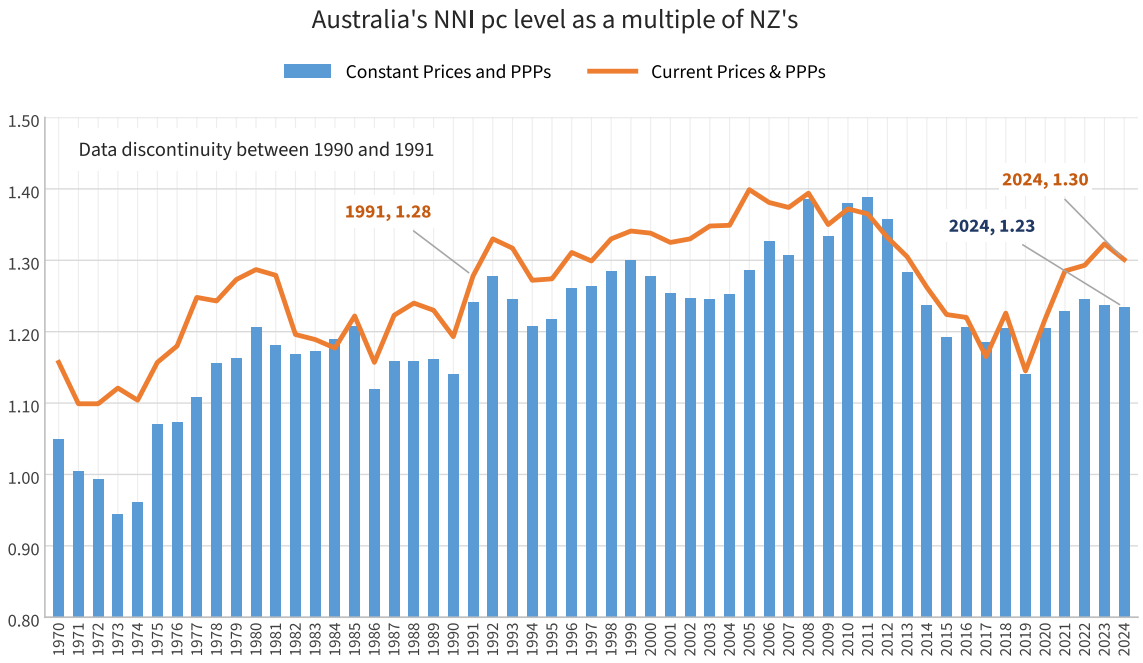
Net national income per capita is a better measure than GDP of the actual income of residents. It nets out income accruing to overseas investors and measures income as net of capital consumption. Residents cannot regard either as part of their income, and in Ireland's case the difference is extreme.

In 2024, Australia's net national income per capita was about 30% above New Zealand's, on a current price and PPP basis and 23% on a 2020 constant price and PPP basis. See Figure 1. This outcome is close to the 34% GDP per capita gap shown in Table 1. That 30% gap is also the average over the 32-year period to 2024, albeit amidst considerable volatility.

The OECD's population time series for New Zealand has a material discontinuity in its value for 1991. This is when Statistics New Zealand (SNZ) changed its measure from a de facto basis to a resident population basis. The current price ratio in Figure 1 rises from 1.19 in 1990 to 1.28 in 1991. But for this discontinuity the rise might have been to 1.25.

The 30% gap represents a missing NZ$20,000 per person, or roughly $105 billion a year across 5.3 million people.[16] An ongoing net migrant outflow of young workers to Australia should not surprise anyone.

Figure 1. OECD Net national income per capita Australia vs NZ 1970-2024



Source: OECD Data Explorer

The current price gap responds to changes in relative prices, hours worked and productivity growth. It narrowed markedly after 2005 on this measure but has widened again since 2019.

The gap would go up if New Zealand did well, but Australia did even better, or if both fell, but Australia less so. Both events contribute to the time series in Figure 1, but the former dominates after 1991.

To appreciate what the chart is showing, some reminders of historical events might be useful. The constant price gap opened up a great deal between the mid-1970s and the early 1980s. The two global oil price shocks in this period likely hit New Zealand harder. The gap reduced during the second half of the 1980s at the onset of New Zealand's liberalising reforms. Both countries had negative growth in 1991, but New Zealand more so, even when removing the data discontinuity. New Zealand's 1991 recession was severe, in part because monetary policy had to be tight to deal with the breakout of inflation after the wage and price freeze.

Both countries had very strong real per capita income growth subsequently, Australia's 2020 income level being 92% up on 1991 and New Zealand's rise being marginally more at 96%. Those increases average out at a remarkable 2.3% and 2.4% growth p.a. There were ups and downs in the ratios within this 29-year period, with New Zealand doing less well during the period of the global financial crisis and the Canterbury earthquakes.

Between 2020 and 2024, both countries have hit lean times, Australia's income per capita on this measure being only 2.1% higher in 2024 and New Zealand's barely at all at 0.6%. That has taken the gap back to 1991 levels. The gap has risen by more in this period on a current price basis; the prices Australians have been receiving for mineral exports may be a factor.

Wage rate gaps with Australia are also relevant to workers thinking of migrating. On the OECD's numbers the annual wage earnings gap for a full-time employee in 2025 was US$11,000.[17] This is about NZ$17,000.[18]

New Zealanders would have needed to earn about 18% more to close that gap.

The bottom line is that all the measures reviewed here and in Appendix 1 indicate that New Zealand is uncompetitive with Australia in terms of average material standard of living.

SECTION 3

The Productivity Gaps and Malaise

Labour productivity may be of greatest interest to New Zealanders as wage earners since wages must track labour productivity in competitive industries (as distinct from in the public sector).

That is why this section looks first at labour productivity trends, even though labour productivity is not the only important productivity consideration.

New Zealanders' material welfare also depends on how efficiently capital and natural resources are being used. We know the country has serious problems in both respects. The Infrastructure Commission has highlighted the issue of poor-quality spending on infrastructure and the current government has worked hard to address the unconscionable delays and costs of getting resource consents to use land and other natural resources. New Zealanders are likely most aware of these problems in the form of inadequate infrastructure and unaffordable housing, but the problems are wider.

That is why this section also looks at the use of capital in terms of capital to labour and capital to output trends and comparisons as well as overall efficiency measures. The overall efficiency measures may be called total factor productivity or multifactor productivity. That form of productivity gain is the holy grail. More output from unchanged inputs.

Productivity trends are best assessed using constant price (volume) measures rather than current price measures. Productivity rises when the volume of output rises faster than the volume of inputs. This section focuses on constant price measures for this reason.

The measures reviewed in this section are all averages, but readers should note that wages and prices are determined at the margin. Specifically, wage rates in competitive activities should reflect the productivity of an additional worker more closely than they track average productivity. Average productivity may exceed marginal productivity because of diminishing returns.

3.1 Labour productivity as output per hour

There is a tight algebraic relationship between income per capita and productivity per hour.

In words, labour productivity, measured as output in constant prices per hour, is identical to real output or income per capita multiplied by people per hour.[19]

In symbols: $Q/L = (Q/N) \times (N/L)$

where Q is income, N is population and L is hours worked to produce Q.

It follows inexorably that New Zealand's productivity gap with Australia is larger than its income per capita gap if New Zealanders work longer hours per capita than do Australians. (i.e. if N/L is larger for Australia).

Statistics New Zealand does not publish estimates of total annual hours worked in New Zealand. This means international organisations have to estimate this for themselves when calculating, say, GDP per hour for New Zealand. They might use SNZ's household labour surveys of average weekly hours worked and its estimates of total numbers employed. They have to assess how this treats self-employed hours worked, how to allow for full-time and part-time hours worked and

how to adjust hours worked for public holidays and annual leave, or self-employed unpaid hours worked. And they have to try to get their estimates on a like-with-like basis with other countries.

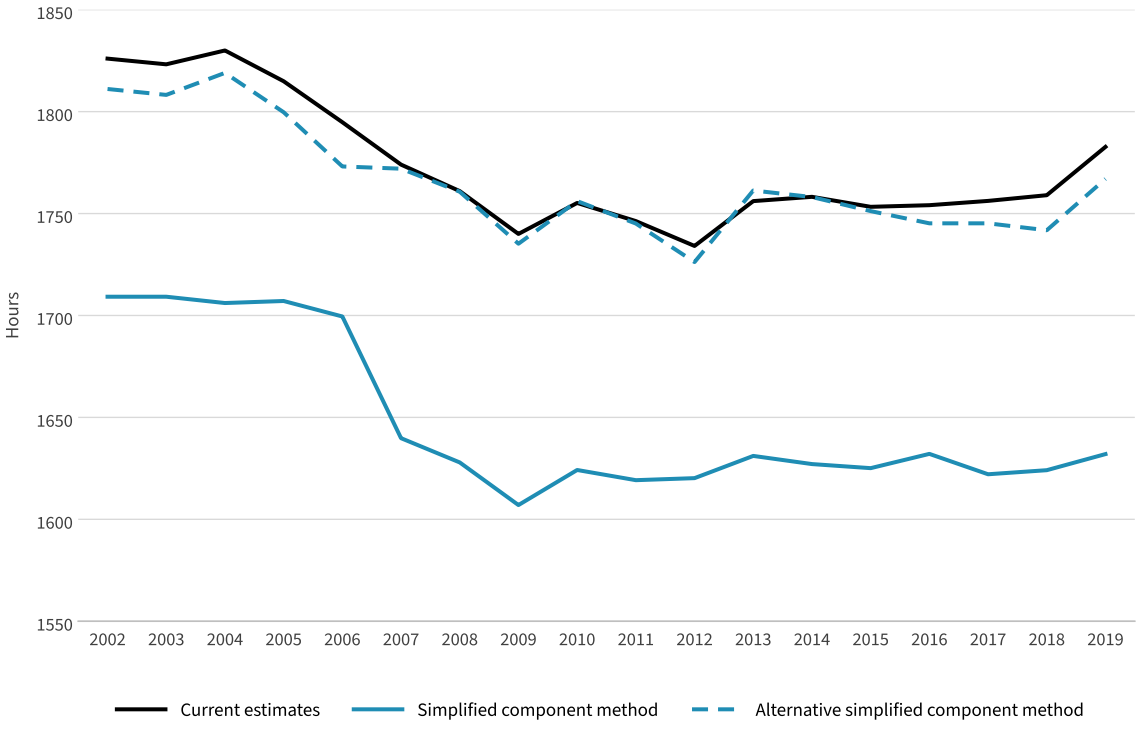
Currently, they commonly estimate that New Zealanders work more hours per head of population than Australians. That makes New Zealand's productivity gap larger than the income gap (if they are all using the same population estimates).

New Zealand's labour productivity gap with Australia is larger than its income gap because as currently measured, hours worked per capita (L/N) is larger for New Zealand, so N/L is larger for Australia.

For example, GDP per hour in Australia in 2023 exceeded that in New Zealand by 47% when the income gap was 'only' 37%. This is according to the OECD's published measures in current prices using current PPP conversion factors. The difference is entirely due to the OECD's estimates that hours worked per capita in New Zealand were 7% higher than in Australia. (This means that N/L in Australia is 1.07 times higher than in New Zealand.)

In numbers, 1.47 = 1.37 x 1.07

Figure 2. Disparate estimates of hours worked in NZ 2002-2019



Source: Stats NZ

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The OECD's 7% hours per head gap is not out of line with other reputable estimates. New Zealanders worked 10% more on the Conference Board's estimates and 14% more on the Penn World Table's (PWT's).

This does not mean we should believe it. A Treasury analysis published in 2022 makes a

cogent case that the like-with-like difference in annual hours worked per capita is smaller than these estimates suggest.[20] Figure 2 replicates Figure 8 from the Treasury report. It shows that the difference is significant. A 10% difference in estimated hours worked is likely to be significant when it comes to comparing hourly productivity levels across countries.

New Zealand is one of a small number of countries that measure annual hours by annualising the hours respondents report to the Household Labour Force Survey, with no explicit adjustment for public holidays, annual leave or sick leave, on the grounds that the continuous survey should capture them. Most OECD countries build annual hours from usual weekly hours with explicit deductions for leave. A 2018 OECD review found that countries using unadjusted self-reported hours systematically overstate labour input and so understate labour productivity, by around 10% in the case of the United Kingdom.

When Statistics New Zealand applied the OECD method to New Zealand it obtained 1,633 hours per worker in 2019 against 1,783 on the official method, about 8% fewer. Treasury's own calculation found the discrepancy had grown from about 3% in 1990 to about 6%, which means the growth rate of New Zealand's measured productivity, and not only its level, has been biased down.[21] On Treasury's estimate the correction lifts New Zealand two places in the OECD labour productivity ranking.

That lift does not eliminate the gap with the OECD average, and would take more research to assess which way the comparison with Australia goes. Australia's statistical agency also uses surveyed labour force hours.

In 2023, the output of an hour worked in Australia on the PWT database shown in Figure 3 was worth US$76.8 on average but only US$49.6 in New Zealand. This is in 2021 prices. On this measure, Australia was getting 55% more value for each hour in 2023. Expressed differently, in 2023 an Australian worker produced in 39 minutes what it took a New Zealand worker an hour to produce.[22]

New Zealand's figure of US$49.6 an hour on this measure placed it 20th out of 29 countries in The New Zealand Initiative's publication *New Zealand by Comparison*. It was a whisker above Japan, below South Korea, and 31% below the average of the OECD members in that comparison. The meaningful leaders[23] are Norway on 130, Switzerland on 100 and Denmark on 89, followed by a cluster of countries, including the United States, on 84 to 85.

The above statistics show recent snapshots of the productivity gap per hour; they do not show the trends. The OECD's published estimates for annual hours worked in New Zealand between 1971 and 2007 are so wrong as to be unusable.[24]

The PWT's time series for GDP, hours worked and GDP per hour look much more coherent.

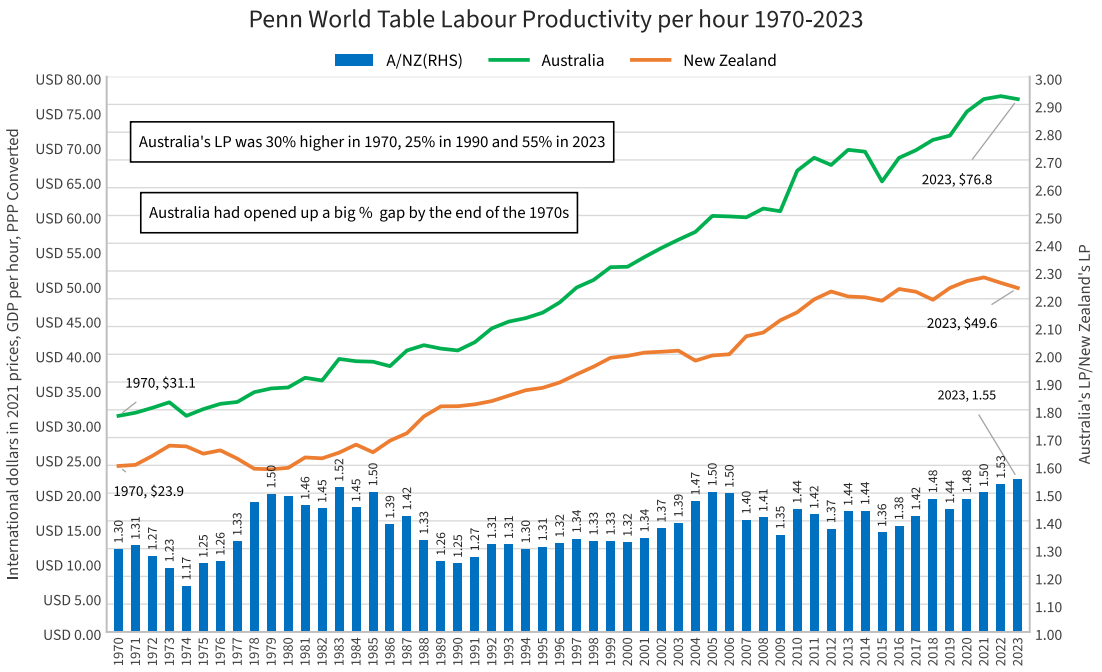
Figure 3 shows the difference in levels and trends for real GDP per hour between 1970 and 2023 according to the PWT series. PWT used Purchasing Power Parity price differentials to convert to common international dollars. The time series for multiple countries is published by Our World in Data but its origin is in the Penn World Table (PWT) series authored by Robert C. Feenstra, Robert Inklaar and Marcel P. Timmer.[25]

As already noted, the shortfall is not one of effort. It lies in what each hour has to work with, meaning capital, scale and know-how, and in how well all three are allocated.

3.2 The labour productivity gap is not a "given"

The current gap is large from the half-century perspective shown in Figure 3. There is a lot of New Zealand's economic history embedded in the lines on that figure.

Figure 3. PWT GDP per hour Australia & NZ 1970-2023



Feenstra et al. - Penn World Table (2025) – with major processing by Our World in Data

If we look at the first portion of the orange line for New Zealand, we can see the effects of very big swings up and down in the price of exports relative to imports with two global oil price shocks hitting New Zealand harder than Australia through to the early 1980s.

New Zealand's restructuring in the mid-1980s quickly picked up labour productivity growth both absolutely and relative to Australia. New Zealand's improved labour productivity growth continued but at a slowing rate as 'reform fatigue' and MMP governments took hold in the late 1990s. But Australia's growth was even faster and this continued until around 2006 when the gap was 50%. New Zealand's productivity growth in this measure all but stopped in 2012 allowing Australia's growth to extend the gap to the 55% referred to above.

In short, the gap has waxed and waned often in the last half-century with both overseas and domestic events in each country playing different roles at different times.

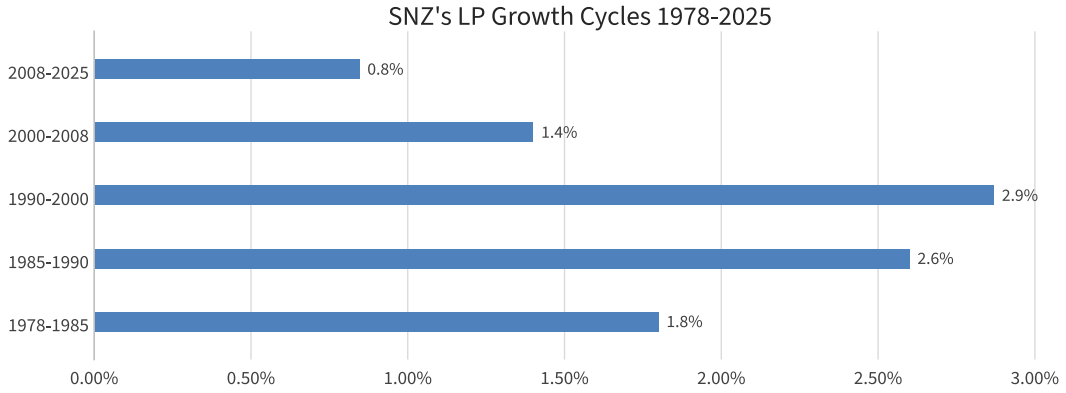
It is important to avoid the nihilistic feeling that there is nothing a New Zealand government can do to close the gap and give productive young New Zealanders a stronger reason to build their careers in New Zealand.

Government plays such a major role in the New Zealand economy (see sections 5 to 7 below) that there should be no doubt that what it does can

make a big difference to the opportunities people have to make the most of their abilities here, without emigrating.

Figure 4 brings that issue into sharper focus by showing the changing rates of productivity growth during the reform period that was at its most intensive between 1985 and 1996, and on either side of it. Reform zeal was faltering before the advent of MMP in 1996 and had fully gone by 2000.

