Rebuild New Zealand: A reset and where next?

10 December 2020

Rebuild New Zealand: A reset and where next?

Overview

In this final report in our Rebuild New Zealand 2020 series we recap the major events of the year and take stock of the effects on businesses and households. We look at the ongoing importance of keeping New Zealanders safe and how this might be improved. We also examine the new Government's agenda, and what we see as the priorities for local businesses as they look to recover and rebuild while the pandemic continues to unfold in much of the world. We then assess where we stand relative to the seven planks that we identified in our original Rebuild New Zealand report in June.

We argue the case for a reset. It is time to shift the focus from the challenge of confronting COVID-19 to proactively engaging in how we, as a nation, seize the opportunity afforded by our COVID-free status to address long standing issues. It's a chance to look at how we rebuild our economy, generate prosperity, and enhance wellbeing for all of Aotearoa New Zealand in 2021.

> We urgently need to progress longer term initiatives to boost economic growth and productivity to lessen the burden of debt that future generations will bear as a result of the pandemic.

This report canvasses a range of initiatives where we would like to see significant collaboration between government and the private sector in 2021:

- A call to action for the Government to develop more coordinated approach to our national COVID response, informed by international best practice and involving greater collaboration with the private sector.
- Long overdue reform of our education system to boost intellectual capital and productivity.
- Encouraging capital investment in the productive sector, including imported capital.
- Improved resource allocation to match available skills and resources with those areas of greatest need.
- Smart and suitably funded infrastructure investment by central and local government to drive growth and improve productivity.
- Revisit our KiwiSaver and national superannuation settings to moderate growth in future debt levels.
- A broader range of risk-based measures being used outside, at and inside the border with multiple layers of defence enabling us to maintain our hard won successes and allow us to capitalise on our COVID-free status and re-engage with the rest of the world.

There is good reason to believe that New Zealand's economy can weather 2021 in reasonable shape – if our primary sector continues to perform strongly, and if we adopt a risk-based approach to managing our borders that enables vital workers and capital to enter New Zealand to support key industries, alongside a resumption of trans-Tasman travel (in the interim) to bolster our tourism industry. However, this is not where the discussion should end. We urgently need to progress longer term initiatives to boost economic growth and productivity to lessen the burden of debt that future generations will bear as a result of the pandemic. We can also utilise our economic success to invest in delivering key social and health outcomes for all New Zealanders.

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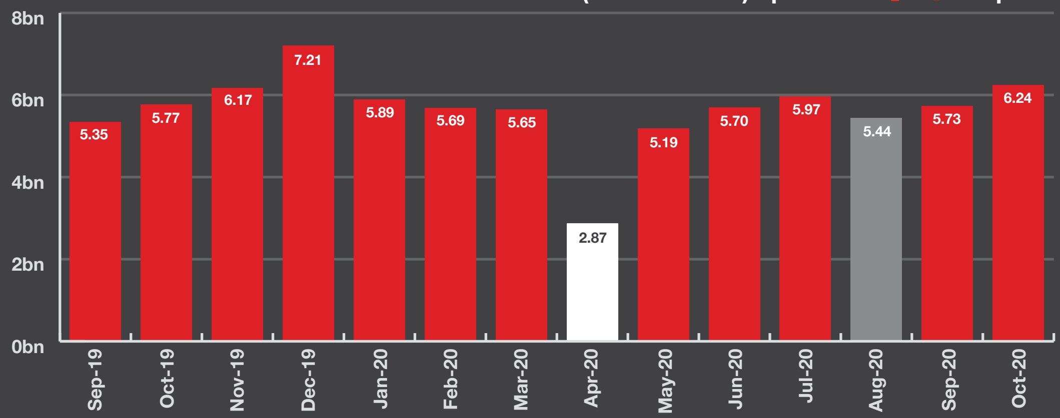
2020 in numbers and words

Retail spending

Retail spend for September quarter (last available) up **7%** from Sept 19

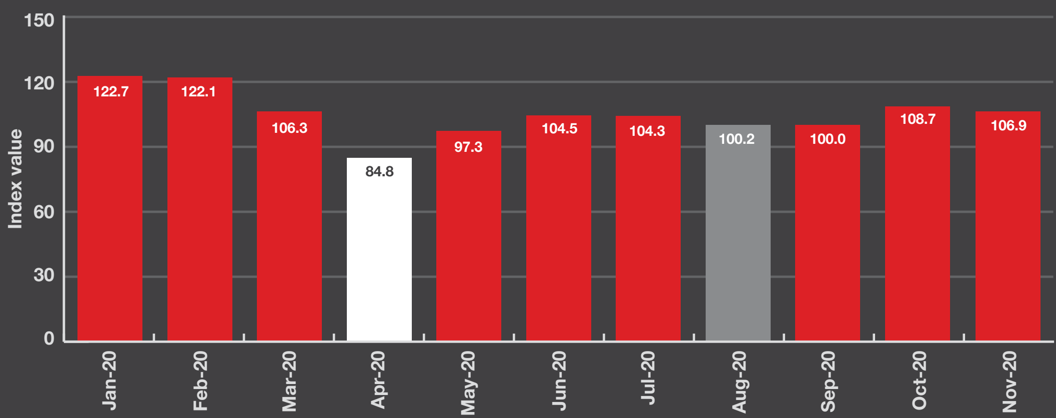


Source: Stats NZ

First lockdown Auckland lockdown

Consumer confidence

Oct 20 down **11%** from Jan 20, but up **28%** from Apr 20 low



Source: ANZ

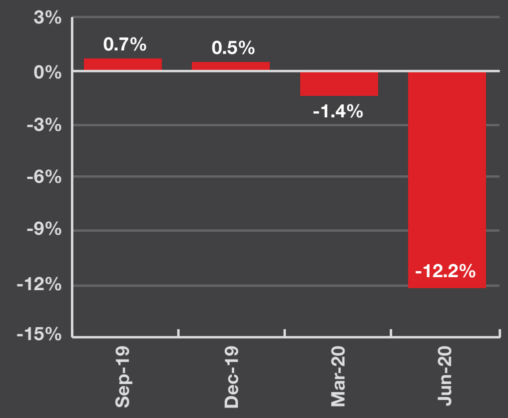
First lockdown Auckland lockdown

Trade Weighted Index

TWI was **73.4** at 3 Jan 20, then **74.3** at 30 Nov 20

Source: RBNZ

GDP movement for last four quarters



Source: Stats NZ

Words of 2020

- COVID-19
- Coronavirus
- Lockdown
- Bubble
- Essential worker
- Self-isolation
- Social distancing
- Contact tracing
- Community transmission
- MIQ
- PPE

