



**ECONOMY ON THE EDGE: SWAN DIVE OR
BELLY FLOP? A DRAFT STRATEGY FOR
COMING OUT OF THE CRISIS STRONGER
(VERSION 2)**

3 NOVEMBER 2008

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PART I: EXECUTIVE SUMMARY

A. Introduction

We are facing a global economic crisis that is already hitting New Zealand very hard. It will get worse. In the first draft of this document we stated that the New Zealand economy is at the top of the cliff with a dive to execute. That dive can be a swan dive - elegant and strong and from which we emerge with real energy - or it can be a brutal and painful belly flop. In our view, the New Zealand policy response to date remains inadequate to provide confidence that New Zealand will both steer through recession well and emerge as strongly and as quickly as possible.

Our estimate of the seriousness of the economic and financial problems has increased as we have seen the pressure countries like Iceland, Hungary, South Korea, and many others have come under. The IMF is dispensing emergency funding to these countries, and estimates of the severity of the global recession are constantly being increased. Our lack of appropriate response three decades ago led New Zealand to the economic brink a decade later. We now face the same risk.

New Zealand has significant exposure to these global pressures. We are heavily reliant on foreign credit, we have significant exposure to declines in housing stock and commodity prices, and we continue to see new records in people leaving.¹

After a decade of relative economic health, the New Zealand economy has “spun on a dime”, with ten years of deficits forecast. This shows the real fragility of the New Zealand economy and its productive base. The economic debate remains discouraging. While each party, for example, has announced plans to provide a safety net for those who lose jobs, this strikes us as an argument about who provides the best ambulance at the bottom of the cliff, with less focus at all on the firms and farms that provide these jobs in the first place. The relative lack of focus on strengthening the firms and farms that provide these jobs, and how to attract or keep people in New Zealand, has, unfortunately, grown louder. We believe that, while there is little we can do about the global financial system, there is a lot we can do to determine the health and performance of the New Zealand economy. This is the premise of this document.

¹ We note as particularly applicable to New Zealand, a comment by IMF economist John Lipsky that:

“There are two key risks... that housing [values] will substantially undershoot reasonable long term levels... [and] reinforcing rounds of real and economic distress.”

New Zealand has major choices to make. If we act on the right strategy that delivers increased investment in New Zealand over this period, we will emerge stronger and more competitive relative to those peers who have surged ahead of us in most economic indicators over the last decade. However, if the scattered policy offerings - with no clear strategy or targets - are all that we get, we will be left struggling behind.

The first draft of this paper was released a fortnight ago. We have received substantial feedback since then, commenting on our proposals as well as suggesting new ideas. The feedback has been thoughtful and informed, and has been used to take this document up a level. The proposed actions have been revised and reframed, and we believe they are both robust and actionable. We believe that the need for these recommendations or some like them, to be implemented continues to rise.

B. Need for a New Zealand Economic Strategy

It has become apparent from nearly all the feedback we have received that there is a real demand for a coherent New Zealand economic strategy. Such a strategy would clearly outline how New Zealand will be positioned to compete more effectively into the future.

We believe that a clear strategy blueprint, including well-defined and measurable outcome targets, is critical. We believe that there should be a public commitment by politicians to deliver such. We hope that this revised paper makes a constructive contribution to this process. Part III lays out some criteria for a successful strategy.

C. Recommendations

The recommendations in this document represent a strategic response to a crisis. We believe that they could usefully form a cornerstone of an overall economic strategy for New Zealand. However, this is only part of the picture. The economic strategy for New Zealand needs to be much broader.

We have grouped our proposed actions into five categories. The first category outlines actions that can and should be taken immediately as a response to the short-term implications of the crisis. The next four outline some key planks to our medium term response to the crisis, designed to strengthen the long-term position of the New Zealand economy.

1. Urgent Actions - quick wins and bridging measures. Over the next 24 months New Zealand firms and farms face significant dislocation risk that, if not addressed, will have a very negative long-term impact on the fabric of our economy. The urgent actions and bridging measures outlined are focused on this 24-month period, and, depending on conditions at that time, could be relaxed as appropriate. They include:

- Tax measures to mitigate lumpy economic shocks (e.g., from exchange rates, credit rationing, volume and price falls domestically and in exports, etc). Key measures include:
 - Elimination of provisional tax uplift in all years Treasury predicts corporate tax declines; parity between penalties and refund rates, a wider band within which payers obtain neither penalty nor refund band; and a higher threshold introduced before firms become eligible;
 - Accelerated depreciation rates for new capex initiated from 2009-2011, with acceleration highest for technology investments;
 - Expansion of tax deductibility for legitimate business expenses (e.g. holiday pay accruals);
 - Tax deductibility for “black hole” expenditure, as capital raising (black hole) in this period will be core to survival and is a core part of business;
 - Elimination of imputation credits based distortions that create disincentives to remain in New Zealand and incentives for foreigners to own 100% of New Zealand firms;
 - Moderate fiscal stimulus and aggressive interest rate easing.
2. Driving increased local investment. These measures recognise that, as a net capital importer, and with foreign and local savings imperfect substitutes, the New Zealand productive sector has lagged in investment, and our overall productivity and GDP growth are weak.
- Government borrowing, fund a variety of infrastructure projects;
 - Directing the NZSF to invest a substantially greater proportion of their funds into New Zealand; and
 - Creation of KiwiCo, a holding company for certain SOEs, with a growth mandate and proper monitoring, management, and governance arrangements.
3. Quickly create a much more supportive growth environment for New Zealand firms. Policy neutrality is not sufficient; policy needs to be deliberately designed to support strong growth by New Zealand firms. We need local and global firms to grow from New Zealand because it is in their economic, not just their patriotic interest, to do so:
- Significantly strengthen New Zealand capital markets;
 - Transition KiwiSaver to a compulsory savings scheme (2%);
 - Remove the real estate tax bias;

- Implement a reframed, workable R&D tax credit; and
 - Reduce the corporate tax rate significantly and eliminate imputation altogether.
4. Win in the global economy. New Zealand is a net provider of value (people, acquisition targets, etc) to a globalized world. This needs to be reversed so we are a net gainer.
- Use tax and other measures to attract new firms and people - with fish hooks if they leave; and
 - Utilise government assets to create a more significant offshore physical presence to help New Zealand firms successfully go global, in combination with an aggressive FTA strategy;
5. Public - private sector cohesion. The best and clearest strategy is executed. If the public and private sectors do not understand, trust or respect each others motivations, and work cohesively together, we will fail. The public sector needs to access expertise from the private sector.
- Create meaningful, formal, advice roles for the private sector; and
 - Change the insular culture of the public service by hiring more senior private sector people (the economic agencies in particular need more practical experience and private sector insights).