Figure 4. SNZ Labour Productivity (LP) Growth Cycles 1978-2025



Source: SNZ, 2025, Table 2.09, "Productivity in the former measured sector" except that six of its eight cycles have been pairwise to simplify the chart and the 2025 outcome (of 0.0%) has been added to the 2020-24 cycle which was also 0.0%.

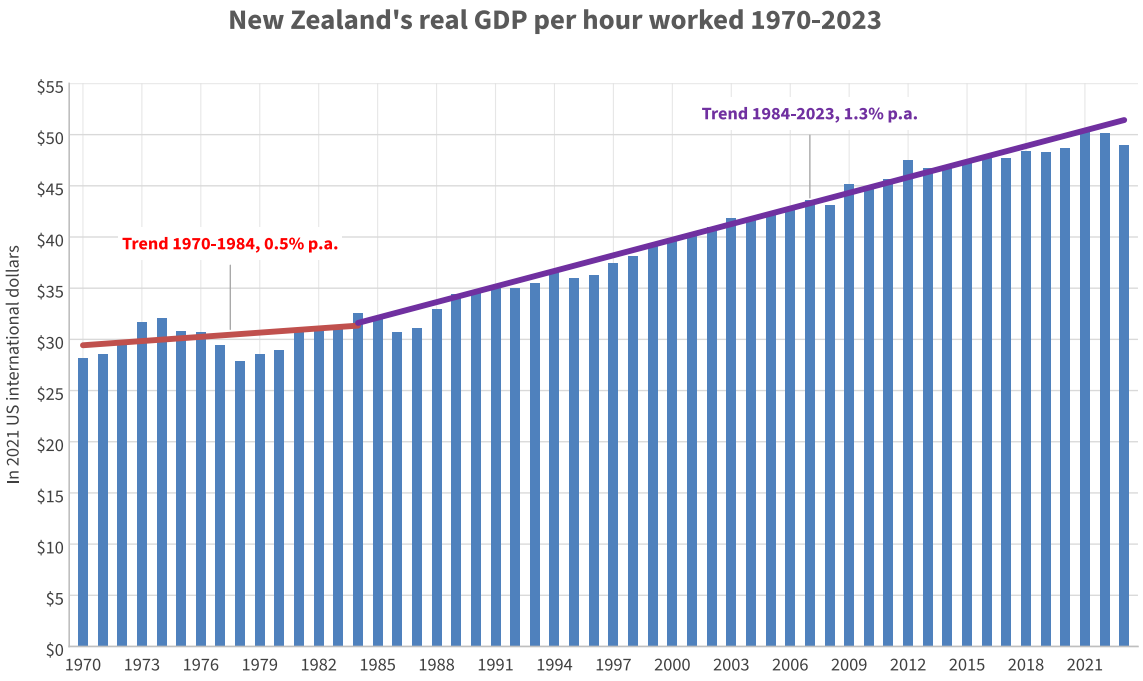
The average annual rate of growth in the 17 years to March 2025 was 0.9% p.a. on average. This period encompasses two SNZ growth cycle within the 16 years to March 2024 for which the combined average annual rate of growth was 0.9% p.a. and 0.0% change between the years ended March 2024 and 2025. The average annual growth rate for the latest SNZ cycle (years ended March 2020-2024), was 0,0% p.a.

No wonder people are hurting. By far the best growth cycles have been in the 15 years to March 2000.

The overall growth rate of 1.8% p.a. in the 1978-1985 March years was respectable by the standards of the last 25 years, but it was associated with heavy investment in oil substitution projects that lost taxpayers a lot of money and unsustainable deficit spending and economic controls that could only temporarily suppress inflation. The peak 11% rate of unemployment that followed from these excesses should remind everybody that such lax policies can come at a dreadful cost.

The PWT's time series for real GDP per hour from 1970-2023 also provides grounds for hope that governments can make a difference.

Figure 5. New Zealand's real GDP per hour 1970-2023



Source: Penn World Tables real GDP, variable rgdpna, in US 2021 international dollars

There were major productivity gains in some restructured state-dominated industries. Employment growth was remarkably strong after labour market deregulation in 1991 in conjunction with further expenditure control measures. The faster economic growth from 1984 to 2023 is shown in Figure 5.

The reforms were not the only factor. Good export prices helped. But the outcome defied the academic critics who believed that the fiscal measures taken could only worsen the recession regardless.[26]

The 1.3% average is over twice the average growth rate during the earlier period. The warning sign is in the frequency with which it has been below that trend line since around 2015.

Figures 3, 4, and 5 focus on output per hour. Arthur Grimes and Shine Wu[27] have argued that this is the wrong yardstick for a country's productivity performance, because it captures technical efficiency alone and ignores what production is for, which is consumption.

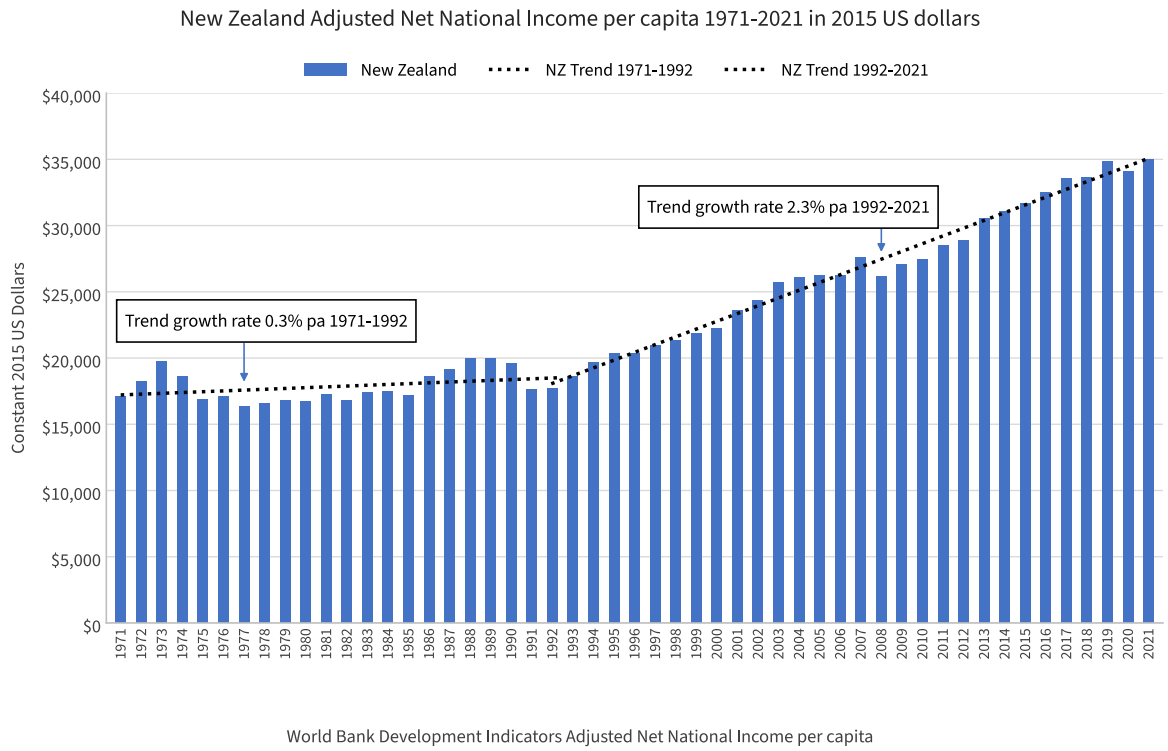
They favour a national income measure because it will incorporate gains or losses from changes in the price of exports relative to imports, compared to a constant price GDP measure.[28] They argue for a per capita measure rather than a per hour one on the grounds that work has value in itself for many people.

They also argue for a measure that nets out capital consumption and resource depletion and income paid out to overseas investors since none of these elements contribute to the ability of residents to consume.

The World Bank's time series for New Zealand's adjusted income per capita serves better than most indicators to meet these requirements. Figure 6 depicts its time series for New Zealand in

a comparable manner to the two-period comparison in Figure 5.

Figure 6. Real adjusted net national income per capita, 1971–2021



The two figures tell much the same story – only 0.3-0.5% p.a. growth in the first period, followed by a much faster growth rate. The timing of the change in slope can (and should) be debated, but the evidence of a 'before and after' difference is strong.[29]

There are no grounds in Figures 4 to 6 for despair over the ability of government to make a difference given the political will.

Grimes and Wu go one step further. They argue that since satisfying consumption is the prime driver of production, the World Bank's net income measure should be deflated by consumer prices, not a broader price measure such as the GDP deflator.

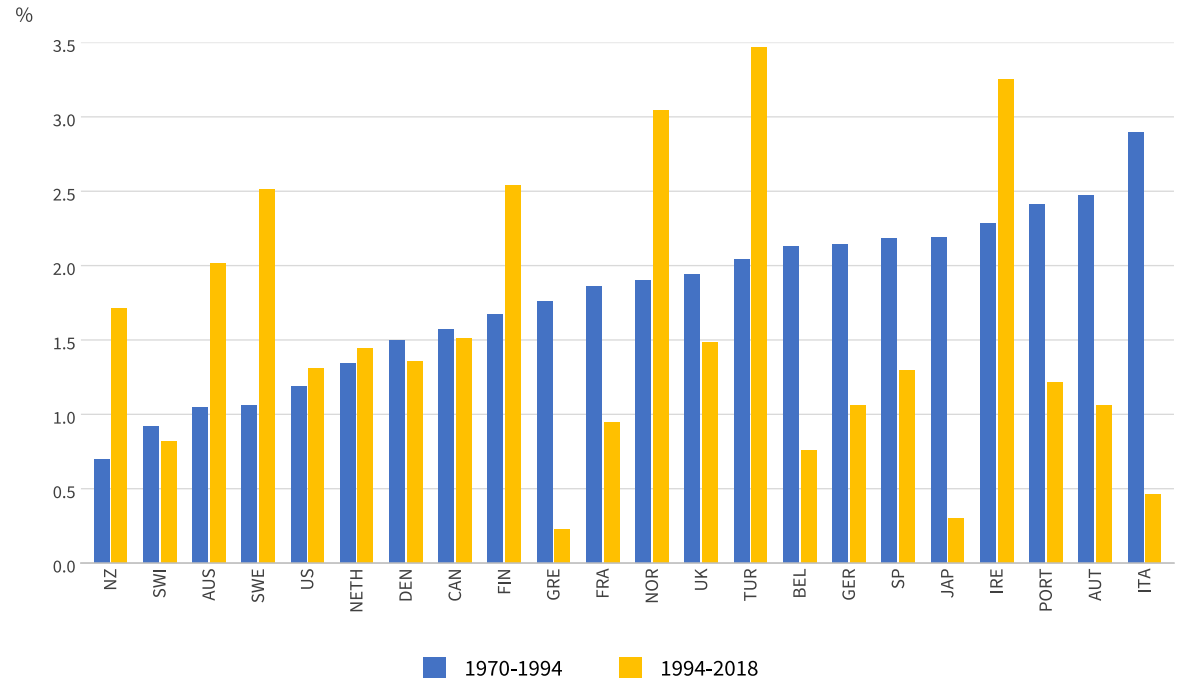
Figure 7 replicates a chart from a Treasury Analytical Note in 2022 that Janssen et al source to the paper by Grimes and Wu. The chart puts their result into a 22-country comparative perspective. These 22 countries were members of the OECD when New Zealand joined in 1973.

Over 1970 to 1994 New Zealand had the slowest growth on this measure of all 22, at 0.7% a year, with none at all between 1970 and 1991.

In sharp contrast, for the 1994 to 2018 period its growth rate ranked seventh, at 1.7% a year, ahead of the United States, the United Kingdom, Canada, Japan and most of Western Europe. Real GDP per capita tells the same story, ranking New Zealand sixth over the second period.

Grimes and Wu conclude that the reforms of the 1980s and early 1990s improved allocative[30] as well as technical efficiency. Material living standards rose 51% in the following 24 years, although the reforms will not be the only factor.

Figure 7. Real adjusted NNI per capita growth, 22-country comparison, 1970-1994 and 1994-2018



Source: Grimes and Wu (2021)

Australia outperformed New Zealand in both periods. The pick-up in New Zealand's growth rate matched that in Australia, but the level gap was still widening.

Two qualifications are needed. First, Grimes and Wu's time series end in 2018, before the weakness that Figures 3 and 4 show in recent years. Second, the cross-country chart says nothing about how the gains were achieved.

A Treasury analytical note in 2022 does not quarrel with Grimes and Wu's findings, while noting that neither the terms of trade nor the gains since 1994 have restored the income relativities New Zealand held in 1970.[31]

3.3 Decomposing the labour productivity gap

Statistics New Zealand decomposes its sectoral changes in labour productivity series into two components that are multiplied together to form the total change. The two components are the contribution of the change in capital intensity, as measured by the capital to labour ratio weighted by capital's income share, and the change in total output that is not due to the rise in inputs to production. The latter component is called multifactor productivity (MFP).

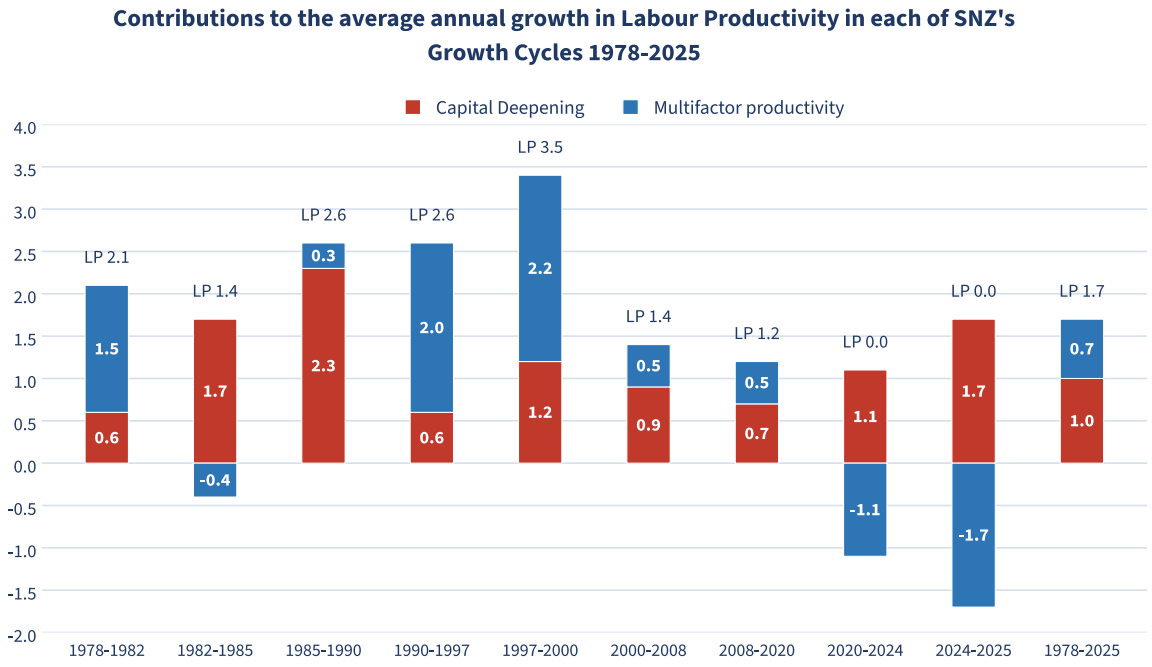
Wrapping more productive capital around each worker lifts labour productivity in itself. But finding or inventing more efficient ways of doing

things that raise output per unit of labour even more adds to the gains.

Figure 8 provides this breakdown for SNZ's eight growth cycles that were combined into five in Figure 4.

By far the fastest rates of increase in MFP occurred in the decade to the year ended March 2000. The strong labour productivity growth in the 1985-1990 period is shown to be due to capital deepening (2.3% p.a.). Labour shedding of disguised unemployment in New Zealand Rail and New Zealand Post and other reformed sectors likely contributed to the capital deepening. These were painful but necessary and long-delayed reforms.

Figure 8. Efficiency vs Capital Intensity Gains 1978-2025



Source: SNZ, 2025, Table 2.09, "Productivity in the former measured sector", Growth Cycles

Until 2000, MFP was only negative for one full growth cycle, 1982-1985. This was, of course, the period of an extensive wage, price and interest rate freeze. That has to stifle innovation and change.

We should expect policy to make a difference for better or for worse, because it does.

3.4 The capital-output ratio and capital intensity

Labour productivity is also related to capital productivity and capital intensity by the following identity.

$Q/L = Q/K \times K/L$

(Where Q = Output, and K and L are respectively capital and labour production inputs. For given

K and L, Q is higher if technical efficiency is higher.)

In the 29 years to 2024-25 labour productivity grew by 39% (1.14% p.a.) for New Zealand's measured sector. Capital productivity fell by 12% and the capital-labour ratio rose by 58%.

Expressed in terms of this identity, New Zealand's outcomes were:

1.391 = 0.879 x 1.583

For Australia's market sector the corresponding outcomes were:

1.604 = 0.808 x 1.984

Australia raised its capital-labour ratio by 98%, and increased labour productivity by 60% (1.64% p.a.) at the expense of a fall in capital productivity of 19.2%.

Excluding Australia's large capital-intensive mining sector changes these figures materially. Here is the resulting identity:

1.627 = 0.895 x 1.817

Excluding mining lifted both labour and capital productivity relative to including it while materially reducing capital intensity, relative to the outcomes that included the mining sector.

Dividing the Australia components by the New Zealand ones gives the following relative movements:

Not excluding mining 1.153 = 0.920 x 1.253

Australia widened the productivity gap with the New Zealand measure by 15.3% and capital intensity by 25.3%, those increases being offset by a faster fall in Australia's capital productivity.

Excluding mining gives 1.170 = 1.019 x 1.148

Excluding Australian mining, capital productivity in the rest of Australia's market sector fell less than in New Zealand's measured sector, capital intensity rose 14.8% more and labour productivity rose 17.0% more.

These are the most authoritative official figures and they show Australia widening the overall labour productivity gap with New Zealand during this long period.

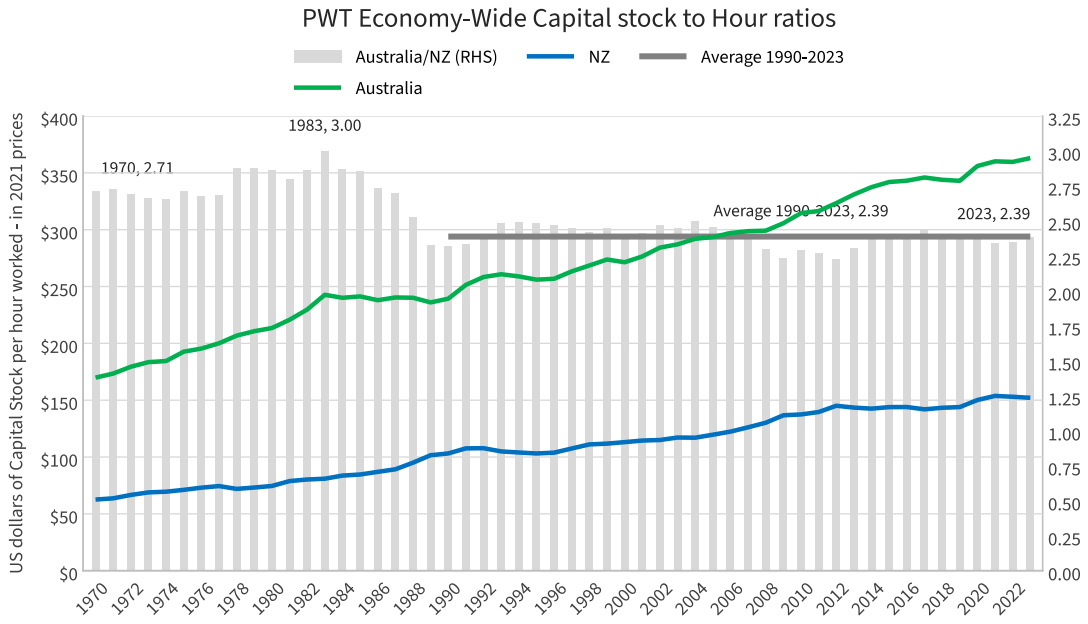
Two other points to keep in mind are that these statistics tell us nothing in themselves about causation and they are not fully comparable. On the latter point, the two countries measure hours worked differently and the industry coverage is not identical.