Net core Crown debt has increased **57%** from Jan to Sept 20, to **$94 billion**

Negative **2%** annual impact on NZ GDP to Jun 20 (compared to 2.4% to June 19)

37,000 jobs lost in Sept quarter – largest number recorded since series began

Unemployment increased to **5.3%** well below the predicted **9.8%**

National median house price increased by **19.8%** over the 12 months to Oct 20

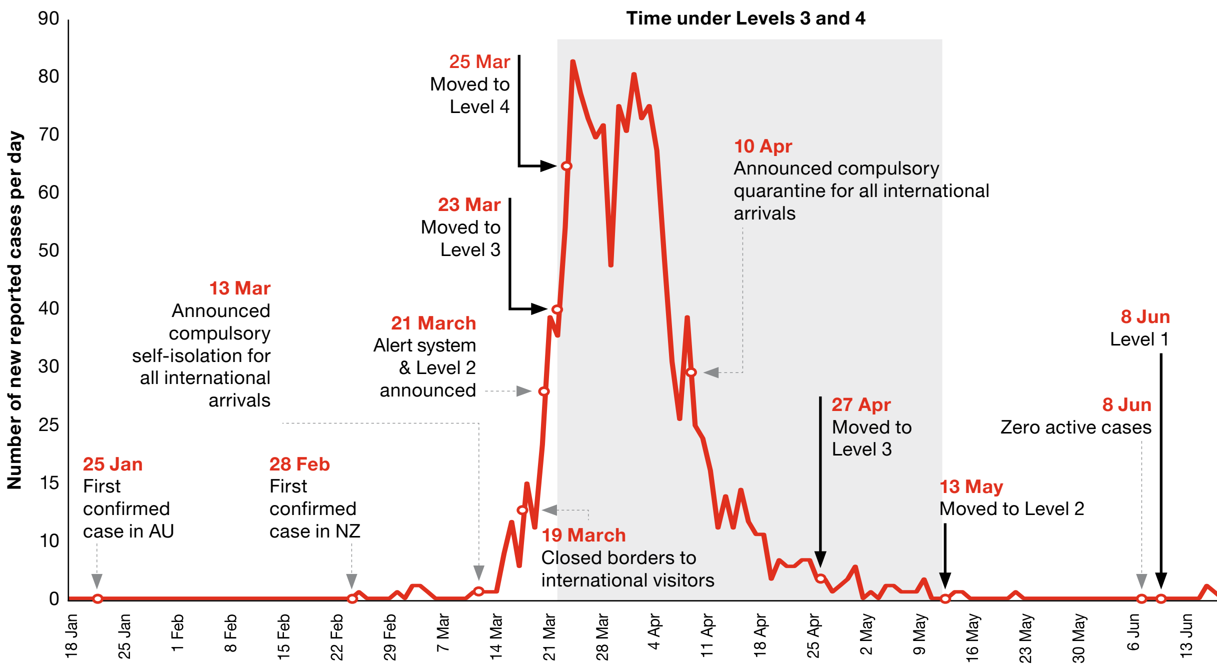
CPI (Consumer Price Index) experienced **1.4%** annual change to 30 Sept 20

$5 billion equity capital raised through NZX Jan to Oct 20

A stocktake of 2020

New Zealanders have a great deal to be thankful for as we near the end of 2020. It has been an eventful year for everyone, and for many a truly challenging one with changes to the way we live and work that we would never have imagined. Aside from our two periods of lockdown, everyday life has largely continued in a relatively normal manner for many New Zealanders. Our ability to work, attend school, play sport, enjoy the arts, travel domestically and socialise when and where we wish has been largely unaffected outside of these two periods.

Our border closure and the controls now in place, including the all important MIQ regime, is working effectively. Since 26 March over 80,000 international arrivals have been processed through these facilities, spending a mandatory 14 days in managed quarantine, and this has resulted in more than 380 cases of COVID-19 having been picked up, and in all instances managed, through to recovery. These measures have kept the virus in check, and other than isolated cases, which appear confined to people working either at, or close, proximity to the border, we have avoided ongoing community transmission and the dreaded 'second wave' that is now plaguing many countries in the EU.



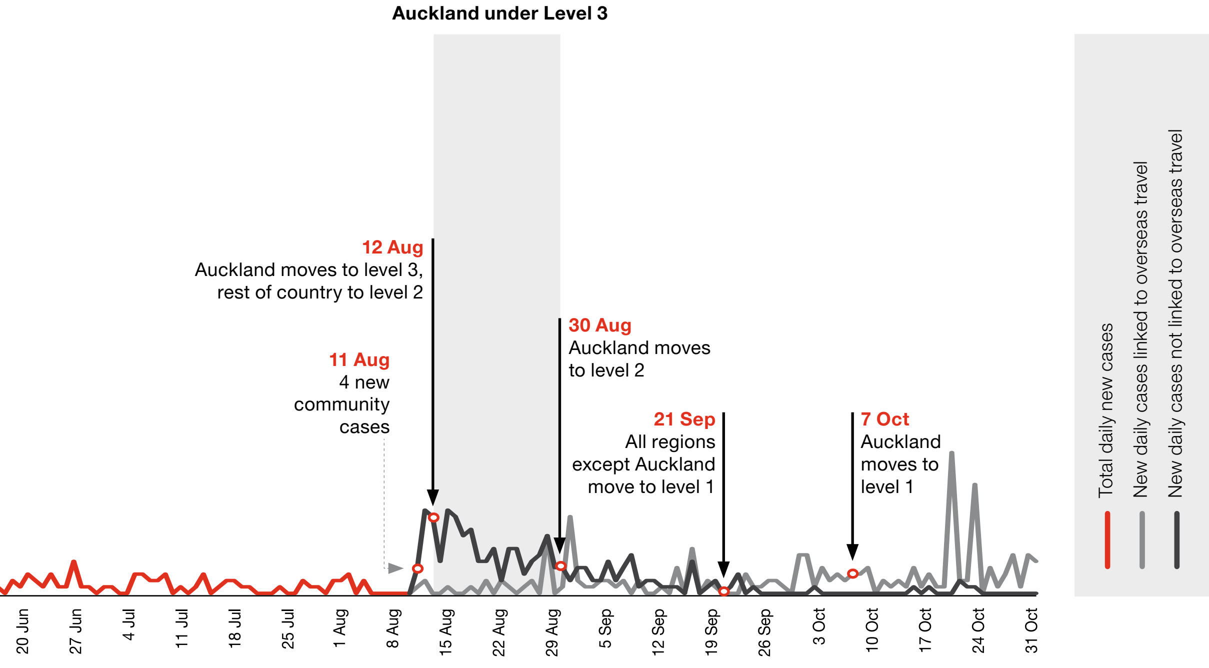
Although all of New Zealand is now back at Alert Level 1, some additional precautionary measures are in place, such as the requirement to wear masks on aeroplanes and on public transport in Auckland. The prospect of fresh community outbreaks of COVID-19 remains very real, meaning that further lockdowns could occur. On the other hand, it is apparent that the public's willingness to tolerate such blunt measures is waning, meaning that over time compliance with these measures may decrease and complacency may grow.

