Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people.

[2] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials.

[3] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions.

[4] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice.

[5] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, an [8] appearing where information has been withheld in a release document refers to section 9(2)(h).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.
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1 Foreword

This briefing comes at a time of substantial uncertainty in the global economic environment. Since the economic forecasts included in the Treasury’s Pre-election Economic and Fiscal Update (PREFU) were finalised in late September, the euro-area’s sovereign debt crisis has intensified, prompting further efforts by policy-makers to calm markets, as illustrated by the European Union Summit on 9 December.

Financial markets are displaying significant volatility and heightened risk aversion and uncertainty. This reflects ongoing concern over the sustainability of public debt (in Europe and the US), increased worries over the health of the European banking sector and a weakening in the outlook in many, particularly advanced, economies. Forecasts of global growth are being revised down and we are looking carefully at the outlook for New Zealand’s key trading partners. But it is the prospect of volatile and more expensive credit markets and the impact of lower global growth on commodity prices where the greatest risks lie. Developments in these areas are extremely difficult to predict. At this stage we estimate global developments could reduce our forecast of New Zealand real GDP growth in year to March 2013 to around 3 percent, about ½ percent lower than in the PREFU. Our next official forecasts will be released in Budget 2012.

The turbulence in the markets represents a continuation of the 2008 financial crisis and the underlying problems are unlikely to be resolved in the near future. Although New Zealand has so far avoided a severe economic shock, growth has been weak for some time and our large fiscal deficit and high level of external indebtedness continue to expose the economy to risks. The slowdown in growth has also revealed that the current overall cost of government programmes is too high.

Maintaining and improving living standards for all New Zealanders requires policy changes to build economic resilience, to lift trend growth and to capture the enormous economic opportunities created by the ongoing rise of the Asian economies.

The following briefing (finalised 25 November) provides you with a short summary of the Treasury’s advice on the key policy changes that in our view would substantially increase both resilience and trend economic growth. It is an ambitious and challenging programme of reforms aimed at improving the living standards of all New Zealanders. We are ready to discuss each of these policies with you, as well as your priorities in the coming weeks.

Gabriel Makhlouf
Secretary to the Treasury
2 Executive Summary

The global economic environment remains highly unstable

The repercussions of the Global Financial Crisis continue to dominate the outlook for the world economy. Although the Euro area sovereign debt crisis is the greatest source of financial market and economic volatility at present, the challenges facing the global economy are deep-rooted and widespread. Global economic recovery will be protracted and uneven. Uncertainty will remain elevated for some time to come.

Building greater resilience and lifting trend economic growth is critical for improving New Zealanders’ living standards

So far New Zealand has managed to avoid the financial market instability and disruption to economic activity that has afflicted a number of other developed countries, and a gradual recovery in growth is taking place. To date the economy has evolved broadly in line with the forecasts published in the Pre-election Economic and Fiscal Update 2011. However, our underlying economic performance has been poor for some time, pre-dating the onset of financial turmoil in 2008, with labour productivity and trend growth slowing over the past decade. High average real interest rates compared with other countries’ and a persistently high real exchange rate have been two contributing factors. New Zealand’s longstanding large net external liabilities, high levels of private sector debt and currently large fiscal deficit expose the economy to financial risks, especially if the global economy deteriorates further. Building greater economic resilience and lifting trend economic growth is critical for increasing incomes and improving the wider living standards of New Zealanders.

Returning to fiscal surplus and other policies to increase national saving are required to increase resilience

Returning to surplus and rebuilding fiscal buffers by reducing Crown debt is the most direct and immediate contribution that the Government can make to increasing resilience and trend growth. We recommend that the Government adopts a firm commitment to returning to fiscal surplus in 2014/15 in its short-term fiscal intentions, and to reducing net debt (excluding the New Zealand Superannuation Fund) to no higher than 20 per cent of GDP by 2020. Additional policy changes will be required to generate a lift in overall national saving relative to investment sufficient to arrest and then reverse further deterioration in New Zealand’s net external liability position. These changes may involve reforming retirement income and tax settings.