The PWT economy-wide statistics are more helpful in that they allow levels to be compared as well as changes in levels. They can do this because they measure output, capital stock levels and hours worked directly, rather than as index numbers.

In Figure 3, the economy-wide Q/L ratio is 1.55 in favour of Australia in 2023, at 2021 international prices. On the PWT's national-accounts constant-price basis it was fractionally higher at 1.580 times. From the same PWT database, in 2023 Q/K for Australia was only 66.2% of that for New Zealand, and K/L was 2.387 times higher for Australia.

The above identity is satisfied since 1.580 = 0.662 x 2.387.

Figure 9. Economy-wide Capital Intensity 1970-2023



Source: Feenstra, Robert C., Robert Inklaar and Marcel P. Timmer (2015), "The Next Generation of the Penn World Table" American Economic Review, 105(10), 3150-3182, available for download at www.ggdc.net/pwt

These figures are 2023 snapshots, 2023 because this is the latest year for which these time series have been published. The above identities also hold for proportionate increases between any two years for which observations are available.

The PWT series can also be used to assess trends in the capital to labour ratio for each of New Zealand and Australia, as depicted in Figure 9.

Australia had lifted its capital intensity both absolutely and relative to New Zealand between 1970 and 1983. It peaked at three times New Zealand's ratio in 1983. Australia did not grow capital intensity at all for the next seven years while New Zealand's rose strongly. Remarkably, the relative ratio is largely flat for the 33 years since 1990 around an average value of 2.39 times New Zealand's capital intensity ratio. This is despite the heavy investment in the large Australian mining sector in part of this period.

That means that any gains in overall labour productivity for Australia relative to New Zealand *on this measure* must come from a relative fall in Australia's economy-wide capital output ratio. But this is far from the whole story.

The first big qualification is that the economy-wide capital stock series includes residential dwellings but the hours worked series does not include unpaid hours on one's own dwellings. So to measure the contribution of capital to hours worked, the stock of dwellings needs to be excluded. Of course, hours worked in the industries in building and construction and value added will be included in the industry statistics.

A second consideration is, of course, Australia's much larger mining sector. Its inclusion in the comparison in Figure 9 also fails to give a realistic comparison of differences in capital per worker in industries that dominate in New Zealand.

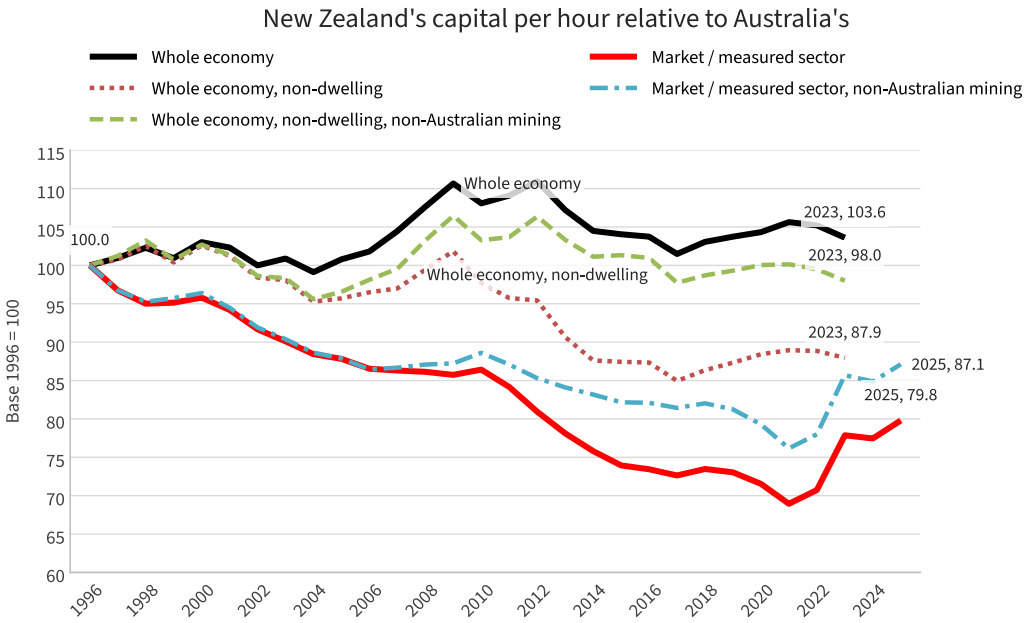
The PWT database does not allow either component to be identified, but the respective capital stock estimates by the Australian and New Zealand government statisticians do allow this, although only to 2023 currently.

New Zealand's dwelling stock has risen faster than Australia's so removing that stock from both reduces New Zealand's capital stock per hour ratio from 100 in 1996 to 87.9 in 2023, compared to a rise to 103.6 if dwellings are included (see Figure 10). That is a 15.1% reduction.

The further step of removing the large, capital-intensive, Australian mining sector from the comparison swings it substantially back the other way. Its 2023 ratio of 98.0 is 5.4% below the 103.6 value for the total economy ratio. With both excluded, New Zealand's capital intensity ratio to Australia in 2023 was only 2.0% lower than in 1996. Can this really be true?

The remaining two lines in Figure 10 show much stronger growth in capital intensity in Australia since 1996 in the market sectors of the economy where we can have greatest confidence in the accuracy of the estimates. Not excluding Australian mining from this comparison shows New Zealand's capital intensity ratio falling 20.2% from 1996 to a 2025 index number of 79.8. Excluding Australian mining only reduces the fall to a still material 12.9% for a 2025 index number of 87.1.

Figure 10. Capital intensity excluding dwellings and mining 1996-2025



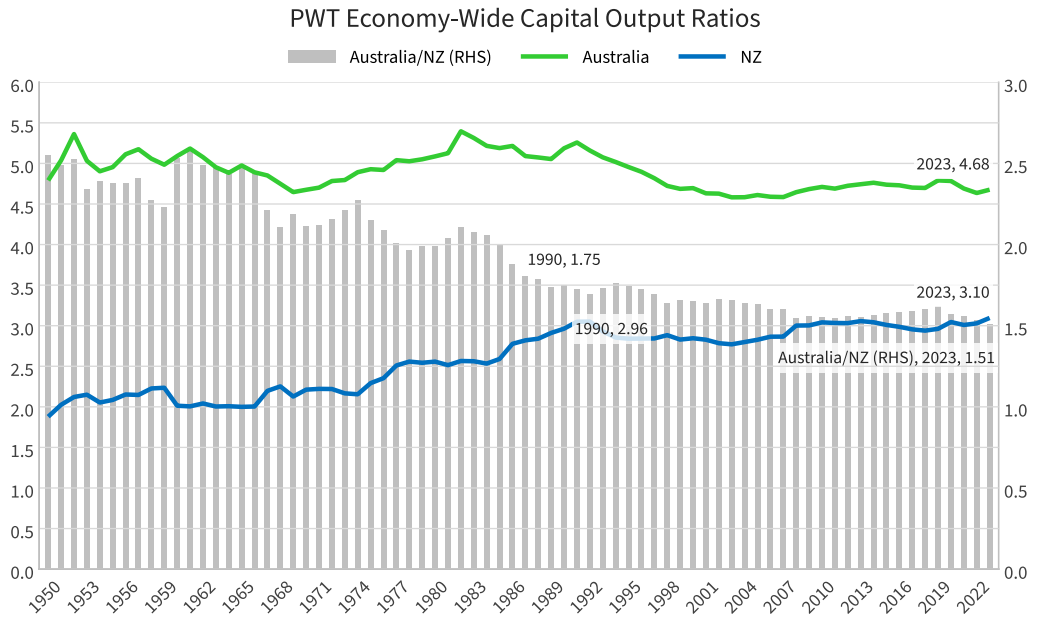
Sources: PWT Calendar Years for whole economy, years ended March for NZ's former measured sector and years ended June for ABS's market sector. Dwelling capital stocks from SNZ and ABS. Mining strock and hours from ABS.

The (likely brief) rise of 15.7% to 79.8 in New Zealand's capital per hour relative to Australia for the market/measured sector since 2020-21 is due to a 3.0% fall in capital intensity in Australia, while it rose by 12.4% in New Zealand. Australia's market-sector capital intensity has

increased every June year since 1996, except for 2018, 2022 and 2023.

In short, there is a disjuncture between the whole economy indicator of the relative capital intensity paths between Australia and New Zealand and the narrow coverage but more reliable market/measured sector comparisons. One point is that the former uses capital stock estimates that include government-owned capital, whereas the latter use annual flow estimates of the capital service inputs into commercial production.

Figure 11. Economy-wide Capital to Output 1950-2023



Source: Feenstra, Robert C., Robert Inklaar and Marcel P. Timmer (2015), "The Next Generation of the Penn World Table" American Economic Review, 105(10), 3150-3182, available for download at www.ggdc.net/pwt

The estimated value of the government capital stock may, in both countries, be a very poor indicator of the unobservable value of its contribution to production. Another point to keep in mind is that the measures of hours worked differ and that this could affect both levels of productivity and their changes through time.

Turning now to the inverse of capital productivity, namely, capital per unit of output, on the PWT's database New Zealand's capital-output ratio peaked locally in 1992 at a level of 3.05, only a little below its 2023 level of 3.10. During the same period Australia's ratio declined further before flattening out at a bit above 4.5 from 2007.

The long decline, until around 2008, in the capital-output ratio for Australia relative to New Zealand is a rise in the relative output to capital ratio. This rise would tend to lift labour productivity for Australia relative to New Zealand, although the decline in the relative capital to labour ratio until 1990 was an offsetting factor.

The chart does not show adjustments to this measure for dwellings and the Australian mining

sector, but Figure 10 suggests they would be significant, stepwise at least.

3.5 The importance of innovation for capital intensity

Innovation is a critical contributor in time to both labour and capital productivity. Competition for customers drives commercial innovation and the need for scientific and technical advances. As shown below, innovation induces investment.

Innovation can be disruptive, but it commonly takes the form of cumulative small improvements and the scale economies from specialisation that Adam Smith wrote about in 1776. Henry Ford showed the world the advantages of mass production through specialisation.

Countries that suppress innovation through bans and red tape will tend to have lower labour productivity through both channels. Less innovation reduces achievable Q and thereby achievable Q/L and Q/K on both sides of the above identity.

Less obviously, less innovation tends to reduce economy-wide K/L. This is because it lowers the marginal productivity of capital for domestic projects relative to the cost of capital in world markets. That lowers domestic investment relative to labour.[32]

New Zealand's long-standing restrictions on genetic crop research surely held back farming in New Zealand on both counts.[33] Less restrictive countries have gone ahead with no global headline disasters. A riskless society is a stagnant one. Risks should be assessed, but stirring emotions about "Frankenfood risks" should not displace rational analysis.

3.6 The overall efficiency perspective

What counts is not which country has more capital or labour relatively, but which is better at generating more output from given inputs at prices people are willing to pay. (If the volume of output rises by more than the volume of the bundle of inputs there has been a gain in productive efficiency.)

Capital and labour need to be allocated efficiently across diverse products. In producing any given product, efficiency requires that there is no way of getting more product from those capital and labour inputs. Economists call the former allocative efficiency and the latter productive efficiency. Both are as judged by customers' willingness to pay.

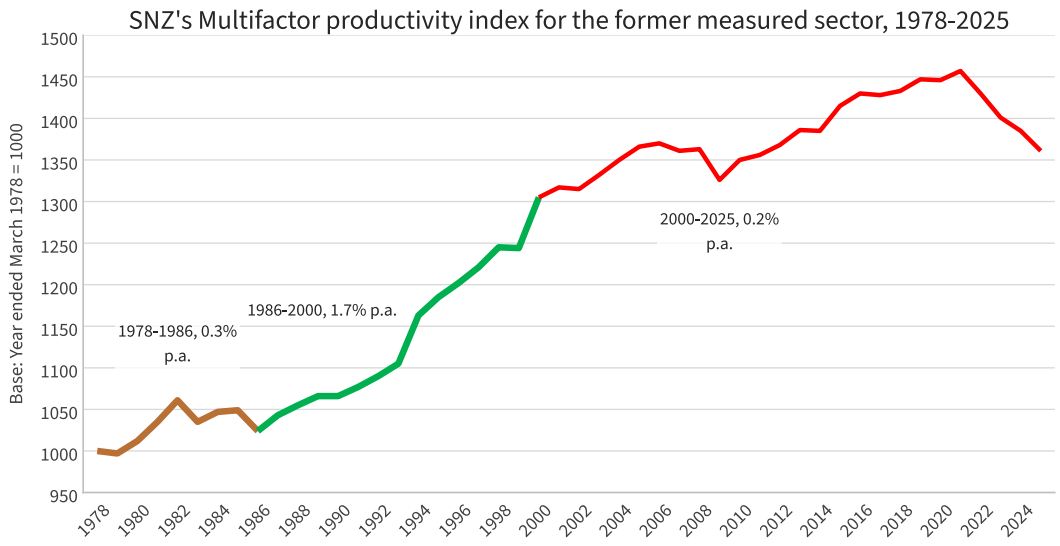
SNZ produces a measure of overall efficiency in the sense of more output for the same inputs for the subset of the economy that it calls the measured sector.[34] It calls its measure multifactor productivity (MFP). It does not publish economy-wide estimates because of measurement difficulties.

The longer of its time series is the one it calls the former measured sector. It covers the period from 1978 to 2025 and the track it shows changes its slopes in a way that supports the view that government policies for better or for worse do make a difference. The period of two adverse oil price shocks and increasingly stultifying controls saw an annual average rate of growth in MFP of only 0.3% p.a. from 1978 to 1986 (Figure 12).

The stark contrast is with the average annual compounded rate of growth of 1.7% p.a. between 1986 and 2000 (years ended March). In late 1999 a government that did not favour further reforms of the same type was elected. The years since 1999 have seen periods of prolific government spending increases followed by grinding years of spending constraint amidst increasing regulation of a safety and environmental nature.

Infrastructure development has languished and housing affordability is a devastating problem.

Figure 12. SNZ's MFP Index 1978-2025



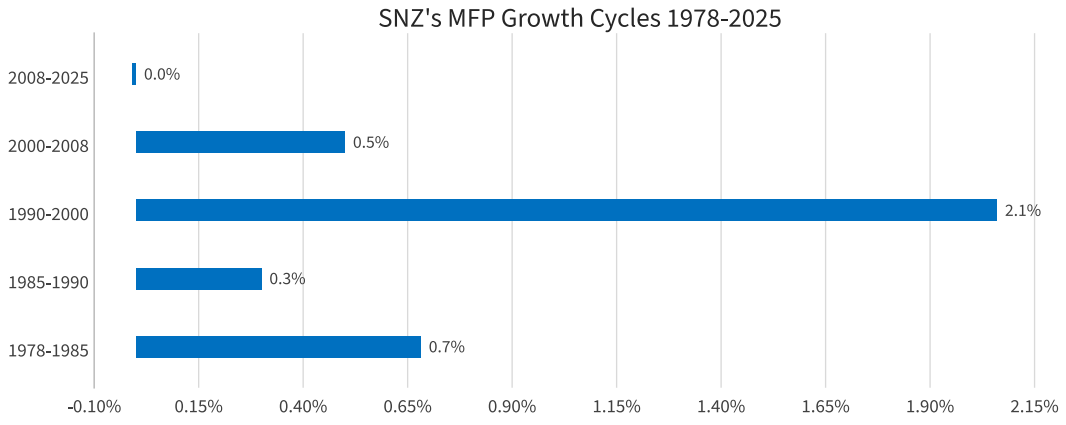
Sources: The author - using index numbers published by SNZ in 2025, Table 2.01, Productivity in the former measured sector, 1978-2025. Years ended March

The growth cycle periods that SNZ reports line up with political periods in which governments were in place that implemented major economic liberalisation and fiscal control and those of a different mind.

Starting with a major foreign currency crisis amidst suppressed inflation, extensive financial repression (forced lending to government at low controlled interest rates) and large ongoing fiscal deficits, governments were forced to free up much of the economy and to work to balance the fiscal books to stop a public debt spiral. That reform zeal was at its peak during the years ended March 1985 to 1994, but slowly faded to be fully snuffed out after the 1999 general election.

The incoming government in late 1999 was the beneficiary of strong employment and tax revenue growth and, for a time, fiscal surpluses. But when it lost the 2008 general election, the combination of its big spending increase, the global financial crisis and the Canterbury earthquakes returned the Crown accounts to heavy deficits, and much borrowing. It took that National-led government until 2014-15 to get the books back into surplus, but again in 2017 the electorate voted for another big spending government that bequeathed heavy deficit spending and big increases in the public debt to the next government.[35]

Figure 13. SNZ's MFP Growth Cycles 1978-2025



Source: SNZ, 2025, Table 2.09, "Productivity in the former measured sector", Growth Cycles combined described in Figure 4.

The lack of any sustained appetite in the electorate for doing better has seen the annual MFP growth rate average only 0.0% p.a. in the 17 years from 2008-2025. The MFP trends shown in Figure 13 tell much the same story as the labour productivity trends shown in Figure 4.

The average annual rate of MFP growth in each of SNZ's growth cycles 2000-2008 and 2008-2020 was only 0.5% p.a. This was only a quarter of the growth rate for MFP in the two growth cycles from 1990-2000 (see Figure 15 for each of these cycles).

Much worse, it has been negative for four of the five years to 2024-25. The cumulative fall since 2020-21 is 6.6%.

Both Figures 4 and 13 show the strongest growth to be in the 1990-2000 period. There is a big difference in the growth in the two charts for the 1985-1990 period. Employment growth was negative in the former measured sector during these years while output growth was positive (Figure 15). That is why labour productivity growth was so strong for this sector from 1985-1990.

Nevertheless, the diverse productivity outcomes in Figures 4, 12 and 13 are far from determined solely by changes in domestic policy tastes. Events out of the hands of the government of the day can play a very important role and all governments can do is respond to them, for better or for worse.