Prior to COVID-19, the economy had been growing strongly coming into lockdown, with 2019 annual growth running at 2.3%, but as of now, the country is technically in recession.

The Government has set aside $50 billion as its COVID-19 Response and Recovery Fund, of which around $36 billion has been allocated to date. This includes the $15 billion wage subsidy scheme (now closed), $5.2 billion earmarked for the Small Business Cashflow (Loan) Scheme (SBCS) and the business finance guarantee scheme. Most of this expenditure has, or will, be funded through additional Crown borrowings.

The Reserve Bank of New Zealand (RBNZ) moved quickly to loosen monetary policy by reducing the Official Cash Rate (OCR) and implementing the Large Scale Asset Purchasing Programme. This has supported a strong rebound in activity, although we won't know the full extent until the Q3 2020 GDP is released on 17 December.

Business confidence has also rebounded from its low in April. Consumption picked up quickly once the country emerged from lockdown, with retail spending and traffic movements increasing, although the trends are not uniform across all retail segments or in all regions.



On the other hand, there continues to be sectors such as tourism, events and education feeling the pain of an economy that has stuttered between lockdown levels and is carrying a hefty economic burden due to the continued closure of our international borders. Some of these sectors such as tourism will struggle over the coming summer, which will be devoid of the traditional influx of international visitors who typically spend much more per day than domestic holidaymakers.

As well as the shocks of COVID-19, the other major event in New Zealand in 2020 which will influence the next three years and beyond was the general election. The Labour Government has returned with an absolute majority in Parliament, the first time this has occurred since MMP was introduced in 1996. The Labour Party's handling of the COVID-19 crisis was the central plank of its election manifesto. The electorate's strong support for the Government indicates widespread confidence amongst New Zealanders about the manner in which the country has responded, the Government's overall leadership and the outcomes that have been achieved to date.

New Zealand has distinguished itself on the global stage as a country that has responded well to COVID-19 in terms of keeping its own population safe. This has contributed to an enhanced sense of domestic stability and confidence against the backdrop of an incredibly disrupted world. However, it is imperative that the Government is able to lead decisively and strategically as the nation emerges from crisis mode so that we take advantage of the opportunities afforded by our COVID-free status.

Keeping New Zealanders safe

It’s time to consider the next phase of our national response to the pandemic in terms of how we can improve our risk management both outside the border, at the border, and internally.

Our Government and its agencies have worked hard to keep New Zealanders safe. Now, as part of that ongoing commitment, we would like to see a broader range of measures used to manage risk at, and around, the border so that we have multiple layers of defence. This includes for example, pre-screening of all passengers bound for New Zealand, and different measures for passengers arriving from higher risk countries.

Adopting a more nuanced risk-based approach to management of our borders can free up MIQ capacity and enable more New Zealanders to return home, seasonal and highly skilled workers required in key industries to enter the country, as well as others who wish to do business with New Zealand. If we can relax quarantine requirements for those entering New Zealand from ‘safe’ countries such as the Pacific Islands and potentially Australia, or require shorter quarantine periods for some arrivals, there is potential to free up MIQ capacity. A simple ‘one size fits all’ approach is likely to prove overly cumbersome and unnecessarily restrictive over time.

Similarly, there are more measures that can be adopted domestically to keep New Zealanders safe, through managing risk and maintaining awareness therefore avoiding complacency. These include:

- In addition to the ongoing and ideally more widespread use of existing PCR testing, adoption of alternative testing procedures, such as saliva tests, that can be performed more frequently, at lower cost, with rapid results could be a “game changer”. Although these tests may not be as accurate as the current PCR regime, they will enable an ongoing testing regime which, if deployed widely can have a major impact in terms of monitoring the risk of community transmission.
- Improved contact tracing which includes adoption of new technologies that allow passive recording of contacts. Clearly the current COVID-19 tracing app is being used by only a small minority of the population.
- Ongoing public safety measures such as mandatory wearing of masks on public transport (including within associated facilities like terminals).
- Reinforcing the need for personal responsibility and changes in behaviour, such as regular handwashing, covering the nose and mouth while coughing or sneezing, and not going to work or mixing socially while exhibiting any COVID-like symptoms.

Widespread use of a range of preventative and control measures within our country, alongside clear and effective public messaging is important to maintain support for the initiatives. It will also alleviate the ever present risk of New Zealanders lapsing back into a state of complacency that can dramatically escalate the risk of future outbreaks. The measures and messaging need to be consistent. Changes in the rules, e.g. whether or not masks should be worn while using public transport, and inconsistent messaging, creates confusion and discourages compliance.

We believe these measures are a small price for the community to pay to avoid the enormous cost associated with combating the community outbreaks that occurred this year. It is apparent that while lockdowns are an effective control measure, the cost in both economic and wellbeing terms is high, and the public's tolerance for drastic measures is waning.

The public health and safety measures that we believe need to be progressed involve relatively minor adjustments to our way of life. While some measures might be viewed as an invasion of privacy (for example, through a technology-based passive tracing regime), we would argue this is justified in order to avoid another lockdown, which in itself would involve a massive invasion of personal rights and freedoms, and comes at enormous cost.