Reforms are needed to manage fiscal pressures and improve outcomes

Returning to fiscal surplus in 2014/15 and reducing net debt to below 20 per cent of GDP by 2020 will require annual allowances for new spending or tax initiatives set much lower than they were during the past decade. Living within these allowances, while protecting priority public services, will require further efficiency gains and innovation in state sector service delivery, together with better targeting of government expenditure. We see considerable scope for using government expenditure more effectively to improve outcomes for the most disadvantaged New Zealanders. Improving the way the core public service works will be critical to assisting the Government to manage within the allowances, while improving overall economic and social outcomes.

Increasing trend economic growth requires a wide and ambitious reform agenda

Lifting national saving will reduce pressure on interest rates and the exchange rate, and support growth in the more productive tradable sector. However, materially raising trend economic growth will also require a wider programme of policy reform. In an increasingly globalised world, improving our international competitiveness is vital. Policy changes are needed to increase incentives to invest and conduct business in New Zealand, raise the productivity performance of firms operating here, minimise the cost pressures they face, and maintain their ability to adjust to changing circumstances. This would entail a wide and ambitious programme of reform across government policies relating to education, welfare, tax, regulation, science and innovation, infrastructure, and the management of natural resources.
Box 1: Summary of key policy recommendations

Building greater economic resilience and lifting trend growth, by enough to materially narrow the income gap between New Zealand and the most advanced economies, will require a wide and ambitious programme of policy reform. Although some progress has been made, current forecasts indicate that partial or incremental reforms are unlikely to be sufficient. The policy recommendations below summarise the Treasury’s advice for increasing trend growth and resilience. Implemented as an integrated programme, our assessment is that these recommendations would lead to a substantial lift in economic performance within the next decade, with corresponding improvements in New Zealanders’ living standards.

1. A resilient and stable macroeconomic environment
   - Restore fiscal buffers and support rebalancing of activity towards the tradable sector by adopting a fiscal strategy that commits to:
     - returning the total Crown operating balance before gains and losses to surplus in 2014/15
     - reducing net debt (excluding the New Zealand Superannuation Fund) to no higher than 20 per cent of GDP by 2020
   - Introduce further measures to increase the resilience of the financial system, such as requiring banks to hold more capital to absorb losses and tools to safely resolve failing institutions
   - Add macroeconomic stability and fiscal structure dimensions to fiscal responsibility provisions in the Public Finance Act to reduce risks of procyclical fiscal policy during future periods of strong economic growth, and to improve the impact of government expenditure and revenue on the economy and other government objectives
   - Address long-term fiscal sustainability issues by building broad public consensus on the required policy adjustments, particularly in the areas of health and retirement income. In addition to addressing long-term fiscal sustainability, reforming retirement income settings could help reduce saving-investment imbalances and increase labour force participation
   - Consider the role that tax reform could play to reduce distortions to saving and investment decisions, and encourage a higher overall rate of national saving

2. A smaller, more effective and responsive state sector
   - Actively manage overall state sector cost pressures, particularly in health, welfare, education and justice, in order to achieve the recommended fiscal strategy while growing priority services:
     - Drive further efficiency gains
     - Encourage greater innovation and contestability in service delivery
     - Prioritise expenditure that has clear public good benefits and a focus on improving living standards
     - Make better use of the Crown’s assets and overall balance sheet
   - Reform the education system to improve educational attainment at lower cost:
     - Target existing early childhood education funding to children in low-income households
     - Implement initiatives to improve school teacher quality, funded by consolidation of the school network and increasing student/teacher ratios
     - Reintroduce interest on student loans and target tertiary funding to younger students and higher-level qualifications
   - Strengthen agreed welfare reforms with wider changes to improve social and labour force outcomes while reducing benefit expenditure:
     - Ensure sufficient capability within Work and Income to deliver a new service delivery model, including more extensive use of contracting-out to external providers where appropriate
- Simplify and align benefit payments with work expectations
- Reduce the age of the youngest child at which work testing for sole parents begins, and tighten eligibility criteria for the Supported Living Payment