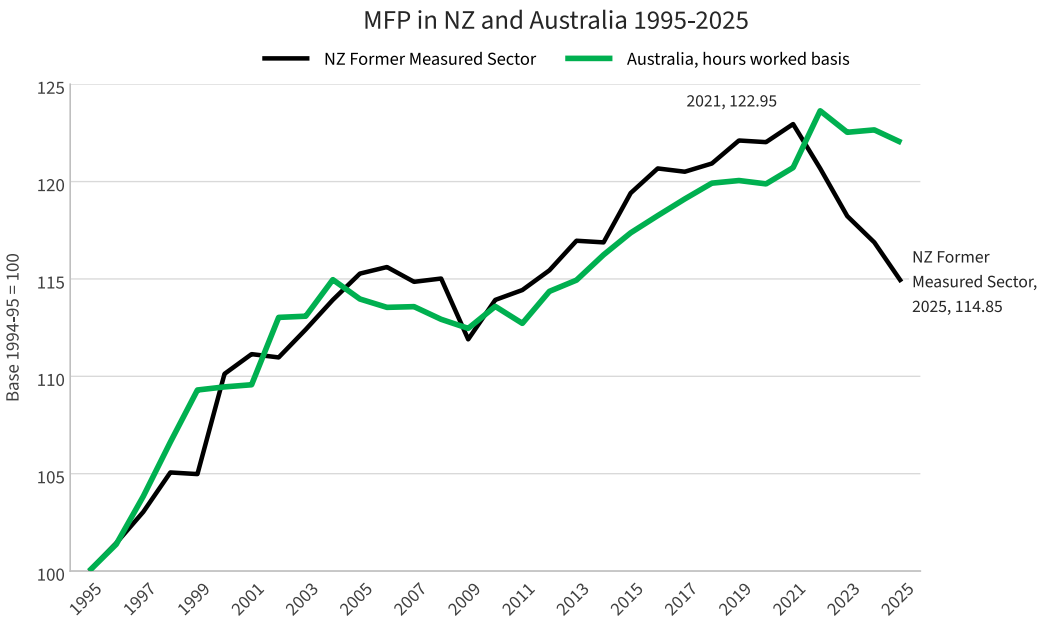
Australia's experience is always a useful comparator to look at when evaluating New Zealand's performance, for obvious institutional, cultural and economic reasons.

The difficulty in this case is that when it comes to assessing the possible role of reforms, Australia also liberalised its economy considerably in the 1980s and early 1990s under the Hawke and Keating Labor governments.

Australia's market sector MFP growth from 1994-95 matched New Zealand's former measured sector growth remarkably closely until 2021. We do not know from Figure 14 alone if that was because both countries' economic policies had about the same effect, for better or for worse, or if neither of them had any effect. But the dramatic difference is in New Zealand's

MFP slump after 2021, both absolutely and relative to Australia.

Figure 14. MFP Australia & NZ, 1995-2025



Sources: ABS and SNZ. Hours worked basis (as distinct from quality-adjusted hours). Years ended March and June for NZ and Australia respectively.

SNZ's tables also allow the accounting contribution of MFP, labour and capital inputs to be compared, growth cycle by growth cycle. This comparison is depicted in Figure 15.

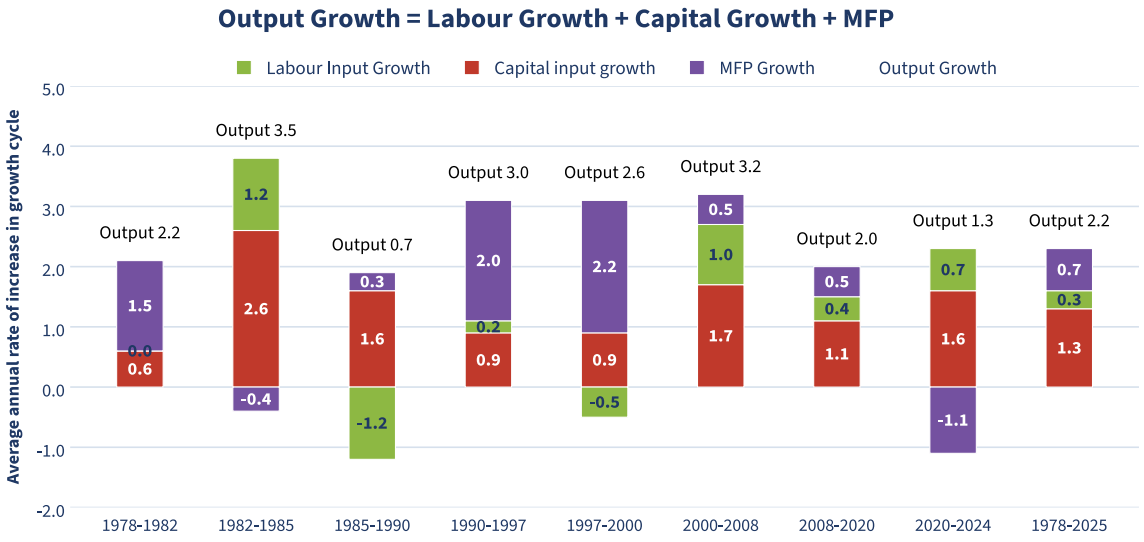
The biggest growth rate contributions of 2.0% p.a. and 2.2% p.a. occurred during the 1990-97 and 1997-2000 growth cycles respectively. Efficiency gains made the largest contribution to output growth in these two cycles. Next best was the 1978-82 period. MFP growth rates in the growth cycles in the 2000-2025 period show deep malaise.

The strongly negative MFP growth since 2021 is alarming, from both a 'before and after' and a relativity with Australia perspective. It will not be because industry is inherently incapable of increasing efficiency. Nor will it be because of anything new about distance to markets, geography or scale.

What about the economy-wide efficiency gains? The former measured sector statistics excluded health, education, housing and most of local and central government.

At least one international database does publish estimates of economy-wide efficiency gains that include New Zealand, and Australia. This measure is called total factor productivity (TFP).

Figure 15. Contribution of MFP to output growth 1978-2025



Source: SNZ, 2025, Table 2.09, "Productivity in the former measured sector", Growth Cycles

The PWT dataset calculates TFP by comparing real GDP against total labour and capital inputs, adjusted for quality differences such as human capital and capital stock composition. It again measures the extent to which output volume rose faster than can be explained by growth in the bundle of inputs, capital and labour.

Figure 16 is a 69-year whole-economy picture, built from an international dataset designed for comparing growth rates across many countries. It indexes both countries to 100 in 1954 and compares the paths each since took. Australia has grown TFP faster than New Zealand since 1974. By 1990 the gap was 5% from 1954.

New Zealand's TFP was no higher in 2023 than in 2000 while Australia's was 11% higher. That saw the gap rise to 24% in 2023, the last observation in this time series. (Note that this is a change in the gap from 1954; it does not tell us what the absolute gap was then or now.)

Australia's efficiency on this measure grew on average at 0.50% a year from 1994. New Zealand's grew 0.04%, next to nothing overall.

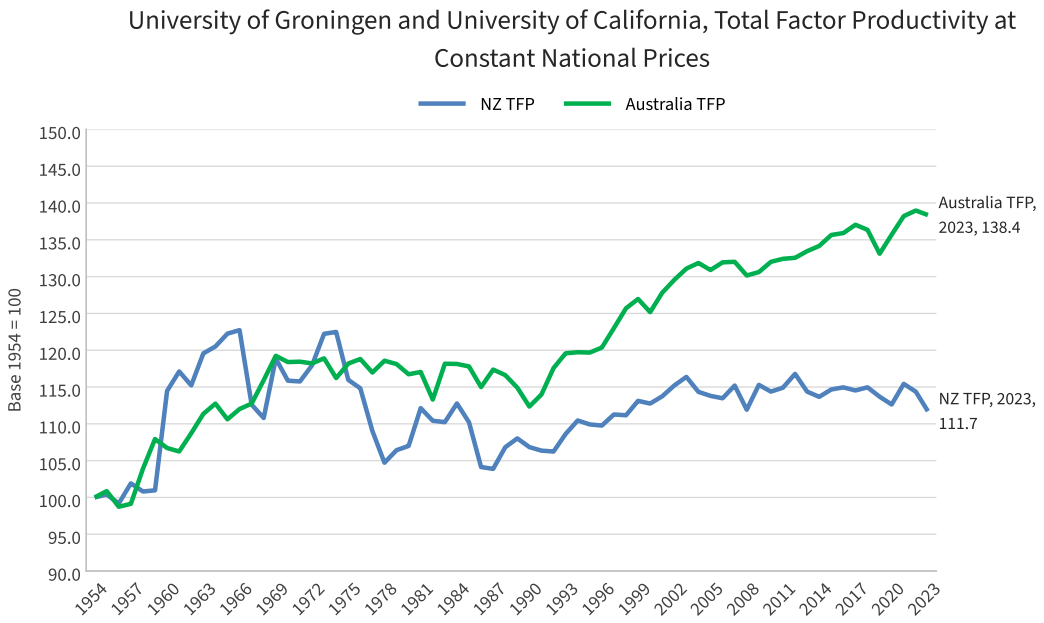
That is a more than tenfold difference. The power of compounding turns that into a 15.6% gain for Australia in 29 years compared to a 1.1% gain for New Zealand. According to this measure, Australia has done a much better job of raising living standards, other than by working harder, raising one's skills and experience, belt-tightening and saving and investing more.

However, the TFP and MFP measures disagree markedly on the size of New Zealand's efficiency growth deficiency relative to Australia since the mid-1990s. On the MFP measure in Figure 14, New Zealand's growth was fractionally greater until 2021. (This is also true of the former measured sector; for the measured sector the two were virtually equal.)

The whole-economy statistics include housing, government and other sectors where output is hard to measure well, as may be the value of public sector capital stock. The narrower official MFP sector statistics cover the industries in which output can be measured most accurately, but they leave out government, most of housing services and other non-market activity. That greater accuracy makes the sharp drop in the

MFP measure since 2021 all the more concerning.

Figure 16. Total factor productivity 1954-2023 NZ and Australia



Source: University of Groningen and University of California, Davis, Total Factor Productivity at Constant National Prices for Australia [RTFPNAAUA632NRUG], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/RTFPNAA

3.7 Summing up

Readers can have greatest confidence in the productivity time series SNZ produces for the measured sector. These tell a clear story of productivity growth malaise from 1978-1985, followed by 15 years of much higher growth, that had petered out by 2008 with the onset of the global financial crisis. Since then the overall productivity growth for this portion of the economy has gone from hardly positive to significantly negative. Regardless of what one makes of the reasons for these swings in growth rates, the recent outcomes are so bad as to make the community's angst about the cost of living very understandable.

The international comparisons reviewed in this research come with many statistical compromises. Here are some:

- New Zealand's measure of hours worked could be too low, as it may use hours paid, which are commonly fewer than the hours worked figure used internationally. Working in the opposite direction for evidence of a labour productivity gap, New Zealand's series for hours worked or paid may fail to deduct hours paid but not worked because of annual leave, sick leave and public holidays, compared to the adjustments for other countries.
- Another feature is the quality of the average hour worked. The Australian Bureau of Statistics (ABS) estimates labour productivity on a straight hours worked basis and on a

quality-adjusted hours worked basis. Labour productivity rose 64% on the first measure from 1995-2025, so 1.7% p.a., and 40% on the second measure (1.1% p.a.). That is a substantial difference.

- SNZ's population estimates for New Zealand have a significant break (of about 2%) in 1991 when it switched from a de facto to a residency basis. Most overseas income per capita comparisons do not adjust for this break. That can seriously compromise comparative assessments of economic performance that include that period.
- There are sometimes glaring inconsistencies between GDP as an income measure and a closely related one, such as industry gross value added.
- Estimates of capital stock and of the services provided by capital are subject to concerning errors, particularly in estimating the stock in the first years of a time series. With respect to capital stock owned by government, there may be no reliable market values, in which case historic cost or depreciated replacement cost might be used, but none of those capture the value that is needed – the opportunity cost, or market value. There may be significant differences between measures of the capital stock used in an activity and the value of the capital services that combined with labour in the same period to generate those outputs. The SNZ and ABS measures use the flow of capital services to measure the capital to labour ratio. The whole economy measures tend to use the capital stock.
- As shown above, the stock of dwellings can be large relative to the economy-wide measure of a community's built capital. That needs to be allowed for if the focus is on productivity efficiency. As illustrated by the Australian mining case, differences in industry structure can also have a significant effect on comparisons.
- International comparisons may also catch countries at different phases of their boom and bust cycles. Experts can validly dispute the start and end points of such cycles too, so this problem may not be an easy fix.
- Intellectual property is a growing measurement issue, and one not addressed in this review.

So what can be safely concluded other than that great care must be taken to avoid misleading others and oneself by not being sufficiently aware of all these variables, time period differences and data errors? Here is a list:

- The findings that Australia has much higher average labour productivity and income per capita and capital intensity look robust. This is on both economy-wide measures and on the market sector/measured sector comparisons.
- But how big the gap is clearly depends markedly on the measure and the time period. The most powerful evidence that it could be much smaller than the mainstream view suggests (e.g. the 55% gap for labour productivity and perhaps 34% for GDP per capita) is the much smaller gap of 12% in both cases, for actual individual consumption per capita on the OECD measure and for adjusted net national income per capita on the World Bank's measure. Grimes and Wu focus on the latter, and give cogent reasons for doing so.
- On the basis of the most reliable statistics to hand, the labour productivity gap has grown materially in the last 30 years. Nor does New Zealand look as good for overall efficiency gains. On the ABS/SNZ market/former measured sector basis, between 1995 and 2025:
    - Australia's labour productivity increased by 64% in these 30 years and 49% for New Zealand.[36]

    - Australia increased its capital intensity by 101% compared to an 83% increase for New Zealand.
    - New Zealand grew MFP marginally faster until 2021, but New Zealand's MFP has since plummeted. The 30-year increase is 22% for Australia and 15% for New Zealand.
- Economy-wide the comparison with Australia of total factor productivity gains is also a cause for concern. Measurement issues and errors are troubling, however.

New Zealand's capital intensity shortfall with Australia has developed over past decades, but the recent rate of relative decline is marked, and it is a trend that Australian mining only partly explains.

The relative growth slide in efficiency is a red flag in a public policy context because it asks if there might be undue barriers to innovation. Those barriers could be holding back capital intensity. Delays in getting approvals for infrastructure spending are an example.

Regulatory barriers are mostly due to domestic policy making, and what policy has made it can unmake.

SECTION 4

What Drives Productivity Growth?

If New Zealand's shortfall is in efficiency rather than in effort or in the volume of investment, what determines efficiency?

New Zealand productivity debates commonly point to our remote location, focus on primary product exports and lack of scale as reasons for our low productivity level. Indeed, they may be factors that help explain New Zealand's poor ranking for GDP per hour relative to its ranking for economic freedom. But if so, that undermines the argument that New Zealand could be more prosperous with less economic freedom.

Digging deeper, however, note that New Zealand was once more prosperous in global comparisons than it is today. And static factors to do with location, geography and scale, that cause a lower level for productivity do not necessarily force a lower productivity growth rate.

Other countries that are more prosperous have different locations, geography, scale and vulnerabilities to foreign occupation. New Zealand is quite fortunate in many respects. Peace rather than war and destruction is a blessing.

Much of the answer lies in things that governments decide.

Empirical research by Jakob Madsen found that total factor productivity (TFP) and demographics were the main drivers of income growth. He studied 17 OECD countries from 1870 to 2006 and found that per capita income growth was predominantly driven by demographic change and TFP; capital deepening independent of TFP played only a minor role.[37]

Over the centuries, capital formation is determined by deeper causative factors, and Madsen has made the case that population growth, human skill attainment (greater investment per child because of fewer children per mother and rising prosperity) and human ingenuity (TFP) are the fundamental factors that saw GDP per capita take off in the 1800s compared to earlier millennia. But not in all countries at once. Some cultures and institutions are more conducive to entrepreneurship and investment than others.

The spectacular post-World War II recovery growth of 1950–73 was, in his analysis, almost entirely attributable to high TFP growth. The post-1975 slowdown reflected near-completed convergence among these countries and slower growth in knowledge imports and educational attainment, and hence slower TFP growth.

TFP in turn was driven by R&D, knowledge spillovers through imports, educational attainment and the interaction between education and proximity to the technology frontier.

Paul Romer (1990) and Philippe Aghion and Peter Howitt (1992) identified the mechanisms through which policy settings have permanent growth effects.[38] Romer showed that ideas, being non-rival, can sustain growth indefinitely when investment in them is rewarded. Aghion and Howitt formalised Schumpeterian creative destruction: growth depends on the entry of more efficient firms and the exit of less efficient ones, which in turn depends on competitive markets and secure property rights.

Douglass North took a wider view. Formal institutions such as laws, property rights and contracts, and informal ones such as norms, trust and conventions, determine transaction costs and therefore the feasibility and profitability of economic exchange.[39]

This interest in the quality of institutions as a determinant, or at least a necessary condition, for prosperity engendered considerable work in the 1990s focused on assessing the empirical support for this proposition. This literature was reviewed critically by Janine Aron for the World Bank in 2000.

Janine Aron's review pointed out the importance and the difficulty of establishing causation rather than correlation. She concluded reservedly that institutional quality has "a robust and significant indirect relationship to growth via its effect on the volume of investment", with any direct effect weaker.[40]

A subsequent paper in 2004 by Dani Rodrik, Arvind Subramanian and Francesco Trebbi estimated the relative contributions of institutions, geography and trade to incomes around the world and concluded that "the quality of institutions 'trumps' everything else".[41]

Daron Acemoglu, Simon Johnson and James Robinson (2005) argued, drawing on historical and econometric evidence, that inclusive institutions, meaning secure property rights, the rule of law, competitive markets and broad political participation, foster innovation and growth, while extractive institutions concentrate power and stifle creative destruction.[42]

The robustness of their empirical findings is still being debated and contested. See, for example, David Albouy's contrary empirical findings published in 2012.[43]

The proposition that the quality of institutions matters is reasonable; the proposition that it is the fundamental cause is much harder to establish. The quality of institutions might improve because other factors, fortunate or deliberate, become conducive to such an improvement.

For the purposes of this research paper, the reasonable proposition is that institutional quality should be improved if this can be done by well-justified measures.

A narrow question is the degree to which big government makes even prosperous countries less prosperous than otherwise. The high tax burdens required to fund the transfer payments that dominate government spending in most prosperous countries come at a cost, in terms of both economic freedom and the costs of complying and changing one's affairs to reduce taxable income and make it easier to tap into a government spending programme.

A significant research effort has gone into assessing whether the government spending component of the economic freedom measures is bad for economic prosperity.

The link from living standards to fiscal policy runs through a distinction drawn by Barro in his 1990 endogenous growth model.[44] Barro distinguished public expenditure that enters private production functions, such as infrastructure, education and public order, from expenditure that does not, such as transfers and subsidies. The former raises the marginal product of private capital and can sustain growth; the latter diverts resources without raising productive capacity. Both must be financed by taxation, which imposes deadweight costs on the economy. The growth-maximising share of government spending exists where the marginal productivity gain from the last dollar of productive expenditure just equals the marginal deadweight loss from the taxation required to finance it.

Richard Kneller, Michael Bleaney and Norman Gemmell (1999) tested Barro's suggestion

empirically on a panel of 22 OECD countries over 1970–95.[45] A subsequent paper by Norman Gemmell, Richard Kneller and Ismael Sanz (2016) found that shifting spending towards infrastructure and education raised long-run GDP levels while shifting it towards social welfare transfers had at most modest negative effects.[46]

Andreas Bergh and Magnus Henrekson (2011) concluded that, in the more comparable panel evidence for rich countries, larger government is associated with slower growth, although high social trust and market-friendly institutions may offset this association.[47] Bergh and Bjørnskov (2020) examine the trust qualification directly and find no robust evidence that high trust insulates countries from the growth cost of big government, while Bergh and Bjørnskov (2021) find that improvements in institutional and policy quality are associated with income growth across the income distribution.[48] Taken together, the papers indicate that the negative growth implications of large government depend materially on the institutional environment and on complementary market-oriented policies.