The prospects of a successful vaccination program

Over recent weeks there has been more optimism about the pending arrival of one or more vaccines. However, we believe a cautious approach is required in this regard, given the long term efficacy of any of these vaccines is still unknown. Some, such as Pfizer's, require complex cold supply chains prior to use meaning their deployment is difficult. Also, the available quantities of vaccines will be limited and New Zealand might not be at the forefront of the global queue. Achieving any level of community immunity from a vaccine will involve a nationwide vaccination program on a scale that is unprecedented, and is likely to take years rather than months to implement.

Our future plans should not hinge solely around the availability of a vaccine. Instead, we need to have a raft of measures in place to keep our country safe and our economy moving in the right direction. Irrespective of what happens on the vaccine front, COVID-19 will be with us for at least the next two to three years. The prospect of a vaccine cannot be allowed to let New Zealand lapse back into a passive, or worst still a complacent state, which could put at risk the gains we have worked so hard to achieve in 2020.

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The trans-Tasman and Pacific Islands travel bubbles

If we can make progress on all of the above matters, and especially the border controls and domestic public safety measures, then we can start to confidently look towards a resumption of quarantine-free travel with Australia and some Pacific Islands during 2021 (subject to what happens within various states in Australia). However, it is apparent that New Zealanders remain understandably nervous about the prospects of any reintroduction of COVID-19 domestically, and it is likely that these fears will only escalate given what is happening in the United States and the European Union.

Reopening our borders at least with Australia will be a 'game changer' for New Zealand's beleaguered tourism industry. While domestic tourism has held up strongly this year, the fact remains that overseas tourists, including those from Australia, spend considerably more each day than New Zealanders. Pre-COVID New Zealand was attracting around 1.5 million Australian visitors each year, out of more than 9 million Australians that travelled abroad. The opportunity exists to substantially boost this number given the limited alternative options for Australians wishing to travel overseas in the foreseeable future.

Tourism was our largest export earner pre-COVID. The lull in New Zealand's international tourism industry brought about by COVID-19 provides the opportunity for a thorough strategic review of the sector, with a reset that focuses on shifting from volume to value. Our tourism industry requires a vision for what a high value, low impact, sustainable business model across the sector could look like.

However, reopening the border not only makes a huge difference to New Zealand's tourism sector, but also has considerable significance for other sectors, including international education, retail and hospitality, infrastructure, construction and the primary sector. It will also help to facilitate capital flows, international business connectivity, and international social connectivity. More than half a million New Zealanders live in Australia, so family connections remain vitally important between our two countries.

Similarly, reopening a travel bubble with the Pacific Islands will be of enormous significance to their economies that rely heavily on tourism, as well as enabling families to reconnect with each other.

The Government's agenda

Our Rebuild report from July 2020 expressed concern that the 2020 general election would impede progress on recovery from COVID-19, as electioneering would dominate, at the expense of sound policy formulation and a relentless focus on effective execution.

In retrospect, the 2020 election may well have come at a good time for New Zealand. We are now emerging from our initial response phase to COVID-19 and it is timely to have a new government installed with a fresh mandate. The Labour government was reelected with an outright majority in Parliament, although it has entered into a support arrangement with the Greens. As a result, the Labour government is not beholden to any coalition partners, who might serve to be a handbrake on new policy initiatives, but equally, the new Government has nowhere to hide. It can no longer blame its coalition partner or the former National government.

The Prime Minister and her government have cemented their political power following the election, and possess considerable political capital. This needs to be used wisely, and in our view can enable the Government to be bolder with initiatives such as those mentioned in this report, to tackle our longer term rebuild. We would also encourage the Government to move quickly, as the realities of our relatively short three-year election cycle are all too apparent.

The Government has made clear its two priorities:

- To keep all New Zealanders safe (from COVID-19); and
- To accelerate our economic recovery.

We believe the Government will also signal a much stronger emphasis on addressing three other fundamental and longstanding challenges, being:

- Climate change.
- Housing.
- Child poverty.

On 2 December the Prime Minister declared New Zealand's 'climate emergency' and committed the Government and public sector to achieving carbon neutrality by 2025.

We can expect to see announcements in the areas of housing and child poverty also featuring strongly in the Government's agenda.

It has demonstrated excellent leadership throughout 2020 in terms of its response to COVID-19. Keeping New Zealanders safe has enabled most of us to weather 2020 in a far better way than those in many other countries.

We need only to look overseas to realise just how fortunate we are within our New Zealand bubble. The Government rightly deserves kudos for its leadership and our enviable status in the eyes of other nations.

We now need to capitalise on this advantageous position as perhaps the world's safest developed country and use this 'once in a lifetime opportunity' to rebuild our economy and our society in a way that benefits everyone. Unfortunately, the Government's second priority, to accelerate our economic recovery, still lacks substance and detail.

If we don't take advantage of our COVID-free status and continue to invest in innovative ways to maintain this, it is quite likely that our near neighbour, Australia, will do so at our expense. Warning signs are already evident. For example Australia's encouragement directed towards securing seasonal workers with the promise of a $2,000 bonus. The same might happen in the tertiary education sector, where Australia is already trialing a process to allow foreign students to return to carry on their studies via a pilot programme in Adelaide.

We would like to see much more of a 'can do' attitude accompanied by greater agility. This can be enabled through partnering with the private sector. In saying this, we recognise that this must be accompanied by a non-negotiable requirement that we don't allow COVID-19 to take hold in our country. However, we believe that with clever management and by harnessing the best of the public and private sectors, as well as learning from offshore best practice, we can do much more.

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What are the priorities for business now?

Most businesses have now emerged from their immediate COVID-19 response phase. This involved difficult decisions around reconfiguration of business models, reduction or elimination of capital expenditure, reduced working hours and in some cases staff retrenchment, and a range of other cost reduction initiatives. It also required a reforecasting of anticipated business performance and cash flows against a backdrop of pervasive uncertainty, with a much greater focus on scenario planning under a range of different assumptions about the extent and severity of the COVID-19 induced recession.

Businesses with liquidity issues have confronted difficult discussions with their banks, in many cases resulting in renegotiated debt facilities and extended maturities. Other companies, such as those listed on the NZX, have raised substantial amounts of new capital. Since the beginning of 2020 more than $5 billion of capital has been raised through the NZX, indicating there is a willingness by investors to support companies.

Investors' desire for yield has contributed to a strongly performing NZX, given the extremely low returns on bonds. This has encouraged a number of potential Initial Public Offerings (IPOs). There appears to be an abundance of capital available for investment in the financial markets.