D. Next Steps and Actions

The period after the election provides a window of opportunity to make rapid progress. We believe that New Zealand should adopt a war-time footing in response to the changed circumstances. Public and private feedback to us confirms this, and indicates a very strong need to see whoever forms the next government do two things. First, implement the urgent bridging actions this side of Christmas. Second, within no more than 100 days of being sworn into office, deliver a comprehensive “New Zealand Economic Strategy”.

It requires the authentic language of leadership and action, not costly talkfests and meaningless slogans that resonate only as political sound-bites.

This is not a time for incremental steps. The next government will be judged on how well they step up to this challenge.

PART II: NEED FOR A STRATEGY

While there are huge risks, there is also a unique opportunity to act in front of the curve so that we emerge stronger and more competitive relative to peers who have surged ahead of us over the last decade. The Chinese character for crisis is said to comprise the symbols for danger and opportunity. A well crafted strategic response for New Zealand will involve both.

Currently there is no clear sense as to how best to position New Zealand, which is perhaps understandable given the speed with which the crisis has developed, but it is unsatisfactory and dangerous. However, hope is not a strategy. It is thus critical that the government crafts and communicates a clear strategy. How we deal with this will be the single biggest issue that New Zealand faces over the next two terms of government.

Our view is that New Zealand's economic strategy, when released, needs to be evaluated against eight criteria.

First, the policy response needs to be proportionate. The financial and economic crisis is a serious problem, and requires a material response. Consider the scale of the response in numerous overseas jurisdictions (e.g., US, Europe and the UK., etc).

Second, New Zealand's response needs to have strategic coherence. If the reaction is a series of short-term fixes driven by pork-barrel politics, the final outcome will be a painful belly flop.

Third, the approach needs to combine risk management with a purposeful intent to strengthen the fundamentals of our economy. This means that right now we need to determine both how we mitigate downside risk, while strengthening the New Zealand economy. The strategy needs to be broad but with a particular focus on supporting investment levels and growing our overall competitiveness.

Fourth, it should be designed to have impact in each of the near, medium and longer terms.

Fifth, it must have goals that are measurable - and they must be measured and reported against. One measurement that has been suggested by Lloyd Morrison is GDP per capita. We believe that one 'hard' economic goal such as this is appropriate, but must be augmented by focus on such other key areas as the talent drain - a real indicator of New Zealand's attractiveness as a place to live and work, and a leading indicator of economic performance - as well as something inclusive, such as an 'Ownership Democracy'. Much deep thinking and real analysis is needed on this.

Sixth, lasting commitments must be made to achieving defined outcomes (i.e., they need to be taken more seriously than previous goals such as returning New Zealand to the top half of the OECD in terms

of per capita income). The time for meaningless slogans is long past. They are no longer effective as galvanizing tools, and New Zealanders are regarding them with growing cynicism.

Seventh, a strategy must have one or two organizing ideas (e.g., improving New Zealand's global competitiveness) that drive all the micro choices across the mass of policy and regulations (e.g., the tax there is often a choice between tax purity and economic competitiveness).

Finally, the strategy should be limited to no more than ten key priorities. Strategy is as much about deciding what not to do as it is about deciding what to do. Clarity in scope and priorities will ensure that the public and private sector both understand the strategy, and how to execute it.

PART III: NEW ZEALAND'S EXPOSURE

The global financial crisis is still spreading, and rapidly becoming a major global economic crisis. While this has a long way to go, it is looking increasingly likely that this will be the most serious global economic crisis since the Great Depression.

We have seen the global financial system move to a different footing (and ownership structure). The last decade of consumption-driven growth, financed by mispriced and loose credit in the first instance, and credit that 'doubled-down' based on a global housing bubble in the second, has come to a wrenching end. Bringing the global economy into line with its real, (i.e., less leveraged), spending power is already feeding through into recession in most major market economies. This is not a short-term cyclical downturn. Instead, the impacts of deleveraging and reduced consumer purchasing power will very likely result in depressed growth rates in consumption and investment for several years to come.

There are two key channels through which New Zealand is exposed. The first is the state of the global economy. The U.S. is in trouble, Europe is in recession, Asia is slowing, and Australia (our largest trading partner) is seriously exposed. The process of de-leveraging, and the deflating of asset price bubbles (in particular housing) is likely to have a serious negative effect on global growth for years to come. This is bad news for New Zealand, as an exporter with high dependence on the soft-commodities sector, and worse news for importers facing a weak New Zealand dollar. Indeed, just last week the IMF sharply revised their global growth projections downwards.

The second channel is the credit channel. In our view this is the most consequential. We have seen credit markets drying up in global markets, with access reduced and prices spiking (even in the inter-bank market). Whole countries are in trouble. New Zealand is one of the most exposed countries to changes in the credit market. New Zealand has consistently run substantial current account deficits, and are heavily reliant on importing foreign capital. Our real economy, driven hitherto by cheap credit, a housing bubble, and an unhealthy dependence on the "white gold" of dairy exports, is thus highly risked.

When combined in a timing sense with real negative economic shocks to consumption, investment and exchange rates, the combined effects, if not addressed, are likely to be pernicious.

We must ensure that productive investment continues to be made, and that this extends beyond government infrastructure and capital spending programmes. The primary focus of our recommendations therefore is on encouraging ongoing private sector investment for growth, employment and ultimately economic survival.

PART IV: PROPOSED SOLUTIONS

This section makes a series of recommendations as to what measures can be taken both to address New Zealand's exposure to the global economic and financial crisis, and to strengthen the long-term position of the New Zealand economy.

A. Urgent actions, quick wins, and bridging measures

These policies can be implemented as soon as Parliament resumes sitting; probably in early December. They will have a positive, smoothing effect on the New Zealand economy over the next 12 to 36 months.

(i) Fiscal stimulus

Fiscal stimulus is being discussed right now in many economies as a key part of the response to slowing economic activity. The major political parties in New Zealand have made commitments in this regard in terms of increased government spending and tax cuts. This is clearly one part of the solution, in the short-term. But care should be taken. The government's fiscal position is already forecast to worsen with a slowing economy. For one thing, the fiscal surpluses have been the one bright spot in the New Zealand savings record – if this was to change, New Zealand's credit rating may suffer and foreign investors may be less inclined to advance credit to New Zealand. We should preserve flexibility to act in the future if required, which suggests some degree of caution and moderation with respect to the fiscal stimulus.