Support the objectives outlined in the Better Public Services Advisory Group Report to deliver a state service that:

3. A more internationally-competitive business environment

- Improve international connections:
  - Strengthen external relationships, especially with Australia, the US, China and India
  - Reduce “at-the-border” barriers in New Zealand and overseas
  - Ensure domestic policy settings take better account of the international context

- Increase the efficiency and competitiveness of the tax system:
  - Reduce personal and company tax rates, funded by more base-broadening and/or reductions in low-value expenditure (without compromising fiscal targets)
  - Continue to push for mutual recognition of imputation and franking credits with Australia

- Drive regulatory change at the regime and system level:
  - Reform regulatory regimes relating to investment screening, resource management, local government, new organisms and chemicals, housing supply and the minimum wage
  - Promote principles of best practice and improve regulatory scanning and planning

- Focus science and innovation policy on firm-led research & development and commercialisation:
  - Increase the proportion of Crown expenditure on research & development that is business led
  - Increase the incentives for research and tertiary education institutes to undertake more firm-relevant research and to transfer knowledge to firms

- Continue network infrastructure investment and management, with a particular focus on:
  - Ensuring a realistic and confidence-building plan for Auckland transport, including use of network pricing and other demand management tools
  - Prioritising and accelerating future investment in growth-enhancing projects (where benefits exceed costs), and using a range of funding mechanisms including increases in fuel excise and road user charges

- Manage natural resources more efficiently:
  - Continue reform of the Resource Management Act to ensure appropriate consideration of economic objectives and incentives for better planning at the local level
  - Establish administrative and market structures to facilitate more efficient use of water
  - Reduce the short-term costs imposed by the Emissions Trading Scheme, while positioning the economy for the longer-term risks and potential opportunities associated with climate change

- Ensure that the longer-term recovery strategy for greater Christchurch is realistic, maintains confidence in the future of the city, and contributes to the return of normal operation in the insurance, financial, property and labour markets
3 Introduction

This briefing provides you with a short overview of the key challenges and opportunities facing the Government for raising New Zealand’s trend economic growth and increasing resilience. The briefing is deliberately not exhaustive in its coverage and the issues raised are not dealt with in depth. We are able to provide detailed briefings for you on individual issues as directed.

The Treasury’s vision is to be “a world class Treasury working for higher living standards for New Zealanders”. Our concept of living standards encompasses economic, human, social and environmental dimensions. As your advisor on economic, financial and regulatory policy, one of our core priorities is improving New Zealand’s economic performance, as measured by income per capita. Although income is only one dimension of wellbeing, OECD analysis suggests that it is one of the key elements of living standards where New Zealand has the greatest room for improvement relative to other OECD countries (figure 1). Increasing income is also critically important, given it directly affects a country’s ability to sustain improvements in other aspects of living standards.

Box 2: Inter-departmental approach to increasing economic performance

The Treasury, the Ministry of Economic Development, the Ministry of Foreign Affairs & Trade, the Ministry of Agriculture and Forestry, and the Ministry of Science & Innovation are committed to working more closely together with a view to lifting international competitiveness and economic growth. This commitment flows from a shared concern that past economic performance has not been sufficient to reduce the gap in relative per capita incomes with other developed economies. Since the mid-2000s, New Zealand’s economic growth has weakened and the tradable sector has contracted. Agencies assess that only some of this deterioration in performance can be attributed to external factors.

Agencies are committed to offering policy options directed at making the economy more internationally competitive and lifting economic performance through several channels:

i. improving macroeconomic stability

ii. improving the environment for firms exposed to international competition, and

iii. lifting domestic productivity.

Figure 1: OECD Better Life Index for New Zealand

Index Score (0=minimum, 10=maximum)

OECD Dimension of Wellbeing

- Work-Life Balance
- Safety
- Life Satisfaction
- Health
- Governance
- Environment
- Education
- Community
- Jobs
- Income
- Housing

Source: OECD
4 New Zealand’s Recent Economic Performance and Key Policy Challenges

The repercussions of the Global Financial Crisis continue to dominate international economic developments. Since mid-2011, global financial markets have again displayed heightened risk aversion and uncertainty, amid signs of slower growth and concerns about public debt sustainability in Europe and the US. Forecasts of global growth are being revised down, driven by a weaker outlook in many advanced economies, particularly in Europe.