Some businesses continue to operate in what might be termed 'survival' mode, where they are operating on a reduced scale and simply trying to break even. However those businesses are confined to sectors most severely and directly impacted by COVID-19. This includes tourism businesses reliant on international visitors; educational institutions that are either wholly or largely reliant on international students; and the events industry where planning has been extremely difficult due to the prospect of further lockdowns and the inability to bring international attractions to New Zealand.

We are seeing signs that some small to medium enterprises (SMEs) are struggling. The next six months could be particularly challenging for them given the Government's support measures have largely finished and mortgage relief provided by the banks is coming to an end. While these SMEs have been able to manage through 2020, the outlook for 2021 still contains significant downside uncertainties.

On the other hand, the September quarter retail sales bounced back strongly after the second lockdown, showing the largest quarterly rise since this measure was introduced in 1995. Total retail spending for the quarter was 7.4% greater than in the equivalent 2019 quarter, and on an annualised basis, sales for the 12 months to September 2020 were only marginally below the corresponding 12 months to September 2019. Virtually all retail sectors experienced increased volumes with significant increases in spending on consumer durables, including electrical and electronic goods, motor vehicles, hardware and building supplies. The only two major exceptions to this trend were, unsurprisingly, accommodation and food & beverage, both of which have been impacted by the absence of international visitors.

For many businesses outside of those that are in survival mode, the focus is shifting towards planning for a future under the 'new normal' where international borders, other than with Australia and some of the Pacific Islands, are expected to remain closed for the next 12 months or longer. There is also considerable uncertainty about how the global economy will perform, meaning that further economic shocks cannot be ruled out. Planning in this environment continues to be a dynamic exercise, with forecasts often based on presentation of multiple scenarios. There is a need for a 'Plan B' and sometimes also a 'Plan C' showing how the business will cope if less favourable scenarios emerge.

Alongside this dynamic planning process, businesses need to ensure they are well positioned to recover, so that they not only survive, but can thrive. This involves strategies that we broadly describe under the umbrella of ‘fit for growth’. Examples include:

- Accelerating digital transformation so that businesses can utilise more remote working and collaboration.
- Revisiting accelerator and disruptor timelines, including digitally enabled business models and opportunistic M&A and investment strategies.
- Assessing potential long-term shifts in customer expectations, market behaviours, workforce expectations and business models.
- Identifying and addressing vulnerabilities in footprint strategies for those in the manufacturing, supply chain, and business process services sectors in particular.
- Building greater trust with customers and other stakeholders so that the business emerges stronger and more resilient, and can contribute to the national economic rebuild.

For further advice for businesses, see our recent report Rebuild New Zealand: planning guidance for mid-sized businesses.

We are currently seeing all businesses in New Zealand, irrespective of size, coping with some new realities, e.g:

- The fact that COVID-19 is likely to be omnipresent globally for the foreseeable future and businesses must plan on this basis. It is unlikely there will be any speedy return to the ‘old ways’ in the near future, if ever.
- The trend towards ever-increasing globalisation appears to have halted for the time being, and instead national resilience is likely to encourage greater domestic self sufficiency.
- New Zealand is particularly vulnerable in terms of supply chain management, given our physical distance and lack of domestic manufacturing. This is already evident in terms of the timeframes for obtaining some consumer goods and also many critical inputs needed by businesses.
- Despite the rise in unemployment, labour shortages continue to be a paradoxical challenge for a number of New Zealand business sectors. Recently attention has been paid to the plight of the horticulture sector and its desperate need for more Recognised Seasonal Employer (RSE) workers, however, labour shortages, particularly in highly skilled areas remain acute for many other sectors such as engineering and construction.
- Work practices have changed dramatically in 2020, with some of those changes likely to be long lasting. This is evident in our major cities, especially Auckland, where the CBD working population has not recovered to anywhere near pre COVID-19 levels, with implications for landlords and retailers alike.
- The move towards remote and more flexible working practices has significant implications for businesses in terms of their investment in IT infrastructure and digitisation of processes, while at the same time requiring greater focus on maintaining collaborative working practices and ensuring that employee wellbeing is safeguarded.

Progress against the ‘seven planks’ to rebuild New Zealand

Our initial June 2020 Rebuild New Zealand report noted that fragilities already existing in New Zealand’s economy and society have been exposed as a result of the COVID-19 pandemic and its impacts.

These issues have now become even more apparent. They include:

- A lack of real growth, with much of our recent growth fueled by favourable net migration trends.
- A slow but steady decline in our productivity relative to most other OECD countries.
- An ageing population and high house prices in real terms which combine to create a sense of intergenerational inequity.
- Question marks over New Zealand’s ‘clean green’ image and the necessity for all parts of our economy to transition to a more sustainable and environmentally friendly model.
- Underinvestment in critical infrastructure that impedes economic progress, creates inefficiencies and adds cost for businesses and households.
- Social inequities, particularly the overrepresentation of Maori in the criminal justice system, health and unemployment statistics.
- Mental health and wellbeing, given New Zealand’s statistics such as youth suicide are amongst the worst in the world. COVID-19 and its associated disruption has only exacerbated our mental health issues.

The COVID-19 recovery presents a once in a lifetime opportunity to tackle these issues, many of which require longer term non-partisan solutions. In the alternative, there is a real risk that COVID-19 will simply reinforce and deepen the inequalities which exist in our society. It is vital that the recovery is truly inclusive.

It is timely to review where we stand against the ‘seven planks’ to rebuild New Zealand that we set out in our June report.

1 Maintaining employment

In March the Government quickly rolled out a broad-based Wage Subsidy Scheme (along with a range of other support measures) which it subsequently extended. Although it has come at an enormous cost (around $12 billion) it has been effective in terms of assisting businesses to maintain staffing levels throughout most of 2020. Fortunately unemployment failed to get anywhere near the levels originally projected, reaching 5.3% at the end of September 2020 compared to Treasury's forecast at the time of the 2020 budget of around 9.8%.

However, in the September quarter 37,000 jobs were lost, the largest number ever recorded in a single quarter. With the Wage Subsidy Scheme now behind us, but with huge uncertainty continuing to confront many businesses, and realistically an inability to roll out a further iteration of the Scheme on a broad basis, the challenge of maintaining employment is likely to be greater in 2021.

There is also a disconnect between the unsatisfied demand for additional staff in certain key sectors of the economy (e.g. horticulture) and the desire or ability on the part of New Zealanders to do this work.