(ii) Interest rates

The RBNZ clearly has an important role to play. There is scope for very significant cuts in interest rates given New Zealand's high rates and significantly reduced medium term inflation risk. We believe that an end point for the current easing cycle at 2.5-3.0% above the U.S. Federal Reserve rates is appropriate.

(iii) Provisional tax

Provisional tax is required to be paid in advance on estimated profits, with high penalties for incorrectly estimated future profits, and an automatic uplift paid to the IRD on the basis of assumed profit growth. Looking ahead, Treasury forecasts show a reduction in the expected corporate tax take for 2009 of \$900m. Many in the private sector believe this to be very light. Regardless, profits will be significantly reduced for businesses over the next 24 months. Where credit is scarce and business is declining,

and firms are likely to face real cash-flow issues which threaten their viability, the provisional tax regime in its current form is a real risk to firm's viability, and hence jobs.

A large amount of feedback was received on this topic. As a consequence, the original recommendation has been revised to four individual recommendations:

- a. Reduce the use of money interest rates, which have become punitive. Currently it is much "cheaper" for firms to always overpay the IRD, than risk the penalties of underpayment;
- b. Increase the margin of error within which neither penalties are paid nor rebates received;
- c. Eliminate the uplift provision for the next three years, with a review at that time. The uplift provision, if reinstated, should in the future never be higher than GDP growth forecasts across the whole economy; and
- d. The threshold at which provisional tax becomes payable is too low (\$2,500) and has not been changed since 1989. This is a huge compliance cost for small enterprises. The threshold entry level should be changed to a more realistic \$30,000.

(iv) Accelerated tax depreciation on capital investment

New Zealand faces deep productivity issues, partly because of low levels of investment. Any further reduction in capital investment - almost certain in the next 24 months in New Zealand - is a real risk to our medium term competitiveness. There was a consensus in feedback that incenting such investment would improve the speed and strength of the economic recovery. However, the fiscal cost of 100% depreciation, and the need to ensure that the capital investment is productivity-enhancing, were also identified in feedback as needing to be addressed. The key adjusted recommendations in this area are as follows:

- a. Accelerated depreciation for a five-year period of an additional 33% claimable each year on IT, technology and machinery investment; and
- b. Accelerated depreciation for a five-year period at an additional 10% claimable each year on plant, buildings, and related capital expenditure.

(v) Extension of business tax deductions

Deductions need to be allowed for accruals of holiday pay. This is a real cost that goes through the P&L, under legislation, and deductions need to be allowed for this real cost.

(vi) Black-hole expenditure

Currently, unlike, say, Australia, expenditure incurred by firms on capital raising is not tax deductible. That is, our tax code does not view raising capital as a core part of business operations, unlike say, recruitment costs for labour, which is seen as part of core business. As firms need both capital and labour to work properly, we find this distinction confusing. Regardless, in the current environment, with real risks to firm viability, and the need to raise capital being increasingly core, this expenditure simply must become tax deductible.

(vii) Tax – review of imputation regime

The current New Zealand imputation system is a major risk to our productive base, as it provides a clear incentive for overseas majority owners to acquire 100% of a New Zealand company, increase debt to the maximum thin-cap levels and thereby minimize the incidence of tax paid in New Zealand. Further, the current imputation regime provides a disincentive to foreign expansion by New Zealand companies on the basis that foreign investments will not generate imputation credits. Therefore they require a much higher return to be justified for New Zealand shareholders. The current review of New Zealand's imputation system presents a real opportunity for the next government to strengthen our economy by providing incentives for New Zealand companies to remain based here while growing internationally, with ready access to capital. Both NZX and Fletcher Building have submitted proposals to the IRD designed to address the issues highlighted above.

The NZX proposal addresses the issue whereby non-resident majority owners currently have a tax incentive to purchase 100% of New Zealand businesses, highly gear the company to the thin capitalisation limits allowed, and thereby erode the New Zealand tax base and capital market. NZX proposes to provide overseas majority owners of New Zealand companies an incentive to keep or gain New Zealand shareholders in the form of a tax credit to the extent that the company has New Zealand owners. Operationally, this could be implemented via a refundable tax credit equivalent to 50% of the total imputation credits that are distributed to New Zealand owners of a company.

The Fletcher Building proposal would allow streaming of foreign sourced income to foreign investors and streaming of New Zealand-sourced income to New Zealand investors. We believe that the fiscal cost of the proposal will be outweighed by the benefit to the New Zealand economy from outwardly mobile companies remaining in New Zealand, and from the direct job and other benefits to New Zealand of continuing to have at-scale companies like FBU go global from New Zealand, rather than elsewhere. However, this proposal should only apply in limited circumstances where the company is a New Zealand resident; the company has its headquarters in New Zealand; and, if listed, the company has its home exchange in New Zealand.

These requirements restrict the benefits only to those companies that provide the New Zealand economy the additional benefits of having their headquarters in New Zealand.

We should note, however, that we believe imputation itself is highly distortive, and that serious consideration should be given to eliminating it altogether. This is outlined in section C (iv) of this Section.

(viii) Deposit insurance

New Zealand has now announced implementation of a deposit insurance scheme. As with most things in the New Zealand financial system, the fact that the banks that comprise our banking system are almost entirely overseas owned creates some interesting issues. The asymmetry between the risk the New Zealand taxpayer takes from having and insuring an entirely overseas owned banking system, and the returns from that risk (limited to the orderly functioning of a banking system and corporate tax paid only) creates some fundamental issues in tail-event situations like we are currently experiencing.

The New Zealand government, has been placed in a difficult situation by the Australian scheme which, in the context of the trans-Tasman capital market, has meant the New Zealand Government has had to act. In this context, the scheme is well crafted, should push more lending to floating rather than fixed rates, and improve the efficacy of the OCR as a tool. However, it is also likely these new changes will result in either capital being re-allocated by the banks to higher return jurisdictions and/or, these charges will pass through to New Zealand households and firms so that bank profitability is not impacted negatively by the scheme. There is a potentially large misalignment between the right answer for the New Zealand economy, and the equity holder of the Australian banks.

Lets therefore look at the potential risk the taxpayer is now insuring. It is highly concentrated, highly correlated, non-diversified and potentially bigger than our ability to pay. If we were an insurance company, we would lay that risk off onto the re-insurance market. The New Zealand Government, however, has no ability to lay off this risk. Risk that is this concentrated has a name in finance - it is called equity-level risk. This is why the U.S. and other countries that have taken such risks are also taking equity positions in the banks. It is the only fair recompense for the risk taken. Australia has not taken direct government ownership in the banks, but over 70% of their bank's equity is estimated to be Australian taxpayer owned.