The Pre-election Economic and Fiscal Update 2011 (PREFU) forecasts were finalised in late September and assumed that overall trading partner growth would evolve broadly in line with the historical average. Growth in Asian trading partners and Australia was expected to offset lower growth in the US and Europe. European economies were assumed to manage their way through the current sovereign debt crisis, albeit with weak growth. The PREFU also included a downside scenario in which there was a more disruptive adjustment in Europe, accompanied by a slower recovery in the US and a major downturn in property markets in emerging Asia. Latest developments suggest trading partner growth in 2012 is likely to undershoot the main forecasts but, at this point, it remains some way from the downside scenario. Much weaker growth is still a risk. In addition, financial market developments mean that the availability and price of credit globally are more adverse than was built into our forecasts.

A New Zealand’s Recent Economic Performance

New Zealand’s economic performance has been weak for some time ...

So far, New Zealand has managed to avoid the financial market instability and deep falls in economic activity that some other countries have experienced in recent years. However, the recovery from recession has been gradual and slower than experienced historically. Per capita real GDP is still below its pre-recession level, despite the economy growing for over two years (figure 2). New Zealand’s overall growth performance has been weak for some time, pre-dating the onset of financial turmoil. The average income of New Zealanders, as measured by real GDP per capita, is currently similar to its level in 2004.

At the household level, the impact of weak economic conditions has been most visible in the incomes of the top 20 per cent of households. Average income for this group declined between 2006/07 and 2009/10, due to falls in earnings from self-employment. For other households, gross income from wages and salaries, investment, and self-employment was broadly static on average over the same period, but their average disposable incomes increased as a result of higher government transfers and tax reductions (figure 3).

Erratum: Figure 3 was mistakenly labelled household disposable income. Disposable income is defined as market income earned adjusted for direct taxes paid and income support received. The actual data shown is household gross income, defined as market income earned plus income support. Trends in household gross income and household disposable income are similar over the period shown.
... reflecting poor productivity growth, and a deterioration in competitiveness

Following an increase in trend growth over the 1990s, the deterioration in New Zealand’s economic performance over the past decade reflects a stalling in productivity growth and a pattern of growth biased towards consumption. Domestic demand, fuelled by rapid increases in private sector debt and government spending, has increasingly dominated overall activity. The more-productive tradable sector declined, as ongoing growth in the non-tradable sector drew in resources (figure 4) and resulting capacity constraints put additional upward pressure on costs and on interest and exchange rates. Although average real interest rates were lower during the 2000s than in the previous decade, they have remained high relative to other developed countries’, and have contributed to the persistently high level of the real exchange rate. At the same time, growth in New Zealand’s labour costs exceeded productivity gains (ie, unit labour costs have increased) by more than for many of our major trading partners since 2000. This has exacerbated the negative impact on our international competitiveness of the high nominal exchange rate (figure 5).

Weak growth has been associated with increasing vulnerabilities ...

This pattern of growth has also been associated with a build-up in macroeconomic imbalances. In the years leading up to 2008, household debt levels rose sharply and the current account deficit widened. More recently, the fiscal position has moved from surplus to large deficit. New Zealand’s long-standing large net external liability position (as reflected by our international investment position) was at a level in 2008 that was comparable with many of the countries that have since suffered severe economic crises, as markets came to doubt their ongoing solvency (figure 6).
... but robust institutional settings have helped to smooth the necessary adjustment to shocks

New Zealand’s strong institutional settings, particularly overall policy credibility, our relatively low starting level of government debt, credible monetary policy arrangements, healthy banking sector, floating exchange rate, and generally flexible microeconomic policy settings have been important differentiating factors that have protected New Zealand from a more serious economic downturn. Furthermore, in contrast with developments in many of the troubled European economies, there has been some reduction in imbalances. Reflecting an increase in private sector saving relative to investment, New Zealand’s current account deficit has narrowed. This, together with reinsurance inflows, has seen a decline in our net external liability position (figure 6). However, partly because of the extra investment needed for the Canterbury rebuild, much of the reduction in the current account deficit is likely to be temporary. The PREFU forecasts an increase in net international liabilities equivalent to nearly 10 per cent of GDP over the next five years.