If the Government and businesses can work together, and focus resources in the right areas, particularly those sectors that underpin our economy such as primary production and elements of construction, then the likely increase in unemployment can be suppressed.

2 Understanding what real growth means and stimulating this

As a nation we still lack consensus about what real growth means, how well we are doing in this regard, and why growth is important.

The COVID-19 response has resulted in a massive increase in net core Crown debt, projected to increase from approximately 30% of GDP at 30 June 2020 to over 50% of GDP by June 2023. This dramatic increase in our borrowings creates an intergenerational burden as the task of repaying debt will fall on the next generation; and it reduces our flexibility to cope with any further economic shocks.

The best (potentially the only) way to realistically tackle this debt burden is to achieve the strongest possible growth in our economy. This will reduce the relative significance of debt when measured as a proportion of GDP. More can and needs to be done to stimulate growth. We know that clever investment in infrastructure can be a significant driver of economic growth. Equally, incentives that enable resources to flow into the sectors where New Zealand has genuine global competitive advantage such as grass-based protein production will encourage individuals and businesses to invest in the productive economy.

3 Removing the impediments to real and sustained, across-the-board productivity improvements

Like economic growth, the challenge of improving New Zealand's productivity has proved elusive for decades. Instead, New Zealand has declined in relative terms, and now ranks amongst the bottom quartile of OECD countries when it comes to productivity.

Although the Government has launched initiatives aimed at skills-based training, this needs to be accompanied by a much broader range of initiatives. This includes fundamental changes to our education system, stronger incentives for research and development, and encouraging greater capital intensity within businesses. It also includes an environment that nurtures the growth of globally successful businesses that will fund the innovation required to succeed at scale.

The reality is there is no 'quick fix' in terms of reversing the productivity decline. Yet it is probably the greatest long term impediment on our economic aspirations. Short term policies designed within a three year election cycle are unlikely to be effective.

4 Addressing the growing degree of intergenerational inequity

We have already noted the immediate and direct cost of funding New Zealand's response to COVID-19 which will result in a substantial increase in net core Crown debt. This debt burden will fall on future generations.

New Zealand's national superannuation regime is increasingly unaffordable due to its universality and the fact that the age of entitlement has not changed in decades. There is also limited encouragement of private savings, with our KiwiSaver regime being relatively lightweight compared to the compulsory savings regimes in other countries such as Australia. The extremely low interest rate environment currently prevailing does not assist either, depleting returns for many investors while at the same time fueling a rise in asset prices.

Perhaps the most dramatic example of growing intergenerational inequity in the COVID-19 era is evident from our rampant house price inflation. The national median house price has increased by almost 20% over the last 12 months, meaning that for many aspiring homeowners the goal of purchasing a home is becoming more difficult by the day.

5 Tax reforms to broaden the Government's revenue base, remove distortions on investment decisions and create greater fairness

Substantial reform of New Zealand's tax system appears to be off the agenda. Prior to the 2020 election, the Labour government somewhat predictably announced its intention to increase the top personal marginal rate from 33 to 39 cents for income above $180,000. This is not a true reform. In fact, the unfortunate reality is that this increase will only affect around 2% of taxpayers and collect an additional $550 million of annual revenue, in large part reflecting the fact that New Zealanders enjoy relatively modest incomes when compared to other developed countries.

The Government could use its strong political mandate to be bold and consider how the tax system could be reformed. This could include broadening the revenue base, removing investment bias, and creating a fairer system, while also enabling the Government to collect the revenue that it needs to fund our recovery.

Our June 2020 Rebuild report encouraged an open debate on the contentious topic of introducing a simple broad-based capital gains tax (CGT). We noted that the debate might be different if New Zealanders had a better understanding of the extent to which CGT would actually impact them during their lives, and also the potential long term trade off between CGT and income tax. It was interesting to observe the public's reaction to the Green Party's proposed wealth tax. We do not favour a wealth or land tax, because although it may have the attraction of being relatively simple to administer, over time it can be very costly, and it imposes a tax impost without there being any underlying cash flow to pay that tax.

The Government is presently reviewing the effectiveness of the 'bright-line' test, and particularly whether the current five year threshold with respect to taxing gains on land sales (excluding the family home) is working as intended. Any extension of the 'bright-line' test beyond five years is likely to be viewed by many as a form of CGT that is being introduced by stealth and in contravention of the Government's election promise that there would be no new taxes.

Any proposed environmental taxes will need to be carefully balanced against possible short term negative economic impacts for New Zealand businesses who are already under pressure.

In the meantime, we expect to see Inland Revenue placing greater emphasis on enforcement of the existing tax rules, putting their significant data analytics capabilities into action with more tax audits and a focus on the collection of tax arrears.

6 Addressing the urgent challenge of climate change so that there is a planet for future generations to enjoy

Our June 2020 report noted that at the start of the year, before COVID-19 dominated headlines, climate change represented the number one issue on the minds of business leaders.

New Zealand's commitment to transitioning to a low-emissions economy and ensuring environmental and climate change considerations are integrated into all economic and business decision making remains of critical importance, especially for future generations. Climate change considerations cannot be relegated in the wake of COVID-19. Instead, they need to be at the forefront of all decision making to ensure that New Zealand 'builds back better'.

The Government is looking to lead by example by declaring New Zealand's climate emergency and committing the public sector to going carbon neutral by 2025.

> Climate change considerations cannot be relegated in the wake of COVID-19. Instead they need to be at the forefront of all decision making to ensure that New Zealand 'builds back better'.

7 Partnering effectively by all elements of the public and private sectors to aid recovery

The Government and its various agencies, such as the Ministry of Health, have found themselves in unusual and unprecedented situations, grappling with decisions on a daily basis that directly and immediately impact how businesses operate and how people go about their daily lives. This is a very different environment from those which governments are more familiar with – their traditional role tends to focus on establishing policy and legislative frameworks and monitoring these. To provide the innovation and agility needed to capitalise on our natural advantages (especially our COVID free domestic status), New Zealand can achieve far more if there is effective partnering between the public and private sectors, drawing on the best of both.

Where next – 2021 and beyond?

It's time for a reset where we can engage constructively and proactively on a range of fronts to seize the opportunity to reinvigorate our economy. In the short term this means capitalising on our COVID-free status; and in the longer term we must address the fundamental planks necessary to rebuild a better and more prosperous New Zealand.