The basis for charging under the scheme is a fee basis, based on underlying commercial criteria and assessed risk. While the pricing, as against the Australian scheme, is appropriate, there remains a flaw in the initial underlying logic. The New Zealand Government is not a commercial insurer, is not in this for a return, does not want to be in this business, and is not taking risk (tail event) for which a premium can fairly compensate it.

As the risk side of the equation for New Zealand is growing, so should the return and, like the U.S., UK, Germany etc., New Zealand should extract a fair pound of flesh for the benefit of access to

sovereign risk if a tail event should occur. From a New Zealand taxpayer perspective, we should have “skin in the game” for taking on this risk. Two possible options are outlined below. Each could be added into the scheme as conditions that would apply, should the insurance actually be called.

First, require each bank that opts into the wholesale insurance scheme to float a minimum of say, 15-20% of New Zealand businesses. Of this new capital of 10% could be offered first to the NZSF, which may elect to take a long-term ownership position in these cornerstones of the New Zealand economy (legislative change to NZSF legislation required here); and offer the rest first to New Zealand residents.

This float would have three benefits. First, it would shore up the equity capital base of the New Zealand banks - reducing their risk profile in terms of the risk that the New Zealand taxpayer is taking on these banks and reducing the moral hazard risk that reduced profitability in New Zealand due to insurance scheme costs will lead to capital being allocated away from New Zealand to high reform destinations. Second, it puts a market value on the equity of each of the New Zealand banks. Third, through new equity capital raised, it lowers the risk of default.

The second option, either combined with the above or independent of it, would be for the New Zealand government would take an option on, say, 15-25% of the equity of each New Zealand bank that opts into the scheme, which, in the event of the government having to pay out on the insurance, it would have as a call option. New equity would be issued to the New Zealand government at a price at a deep discount (say 25%) to the trading price at such point in time as any deposit insurance scheme was invoked. This would give the New Zealand taxpayer some upside for stabilizing the operation.

If any bank chooses not to opt into this wholesale deposit scheme, then these provisions need not apply.

B. Drive increased local investment and performance

The government should more actively use its balance sheet and other capabilities to strengthen the economy. The government's balance sheet has total assets of over \$200 billion and a net worth position of over \$100 billion. It is in its current strong shape, presumably, so that it can be used when needed. That time is now. We believe that there is scope to use both the liability and asset sides of the balance sheet drive increased local investment that will both manage risks and strengthen the economy so that we emerge from the current crisis in even stronger shape.

Five proposals are made. The first two are conventional recommendations, relating to the ability of the government to borrow to finance infrastructure projects and other productive investments. The last three recommendations relate to a more active use of the asset side of the balance sheet. The

Government has significant financial and commercial assets, organisational vehicles and capacity that can be deployed more effectively to strengthen the productive base of the New Zealand economy. Indeed, given the potential constraints on the use of the debt side of the government balance sheet, there is more need to actively use the assets on the government balance sheet.

(i) Borrowing for productive investment

The government can use its borrowing capacity to debt-finance important infrastructure projects, which will bolster the productive base of the New Zealand economy. However, caution ought to be exercised as to the extent of debt-financing of infrastructure, in order not to stretch the government balance sheet too much. SOEs who raise debt should be required to offer those bonds to the New Zealand public, in order to provide some low risk, high quality, yield investment product - of which there is a real paucity.

(ii) Develop long-term yield curve

Supportive feedback was received from professionals regarding the benefit from issuance of both a long-term risk-free benchmark (e.g., 30-year New Zealand Government Treasury Bond - for which there would be sufficient demand and liquidity to establish a proper long-dated price and hence a full yield curve) and long-term infrastructure bonds. The benefits would be to capital markets, retail investors, and corporates who undertake long-term projects and lack the ability to accurately price duration risk because of the lack of availability of appropriate long-dated benchmarks.

(iii) Improve SOE performance and governance immediately

As a short-term measure to improve SOE performance, we propose that the SOE monitoring function be transferred from CCMAU to private research analysts. We believe that this would result in significant cost savings and, more importantly, substantial quality improvements in the analysis of SOE performance. If each energy SOE, for example, had 2-3 different research analysts issuing two reports per year (on half-year and full-year earnings) as well as event-driven reports (e.g drought, ETS impact, etc), the quality of information to management, the Board, the public would much improve. This would almost certainly drive improved performance.

We also propose that the Chair of each SOE has responsibility for Board appointments, as is standard in the private sector. And instead of CCMAU recruiting and screening of candidates, each Chair should be free to choose their own method of recruiting, and be free to use any of the well known search firms that perform this function, as well as make choices themselves. As these are commercial Boards, the final appointments should not be political, but should be recommended by the Chair, with the shareholding Minister given a limited period of time to review the recommendation, which they can overturn only if they deem it “not to be in the public interest”.

(iv) Create KiwiCo

The government balance sheet includes over \$25 billion of SOEs, about half of which are fully commercial operations (as opposed to natural monopolies like Transpower). This group is over 15% of our economy, yet these businesses do not generate adequate returns for the taxpayer (last year, they returned just 6.6%, about 2% lower than the OCR).

While removing CCMAU, as outlined above, can be done quickly with immediate benefits, there is much more upside for New Zealand to be obtained from the establishment of a single ownership vehicle for a series of SOEs (KiwiCo) in terms of providing an environment in which at least some of these companies can invest and grow in a material way. The commercial SOEs (including Meridian or Mighty River Power, Solid Energy, New Zealand Post, Kiwibank and TVNZ), which are valued at around \$12-13 billion, would be put into KiwiCo. KiwiCo would have a world class commercial Board and management team that would have a mandate to grow these companies aggressively where appropriate. SOEs are a significant part of the economy and it is important that they are operating at peak performance. The CCMAU initiative, if undertaken immediately, would also be preparatory for the higher performance environment of KiwiCo.

Concerns have been raised about competition issues associated with KiwiCo holding three electricity generation companies. The easiest solution is for KiwiCo to take one of these companies and leave the others in the current ownership structure. A more interesting solution proposed is that as renewables generation is a real New Zealand skill that we could (with the right capital structure), successfully take globally, to take the renewable generation parts of the SOEs out, and create one large renewables generator within KiwiCo. We would then be left with retailers that had to fight for customers, instead of the situation we have now with vertically integrated generator-retailers.

KiwiCo would be organised in a similar manner to a company like Infratil, from New Zealand, or Temasek, from Singapore. It would have its own CEO and Board. It would own a portfolio of companies, such as are outlined above. KiwiCo would help to develop strategy, appoint Boards, and to manage the overall portfolio. The economic benefit would derive from the quality of the central company's management and governance relative to the status quo – it would have much more of a private sector feel, despite remaining in public ownership. It would also be freed from constraints that arise from the shareholding Minister arrangement in terms of the ability of the companies to grow and expand that this would solve, as well as eliminating politics from the operating level.