In short, there seems to be more agreement that transfer programmes funded by distorting taxes can hold back prosperity than there is that the total size of government does. Given that big government is only big because of the scale of transfer payments in cash and in kind, and the taxes governments use are overwhelmingly distortive, the distinction does seem moot. Common ground can be found in the view that the quality of government provision and oversight of public goods is very important for law and order, infrastructure and much else.

What about government spending on R&D? Terence Kealey challenged the conventional assumption that government funding of science drives economic growth.[49] His argument, set out at length in *The Economic Laws of Scientific Research* and in subsequent papers with Al-Ubaydli, was that the "linear model" of innovation, in which government funds pure science that flows to applied science and then to growth, is empirically wrong.[50] The causal direction runs the other way: the competitive pressure to innovate to cut costs drives businesses to seek commercial innovations and academic scientific inquiry can help find better solutions. He argues that government R&D funding tends to crowd out private funding rather than supplement it. This challenge to the conventional view and to the funding paths of those who access R&D funding has yet to win the day.

The Austrian and market process tradition saw the problem differently. Hayek argued that the economic problem is not the allocation of given resources to known ends but the use of knowledge dispersed among millions of individuals, knowledge that is often tacit, local and impossible to centralise.[51] Israel Kirzner identified entrepreneurial alertness to unnoticed profit opportunities as the driving force of market coordination.[52] On this view innovation is a discovery process, not a production function that government can direct. Frederic Sautet applied the point to New Zealand in a paper for the Treasury, arguing that the then Labour-led government's "Economic Transformation" programme rested on what Hayek called the pretence of knowledge.[53]

Lew Evans, Neil Quigley and Jie Zhang (2000) formalised the trade-off between static efficiency (producing at minimum cost today) and dynamic efficiency (investing in the innovations that reduce costs tomorrow).[54] Regulation that pushes prices to marginal cost destroys the quasi-rents that fund innovation. Centralised decision-making, where government controls a large share of the economy, replaces a portfolio of decentralised entrepreneurial bets with a single consensus view.

As mentioned in the introduction to this paper, a puzzle emerges when these frameworks are applied to New Zealand. The economics

literature accepts that the quality of a country's institutions affecting economic activity is very important for that country's prosperity.

Of course it is not decisive; war can produce death, destruction and famine regardless, as can natural disasters. Sound institutions should be accepted as foundational for prosperity, but not a guarantee. It is people and events that make the difference.

New Zealand ranks at or near the top globally for institutional quality – third for economic freedom in the Fraser Institute's index and fourth equal in Transparency International's Corruption Perceptions Index. Its formal institutions, its laws, its courts, its democratic processes, score well by any international measure. Yet its productivity performance is relatively poor.

This disparity provokes the question: "Why can New Zealand not achieve greater prosperity with even bigger government and in that respect less economic freedom as do many more prosperous countries?"

One response is that the more prosperous countries with bigger shares of government spending tend to be in Europe where there are advantages of scale, proximity and historical accumulation of capital. Many were wealthy before expanding their welfare states from the 1960s. There is an element of wishful thinking in those who excuse New Zealand's languishing productivity and income per capita on the grounds of geography, lack of scale and distance from markets but do not see this as a reason why New Zealand governments need to be even more diligent than otherwise to avoid higher tax burdens to fund voluminous ill-justified spending.

Even so, the question is understandable in that economic outcomes can never hope to satisfy everyone. Schumpeter's term "creative destruction" for competitive economic progress applies. Someone who does not like to see destruction of any sort might well ask the above question.

This challenge embodies the view that economic freedom has regrettable aspects (which it does) but wishfully hopes that they can be traded off for something else (perhaps greater social unity) that generates higher prosperity overall.

The odds are against this as a general proposition. An oil-rich state with little economic freedom might be very prosperous overall under a repressive government. But it does not follow that it would be even more prosperous with even more state direction and control.

The empirical literature is very clear that high levels for economic freedom are strongly associated with measures of prosperity.[55] This does not mean that nothing else matters. Many other factors, be they cultural, geographic or health-related, or access to waterways and plentiful natural resources, can cause differences across countries, even where measured economic freedom is similar.

Another cause of such differences is measurement error. Measures of economic freedom, like other measures of institutional quality, are work in progress. A country might have sound institutions on paper but how good they are in practice is what matters, and this might not be easy to measure. The application of the RMA 1991 in practice has fallen far short of the liberal consent regime that its architects intended. Indeed, New Zealand's 2025 Taskforce observed that New Zealand consistently scores better on the quality of its institutions than on material living standards, and that the surveys behind such scores cannot capture all aspects of the institutions that matter.[56]

A further point is that the freedom indexes are aggregate measures of their components. The

weights each index gives to those components are problematic and are an ongoing matter for research enquiry. Some researchers have put considerable effort into assessing which components are most associated with greater prosperity.[57]

In summary, overall the proposition that a high level of economic freedom is correlated with a high level of prosperity is widely accepted. Causation is plausibly from freedom to prosperity, but there could be two-way elements. The economic freedom score for any one country will not necessarily be in lockstep with its measure of prosperity because of measurement problems and the role played by other non-measured factors, such as culture, trust, attitudes to education and enterprise.

The bottom line is that all government policies should be assessed on their own merits. The empirical literature justifies a presumption in favour of a measure that increases economic freedom – and this includes improved provision of public goods as economists use this term – but the case for or against still has to be made.

The remaining sections of this report focus on the fiscal and regulatory policy aspects of the broader economic freedom and productivity measure. The focus is on four channels: the composition and quality of public spending; the deadweight costs of the taxation that funds it; the displacement of entrepreneurial judgement by bureaucratic judgement; and the security of the property rights and institutions that underpin investment. None of the four turns on New Zealand's distance from markets or the size of its domestic economy.

SECTION 5

The Extent of Government Spending in New Zealand

Government in New Zealand commands about half of national disposable income. (National disposable income is the sum of final consumption and saving by residents, where saving is net of capital consumption.) The scale of that spending demands tests of the value for money from the programmes thus funded.

First, the scale measurement issue. There are many measures of the extent of government spending, and precision about which statistic to use for what purpose matters.

The OECD's current forecast for New Zealand for the 2026 calendar year is that total outlays[58] by central and local government combined will be 42.9% of GDP. For Australia it forecasts 39.8%. That is a material difference in fiscal burdens, given that Australia has three layers of government, bigger distances to conquer by road, and spends more on defence relative to GDP. (Tax burdens are different from regulatory burdens. Tax burdens on their own do not give the full picture of how intrusive government is in directing resources.)

Back in 2017, when the last big spending Labour-led government was elected, New Zealand's spending ratio on this measure was 35.6%. That extra 7.3% of GDP has generated the funding problem that persists to this day.

These figures understate the degree to which central and local government command national disposable income. For New Zealand, that measure of income is only 82% of GDP.[59] The change in denominator alone lifts the OECD's 42.9% ratio for 2026 to 52%.

Statistics New Zealand's detailed tables allow more to be ascertained. In the year ended March 2024, national disposable income was $341 billion. General government, central and local combined, took $160 billion in taxes and other current revenues. It spent all of that plus another $15 billion it borrowed. That combined spending of $175 billion was 51% of national disposable income.[60]

Very little of that was spent on public goods in the sense of goods such as national defence, the police and the courts. Specifically, of that $175 billion, 61% was spent on transfer payments[61], 20% on collective consumption (such as national defence), 12% on (non-market) gross fixed capital formation, 4% on interest payments, and the net 3% on everything else.

Government-owned commercial entities command more again. Their gross "market" capital formation was around $10 billion in the year ended June 2024, a further 3.0% of national disposable income.

These figures measure command over national income rather than what government buys for itself. On its own account general government spent $118.8 billion in the year ended March 2024, 28% of all spending in the community on consumption and capital formation, or about 35% of national disposable income.[62] Much of even that is for the benefit of the individual

receiving the education or the hospital service rather than for any collective good.

Government has not always been so grasping, times of war aside. Reverting to GDP as the denominator, central government current spending was around 23% of GDP in the 1950s and 1960s.[63] It reached 34% for the year to March 1980 and peaked at 39% in the year to March 1988.[64]

The reforms of the 1984–1993 period reduced it from that peak to 31%. It rose markedly through the 2000s during the big-spending fifth Labour-led government (1999-2008), contracted modestly under fiscal consolidation following the global financial crisis, and surged once more during the 2017–2023 sixth Labour-led government, peaking as measured by core Crown operating expenses at over 34%.[65]

The trajectory is unstable and the source is political. The instability starts with periods of over-optimistic expansion. Years of fiscal pain and eventual consolidation typically follow. But in each case, this has only set the platform for the next government to reopen the fiscal taps.

Fluctuations in net public debt echo this 'policy matters' refrain. Fiscal consolidation, asset sales and economic growth had eliminated net "former" core Crown debt by June 2008. Spending fell from approximately 36% of GDP to 29% by the early 2000s. Real GDP growth averaged 3.8% p.a. from 1993 to 2003, the country's best sustained performance in decades, [66] and the Standard and Poor's credit rating was restored.[67]

The big government spending surge, from 1999-2000 to 2008-9, reversed much of that consolidation. Core Crown expenses excluding finance costs were 32% higher per capita at the end of this nine-year period, CPI deflated. Core Crown spending in 2008-09 was 33.6% of a growth-enhanced GDP, up from 30.5% in 1999-2000 and up from its low ratio of 28.4% of GDP in 2003-04. This was despite inherited fiscal surpluses reducing finance costs relative to GDP.

The global financial crisis and Canterbury earthquakes next forced six years of struggle to turn deficits into a fragile surplus, leaving debt elevated and the buffers of the 1990s spent.

The next Labour-led government spending surge, from 2017 to 2023, was more dramatic.

Planned pre-election 2017 new spending of $11.7 billion quickly blew out to $29.7 billion. This was before Covid-19 spending occurred.[68] A subsequent Royal Commission of Inquiry reported that around half of the Covid-19 Response and Recovery Fund's total spending "was not directly related to the pandemic, including infrastructure projects, and nature conservation and school lunch programmes."[69] The government's later response to it observed that the fund's $60 billion was spread across more than 800 programmes of which about half "were not directly related to the pandemic".[70]

What happened next provides a textbook example of how a government can use a crisis to permanently ratchet up base government spending. US economist Robert Higgs prominently documented US examples of this ratcheting tendency in his 1987 book.[71]

Table 2 summarises this aspect of New Zealand's fiscal history. It uses Treasury's fiscal strategy model projections for Budget 2018 to indicate expected 2024 outcomes based on Budget 2018 policies. The table shows how big increases in spending that occurred later in response to Covid-19 were subsequently used to ratchet up base spending far beyond that government's ability to fund that spending.

Table 2. Covid-19 fiscal ratchet effect 2018-2024

% of GDP	Years ended June		Increase (+) (Percentage points)
	2018	2024	
Budget 2018 Intentions			
Core Crown Spending	28.1%	28.0%	-0.1
Core Crown Tax Revenue	27.3%	28.0%	0.7
Actual Outcomes			
Core Crown Spending	27.3%	33.0%	5.7
Core Crown Tax Revenue	27.1%	28.6%	1.5
Net core Crown debt (June)			
Budget 2018	20.8%	17.6%	-3.2
Actual outcome	19.5%	41.7%	22.2
2018 Intentions vs Outcomes as between 2018 and 2024			
Percentage points of GDP	**2018 Plan**	**Outcome**	**Difference**
Core Crown Spending	-0.1	5.7	5.8
Core Crown Tax Revenue	0.7	1.5	0.8
Net core Crown debt	-3.2	22.2	25.4

In 2018, Treasury projected core Crown spending in the year ended June 2024 to be 28.0% of GDP on the basis of the government's Budget 2018 policy decisions. In the event, the outcome was 5.0% of GDP higher at 33.0% of GDP, as reported by Treasury in its pre-election 2026 (PREFU2026) estimates and forecasts.

Two more precise yardsticks show the extent of the unplanned ratcheting up in spending. The first is a 'before and after' one. The 'before and after' outcome on Treasury's numbers for PREFU2026 was an increase of 5.7% of GDP from 27.3% to 33.0% of GDP. (See the actual core Crown spending row in the table.) The second yardstick is the gap between its forecast intentions and what happened. Treasury assessed that Budget 2018's fiscal policies would see the spending ratio drop by 0.1 percentage points to 2023-24. In the event, the same government's spending produced the 5.7 percentage point rise already mentioned, to make a difference between intentions and outcomes of 5.8 percentage points. (See the core Crown spending row in the lower panel of the table.)

That rise is even more extraordinary than the 5.2 percentage point increase from 28.4% in 2003-04 to 33.6% in 2008-09 that the then Labour-led government presided over.

The extent to which the 5.8 percentage point overshoot was underfunded also shows how opportunistic it was. Core Crown tax revenue rose only 1.5% of GDP – from 27.1% in 2017-18 to 28.6% of GDP in 2023-24. (See the actual core Crown tax revenue row in the table.)[72]

The associated deficit spending took net core Crown debt from an already swollen 19.5% of GDP in June 2018 to 41.7% of GDP in June 2024. (See the actual net core Crown debt row in the table.) This compares with its June 2008 low on this measure, just before the global financial crisis, of 5.4% of GDP.

Governments will likely spend multiple three-year terms wrestling with these bequeathed

burdens on the electorate because there is no tap to quickly accelerate productivity growth. In any case MMP makes decisive and coherent action difficult because it is designed to force compromises, incoherent or otherwise, between parties with competing interests.

The current predicament, from 2024, sees the National-led government slowly reducing core Crown expenses relative to GDP and looking for economic growth to lift revenue by enough to eliminate the fiscal deficit in the near future.

Deficits persist and surpluses are not projected by Treasury to clearly emerge until 2028-29. Benefit expenses are rising, driven by New Zealand Superannuation indexation and rising recipient numbers. Growing public debt and higher interest rates are driving up finance costs. The Iran war oil shock pushed inflation further above the target band, with CPI up 4.1% in the year to June 2026, and weakened the revenue growth the fiscal strategy depends on.

The question is whether this growth in government's share has advanced New Zealand's overall prosperity. The productivity evidence gives no grounds for confidence. New Zealand's relative productivity position has deteriorated over the same period that spending has grown. The country's best growth decade coincided with its sharpest reduction in the spending-to-GDP ratio. The subsequent expansions produced no comparable growth acceleration.

The composition of government spending shows that the focus has long been redistribution rather than provision for the collective good. Spending by general government on collective consumption, the goods and services government provides directly that cannot easily be attributed to individual beneficiaries, such as defence, public order and general administration, has averaged only 7.4% of GDP from 2009-2024. Total general government operating spending excluding interest averaged 36.1% of GDP over the same period. Roughly half of the remaining 28.7 percentage points are transfer payments: superannuation, welfare benefits, health and education spending, and the apparatus that distributes them.[73]

Middle-class welfare is a large component. New Zealand Superannuation is universal and non-means-tested, costing 5% of GDP and rising as the population ages. Core Crown spending on health and education is close to 12% of GDP and is largely not means-tested. James Cox estimated that in 1997/98, 27% of government social expenditure benefited households in the two highest quintiles of taxpayers, including 48% of education and 35% of health spending.[74]

This is not to argue that all transfer spending is bad. Government transfers in kind, such as spending on education and hospitals, do fund state provision of services that should improve productivity, at least against the alternative that assumes no private provision.

SNZ has estimated productivity growth rates from 1997-2025 for education and training and for health care and social assistance. The growth in MFP and labour productivity has been negative for education and training in four of the five periods (SNZ's four growth cycles plus 2024-25). Only two industries have been negative for all five. For health care and social assistance MFP growth has been negative for only two of the same periods. Only three industries have had no negatives.

The incentive effects of transfer spending not focused on assessing outcomes and value for money are likely to be costly. Transfers must be financed by taxation, and taxation imposes deadweight losses that rise more than proportionally with marginal rates, the excess burden being a function of the square of the rate.[75]

Governments that want to discourage behaviour know that putting a tax or levy on it works. Taxes on income similarly discourage people from earning taxable income.[76]

Economists have estimated the extent to which people are discouraged from earning taxable income when their marginal income tax rate increases. The literature calls this parameter the elasticity of taxable income. It is the percentage change in taxable income divided by the percentage change in the net-of-tax rate, that is, the share of an extra dollar of income that the taxpayer keeps.[77]

Recent New Zealand research finds an elasticity of about 0.2 to 0.3 for taxpayers overall.[78] At a 39% marginal tax rate, that range implies that raising an additional dollar of revenue costs society not merely the dollar transferred to government but, in addition, roughly 15 to 24 cents in deadweight cost from the resulting fall in taxable income. An earlier (1996) study by Erwin Diewert and Denis Lawrence, using a different method, put the marginal deadweight cost of taxing labour income in New Zealand at about 18 cents per dollar in 1990–91, within the same range.[79] In this illustrative case, a dollar of spending must therefore generate benefits worth more than about $1.15 to $1.24 to pass a simple efficiency test.[80]

However, this average hides a lot of variation. The same researchers found that the elasticity was high, at around 0.8 to 1.0 for self-employed taxpayers. A dollar more paid in tax by someone with an elasticity of 0.8 and on a 39% tax rate would impose a deadweight cost of around $1.05. To justify collecting and spending that tax dollar, the social benefit to the community would need to be about $2.05 by the same indicative calculation.[81] A separate study finds larger responses among partnered taxpayers, particularly where both partners are in the same tax bracket.[82]

If the spending on cash transfers financed by taxes is not raising productivity, and the Gemmell evidence reviewed in section 4 puts this in doubt, the net effect on prosperity may be negative. It would be more encouraging if the public sector and successive governments had a demonstrable focus on assessing which programmes were effective. Tanzi and Schuknecht documented that social indicators across advanced countries improved dramatically up to about 1960, when government spending was 25 to 30% of GDP, and that the expansion from then to the mid-1990s produced little measurable additional improvement.[83]

The social benefit from government welfare spending depends to some extent on whether it is perpetuating people's predicaments or helping them get back to independence, where this is possible. That is an uncomfortable but unavoidable question. Meanwhile New Zealand Superannuation costs rise inexorably with population ageing. Such pressures make consolidation difficult and explain why holding spending constant as a share of GDP while waiting for revenue growth is vulnerable to shocks.

New Zealand's spending ratio of a bit more than 40% of GDP on the OECD's measure is often defended on the ground that prosperous European countries spend more, some over 50%. Many of those countries are meanwhile struggling with high debt, ageing populations and poor productivity growth. The question is not whether New Zealand governments are obese compared with those who are more obese; it is whether the burden being imposed on taxpayers is too great for its own health.

Credible evidence of real value for money from existing and planned new spending should precede decisions to increase already high taxes. Fiscal discipline and spending quality are surely complementary objectives.

SECTION 6

Quality of Spending Is Not a Focus

New Zealand has focused more on the efficiency of tax collection than on the quality of what is bought with the revenue. The Broad-Based Low-Rate framework, introduced with GST in 1986 and refined since, is widely regarded as among the most efficient in the OECD. GST covers a broad base at a uniform rate, income taxes are relatively flat, and the system avoids many of the targeted exemptions and concessions that create deadweight losses elsewhere. On the revenue side New Zealand has done well.

The same discipline has not been applied to the expenditure side. New Zealand's budget process is focused on new spending, the "Budget allowance" allocated to each year's priorities, not on whether existing spending delivers value for money. While the Public Finance Act sets principles, specific targets are set by the government of the day and adjustable at will.