To address our longer term issues and capitalise on the opportunity New Zealand finds itself in here are some of the initiatives we believe would strengthen the next phase of recovery:

The Government's leadership and approach

- Honest, deep and unconstrained conversations about the things that really matter including:
  - how we achieve real growth?
  - what role does migration play for New Zealand?
  - what should be our attitude towards foreign direct investment?
  - what is a fair and affordable superannuation regime?
  - how do we encourage private saving and investment?
  - how do we tackle deep seated issues of inequality, particularly as it affects Maori and Pacific peoples?
  - how do we integrate climate change and sustainability into all decision making and are we prepared to accept the financial consequences?
- We would like to see the same level of public debate and energy directed at these key questions as has been apparent this year in relation to our response to COVID-19 because these issues will affect New Zealand well after the pandemic has been brought under control.
- The Government should make the most of its substantial political capital and act boldly and quickly, while at the same time seeking to build non-partisan consensus around longer term initiatives.
- Improved coordination of the Government's response. Its decision to appoint a Minister in charge of the COVID-19 response is a sensible first step.
- In our view this initiative should be backed up by the establishment of a dedicated cross-government agency that can lead and coordinate our national response. It should be informed by the best possible health and scientific advice (including overseas experience), draw on all relevant government agencies alongside private sector experts, able to move quickly and with agility, and have clear responsibility and accountability for achieving the best health and economic outcomes for New Zealand.

We need a dedicated cross-government agency that can lead and coordinate our national COVID-19 response.

Reform of the education sector to boost intellectual capital and productivity

- The way New Zealanders are educated will be vital to accelerating our recovery over the longer term. A great deal has recently been written about the systemic failings within our education sector, meaning that young New Zealanders are falling behind their international counterparts. This is in terms of their preparedness to enter a complex technology orientated and dynamic world, that demands a much higher level of critical thinking skills. Greater investment is needed across all elements of New Zealand's education system, from early childhood through to the tertiary sector and beyond.
- In addition to growing our domestic intellectual capital organically, there is a strong argument for importing more intellectual capital through a change in our immigration settings. The importance of knowledge and technology cannot be understated, especially if we want to accelerate innovation and improve productivity.

Encourage capital investment

- We would like to see a change in stance towards foreign direct investment. New Zealand has a long history and need for imported capital, and nothing has changed in this regard. While some inbound investment is occurring despite the practical difficulties resulting from a closed border, it is also apparent that many transactions and opportunities have stalled. Worse still, these might be captured by other countries instead.
- There is also a case for reviewing our immigration settings to allow ultra high net worth individuals to secure residency providing they invest sufficient capital here. This capital can make a meaningful difference to a small nation like New Zealand, through enabling greater investment in wellbeing initiatives, funding infrastructure, creating jobs and investment in our regions.

The way in which New Zealanders are educated will be vital to accelerating our recovery over the longer term.

Addressing the climate change imperative

- New Zealand is lagging in terms of meeting its Paris accord commitments. We are not transitioning to a low carbon economy quickly enough. The significance that surrounded the climate change discussions at the beginning of 2020 has been overtaken by the COVID-19 crisis, but the urgency of addressing climate change remains, and indeed surpasses COVID in terms of its long term challenge for the world.
- New Zealand's COVID-19 rebuild response needs to integrate climate change thinking and assist our transition to a low carbon economy, with every decision being made with these factors in mind.
- On 2 December the New Zealand government joined 32 other countries in formally acknowledging the global climate change crisis by declaring a climate emergency. The near term objective is for the Government and public sector to achieve carbon neutrality by 2025. A range of specific initiatives have been announced to help deliver this:
  - all government agencies will have to measure and reduce their emissions, and offset where they are unable to do this, in order to achieve carbon neutrality;
  - phasing out the largest and most active coal boilers, such as those used in schools;
  - all government agencies are required to purchase electric vehicles wherever practical and reduce the size of their car fleet; and
  - a green standard for public sector buildings.
- By making this announcement the Government is signalling its intention to lead by example in this most important area.

Improve resource allocation and infrastructure

- The definition of infrastructure needs to be broadened beyond the traditional concepts such as rail, roads, bridges and other transport related projects, and social infrastructure such as schools and hospitals. We need greater investment that will support a more agile, productive and safe New Zealand. Infrastructure decisions need to reflect climate change considerations as well.
- Greater effort is needed to match our country's resources with our most pressing needs. In the wake of COVID-19, there has been talk about the negative impact on sectors like construction, while at the same time we continue to be plagued by a national shortage of housing. How do we direct resources towards this sector so that the housing stock is increased, activity in the construction sector is maintained, and we train more skilled people for this sector and create more employment?
- Similarly, our tourism sector continues to have accommodation facilities that are underutilised or mothballed and a shortage of jobs; while at the same time we have unsatisfied demand from New Zealanders (and foreigners) seeking to enter the country either to return home or for work or other reasons. Can we scale up the range of facilities used for MIQ purposes, utilising our existing accommodation stock, and also training people to work effectively in this vital sector? The Government has a central role in terms of mandating the protocols necessary to manage the border, operate MIQ facilities and keep New Zealanders safe, and then ensuring these rules are being strictly adhered to. This is no different from how many other sectors of our economy already function.

> “We would like to see a more enlightened view around the role that infrastructure plays in our recovery... with a focus on the longer term economic stimulation.

- During the year we have seen a range of announcements about potential closures of major New Zealand industrial operations such as the Tiwai Point Aluminium Smelter in Southland, and possibly the Glenbrook Steel Mill and Marson Point Oil Refinery, as well as the cessation of offshore oil and gas exploration in Taranaki. All of these would result in additional job losses and impact New Zealand's recovery. In a new world where we require greater self sufficiency, we may need to re-examine the business cases surrounding these major industrial operations to ensure there is adequate domestic supply for key resources; and the downside impacts of any closure are carefully managed and mitigated over time. One of the challenges will be how to achieve this in respect of these carbon intensive/resource heavy businesses while at the same time transitioning to a more environmentally friendly low carbon nation.