The expectation is that KiwiCo would lead to improved performance, investment, and growth of its SOE portfolios. There is also an expectation that KiwiCo would be able to raise new capital by increasing the leverage of some of these SOEs (some of which are widely regarded as being under-gearred) and

through receiving dividends. Depending on the political appetite, KiwiCo may be able to undertake partial sales of some companies, and have the shares listed domestically (up to, say, 40%).

This would potentially raise \$4-5 billion in fresh capital that either KiwiCo, or any of the portfolio companies can use for investment. It could, for example, have a mandate to invest in New Zealand infrastructure assets (such as the proposed broadband funds) and other strategic investment opportunities, as well as investing in Kiwi global champions. KiwiCo would remain 100% government owned. It is worth noting that, alternatively, some have suggested a partial capital raising sale of KiwiCo itself, and leave the portfolio companies as 100% owned by the parent.

This solution retains certain, long-term government ownership, but frees the SOEs to grow and raise new capital for desperately needed investment. There are not many New Zealand owned companies of the scale of the SOE portfolio. We must get this sizable part of the economy growing and investing, particularly given the likely constraints on investment in the New Zealand economy. Establishing KiwiCo, and building the team, will add depth to the New Zealand business and market community.

We believe that placing SOEs in this model would enable more rapid expansion, thus allowing investment to flow into other asset classes in New Zealand. Temasek in Singapore and Khazanah in Malaysia are useful illustrations of this model. This will take some time to organise - the middle of 2009 seems an appropriate target date.

(v) Re-directing taxpayer funded savings institutions

The government owns various financial institutions that control in excess of \$25 billion of financial assets (New Zealand Super Fund, EQC, ACC, VIF). We do not believe that these assets are being invested in a way that maximizes both returns and the national interest. Given that New Zealand firms will find it more difficult to access credit for investment, at this juncture, these financial institutions should be directed to place a specified proportion in New Zealand investments.

This is a bold move that would make a real long-term difference to our economic growth and standard of living. National has announced its intention to mandate 40% of the NZSF to be invested into New Zealand, across a series of potential investment classes. Labour has also indicated that it would like to see more of the NZSF money invested in New Zealand, but has not committed to a number. Since our draft paper was released, we have received significant supportive feedback and refinements. These are outlined below.

There are four tests any policy in this area must pass: the 'political interference' test; the investment strategy test; the investment timing test; and the "best outcome for New Zealand" test.

a. Political interference

Under its current legislative mandate the Guardians of NZSF are required to manage the fund in a manner consistent with “best practice portfolio management”. To be clear, this is a directive, and is not neutral. It ensures, for example, that the NZSF also does not own cornerstone stakes in any strategic, quality listed franchises. With a long-term horizon, is this rational? The NZSF is also required to not become “market influential”. Why not? Many investors believe that having influence enables better governance and thus better results. This criterion directly results in a process, that at least initially uses asset consultants such as Frank Russell to create a strategy generated from the classic derivations of Markowitz theory under which the manager must, by definition, end up with a classical portfolio. We are very sure that Warren Buffett’s style would not be best practice or meet this criteria. Nor would the Government Pension Fund of Norway for example, currently at around \$30 billion, which is directed to invest 85% into Norway - an economy of not dissimilar size to New Zealand - with the remaining invested in other Scandinavian countries (i.e., key trading partners). Norway also has a larger fund (\$50 billion), with the specific goal of investing outside Norway. Across all funds, therefore, they have around 30-35% invested in Norway of all funds (and their total funds are a lot larger than New Zealand’s). Other countries (e.g. Canada and Chile) have also mandated certain high percentages to be invested locally. The theory here is that there should be a real “edge” to such investments if a fund at scale focuses on gaining local advantage. This approach is not “best practice portfolio management”.

Importantly, other Sovereign Wealth funds have moved on a significantly from the pure portfolio theory demanded by New Zealand legislation. They have started to make cornerstone type investments in listed businesses. They see their time horizon as giving them an advantage in this sense. We saw the Canadian Pension Fund take this view of Auckland Airports. An at scale fund as proposed here could directly, rather than through a manager, make the same kinds of investments in New Zealand companies. Also, NZSF’s current baseline is to keep the level of ownership in (New Zealand) listed companies at low levels. Why? How does this maximize returns? One of the problems with the New Zealand debate on this issue is that it is taken as a given that any deviation from the current situation is sub-optimal. A key point to understand this is that there are at least two ways of structuring these funds so as to deliver the required risk-adjusted return.

The tiny budget for the NZSF is built directly off the back of this criteria (i.e it assumes a business model of using managers, rather than managing directly). There is already thus “political interference” in the NZSF’s mandate - it is just that the directive is “orthodox” and thus seems neutral, but it is not.

b. The “Best Outcome for New Zealand” test

The “Best Outcome for New Zealand” test assesses the total overall benefit to the taxpayer. To deny that large pools of domestic savings can have real benefit for an economy is as irrational as saying that dinosaurs and humans walked the earth at the same time. There are a number of compelling reasons why it makes economic and practical sense to invest a significant proportion of government-administered funds into New Zealand.

Global capital is not a perfect substitute for local capital. Each country globally overweights domestically - to much greater extent than New Zealand. There is a significant body of evidence to show that foreign savings and domestic savings are not perfect substitutes. Substantial home bias in large countries such as the U.S., Canada, Australia, etc., means that, by definition, if New Zealand “efficiently allocates” under a global diversification approach, many New Zealand investment opportunities will not be funded. If the whole world asset allocated according to a textbook, it would be a different matter, but they don't.

Thus, given certain knowledge that large amounts of global capital is ‘inefficiently’ allocated in its home market, for New Zealand to efficiently allocate capital globally, is to willfully starve the local economy of investment. Having the largest pool of New Zealand savings invested in overseas, when New Zealand is in serious savings deficit and great companies are at risk as funding dries up to globally allocate under a theory of capital flows that breaks down in practice, is bizarre.

The advantages (and lack of disadvantages, equally importantly) of having a domestic pool of capital will likely become even more pronounced over the next several years due the global credit crunch, with massive de-leveraging meaning greater difficulty for New Zealand firms to access capital, particularly with regard to trade sales and private equity whose deals have been largely bank-debt funded, but also in regard to highly leveraged New Zealand sectors, such as parts of agriculture that will need fresh sources of capital as credit is rationed by banks. Given global home bias, to the extent New Zealand does not mirror that, which we currently don't, there must be, by definition a plethora of investment opportunities in New Zealand that are not funded.