The Auditor-General's reports amount to a sustained critique of the government's all too common inability to account for its own performance. The Controller and Auditor-General has found that it is "hard if not impossible" to see the combined effect of approximately $180 billion in annual expenditure[84]; that performance reporting is focused on outputs (activities undertaken) rather than outcomes (results achieved)[85]; that Budget performance measures are so poor that "Parliament does not get the performance information it needs to effectively scrutinise how public money will be spent"[86]; and that its investigations repeatedly find "a failure to apply existing procurement policy or adopt best practice."[87]

These findings come not from a hostile critic but from Parliament's own independent auditor.

High-quality public services and fiscal restraint are complementary when institutional design imposes demand-side discipline. New Zealand's system imposes few such constraints, creating pressure for continual spending growth that crowds out other priorities. The question is not just whether, for example, the health or education system produces better outcomes than if no one spends anything on health and education, but whether the same or better outcomes could be achieved at materially lower cost.

Infrastructure spending is where the quality problem is most visible. Te Waihanga reports that New Zealand has spent around 5.8% of GDP a year on infrastructure over the past 20 years, making it one of the top spending countries in the OECD,[88] yet it ranks in the bottom 10% of high-income countries for infrastructure efficiency.[89] Comparable spending buys dramatically less built infrastructure per dollar here than in better-performing countries, and in each of the last five Budgets, half or fewer of the infrastructure bids assessed by Treasury had gone through a complete business case process.[90]

The consenting regime is a material contributor. Sapere Research Group estimated total infrastructure consenting costs at $1.29 billion per year, with consenting absorbing 5.5% of project budgets on average and 15.9% for projects under $200,000. Direct consenting costs as a share of project budgets rose 70% for consents lodged since 2014, and the time taken to decide consents may have increased by as much as 150%.[91] These costs fall disproportionately on smaller

projects, precisely the domain where entrepreneurial entry should be easiest.

Infrastructure cost escalation is severe and well documented. Waka Kotahi's state highway projects reportedly ran $614 million over budget between the 2020 and 2023 financial years.[92] The estimated cost of eight major Bay of Plenty state highway projects almost doubled, from $632 million to $1.2 billion.[93] Many of the original transport budgets in the New Zealand Upgrade Programme were P50 estimates, which carry only a 50% probability of delivery within budget.[94] Because project costs are skewed upwards, a portfolio budgeted at P50 should be expected to overrun in aggregate.

On the R&D question specifically, Kealey's evidence is relevant to New Zealand. Government R&D spending through Crown Research Institutes (now public research organisations) and university funding accounts for a significant share of national R&D. If, as Kealey argues, government R&D tends to crowd out private R&D rather than supplement it, the productivity contribution of this spending is questionable. Crawford, Fabling, Grimes and Bonner examined New Zealand's R&D and patenting performance relative to other OECD countries, and their analysis suggested that New Zealand was not under-spending on R&D once relevant distinguishing considerations were taken into account.[95] A 2025 Treasury paper concluded, somewhat tentatively, that public R&D "tends not to increase productivity in other parts of the economy", whereas business R&D does tend to do so.[96] This finding raises a question about how adequate accountability for value for money in public R&D spending is.

There are broader institutional reasons for doubting the adequacy of value-for-money checks on public spending. Max Salmon documented that New Zealand has 44% more ministers, nearly triple the number of portfolios and 1.5 times the number of departments of comparable nations.[97] Roger Partridge and Jemma Stevenson have since counted 81 portfolios across 28 ministers and 43 departments, with the Ministry of Business, Innovation and Employment (MBIE) reporting to 20 different ministers.[98] Hartwich found that ministers are housed in the Beehive while their departments are scattered across Wellington, and that ministers cannot hire or fire their chief executives.[99] In no private organisation would the person responsible for results be denied the power to choose their team.

The lead economic agencies have been reluctant to address spending quality directly. MBIE and the Ministry of Foreign Affairs and Trade's 2025 Long-Term Insights Briefing on productivity is forward-looking but identifies nothing governments have been doing for decades that has impaired productivity. Nor does it ask why past governments have not already done what it recommends.[100] Treasury has published substantial productivity analysis, but the key paper states that "policy options for lifting New Zealand's productivity are beyond its scope".[101] That omission raises the question of what was being achieved.

The New Zealand Productivity Commission was established in 2010 as a commitment in the confidence and supply agreement between the ACT and National parties after the 2008 general election. Its subsequent reports identified seven barriers to state sector productivity: hostility to measurement, risk-averse cultures, poor commissioning, restrictive funding models, few budgetary rewards for productivity, patchy monitoring and insufficient demand for productivity measures from ministers.[102] The Commission lost its productivity focus under the sixth Labour-led government and was disestablished in February 2024 by the National-ACT-NZ First coalition government elected in late 2023.

Raising taxes in order to fund spending of this quality does not look like a productivity-enhancing option. The deadweight costs of taxation mentioned above would compound the concern. Even at the low end of the estimates, the cost of funding poor-quality spending through higher taxation is substantial. The same absence of scrutiny applies, with even less restraint, to regulation, which never enters the Budget at all.

SECTION 7

The Regulatory Burden as Quasi-Fiscal Policy

Regulation that compels private parties to spend money on things government wants done is functionally equivalent to a tax-and-spend programme. The economic effects are analogous: resources are diverted from uses chosen by their owners to uses chosen by government, and deadweight costs arise from the diversion. The critical difference is that regulatory compulsion escapes the fiscal accounts entirely. It does not appear in the Budget. It is not subject to annual appropriation or parliamentary scrutiny of the kind that spending programmes receive. No official agency measures its aggregate cost.

The New Zealand Productivity Commission, in its 2014 report on regulatory institutions and practices, concluded that the regulatory system is "as significant as the tax and spending systems" in its impact on the lives of New Zealanders.[103] New Zealand operates approximately 200 regulatory regimes, staffed by more than 10,000 regulatory workers. The Commission found "surprisingly little information exists about regulation and its effects" and identified deficiencies across the system alongside what it described as "surprising complacency." Unlike the Budget for spending, no annual review of regulation exists.

The Resource Management Act provides the most extensively documented example. Chris Bishop, the Minister for Infrastructure and RMA Reform, has described the RMA as a "handbrake on growth and opportunity" and characterised the planning system as having institutionalised a presumption against development, a "culture of no" creating an "obstruction economy." In a speech in 2024 he pointed to: three years to approve housing developments, eight years to get a consent for a wind farm and nearly a decade to extend a port.[104]

The quantified costs are substantial. The Sapere/Te Waihanga study found $1.29 billion per year in direct infrastructure consenting costs alone. An analysis by Castalia estimated that the reformed planning system could reduce compliance and administrative costs by $14.8 billion in present-value terms over 30 years.[105] Infometrics estimated that $2.3 to $4.7 billion a year could be added to infrastructure investment over 2025-31 by reducing infrastructure uncertainty.[106] Bishop observed: "In 1965, we built the longest submarine cable of its kind... Now we find it difficult to consent a solar farm. Not even build it, just getting permission to build it."[107]

The costs extend beyond consenting. Building regulation, occupational licensing, environmental compliance, employment regulation and government procurement requirements all impose costs on private activity that reduce the resources available for productive investment.

Property rights are central to this. Lew Evans and Neil Quigley with Kevin Counsell assessed New Zealand to be "distinguished by having among the weakest protection of private rights in the OECD, a history of confiscation of private property rights, and a long-standing failure to recognise the protection of the basic human right of property rights."[108]

The Universal Declaration of Human Rights recognises property as a human right; the Bill of Rights Act 1990 does not, and a private

member's bill introduced in 2005 to add it was later defeated. Without a requirement for just compensation when government impairs property through regulation, there is inadequate discipline on the cost of regulation. Officials do not face the true cost of their regulatory decisions, because that cost falls on property owners rather than on the agency's budget.

New Zealand's history of property confiscation without compensation is extensive. Māori land was acquired under Crown pre-emption at far below market value. Petroleum was nationalised in 1937 without compensation. Water rights, geothermal energy, gold and silver have been vested in the Crown by successive statutes. Crown pastoral lease rents sought were increased by an average of 553% through policy changes that confiscated the financial viability of pastoral farming.[109]

The RMA illustrates the contemporary manifestation. When a landowner cannot develop property that was purchased for development, the former legal development right has been confiscated, or perhaps even worse for productivity, there was and is little clarity about who can do what to make their land more valuable in the community. The absence of a compensation requirement means this deprivation is costless to the regulator. The Sapere finding that consenting costs absorb 15.9% of project value for small projects amounts to a regulatory tax on investment that falls hardest on the smallest and most entrepreneurial actors.

The economic freedom indices that consistently rank New Zealand in the top three to five globally may overstate the actual freedom of economic actors. The Fraser Institute index evaluates size of government, legal system and property rights, sound money, freedom to trade, and regulation, [110] and Hugo Faría and Hugo Montesinos found using instrumental variables that economic freedom causes prosperity rather than merely correlating with it.[111] New Zealand's high headline scores nonetheless mask specific weaknesses. Stephen Golub found that New Zealand has historically been among the more restrictive OECD countries for foreign direct investment.[112] The 2025 Taskforce's recommendation to liberalise those restrictions has since been acted on only in part: from March 2026 most business assets face a single, faster national interest test, but the scope of what is screened, and the separate tests for farmland, residential land and fishing quota, are unchanged. [113]

From the perspective of dynamic efficiency, the costs that are visible, the $1.29 billion in consenting and the billions in compliance and uncertainty, may be the smaller part of the problem. The larger cost is the investment and innovation that never occurs because the regulatory environment makes it too expensive, too uncertain, or too slow. These forgone projects are invisible in any dataset, but they are ventures that were never started.

The government's three-phase RMA reform programme offers early evidence that the regulatory constraint is not immovable. The Port of Auckland fast-track approval took 66 working days from the convening of the expert panel.[114] But the repeal of the Natural and Built Environment Act 2023 within months of its passage warns that reforms adopted by one government can be reversed by the next.

Giuseppe Nicoletti and Stefano Scarpetta found evidence that pro-competitive product-market reforms tend to raise labour productivity in OECD countries by increasing investment and multifactor productivity,[115] and Guglielmo Barone and Federico Cingano showed that anti-competitive service regulation significantly reduces growth in downstream manufacturing.[116] With approximately 200 regulatory regimes, the

cumulative burden here is significant even if no single regime is decisive.

The dynamic efficiency costs documented by Evans, Quigley and Zhang for New Zealand are likely to be substantial.[117] Centralised decision-making in government-controlled sectors destroys dynamic efficiency because no one bears the consequences of bad decisions, the cost of capital is not properly priced, and no competitive discipline forces the exit of failed approaches. Government controlling a large share of the economy replaces a portfolio of decentralised entrepreneurial bets with a single consensus view that may be wrong, and the losses compound as each year's forgone innovations reduce the base from which future ones would have emerged.

The point for this report is that fiscal policy analysis which ignores regulatory compulsion understates the effective reach of government into the economy. Taxation, spending and regulation are three instruments that serve the same function: directing resources towards government-chosen ends. Their incentive effects compound.

SECTION 8

Public Debt, Its Measurement and Fiscal Targets

Deficits and rising debt are the arithmetic consequences of spending commitments that outrun what the economy produces and what taxpayers will bear. They are a symptom of the problem this report has been describing rather than a separate one. That matters for how much weight the debt question can carry: a great deal of fiscal debate is conducted as though the right debt number were the thing to establish, when the spending and revenue choices that generate it are what actually need attention.

8.1 What is prudent public debt?

The question "what is the prudent level of public debt?" has dominated fiscal policy discussion in New Zealand and elsewhere. The Public Finance Act requires the government to have regard to, among other things, achieving and maintaining prudent levels of public debt. But the economic literature provides less guidance on what "prudent" means than the policy discussion typically assumes.

Carmen Reinhart and Kenneth Rogoff argued in 2010 that median real GDP growth falls by roughly one percentage point when gross public debt exceeds 90% of GDP.[118] Thomas Herndon, Michael Ash and Robert Pollin found coding and weighting errors in that work: instead, properly calculated, average growth above 90% was 2.2%, not the negative 0.1% reported.[119] IMF researchers found no evidence of any particular debt threshold above which medium-term growth prospects are dramatically compromised.[120]

What is prudent is related to what is sustainable. The government's intertemporal budget constraint projected forward over decades is a guide to what spending paths are sustainable given realistic revenue projections. The debt path is a residual in such projections. It is not an independent policy variable.

The constraint says that the present value of all future government cash expenditures cannot exceed the sum of opening public sector net worth plus the present value of all future cash receipts. Opening net worth is inherited from history and cannot be optimised. Given that starting point, an optimising government's task is to choose the path of spending and the path of receipts, not the path of debt.

If spending is optimised, by setting it where marginal social benefits equal marginal costs, the required path of cash receipts is a residual that satisfies the budget constraint. If receipts are then smoothed to minimise the deadweight costs of taxation, the resulting sequence of deficits, and therefore the path of public debt, falls out as a double residual. Debt cannot be independently optimised because the other two choices determine it.

Barro formalised this in 1979. If government minimises the present value of distortionary taxation costs, subject to the intertemporal budget constraint and a given path of spending, the optimal policy is to smooth tax rates over time, with debt acting as a buffer that rises when spending is temporarily high and falls when it is

temporarily low.[121] The debt path follows from the tax-smoothing decision.

Henning Bohn established the standard empirical test: if the primary surplus responds positively to increases in the debt-to-GDP ratio, the intertemporal budget constraint is satisfied. Using United States data from 1916 to 1995 he found a robust positive response and later showed that the usual unit-root and cointegration tests are unnecessarily restrictive.[122]

The implication is that what matters is whether the government's spending commitments are affordable given realistic projections of its revenue capacity, and whether its fiscal policy adjusts appropriately when debt rises. The debt level at any point is a symptom of past spending and taxation decisions, not an independent lever.

Olivier Blanchard mentioned in his 2019 American Economic Association presidential address that when the safe interest rate on government debt is below the growth rate of the economy, debt rollovers may be feasible and the fiscal costs of public debt lower than conventionally assumed. He did not argue for higher debt and identified the risk that a belief that debt is risky can become self-fulfilling.[123] Johannes Brumm, Xiangyu Feng, Laurence Kotlikoff and Felix Kubler questioned even this welfare conclusion, finding that debt-financed transfers produce gains for all generations only under implausible calibrations.[124]

Realistically, an incumbent government cannot know a future government's tax and spending plans and faces expedient spending and revenue pressures of its own. Furthermore, an unexpected overseas or domestic event can unravel any formerly prudent fiscal path. It is sensible to plan for a government net worth or debt buffer to provide more adjustment options for material adverse fiscal events.

Achieving such a buffer before the adverse event is a political challenge. Any government can claim its fiscal plan is prudent by claiming that its plan is to constrain spending growth very tightly in future years when it will no longer be in office. Is this realistic? Of course not, but who can prove this is not the current government's intention if it asserts that it is its intention? Treasury can hardly argue the opposite when the Minister of Finance is its only "customer". A parliamentary fiscal council would be in a better position to make such forecasts.

The IMF and the World Bank have done a lot of thinking about what is a prudent level for government debt, as have professional investors and rating agencies. It might be hard to gauge because it depends on circumstances, but that does not remove the need for prudence.

In New Zealand the Public Finance Act focuses on a prudent level of debt that the government chooses to suit itself. This has been found wanting in the face of Treasury's longer-term no-policy-change projections. Those projections reveal the current spending trajectory is unsustainable under current tax and revenue policies. Demographic trends are an important factor in these projections.

It follows that the current debt path is unsustainable, independently of the issue of a prudent buffer. New Zealand is not in good shape either from a sustainable public debt perspective or a prudent buffer perspective.

8.2 Gross debt, net debt and net worth

Metodij Hadzi-Vaskov and Luca Ricci found that gross debt and government financial assets have offsetting effects on long-term sovereign bond spreads in emerging market economies, implying that net debt captures the relevant information for assessing borrowing costs.[125]

Under the IMF's Government Finance Statistics Manual 2014, net debt equals gross debt minus financial assets that are debt instruments. Equity instruments are excluded.[126] The New Zealand Superannuation Fund (NZSF) has a reference portfolio of roughly 80% equities. On the GFS definition, only around 20% of the NZSF's assets would reduce net debt. A measure that deducts all NZSF assets from gross debt is a different, broader concept. There is nothing wrong with reporting it, but calling it "net debt" impedes international comparison and can flatter the fiscal position.

Treasury has used net core Crown debt as its primary fiscal anchor. Gabriel Makhlouf, then Secretary to the Treasury, proposed in June 2019 an upper limit for net core Crown debt of around 50 to 60% of GDP, a buffer of at least 20% of GDP below that limit, and so a prudent debt limit of around 30%.[127] Treasury is forecasting it will be 44% of GDP in June 2027.

When then Finance Minister Robertson adopted a 30% ceiling under a new measure in May 2022, one that deducted all NZSF assets including equities, he announced the ceiling but no numerical prudent safety margin below it to achieve in normal times. The prudent operating level is the ceiling minus the buffer, and the then Minister committed only to being "below" the ceiling without specifying by how much. Absent that anchor, the ceiling is likely to become the target, which means no safety margin. The IMF's advice was to establish a credible fiscal anchor.[128] The 30% ceiling without an anchor fell short. The March 2024 Budget Policy Statement reverted to the earlier more orthodox debt target that excludes advances and NZSF assets.

Whether public sector net worth is a better measure than net debt is an active research question. The IMF's October 2018 Fiscal Monitor introduced a Public Sector Balance Sheet database covering 31 countries (since extended),[129] and Seyed Yousefi found that financial markets price government assets and net worth, not just liabilities, with stronger balance sheets associated with shallower recessions and faster recoveries.[130]

Maren Brede and Christian Henn extended this to intertemporal balance sheets, adding the present value of all future fiscal flows to the static one.[131] Applying that framework to the G7, Yugo Koshima, Jason Harris, Alexander Tieman and Alessandro De Sanctis found that in 2018 all seven had negative intertemporal financial net worth, meaning projected future spending exceeded current net worth plus projected future revenues on unchanged policies.[132]

The principal architect of New Zealand's financial management reforms nearly forty years ago, Ian Ball has argued cogently that core Crown net worth is a more satisfactory overall measure than net debt, since a rise in net debt should be acceptable if matched by a rise in revenue-earning assets of at least equal value.[133] That is right as far as it goes, but net worth depends on valuing non-financial assets such as roads, schools and hospitals that have no market price, and on whether contingent liabilities and long-term obligations are included. Ben Zaranko concluded for the Institute for Fiscal Studies that net worth is a valuable addition to the set of fiscal indicators but unsuitable as the sole fiscal target.[134]

On Treasury's pre-election forecasts this year, Crown net worth will be 38.8% of GDP in June 2027, down from 45.7% in June 2022.

8.3 Fiscal targets and long-term projections

New Zealand has fiscal rules, but they are political commitments set by the government of the day rather than legislated numerical limits. There is no legislation mandating a specific debt path. There is no independent fiscal council with enforcement powers. The Public Finance Act sets principles of responsible fiscal management, including maintaining prudent debt levels, but

the government of the day sets targets consistent with those principles, adjustable at will.[135]

The credibility of a fiscal anchor depends on the difficulty of changing it, and New Zealand's arrangements impose minimal difficulty. Makhlouf's 2019 framework proposed a prudent debt limit for net core Crown debt of around 30% of GDP, below an upper limit of 50 to 60%. Robertson's 2022 announcement of a 30% ceiling under a different measure came with no numerical anchor below the ceiling.

In this paper, a ceiling is the maximum debt level a government commits not to exceed. An anchor is the operating target, set low enough below the ceiling to absorb shocks without breaching it.[136] Without an anchor, policy drifts towards the ceiling, and the buffer meant to provide room for manoeuvre in a crisis does not exist when the crisis arrives.