- We would like to see a more enlightened view around the role that infrastructure plays in our recovery. Currently, projects are referenced to the number of jobs that will be created during their development period. But, we'd like to see a focus on the longer term economic stimulation that these projects can enable, not only through job creation, but also by helping to create a more efficient and productive economy. More rigorous and transparent cost benefit analyses need to be made available, and procurement models need to adapt. This will enable Crown and local government agencies to achieve better value for money, in a manner that fairly reflects the burden of risk and return. A well-coordinated approach to infrastructure involving both central and local government is required. There is opportunity for the Crown and local government to build infrastructure and fund some of this through recycling existing infrastructure.
- The proposed reform of the Resource Management Act and other regulations will need to dramatically streamline approval processes for building and other infrastructure projects. This will help to boost productivity and growth, without sacrificing the quality of our urban and rural environments.

Local government reforms

- COVID-19 has had a pronounced impact on local authorities, many of whom are now facing declining revenues and increased costs. In some situations that has resulted in local authorities completing emergency budgets, with Auckland Council the highest profile example. COVID-19 will have a lasting impact on local authorities who are now in the midst of their 2021-31 long term plans, with many tough decisions having to be made to reduce projected double digit rates increase.
- While efficiencies are always to be encouraged, a number of these decisions are likely to impact capital expenditures that will reduce the future productive capacity of our cities and towns, and more immediately jobs. Further capital deferrals will exacerbate historical underinvestment in infrastructure, with further adverse impacts on the ability to add housing. Longer term thinking is required. The three waters reform is part of this, but reform of how local government funds and finances itself will unlock further efficiencies, with COVID providing the platform to do so.

Revisit Kiwisaver and national superannuation settings

- One legacy of the Government's response to COVID-19 will be a dramatic rise in net Crown debt from 19% of GDP in 2019 to approximately 54% by 2024, and this level will only decline gradually to 42% of GDP by 2034. New Zealand was fortunate as it entered the COVID crisis with low public debt which afforded a level of flexibility in terms of the Government's response. However the elevated debt level resulting from COVID-19 places the country at greater risk should another crisis arise and exacerbates the intergenerational inequity that already exists.
- A review of New Zealand's retirement savings and income policy settings, which currently represent a significant area of core Government spending and are all funded out of borrowings, is one way to moderate this debt burden. This is important in terms of

addressing our flexibility to deal with future crises, and reducing the intergenerational inequity that will result from the cost of COVID-19.

- Research carried out by Dr David Law of the New Zealand Initiative earlier this year provides a useful insight into the opportunity and potential financial outcomes from revisiting current Kiwisaver and national superannuation settings. To summarise some of his findings:
  - If Government subsidies to Kiwisaver (which currently cost around $950m annually) were ended, this would reduce net Crown debt as a proportion of GDP in 2034 by approximately 4.5%;
  - New Zealand currently offers a universal entitlement to national superannuation for all those aged 65 and over, with the benefit indexed to the average wage. The annual cost of our national superannuation is approximately $15 billion or around 4.7% of GDP. Due to New Zealand's ageing population, this cost is forecast to rise to around 8% of GDP by 2060.
- David Law looked at a range of altered settings. His analysis indicates that if the age of eligibility was to increase by two years from 2025 and the growth of individual superannuation payments was slowed by indexation adjustments from 2021, net Crown debt as a proportion of GDP in 2034 would be approximately 12.4% lower.
- Changes to these savings and retirement income policies are powerful levers available to the Government. Taken together the above two changes have the potential to reduce net Crown debt as a proportion of GDP to around 25% in 2034 instead of the 42% that the Treasury currently forecast.

The case for a reset – let's seize the opportunity

As we come to the end of 2020, we reflect on what has been an eventful and arduous year for virtually every New Zealander; and at the same time be thankful for our relatively safe domestic environment that lets most businesses and households continue to function freely. Unlike in many other countries, we can go about our daily lives feeling confident that we are unlikely to catch COVID-19.

Our economy remains in relatively good shape, with the most significant downside impacts of COVID-19 confined to a few sectors, albeit some like tourism are large. Fortunately, our all important primary sector continues to perform strongly. While there has been a notable rise in unemployment and increasing under-employment, our overall levels of employment remain good by international standards.

However, our export orientated economy remains heavily dependent on our major trading partners. Therefore the impact of the ongoing pandemic has the potential to flow through into significant impacts on our economy in 2021. New Zealand is also exposed to trade risk as a result of the deteriorating relationship between China and Australia, which is already impeding Australian exporters access to the all China market. Any spillover effect on New Zealand's trading relationship with China would pose a major threat to our export sector given the significance of China as our largest single trading partner worth more than $20 billion annually.

Now we need to reset our direction, based on our highly successful response to COVID-19 in 2020, viewing it not so much as a challenge, but rather, as an opportunity. We need to embrace a broader range of risk management practices that will enable us to maintain our

> "Now we need to reset our direction, based on our highly successful response to COVID-19 in 2020, viewing it not so much as a challenge, but rather, as an opportunity.

> We can utilise our future economic success to invest in delivering key social and health outcomes

hard won successes, and also allow us to cautiously capitalise on our COVID-free status, such as by progressively reopening our borders and reengaging with the world safely.

If, as we hope, our primary sector continues to perform strongly, and if we have greater flexibility and a risk-based approach to managing our borders that enables vital workers and capital to enter New Zealand to support key industries, alongside a resumption of at least trans-Tasman travel to bolster our tourism industry, then there is good reason to believe that New Zealand's economy can weather 2021 in reasonable shape. However, this is not where the discussion should cease.

We urgently need to progress longer term initiatives and strategies to deliver better educational outcomes, utilise clever infrastructure and other measures to boost economic growth and productivity and therefore lessen the burden of debt on future generations. We can utilise our future economic success to invest in delivering key social and health outcomes, such as improving the health and wellbeing of our Maori and Pacific communities.

Above all, we need to build on our favourable attributes:

- We are small and agile nation;
- Our natural borders are our friend;
- We have globally competitive primary industries;
- We can explore new infrastructure opportunities;
- We have an emerging tech sector and our digital investment can really pay off;
- We possess an abundance of renewable energy;
- We have strong institutions and political stability.

These factors justify real optimism around New Zealand's response not only to continuing to combat the risks surrounding COVID-19, but equally, to address existing fragilities in our economy that have been exposed. We can seize the opportunity to rebuild our economy and our society so that there is a more prosperous and inclusive future for all New Zealanders.

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Rebuild New Zealand reports

Rebuild New Zealand: June 2020

Rebuild New Zealand: 31 July 2020

Rebuild New Zealand: tertiary education

Rebuild New Zealand: infrastructure

Rebuild New Zealand: private equity

Rebuild New Zealand: primary sector

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