This Fund would also be sufficiently large to successfully demand, for example, that any manager that wants its business must staff an office in New Zealand. Today for example, the NZSF's lucrative Transition Management business is given to two firms who do not have offices or staff in New Zealand, while those that do and also have this global capability (many) are left on the sidelines. The second order effects of using this ‘stick’ would be significant in terms of capital markets. A fund of this size could also pay global salaries - critical for our talent pool.

c. The investment strategy test

The key to a successful business strategy is to identify your unique advantages, and make them the cornerstone of your investment strategy. Thus far, the taxpayer funds of New Zealand have jumped straight into receiving advice from asset allocation consultants who, logically, devise an investment programme based on asset allocation. Because the unique advantages and opportunities of the NZSF and other funds are not explicitly addressed, it means that the strategy is unlikely to best monetize their unique advantages, instead of coming up with an investment strategy that could be that of any large fund. There is a clear returns-based reason that many countries direct meaningful amounts of their own taxpayer savings into their own market. The reason revolves around building a local champion with the ability to be first port of call for all meaningful investment ideas, and a depth of local expertise built up over time that is the strongest of any player.

These attributes should result in a deal flow (from private, local government and public sectors) that achieve outperformance over time. As Warren Buffett showed recently in GE and Goldman Sachs, there are a number of ways to structure investments when you have a “big stick” - which in New Zealand, with our paucity of savings, the NZSF would have. Taking preferred stock, with an interest rate return and the ability to convert to equity, is a great playbook for this completely different environment. Are the NZSF doing this? Outside New Zealand, we have no strategic advantages, simply be an asset allocator.

The next issues is investibility. There is at least \$40 billion in debt funding in the New Zealand agricultural sector, for example. If the long-term trends of global population growth and demand for safe food and reliable proteins continues (which it must), then this is a great sector to be invested in. Yet, to date, despite the funding requirements and the growing capital intensity and global ambitions of New Zealand agricultural businesses, New Zealand taxpayer savings are (almost?) entirely absent from this sector. We would believe, for example, that the next few years will see a severe cutback of credit to this sector, putting its growth profile at risk. This Fund would make a strong, long-term New Zealand shareholder that would be available to this sector to provide growth capital and funding. Once it is known that 40% or so is going into New Zealand, then the local market will react and bring ideas aplenty to the NZSF.

d The investment timing test

There is no benefit in buying a great asset if you pay too much. For the New Zealand taxpayer, this means both asset values and exchange rates must be taken into account. To change investment style, the timing must make sense. The reasons changing approach is the right thing to do now from a timing perspective are that: New Zealand assets are currently cheap; the relative weakness of the Kiwi dollar makes the timing right to overweight local investments; credit crunch means the supply of capital

for local companies is drying up and unique opportunities for a cash-strong player locally will be plentiful; and both political parties have announced increased infrastructure investment.

C. Improve the growth environment for New Zealand business

This is the time to take policy action to create a much more supportive growth environment for New Zealand firms.

(i) Compulsory savings

New Zealanders' household savings record has been very poor, which is why New Zealand is so reliant on importing foreign capital to finance domestic savings and investment. As described above, well-run firms that have relied on imported foreign capital to fund operations, fund working capital, and fund growth will be hit very hard. This places the New Zealand economy at real risk. In this context, any policy that cuts the domestic savings pool, and therefore increases our reliance on foreign imported capital, is hard to understand as a long-run strategy. The lack of a domestic saving pool is both a major source of exposure to the current crisis and a drag on New Zealand's productivity levels and growth. The KiwiSaver scheme is a step in the right direction, but our view is that a commitment to converting it into a compulsory scheme over time is appropriate.

If there was ever a time that reinforced the importance of raising New Zealand's domestic savings, it is now. Lack of savings, and the substantial current account deficit, have led to high cost of capital, exposure to international credit conditions, a small capital market, lower rates of investment, and a volatile currency. New Zealand needs to shift decisively to a savings and investment-led economy, and reduce our exposure to global risk.

The transition to a compulsory KiwiSaver scheme should be planned for the next several years. We suggest compulsion at 2% of cash-based income to begin, with possible increases over time – perhaps in combination with a programme of personal tax cuts.

The related challenge is to ensure that there are investment opportunities available in listed companies, corporate paper, infrastructure projects and the like. The establishment of KiwiCo and the NZSF recommendations should make a significant contribution in this regard.

(ii) Eliminate housing speculation bias

The investment biases that exist toward property need to be removed from our tax system, in order that more investment flows into the productive base of the New Zealand economy. In particular, the structure whereby home improvements and other costs associated with speculation on the housing market are used to shield property speculators from tax has to be eliminated. These speculators have

some responsibility for the bubble we were in, and for the pain and risk the New Zealand economy now faces. We cannot afford this lack of balance to occur, or be incited to occur, again. Similarly, a capital gains tax on property beyond primary domicile (and potentially second home) should be implemented. However, it is not appropriate to impose these measures immediately. Instead, these policies should be enacted in 2009 for implementation in 2012, to give investors the opportunity to realise their positions in an orderly manner. Genuine housing affordability, not a property free-for-all, is the goal. These policies will achieve that.

Imposing a capital gains tax on non-owner-occupied housing, and removing the ability to deduct mortgage interest payments on owner-occupied housing (or substantively owner-occupied housing), are two measures that will correct the skew.

This is politically difficult; political parties have distanced themselves from this recommendation already – and recall the response to a similar recommendation in the 2001 Tax Review. However, the current circumstances may provide a window of opportunity to make a change. Indeed, this proposal has received a surprising amount of positive feedback from people commenting on the NZX Blog.

(iii) R&D tax credit

We received lots of feedback on the R&D credit, and it generally seen as a good thing, but the current version is deeply flawed in design. This reflects an undue focus by IRD and legislators on anti-avoidance, which has resulted in huge compliance cost, with the benefit to the firms actually undertaking the R&D credit eroded significantly by that compliance (time and money) cost. It was generally supported, however, that R&D credits are a positive thing for the New Zealand economy at this juncture. Our recommendations to move this to a more productive footing are as follows:

- a. Recognise explicitly that there are differences between a research/science process, and a development/business process;
- b. Create an approved list of companies eligible for the deduction. There would be some basic, easily devised criteria for this but that would be easy to create;
- c. Have each company simply file for the credit, to the amount that they believe is accurate at year end. However, instead of complex and costly anti-avoidance, have the CFO (or equivalent) person, sign their name to the deduction claim, including that they have appropriate records internally to show the basis upon which this number has been accurately determined. To ensure that this is taken seriously, a strict liability offense would apply (saving court and other costs and time) to the person responsible (e.g., pay IRD 1x the amount claimed if it is shown to be inaccurate), and the firm (e.g., 2x the amount). These would be uncovered on an audit, as with any other tax matter; and

- d. Until this new credit is phased in, companies that have paid the amount necessary to get a 2008 and 2009 tax credit for those plans already in train and committed to should be able to claim for those projects.