The more useful guide to New Zealand's fiscal sustainability is Treasury's longer-term fiscal projections. These model the trajectory of spending and revenue under existing policy settings, taking account of demographic trends (population ageing, rising New Zealand Superannuation and health costs), assumed productivity growth, and the interest rate environment. When the projected trajectory shows debt rising without bound, the message is that existing spending commitments are not sustainable and that adjustment is required. The projections do not prescribe how to adjust, but they identify the scale of the problem.

The current position illustrates the vulnerability of that framework. Net core Crown debt was 41% of GDP in June 2026 and is forecast to peak at 44% in June 2028, and the fiscal strategy set out in section 5 depends on revenue growth that the geopolitical environment threatens.[137]

The r minus g differential, the gap between the real interest rate on government debt and the real GDP growth rate, is a key sustainability indicator. When r exceeds g, debt dynamics are self-reinforcing and the debt ratio rises even with a zero primary balance. For much of the period from 2010 to 2021 r was below g in most advanced economies, creating favourable dynamics, and the rise in interest rates since 2022 has eroded this.[138] New Zealand's ratings still reflect a strong institutional framework, but Moody's and Fitch now both have New Zealand on negative outlook.[139]

Rating agencies weigh both debt measures and broader institutional factors. António Afonso and André Albuquerque found that net debt, budget balances, GDP per capita and default history were the most relevant variables explaining rating differences between agencies.[140] The operational danger signal is interest expenditure as a proportion of government revenue: the number of countries where interest spending exceeded 10% of public revenues rose from 29 in 2010 to 55 in 2020.[141]

SECTION 9

Pulling the Threads Together

New Zealand's persistent productivity deficit is large, particularly relative to Australia and the US. New Zealanders' ready access as migrants to Australia makes this a competitive concern.

The productivity deficit is not immutable. It has multiple causes, some of which are beyond the reach of government.

But many causes are within its reach, and they are the focus of this report. The list of where government dominates, for better or worse, is long. It disposes of over half of national disposable income.

The Auditor-General's observation that the combined effect of $180 billion in annual spending cannot be assessed adequately, even by parliamentarians, is devastating from a value-for-money perspective. It is particularly disturbing because government spending at least gets annual parliamentary scrutiny through the budget process, and there is a convention that Parliament does not delegate the power to tax.

There is even less parliamentary scrutiny of value for money from the regulatory state. Through regulations and ownership government can and does variously control, direct, enable or stifle much of the remaining economic activity, the RMA 1991 being a prime example of the last of these.

The Productivity Commission's view that the regulatory system is "as significant as the tax and spending systems" in its impact should further trouble those worried about productivity.

The inadequate constitutional protection for property rights taken or impaired by the regulatory state without compensation is one source of the problem. Paying compensation forces decision-makers to confront the costs their decision could impose on the community. The permanently lowered land value embodies the forgone value of that land in the community. It endures whether compensation is paid or not. The burden is the housing shortage or inadequate infrastructure that follows. People do not save the community by refusing to pay compensation and allowing a bad project to proceed.

When taxation, spending and regulatory compulsion are considered together, their impact on the quality of the use of national resources in New Zealand is pervasive.

The growth in public debt and the persistence of fiscal deficits add to the need for meaningful change. These developments run contrary to the prudent debt provisions of the Public Finance Act, and Ministers of Finance have found a way of neutering those disciplines. Treasury's long-term no-policy-change projections dispel any thought that the current fiscal path is sustainable. It is not.

The problem is that voter support for the politicians who have been pointing this out for many years is limited.

More of a focus on value for money would inform the public and alarm those who benefit from poor evaluation of spending and regulation. It would also force more accountability from spending and regulatory agencies for the costs their programmes are imposing on the public.

Opposition to greater accountability is what entrenches the status quo. The positive side is

that the benefits of good reform provide higher incomes that make win-win outcomes possible. What people lose from the removal of a government-conferred privilege might be offset acceptably on some other dimension, through lower effective marginal tax rates or greater employment opportunities.

Some spending is so bad that a determined government could plausibly cut its ratio to GDP with minimal fuss from the public at large. Vito Tanzi has documented the cases of Sweden, Norway and Canada that successfully reduced public spending by around 15% of GDP between 1992 and 2007. They did so largely by stopping the growth in constant price spending and allowing the growth in real GDP to reduce the ratio. [142]

Time horizon is a factor. Cutting farm subsidies was very painful for farmers in the late 1980s, but farming here has since proved that it can be profitable and innovative without them.

Transitional assistance can be justified, as long as it really does support the transition rather than preserve the status quo. New Zealand's best growth decade in recent memory, 1993 to 2003, followed sharp fiscal consolidation.

The 2025 Taskforce in 2009 and 2010 produced many recommendations covering spending, taxation, welfare, superannuation, health, education, state assets, infrastructure, regulation, labour markets, trade and R&D. The length of that list shows how widespread the problems are.

That the Taskforce was quickly terminated, and the Productivity Commission first emasculated after 2017 and then abolished[143], illustrates the opposition to change. Euphemistic blocking phrases used in the past have been reform fatigue and "time for a cup of tea".[144]

Most people opposed to change likely mean well and resist the view that slow productivity growth is a consequence. Nimbys only want to stop development in their neighbourhood, but the cumulative effect stifles prosperity and narrows options.

The productivity-inhibiting policies that abound in New Zealand are not there by design, but nor are they by accident. Those who want extractive advantages from government fiscal and regulatory policies have more immediate priorities, and they have political clout. Mancur Olson's analysis of institutional sclerosis informs these perhaps dour observations: stable democracies accumulate distributional coalitions (lobby groups, professional bodies, unions and industry cartels) that impose costs on the broader economy.[145]

Pressures from an ageing population, more burdensome public debt, waves of emigration, and in Europe's case the threat of war, raise the stakes against continuing sclerosis. But the history of the rise and decline of nations gives no assurance that necessary change will occur.

In New Zealand's case emigration to Australia acts as a safety valve, draining human capital while relieving some of the political pressure that might otherwise build, but leaving those who remain anxious.

This report does not claim that fiscal policy is the sole or even the primary cause of New Zealand's productivity deficit.

It does argue that the fiscal and regulatory reach of government is extensive, that much of it has not been subjected to serious productivity scrutiny, and that this represents an addressable part of the problem.

The evidence reviewed here, from Gemmell on spending composition, Kealey on R&D, Evans and Quigley on property rights and dynamic efficiency, the Auditor-General on spending quality and the review of New Zealand's fiscal targets, all suggests that the current combination

of extensive reach and poor accountability is a drag on New Zealanders' prosperity.

Estimates of the potential gains from value-for-money reform are necessarily uncertain, but the Auditor-General and others have given us all good reason to worry that billions of dollars are likely being spent annually without adequate justification and it seems unlikely that the quality of much government regulation has an adequate value-for-money focus either.

Three paths are available for restoring fiscal surpluses. The government could raise taxes to close the fiscal gap. The deadweight cost evidence suggests this would lower growth further, creating a vicious cycle. New Zealand already has high effective marginal tax rates for a minority of lower-income workers when benefit abatement is taken into account.[146]

The government could hold spending growth below nominal GDP growth and hope for enough growth to close the gap. This is approximately the current strategy.

Or the government could improve current institutional structures and constraints by pursuing active spending and regulatory reform: systematically reviewing both for value for money.

The last of these makes sense in its own right. Those in paid work know how hard it is to earn money and keep a job; ask any owner of a hospitality business in Wellington or Auckland today. For governments to take around 50% of national income and spend it poorly is to let hard-working and productive people down, and to breed resentment and mistrust.

Options include:

1. Creation of a fiscal council reporting to Parliament directly and so not under the instruction of a government minister;
2. More meaningful disciplines around the determination of prudent levels for the public debt, so it is harder for the government of the day to set it at a level that is currently expedient and fails to provide an adequate buffer. The proposed fiscal council could play a role here. The IMF's guidance should be used.
3. Building on the Public Finance Amendment Act 2026, bringing sufficiently greater transparency to time-limited spending authorisations as to deprive them of their concealing effect.
4. Giving a much more central role to consideration of the dignity of the individual and respect for the individual's property when making decisions. The Legislation Design and Advisory Committee's guidelines rightly make this a fundamental consideration, but in practice, as we have seen, failures to do so are too common. The key need is to bring the issue of compensation to the fore. The RMA replacement legislation and the Regulatory Standards Act both need strengthening in this respect (and others).
5. Setting in place structures that give non-partisan momentum to rolling zero-base reviews of major expenditure programmes and restrictive laws and regulations. The Controller and Auditor-General has done a good job of identifying inadequate performance, but those assessments tend to end with overly toothless exhortations for agencies to get better at what they should be doing. Persistent inadequacies point to a structural problem that needs to be addressed.
6. Measures to empower Ministers to direct agencies and get relevant and timely information from them. Ministers should not have reason to feel that a portfolio agency is obstructing them for its own purposes.

The evidence reviewed in this report and such proposals should be read optimistically. New Zealanders could be appreciably more prosperous, and feel better about themselves and their country, if governments this large focused much more on value for money. This focus would need to be across the broad range of what government does: what it owns, what it taxes, what it spends and what it regulates.

Nor is there a case for despair that politicians who seek better outcomes will never be elected. Look no further than this 2023-2026 government's drive to get better literacy and numeracy outcomes for school children, and to reform the RMA so as to make housing more affordable for all New Zealanders. Each of those is a daunting task politically and administratively.

As Nobel Laureate Robert Lucas once remarked of differences in countries' growth rates, "Once one starts to think about them, it is hard to think about anything else."[147] Compounding cumulative growth is hard to beat. Easing up on the brakes takes voter support and political courage.

APPENDIX 1

Other measures of the current income gap with Australia

New Zealand v Australia: current-price income gaps across five sources

A. GDP per capita, current price

Source	Series	Year	New Zealand	Australia	Ratio (Australia / NZ)	Gap (%)	Basis
OECD	GDP per capita, current prices, current PPPs (National Accounts, Table 1)	2025	$57,261	$75,328	1.32x	31.6%	Current-year PPP, international $
World Bank	GDP per capita, PPP (current international $) [NY.GDP.PCAP.PP.CD]	2025	$57,350	$71,934	1.25x	25.4%	Current-year PPP, international $
IMF	GDP per capita, current prices (World Economic Outlook, PPPPC)	2025	$55,840	$72,132	1.29x	29.2%	Current-year PPP, international $
Penn World Table	Output-side real GDP at current PPPs (cgdpo), divided by population	2023	$46,862	$64,022	1.37x	36.6%	Current-year PPP, extrapolated between ICP benchmarks from national growth rates - not a fresh price survey every year
Conference Board	Total Economy Database: Real GDP (EKS PPP, millions of 2025 international $), divided by midyear population	2025	$57,042	$68,572	1.20x	20.2%	Chained/ multilateral (EKS) PPP re-expressed in 2025 international $ - not a current-year snapshot

B. National income per capita, current price

Source	Series	Year	New Zealand	Australia	Ratio (Australia / NZ)	Gap (%)	Basis
OECD	Net national income per capita, current prices, current PPPs (National Accounts, Table 2)	2024	$45,536	$59,174	1.30x	29.9%	Current-year PPP, international $
World Bank	GNI per capita, PPP (current international $) [NY.GNP.PCAP.PP.CD] - gross, not net of depreciation	2025	$53,600	$69,930	1.30x	30.5%	Current-year PPP, international $
World Bank	Adjusted net national income per capita, current US$ [NY.ADJ.NNTY.PC.CD] - nets out depreciation and resource depletion	2021	$40,731	$45,711	1.12x	12.2%	Market exchange rate, current US$ - not PPP-adjusted

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Endnotes

1. Treasury forecasts that core Crown interest payments in 2026-27 will be 7.5% of core Crown tax revenue. Its projection for 2065 is 32% ($171 billion cost for $541 billion of tax revenue), if nothing is done. In short, current fiscal policies are unsustainable.

2. NZ Treasury, "Advice on Time-Limited Funding," Treasury Report T2023/2026 (Wellington: NZ Treasury, 4 December 2023), released in *Mini-Budget 2023 Information Release* (May 2024); Nicola Willis, "Strengthening Fiscal Responsibility Rules," Beehive, 20 December 2023.

3. Public Finance Amendment Act 2026; Nicola Willis, "Fiscal Responsibility and Disclosure Beefed Up," Beehive, 31 March 2026.

4. Even so, governments are likely to preside over higher taxes, through fiscal drag or otherwise. Households will feel the pain more directly. Currently, local government rate increases and charges for water show the process at work. Governments will also have to worry about expenditure growth.

5. Treasury's current fiscal model assumes that the response of fiscal deficits to a productivity increase is muted because of widespread spending indexation. Indexation is a policy decision. See NZ Treasury, *He Tirohanga Mokopuna 2025* (Wellington: NZ Treasury, 2025), 34.

6. See sections 5 and 6 below for details.

7. On the OECD's estimates for 2025, both countries were on 77.2% and only Iceland (84%), Netherlands (82.3%), Japan (80.1%) and Switzerland (79.9%) were higher.

8. See John Janssen, Margaret Galt, and Giles Bollinger, "New Zealand's Productivity Performance: Taking a Broader View," Analytical Note 22/05 (Wellington: New Zealand Treasury, September 2022), section 5. Section 3 below discusses this further.

9. In Ireland even national income is a misleading measure as some large global companies have residency. The Irish statistical office published "modified" national income estimates (GNI*) that quantify this aspect to some degree.

10. The Conference Board is a global, independent business membership and research association. It publishes the Total Economy Database, a widely used source of cross-country output and productivity data.

11. The Penn World Table (PWT) is a widely respected macroeconomic database maintained by researchers at University of California, Davis and the Netherlands-based Groningen Growth and Development Centre. It uses Purchasing Power Parity (PPP) estimates to convert national accounts data into a common currency for cross-country studies.
It is widely used in academic research and by institutions such as the World Bank and the Federal Reserve Bank of St. Louis.

12. These comparisons use purchasing power parity adjustment factors to convert local currency estimates into common currency units.

13. Arthur Grimes and Sean Hyland, "Measuring Cross-Country Material Wellbeing and Inequality Using Consumer Durables," *Scottish Journal of Political Economy* 67, no. 3 (2020): 248–271. Page references are to the working paper version, "A New Cross-Country Measure of Material Wellbeing and Inequality: Methodology, Construction and Results," Motu Working Paper 15-09, August 2015, 18 and 23.

14. Janssen, Galt, and Bollinger, "Taking a Broader View," 8.

15. It is the only measure in Appendix 1 that does not use Purchasing Power Parity adjustment factors to put different countries' time series into a common US$ basis. Instead, it converts each year's domestic currency net national income per capita at that year's average market exchange rate. It does this because it estimates the resource use component of this time series directly in US dollars using world prices for resources used. In 2021, the market exchange rates (NZ$1.4138 and A$1.3312 per US dollar) raised Australian income relative to New Zealand's by about 6%, compared with about 5% at that year's PPP conversion factors.

16. OECD, net national income per capita, US$ PPP, 2024, giving a gap of about 30%, converted at the 2024 PPP rate of 1.46. The more commonly cited OECD GDP per capita comparison at purchasing power parity puts the Australian lead at roughly 34%.

17. The OECD uses the purchasing power parity method (PPP) to convert the purchasing power of one country's home-currency income into US dollars. Source: OECD, Average Annual Wages (database), 2025, US$ PPPs.

18. This uses the OECD's 2025 PPP for private consumption (1.529), the conversion the OECD applies to its wage series.

19. GDP is a value added measure that equates production, income and spending on production.

20. Janssen, Galt, and Bollinger, "Taking a Broader View," 14–15, citing Ward, Zinni, and Marianna, "International Productivity Gaps: Are Labour Input Measures Comparable?" OECD Statistics Working Papers no. 2018/12.

21. Janssen, Galt, and Bollinger, "Taking a Broader View," 15–17 and Figure 7. The Statistics New Zealand replication assumes four weeks of annual leave and 2.2 weeks of public holidays a year and doubles reported sick leave to allow for under-reporting. The Treasury calculation is reported on page 15.

22. Calculated as 60 minutes x 49.6 for New Zealand divided by 76.8 for Australia. The full citation for this source is Feenstra et al. - Penn World Table (2025) – with major processing by Our World in Data. "Productivity: output per hour worked – Penn World Table – In constant international-$" [dataset]. Feenstra et al., "Penn World Table 11.0" [original data]. Retrieved 15 July 2026, from https://archive.ourworldindata.org/20260518-093348/grapher/labor-productivity-per-hour-pennworldtable.html (archived on 18 May 2026). The figures cited can be read directly from the right-hand column at this website: https://ourworldindata.org/grapher/labor-productivity-per-hour-pennworldtable Other measures of such gaps abound. For example, the Conference Board gap is measured in 2025 prices and is lower (at 33% rather than 55%) and this represents 45 minutes in an hour for the Australian worker.

23. Ireland's figure of 158 is aberrant as explained in section 2.

24. For example, the OECD has total hours worked for New Zealand at 3,756 million in 2007 which is less than the 3,939 million it has for 1971. In contrast, the PWT and Conference Board series each have an increase of 60%. The former puts the increase in engaged workers at 68% for New Zealand.

25. Robert C. Feenstra, Robert Inklaar, and Marcel P. Timmer, "The Next Generation of the Penn World Table," *American Economic Review* 105, no. 10 (2015): 3150–3182. Data version 11.0 via Our World in Data.

26. Bryce Wilkinson, *New Zealand's Fiscal Reforms, 1984–1996* (Ottawa: Macdonald-Laurier Institute, November 2017), 12. Also, Lewis Evans, Arthur Grimes, and Bryce Wilkinson, with David Teece, "Economic Reform in New Zealand 1984–95: The Pursuit of Efficiency," *Journal of Economic Literature* 34, no. 4 (1996): 1861.

27. Arthur Grimes and Shine Wu, "Reinterpreting Productivity: New Zealand's Surprising Performance or the Shortcomings of an Engineering Approach to Productivity Measurement," paper presented at the New Zealand Association of Economists Conference, Wellington, June 2021, 1–3, 11–12 and 21.

28. Grimes and Wu, "Reinterpreting Productivity," 1–3 and 11–14.

29. Grimes and Wu split the 1970-2018 time period into 1970-1994 and 1994-2018. That counts the strong growth immediately after the 1989-1991 recession as part of the first period, which also contains the reform years.

30. For fuller efficiency, it is not enough to keep producing candles at minimum cost after the invention of electricity has made it sensible to shift resources into making lightbulbs. Permitting that mobility improves allocative efficiency.

31. Janssen, Galt, and Bollinger, "Taking a Broader View," 1 and 10–14.

32. In the standard constant returns to scale production function notation, where A is the overall level of efficiency, sometimes called total factor productivity: $Q = A \times L \times f(K/L)$, so marginal capital productivity is: $Q_K = A \times f'(K/L)$

    If Q_K is set in world markets, the lower is A the higher must be $f'(K/L)$ to justify adding to the capital stock. Given diminishing returns to increasing capital intensity that requires K/L to be lower than otherwise. This is the mechanism set out in Max Dupuy and James Beard, *Investment, Productivity and the Cost of Capital: Understanding New Zealand's "Capital Shallowness"*, New Zealand Treasury Productivity Paper 08/03 (Wellington: New Zealand Treasury, April 2008), 7–10.