Firms in growth sectors have made moves and committed capital and people based on the R&D tax credit. This credit is one area we have an advantage over Australia. Therefore it should not be repealed, but replaced with a better version.

(iv) Significant reduction in corporate tax and elimination of imputation

Our view is that a significant reduction in corporate tax coupled with the abolition of the imputation credit system would result in the optimal environment for growth and success. A much lower corporate tax rate will keep companies here, attract new ones, improve our wealth and result in high paying jobs. This should be the priority over reductions in the personal tax rate.

The only other countries with imputation tax systems are Australia and Sri Lanka - take from that what you will. In our view there are better ways of structuring the tax system (and many that are certainly more understandable to international investors). We need to recognise that we can continue to chose the purist approach, but that the evidence - and greater international capital mobility - makes it time for a change.

Imputation creates four large, negative distortions. First, a preference for domestic rather than offshore earnings (while some of the Controlled Foreign Corporate reforms are a good start, imputation is a the bigger issue). Second, the risk of trans-Tasman relocation when Australian shareholding becomes a significant proportion is high. Third, it creates a disincentive for partial overseas ownership of New Zealand firms - instead creating a tax driven imperative to them to own 100% - and further hollow out New Zealand's ownership structure. Fourth, any Board of Directors must ensure that their imputation account is effectively managed from a returns-to-shareholder perspective. Firms with an inability to pay fully imputed dividends are generally less favored by shareholders, which goes to valuation. For growth companies (think Nasdaq type companies), paying dividends is not a sensible strategy, as cash is better reinvested in growth to create capital value, yet our tax structure is less favorable to growth companies than those that pay yield. If any of our national goals involve growth, eliminating the perverse long-term behavioral incentives at firm level from the tax purity driven idea of imputation bias is critical.

As outlined earlier in this document, the interaction of our imputation regime with Australia's franking credit regime creates some serious problems for New Zealand corporates with Australian operations and growth ambitions. The proposed solutions to these issues, for the most part are focused on Australia. However, if we look at the ownership structure of the New Zealand market, while a large part

of it is Australian, equally as much is not - and focusing exclusively on Australia creates some real risk to other investment

The simple fix that deals with all the above tax-driven negative outcomes for firms (and hence our long-term tax base - which has been shown to be scarily fragile in recent times) is to tax the corporate tax rate to below the “break-even” level as against imputation.

It is thus our view, that New Zealand needs to stop fiddling with its tax system, stop focusing almost exclusively on the fear of anti-avoidance, and recognise that our imputation system as it currently stands is a real danger to not only to the growth prospects of New Zealand firms, but to the viability of them staying here.

In the long-run, one choice at a corporate level is to become simply a waged economy, where we have little ownership here. In which case - lets keep fiddling, lets keep obsessively and exclusively focused on Australia, and lets keep doing what we are doing. The other option is to focus on keeping companies here, attract new ones, and have an Ownership Society with high salaries. To achieve this we will have to move beyond fiddling at the margin on corporate tax. The key proposal here is thus to move corporate tax to around the 15-17.5% level, and eliminate imputation credits entirely.

If this policy is enacted we would see capital shift into growth companies, we would see corporates make no-brainer choices to stay here or come here, and we would create a new behavioral mindset at Board and management level that would materially benefit our long-term economic viability as a nation.

The signaling effect of reducing corporate tax significantly and removing imputation would be huge. It would put New Zealand on the map, and allow for much more effective competition with Australia.

D. Win in the global economy

New Zealand needs to be compete more effectively in global markets, both in terms of attracting and retaining people and firms, but also in terms of supporting New Zealand firms to expand into international markets.

- (i) Compete aggressively for talent and bring talented Kiwis home

Expat New Zealanders around the world are facing an increasingly uncertain future and are more likely to consider returning home than previously. We saw this effect in 2002/3 as New Zealanders in the post 9/11 environment returned home in greater than expected numbers. Currently many New Zealanders with this impulse are likely to end up going to Australia instead. It's like home – but pays more. We proposed in the first draft of this document that New Zealanders returning in the next 12 months who have been away from New Zealand for greater than three years receive a tax rebate on

their first 24 months' working that caps their tax rate at 20%. Our view is that this would provide New Zealand with skilled workers. It would provide viable opportunities for New Zealanders looking to return home. It would also bring fresh capital back to the economy, and help with both the consumption and investment elements of GDP.

For New Zealanders who return from April 1, 2009 to March 31, 2010, the government should allow them to put in up to 10% of total remuneration into KiwiSaver voluntarily, and the government would match that for a two-year period. It's fair to say that, of all our proposals, this attracted the least supportive feedback. Few argued with the need to attract talented Kiwis back home, but most balked at the idea of rewarding those who had left for returning, while ignoring those who had chosen to stay. We acknowledge this, whilst maintaining the view that there is currently scant incentive to attract highly productive Kiwis back home save reuniting distant grandchildren with older family members. For a highly mobile population cohort, this is rarely a compelling enough incentive to settle back home.

(ii) Seize the opportunity to attract new firms to New Zealand

It was agreed that not only do we have a real opportunity to attract meaningful new investment to New Zealand, but we have a need. As we described, industries and firms that don't exist in New Zealand currently don't pay any tax here. Tax incentives to locate here will not cost the taxpayer anything, but if successful, would see the development of meaningful businesses in targeted sectors in New Zealand.

It would bring fresh capital, fresh talent and fresh consumption to New Zealand. Income tax at the individual level would grow, sales tax would grow, and there would be no leakage from the corporate tax base because these firms were not here to begin with.

The proposal for attracting new firms to New Zealand was met with almost universal approval. It is seen as a "no-loss + big-win". The new firms will pay salaries, invest in infrastructure, will likely be export account focused, and will, through spending and investment, grow the tax base. The following summarises the best thinking that came through:

- a. The scheme needs to be effectively marketed in appropriate periodicals (e.g. Economist) and online business publications such as the WSJ, FT, Financial Review, Australian, and Sydney Morning Herald - as this will be a CEO-level decision, and CEOs read the business pages. New Zealand embassies and other trade offices need appropriate materials and should have active recruitment of firms to relocate to New Zealand as one of their KPIs; and
- b. Discussion focused on how to ensure firms do not leave or "location shop" at the end of the time. A bond was dismissed, as potentially costing too much in terms of capital.

The following is the recommendation in this area:

- a. Firms that act on relocation decisions between 1 January 2009 and 31 December 2010 should be eligible for the scheme;
- b. Firms are given two full fiscal years with no corporate tax;
- c. On the third year, the original relocation costs are allowed as a tax deduction;
- d. These amounts in aggregate are repayable, plus cost of capital, to the IRD if the firm leaves New Zealand at any time before their fifth anniversary of locating here, or if they materially downsize and keep only a shadow office. Note that genuine business failure will not be included, but a movement to other offices overseas, etc will be; and
- e. At or before December 31 2009 the effectiveness of the scheme should be addressed.

(iii) Developing a physical presence overseas

Many New Zealand firms are small when they expand into international markets. Assistance with infrastructure and networks can be valuable in terms of supporting their growth. We propose that NZTE shift more of their resources into developing their offshore presence to better assist New Zealand firms to grow globally. Given the likely constraints on the economic growth of New Zealand over the next several years, assisting New Zealand firms to access larger global markets is likely to be particularly important. This process should be undertaken in parallel with FTA negotiations to ensure that New Zealand captures maximum upside from the FTAs that it signs such as that with China.

E. PUBLIC PRIVATE SECTOR COHESION

Cohesion is the key word in executing the strategy. As a number of people, some publicly, some privately, have commented to us, for a small country, the New Zealand public and private sectors do an outstanding job of working against each other, instead of with each other. This is not a new observation. However, the impact is growing, and the risk profile from both poor decisions and mistrust has also grown, as the consequences of getting it wrong at this point for this fragile economy are material. The below outlines the basic issue, what the complications are, and suggests a few clear ways for the new government to effectively address them.

This document has focused on what needs to be done to respond to the crisis, and ensure that the New Zealand economy is strengthened for the long-term. But it has also exposed some deficiencies in the policy advisory community. We need to develop ways of contributing jointly to addressing problems; business, capital markets, officials, politicians, academics and the like.

The New Zealand public sector is populated by smart, well-motivated people. But for the most part they have fairly conventional public policy backgrounds, with few senior advisors having personal experience in the private sector or the capital markets.

We have two specific proposals in this regard:

First, to create two important Economic Advisory Boards, comprised of key leaders from New Zealand overseas to provide counsel on strategy appropriate actions.

- Economic Advisory Board. One probable reason that no private sector players had input into the recent deposit insurance matter, is that there is no formal channel for that to occur. An Economic Advisory Board would provide one. President Clinton instituted his Council of Economic Advisors. These types of Boards/Councils have worked extremely well. They meet on a quarterly or as-needed basis to provide practical advice and feedback. For New Zealand, this would include at least one to two New Zealanders in key business positions in Australia.
- International Advisory Board. Comprised of up to 10 leading global names that have a connection with New Zealand, this group would help the Prime Minister brand New Zealand globally, compete successfully offshore, and identify and access new opportunities.

In addition, it would be useful to establish standing committees of people in the business and markets communities who can be called on to provide expertise and insight, and to supplement the skills of those who are in the various arms of government.

Second, moves should be taken to bring more senior people into the public sector who have private sector experience and strong networks. This will require a deliberate approach to recruiting, and pushing back on the in-built bias towards making hires from within the public sector. The State Services Commission, as with all posts, deems “relevant public sector experience” as critical. We argue that there is a case for having a bias towards “relevant private sector experience”. Government processes can be learned by private sector recruits. Conversely, private sector processes and practice cannot be learned by career public servants who have to rely on models to try and predict human-and-market-behaviours. There must be much more movement of people between the public and private sectors.

Overall, there needs to be a greater degree of cohesion, openness – and co-operation. This will help to prevent unintended consequences of policy, which is more likely to occur when there is not a full understanding of the real-world policy implications.

While we do not believe that a wholesale redesign and restructure of government is required, we do believe that the challenges of a large and complex organisation can be materially reduced, and its effectiveness significantly enhanced, by having a very clear economic strategy document that outlines the key principles, that all decisions (be they tax, investment, savings, etc) are driven by. If we continue to think and operate according to existing structures and legislation, instead of strategic principles we will get... what we have today. Hence the need for cohesion. It will require changes in people, culture and capacity in the public sector, and in the ways in which the public sector engages with the private sector. Much of the latter currently occurs in a government relations consultants, who are able to leverage the mistrust and fear between the sectors and position themselves as go-betweens to interpret between sectors. The sunk costing and drain on productivity, of this lobbying industry can be addressed by direct, pragmatic and cohesive engagement between the sectors.²

² One recommendation received confidentially was that, for the next CE roles in Treasury, MED and other primarily economic agencies, private sector leasers are sought as a matter of priority. The State Services Commission, deems “relevant public sector experience” as critical for these roles. We disagree. A more radical suggestion, but one that is worth considering, is that the CE of the key public service economic bodies is appointed by the government of the day.

PART V: ACTIONS

The global financial and economic crisis is one of the most serious events to confront the New Zealand economy over the past few decades. New Zealand's collective response needs to be strategic and precise. To reiterate, UK Chancellor Alistair Darling has noted that the UK should now be on a war-time footing. New Zealand should adopt a similar perspective.

We urge that the party or parties that form the next government act with speed and urgency. At the moment, there is no coherent economic strategy and so we lack a clear and sustained policy direction. There is a lot of talk but not much action.

There is a need to specify an ambitious aspiration for the New Zealand economy and then propose a concrete pathway that is sufficient to get New Zealand there. The design of a full economic strategy is outside the scope of this note, but is vitally important nonetheless. It is sometimes said that New Zealand needs a good crisis to provide a catalyst for action. The challenge is to extract as much upside from the global financial and economic crisis and to use it as a platform for creating a much stronger New Zealand economy.

In addition, the recent events have acted as a reminder of New Zealand's modest economic outcomes and its exposures. There is a need to act with boldness to strengthen the New Zealand economy. There seems to be a distinctly increased appetite for considering a broader range of options.

Responding aggressively and deliberately to the economic crisis, and then developing a comprehensive economic strategy, ought to be the first order of business for whoever forms the next government. The process of policy development and serious engagement needs to commence this side of Christmas. We agree that a December mini-budget makes sense, and that progress on the immediate actions should be started as soon as the new Parliament sits – probably in early December.

And within the first 100 days, a completed statement of economic strategy should be developed.

The longer that this response is delayed, the more significant the negative implications are likely to become.

We look forward to action ...