33. On the related cost of biosecurity controls on plant imports, a 3 September 2025 article by Richard Rennie, "Biosecurity Bottleneck Chokes Plant Imports," in *Farmers Weekly* quotes germplasm importer Andy McGrath reporting that where in the late 1980s it took about $500 and six months to get a plant approved and arrived, it now costs around $200,000 and takes at least 30 months. The success rate with a new variety is only about 10%. It is far

cheaper and faster in Australia, and New Zealand is getting left behind.

34. Statistics New Zealand, "Productivity Statistics: 1978–2025" (23 April 2026), Table 2.09, former measured sector, indexes and average annual growth rates by official growth cycle. The labour input is hours paid. The contributions of multifactor productivity and capital deepening sum to labour productivity growth within rounding. The year 2024-25 is not yet part of a completed cycle.

35. The Crown's books were in an operating balance before gains and losses (OBEGAL) surplus of 1.9% of GDP in 2017-18 when that government was elected. In that government's last fiscal year in office (the year ended June 2024), the OBEGAL measure was in deficit by 3.1% of GDP. Treasury projected that the government's Budget 2018 policies would see an OBEGAL surplus of 2.0% of GDP in 2023-24.

36. Note that the former measured sector has a narrower industry coverage than the measured sector. Labour productivity grew 49% for the former measured sector between 1994-95 and 2024-25, and 39% for the measured sector between 1995-96 and 2024-25.

37. Jakob B. Madsen, "The Anatomy of Growth in the OECD Since 1870," *Journal of Monetary Economics* 57, no. 6 (2010): 753–767.

38. Paul M. Romer, "Endogenous Technological Change," *Journal of Political Economy* 98, no. 5 (1990): S71–S102; Philippe Aghion and Peter Howitt, "A Model of Growth Through Creative Destruction," *Econometrica* 60, no. 2 (1992): 323–351.

39. Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990).

40. Janine Aron, "Growth and Institutions: A Review of the Evidence," *World Bank Research Observer* 15, no. 1 (2000): 99–135. See p. 128.

41. Dani Rodrik, Arvind Subramanian, and Francesco Trebbi, "Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development," *Journal of Economic Growth* 9, no. 2 (2004): 131–165, see the abstract.

42. Daron Acemoglu, Simon Johnson, and James A. Robinson, "Institutions as a Fundamental Cause of Long-Run Growth," in *Handbook of Economic Growth*, vol. 1A, ed. Philippe Aghion and Steven N. Durlauf (Amsterdam: Elsevier, 2005), 385–472.

43. David Y. Albouy, "The Colonial Origins of Comparative Development: An Empirical Investigation: Comment," *American Economic Review* 102, no. 6 (2012): 3059–3076.

44. Robert J. Barro, "Government Spending in a Simple Model of Endogenous Growth," *Journal of Political Economy* 98, no. 5 (1990): S103–S125.

45. Richard Kneller, Michael F. Bleaney, and Norman Gemmell, "Fiscal Policy and Growth: Evidence from OECD Countries," *Journal of Public Economics* 74, no. 2 (1999): 171–190.

46. Norman Gemmell, Richard Kneller, and Ismael Sanz, "Does the Composition of Government Expenditure Matter for Long-Run GDP Levels?" *Oxford Bulletin of Economics and Statistics* 78, no. 4 (2016): 522–547.

47. Andreas Bergh and Magnus Henrekson, "Government Size and Growth: A Survey and Interpretation of the Evidence," *Journal of Economic Surveys* 25, no. 5 (2011): 872–897.

48. Andreas Bergh and Christian Bjørnskov, "Does Big Government Hurt Growth Less in High-Trust Countries?" *Contemporary Economic Policy* 38, no. 4 (2020): 643–658; Andreas Bergh and Christian Bjørnskov, "Does Economic Freedom Boost Growth for Everyone?" *Kyklos* 74, no. 2 (2021): 170–186.

49. Terence Kealey, *The Economic Laws of Scientific Research* (London: Macmillan, 1996).

50. Terence Kealey and Omar Al-Ubaydli, "Should Governments Fund Science?" *Economic Affairs* 20, no. 3 (2000): 4–9.

51. F. A. Hayek, "The Use of Knowledge in Society," *American Economic Review* 35, no. 4 (1945): 519–530.

52. Israel M. Kirzner, *Competition and Entrepreneurship* (Chicago: University of Chicago Press, 1973).

53. Frederic E. Sautet, "Economic Transformation, the Pretence of Knowledge and the Process of Entrepreneurial Competition," New Zealand Treasury Discussion Paper (Wellington: The Treasury, 2002).

54. Lewis Evans, Neil Quigley, and Jie Zhang, "An Essay on the Concept of Dynamic Efficiency and Its Implications for Assessments of the Benefits from Regulation and Price Control," working paper prepared for the New Zealand Treasury (Wellington: New Zealand Institute for the Study of Competition and Regulation, 2000).

55. See, for example, the surveys by Joshua Hall and Robert Lawson in 2014 and by Lawson, Vincent Miozzi, and Meg Tuszynski in 2024.

56. 2025 Taskforce, *Answering the $64,000 Question: Closing the Income Gap with Australia by 2025* (Wellington: 2025 Taskforce, November 2009), 27.

57. See, for example, Jac C. Heckelman and Michael D. Stroup, "Which Economic Freedoms Contribute to Growth?" *Kyklos* 53, no. 4 (2000): 527–544; and Jakob de Haan and Jan-Egbert Sturm, "On the Relationship between Economic Freedom and Economic Growth," *European Journal of Political Economy* 16, no. 2 (2000): 215–241.

58. This measure comprises current spending plus some capital spending.

59. Capital consumption (depreciation) accounts for most of this difference. National disposable income is net of capital consumption; it is not net of tax. It is the income available to the community to spend on consumption in the same year and to save so as to build net worth. Income is net of depreciation so the cash available to spend on government gross capital formation, for example, is savings plus depreciation, plus any borrowings to fund capital formation or asset purchases.

60. These statistics are derived from SNZ's government sector institutional accounts. The $160 billion for the year ended March 2024 is value as released on 14 Nov 2025 for time series SNEA.S2NB5400S300C0. The $15 billion of net borrowing is the value in the same year for time series SNEA.S3NB9000S300C0. These SNZ statistics do not capture all government spending. For example, Total Crown Expenses alone in the year ended June 2024 were $180 billion and this is merely operating spending that excludes capital spending and local authority spending. Total Crown expenses include non-Core Crown spending by the ACC, public hospitals, SOEs and Crown entities.

61. Roughly half of that 61% in transfer spending is government-directed spending on individual consumption through the provision of schools, hospitals and the like. Transfer spending in the form of cash benefits, by contrast, does not usually direct what the recipients will spend those benefits on.

62. In the year ended March 2024, general government spending on collective consumption was, at $34.223 billion, only 10% of national disposable income of $341.377 billion. Its total final consumption spending, at $87.907 billion, was two and a half times greater at 26% of national disposable income. The source is Infoshare General Government Income and Outlay account, Table SNE201AA,

63. Bryce Wilkinson, *Fit for Purpose?* (Wellington: The New Zealand Initiative, 2018).

64. The Treasury's long-term fiscal time series have statistics going back to 1972. The Official Yearbooks have estimates for earlier years.

65. NZ Treasury, *Pre-Election Economic and Fiscal Update 2026* (Wellington: NZ Treasury, 29 September 2026), Time Series of Fiscal and Economic Indicators, 133; NZ Treasury, Fiscal Time Series: Historical Fiscal Indicators.

66. From $117.8 billion in 1993 to $170.4 billion in 2003, calendar year, GDP(P) measure, 2009/10 prices.

67. 2025 Taskforce, *Answering the $64,000 Question: Closing the Income Gap with Australia by 2025* (2009); Bryce Wilkinson, *Restraining Leviathan: A Review of the Fiscal Responsibility Act 1994* (Wellington: NZ Business Roundtable, 2004).

68. Bryce Wilkinson, *A Historical Perspective on the 2017-2023 Government's Spending Spree* (Wellington: The New Zealand Initiative, October 2023).

69. Royal Commission of Inquiry into COVID-19 Lessons Learned, *Phase Two Report* (Wellington, March 2026), Box 4, 401.

70. Simeon Brown, "Government responds to COVID-19 Inquiry", Beehive, 29 July 2026.

71. Robert Higgs, *Crisis and Leviathan: Critical Episodes in the Growth of American Government* (New York: Oxford University Press, 1987).

72. These statistics are from the Time Series of Fiscal and Economic Indicators on page 133 of NZ Treasury, *Pre-Election Economic and Fiscal Update 2026* (Wellington: NZ Treasury, 2026).

73. For the collective consumption statistic, Statistics New Zealand, *National Accounts*, *General Government Income and Outlay account*, current prices, years ended March, Infoshare table SNE201AA, general government collective consumption divided by GDP(E). For the remaining statistics, Statistics New Zealand's Government Finance Statistics, for the year ended June 2025, years ended June, tables 1.1 and 3.1.

74. James Cox, *Middle Class Welfare* (Wellington: New Zealand Business Roundtable, 2001), x.

75. Martin Feldstein, "Tax Avoidance and the Deadweight Loss of the Income Tax," *Review of Economics and Statistics* 81, no. 4 (1999): 674–680.

76. In the case of an income tax, stopping work to avoid the tax has a cost, so it is conceivable that some people will work longer hours under a higher tax in order to

avoid too big a drop in take home pay. These would be unlikely to be higher income people.

77. The net-of-tax rate is (1-t), where t is the marginal tax rate.

78. Nazila Alinaghi, John Creedy, and Norman Gemmell, "Elasticities of Taxable Income and Adjustment Costs: Bunching Evidence from New Zealand," *Oxford Economic Papers* 73, no. 3 (2021): 1244–1269.

79. W. Erwin Diewert and Denis A. Lawrence, "The Deadweight Costs of Taxation in New Zealand," *Canadian Journal of Economics* 29, Special Issue (1996): S658–S673.

80. The calculation works as follows. When the marginal tax rate t rises a little, the government would gain some extra revenue if taxable income did not respond. Taxable income does respond, however: it falls in proportion to the elasticity e multiplied by the proportional fall in the net-of-tax rate $(1 - t)$. The government then loses tax at the rate t on the income that disappears. Measured against the extra revenue it would otherwise have gained, that loss is $x = e \times t/(1 - t)$, so the net gain in revenue is only $(1 - x)$ of the static estimate. The cost per extra dollar actually collected is therefore $x/(1 - x)$. At $t = 0.39$, an elasticity of 0.2 gives about 15 cents, 0.3 gives about 24 cents, and 0.8 gives about $1.05.
The lost revenue measures the deadweight loss because of how people respond at the margin. A taxpayer who forgoes a dollar of taxable income, whether by working less or by rearranging their affairs, does so only if what they get in exchange is worth at least the 61 cents they would have kept after tax. Their private loss on that marginal dollar is close to zero, but the 39 cents of tax that would have funded public spending is lost to everyone else. Feldstein (1999) showed that, when all behavioural responses show up in taxable income, the deadweight loss is approximately equal to the revenue lost through those responses.
The lost revenue may overstate the true cost. If income moves to another tax base, such as a company taxed at 28%, part of the revenue is still collected and the net loss is smaller. The same applies where the response creates benefits for others, as with tax-deductible charitable donations. The formula is also a marginal approximation, which becomes less reliable for large tax changes.

81. Reader alert: these calculations are simplified examples. In any given case there are several complexities to add to the consideration. Some ways of reducing taxable income may reduce community welfare, others might simply reduce tax revenue without imposing a deadweight loss on the community. The basic elasticity calculation does not distinguish between these cases, but a public policy analysis should do so. See John Creedy, *The Elasticity of Taxable Income: Theory and Estimation* (Cheltenham: Edward Elgar, 2022), for a full discussion.

82. Nazila Alinaghi, John Creedy, and Norman Gemmell, "Do Couples Bunch More? Evidence from Partnered and Single Taxpayers," *International Tax and Public Finance* 30, no. 4 (2023): 1137–1184.

83. Vito Tanzi and Ludger Schuknecht, *Public Spending in the 20th Century: A Global Perspective* (Cambridge: Cambridge University Press, 2000).

84. Controller and Auditor-General, *Observations from Our Work in Central Government* (Wellington: Office of the Auditor-General, 1 July 2025), Part 2, para. 2.61.

85. Controller and Auditor-General, *Do Your Measures Measure Up? There's a Need for Better Reporting on How the Public Sector Is Performing* (Wellington: Office of the Auditor-General, 2023).

86. Controller and Auditor-General, *Observations from Our Work in Central Government*, Part 2, para. 2.64.

87. Controller and Auditor-General, *Strengthening Government Procurement: Lessons from Our Recent Work* (Wellington: Office of the Auditor-General, May 2024), 6. Another comment, at paragraph 1.27, was: "As part of our annual audits in 2021/22, we assessed the procurement policies of a sample of public organisations that are required to follow the Rules. Of the public organisations assessed, we found that 19% had policies that were out of date and referred to outdated versions of the Rules. A further 68% of public organisations we assessed had policies that needed to be improved to be fully compliant with the Rules (based on changes to government policy since 2019)."

88. Te Waihanga / New Zealand Infrastructure Commission, *National Infrastructure Plan* (Wellington: New Zealand Infrastructure Commission, February 2026), executive summary.

89. Te Waihanga / NZ Infrastructure Commission, *Investment Gap or Efficiency Gap? Benchmarking New Zealand's Investment in Infrastructure*, Te Waihanga Research Insights Series (Wellington: New Zealand Infrastructure Commission, December 2021), Figure 8, 13.

90. Te Waihanga, *National Infrastructure Plan*, section 5.1 and Figure 33.

91. Sapere Research Group / Te Waihanga, *The Cost of Consenting Infrastructure Projects in New Zealand* (Wellington, July 2021), 2.

92. ACT New Zealand, "Waka Kotahi's $614 Million State Highway Budget Blowout," press release, 22 July 2023.

93. Kiri Gillespie, "Waka Kotahi NZTA's Billion-Dollar Bay of Plenty Roads Blowout," *Bay of Plenty Times*, 10 July 2022 (figures obtained under the Official Information Act).

94. NZ Treasury, "Cost Escalation Process – Draft Funding Package," Treasury Report T2022/2172 (Wellington: NZ Treasury, 11 November 2022), Annex Two, 6.

95. Ron Crawford, Richard Fabling, Arthur Grimes, and Nick Bonner, "National R&D and Patenting: Is New Zealand an Outlier?" *New Zealand Economic Papers* 41, no. 1 (2007): 69–90.

96. Paul Winter, Hilary Devine, John Janssen, and Chris Thompson, "Why Not Both? The Effects of Innovation and Capital on Productivity in New Zealand," Analytical Note 25/12 (Wellington: New Zealand Treasury, October 2025), 14.

97. Max Salmon, *Cabinet Congestion: The Growth of a Ministerial Maze*, Research Note (Wellington: The New Zealand Initiative, 26 March 2024).

98. Roger Partridge and Jemma Stevenson, *Unscrambling Government: Less Confusion, More Efficiency* (Wellington: The New Zealand Initiative, 2 September 2025).

99. Oliver Marc Hartwich, *Who Runs the Country? Restoring Democratic Control of New Zealand's Public Service*, Research Note (Wellington: The New Zealand Initiative, 8 April 2026).

100. MBIE and MFAT, *New Zealand's Productivity in a Changing World: Long-Term Insights Briefing* (Wellington, 2025).

101. Diana Cook, Hilary Devine and John Janssen, "The Productivity Slowdown: Implications for the Treasury's Forecasts and Projections," Treasury Paper 24/01 (Wellington: NZ Treasury, May 2024), 2.

102. NZ Productivity Commission, *Cut to the Chase: Measuring and Improving State Sector Productivity* (Wellington: NZ Productivity Commission, August 2018).

103. NZ Productivity Commission, *Regulatory Institutions and Practices: Final Report* (Wellington: NZ Productivity Commission, June 2014), 1.

104. Chris Bishop, "Speech on Replacing the Resource Management Act," Beehive, 20 September 2024; Chris Bishop, "Cutting Red Tape to Deliver the Infrastructure New Zealand Needs," Beehive, 9 December 2025 ("handbrake on growth and opportunity"); Chris Bishop and Simon Court, "New Planning Laws to End the Culture of 'No'," Beehive, 24 March 2025. Also see his speech on 7 March 2024 on the First Reading of the Fast-Track Approvals Bill, where he said: "Part of the problem in this country is we've become the obstruction economy, and what I want to say is that there is a better way. We don't have to become a country which has a 'can't do' attitude; we can become a country that says yes to growth, yes to more roads, yes to geothermal power, yes to wind energy, yes to farming, yes to mining, yes to housing growth, and yes to growth." Hansard.

105. Castalia, *Economic Impact Analysis of the Proposed Resource Management Reforms*, report to the Ministry for the Environment, 7 February 2025, 8–9. The Ministry published it on 10 December 2025.

106. Infometrics, *Estimating the Costs of an Uncertain Infrastructure Pipeline*, report for Infrastructure New Zealand (2023).

107. Chris Bishop, speech to Infrastructure New Zealand's Building Nations 2025 conference, 6 August 2025. See also Peter Dunne, "Snags to Making NZ Great Again at Infrastructure," Newsroom, 14 August 2025.

108. Lewis Evans and Neil Quigley, with Kevin Counsell, "Protection of Private Property Rights and Just Compensation: An Economic Analysis of the Most Fundamental Human Right Not Provided in New Zealand," report (Wellington: New Zealand Institute for the Study of Competition and Regulation, 2009).

109. Evans and Quigley, "Protection of Private Property Rights."

110. James Gwartney, Robert Lawson, Joshua Hall, and Ryan Murphy, *Economic Freedom of the World: 2022 Annual Report* (Vancouver: Fraser Institute, 2022).

111. Hugo Faría and Hugo Montesinos, "Does Economic Freedom Cause Prosperity? An IV Approach," *Public Choice* 141, nos. 1–2 (2009): 103–127.

112. Stephen Golub, "Measures of Restrictions on Inward Foreign Direct Investment for OECD Countries," *OECD Economic Studies*, no. 36 (2003/1): 85–116.

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"Reform of the Overseas Investment Act" (accessed 7 October 2026).

114. Chris Bishop, "First Fast-Track Project Approved," Beehive, 21 August 2025. See also Russell Palmer, "Port of Auckland Works First Project to Get Consent under Fast-Track Regime," Radio New Zealand, 21 August 2025.

115. Giuseppe Nicoletti and Stefano Scarpetta, "Regulation and Economic Performance: Product Market Reforms and Productivity in the OECD," OECD Economics Department Working Paper no. 460 (Paris: OECD Publishing, 21 November 2005).

116. Guglielmo Barone and Federico Cingano, "Service Regulation and Growth: Evidence from OECD Countries," *Economic Journal* 121, no. 555 (2011): 931–957.

117. Evans, Quigley, and Zhang, "An Essay on the Concept of Dynamic Efficiency."

118. Carmen M. Reinhart and Kenneth S. Rogoff, "Growth in a Time of Debt," *American Economic Review* 100, no. 2 (2010): 573–578.

119. Thomas Herndon, Michael Ash, and Robert Pollin, "Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff," *Cambridge Journal of Economics* 38, no. 2 (2014): 257–279.

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New Zealand faces two linked problems. Incomes are well below Australia's, and the public finances are on a path that Treasury's long-term projections show to be unsustainable.

On the OECD's measure, Australia's net national income per head was about 30% above New Zealand's in 2024. That is a missing NZ$20,000 per person, or roughly $105 billion a year. Estimates of the gap range from 12% to 37% depending on the measure, but every measure reviewed in this report puts New Zealand behind. The gap narrowed after 2005, has widened again since 2019, and young New Zealanders continue to leave for Australia.

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