More adjustment is needed and risks will remain elevated

The risks associated with New Zealand’s net external liability position were highlighted by rating agencies Fitch Ratings and Standard & Poor’s in their recent downgrades of New Zealand’s sovereign creditworthiness. If market perceptions of the risks associated with New Zealand were to deteriorate significantly, the consequences could be severe, as currently evidenced by developments in some European countries.

B The Global Environment

Growth in China and Australia has also helped the economy to weather shocks, and should continue to support growth into the medium term ...

Another key factor contributing to New Zealand’s relative resilience has been the strength of the Chinese economy, which has also underpinned ongoing growth in New Zealand’s other Asia-Pacific trading partners, most notably Australia. Growth in these economies and other emerging markets has been reflected in rising demand for many of New Zealand’s exports (figure 7); high prices for dairy, meat and other commodity prices; and a corresponding improvement in our terms of trade (figure 8).

The current softening in global growth has led to an easing in some commodity prices from their recent highs. However, in the longer term, ongoing economic convergence – as incomes in China, India and other major emerging economies catch up with developed economies’ - is expected to keep prices for New Zealand’s commodity exports at elevated levels, relative to the past few decades, as global supply struggles to keep pace with demand.
The unprecedented pace and scale of economic development in Asia is illustrated by predictions that the size of the region’s middle class will increase by more than five times by 2030, at which point it will be more than three times larger than the combined middle classes of Europe and North America (figure 9). The benefits for New Zealand are potentially amplified by falling trade barriers, the growing proportion of our population that has emigrated from Asia, and our closer geographic proximity.

... but current instability is likely to be an ongoing feature of the global environment over the medium term

The favourable long-term trend outlook for Asia is tempered by risks associated with the prospects for growth in the world’s advanced economies. Governments in many of these countries face major challenges in stabilising their debt levels, which are largely unprecedented outside wartime (figure 10). In some countries this is exacerbated by high private sector debt, implying that the process of debt reduction has a long way to run. Concerns about the sustainability of government debt, and the strength of banking systems and of economic growth, are likely to continue to create periodic bouts of turbulence in financial markets for some time. As a consequence, the pre-crisis period of relatively strong and stable global growth is unlikely to return in the foreseeable future.

C Implications for New Zealand’s Economic Outlook and Policy Priorities

Global risks highlight the need for significant adjustment to manage risks and build resilience ...

The Treasury’s forecasts for the New Zealand economy, included in the PREFU, are for real GDP per capita growth of 2.0 per cent on average over the five years to March 2016. This growth is expected to be underpinned by earthquake-related rebuilding in Canterbury and a high terms of trade, which together support growth in domestic demand. The potential for ongoing global economic and financial market instability is the key risk to this economic outlook. Global shocks could have negative consequences for export demand and commodity prices, and, potentially more gravely, could lead to greater financial market sensitivity to our net external liability position. A negative change in financial market sentiment towards New Zealand could have very significant effects on the availability and price of credit, and on real economic activity and employment.

These risks highlight the importance of policies to assist in increasing economic resilience. Returning the fiscal balance to surplus and reducing government net debt is a central part of increasing resilience and will necessarily involve expenditure reprioritisation in some areas. But other policies will also be needed to encourage a sharper lift in national saving relative to investment, and to arrest the projected increase in New Zealand’s net external liability position.
... while a focus on lifting productivity and international competitiveness is required to restore parity with high-income nations

Higher national saving relative to investment would help to improve international competitiveness by reducing upward pressure on interest rates (and thereby on the cost of capital) and on the real exchange rate. Reducing upward pressure on the exchange rate from domestic sources is likely to be particularly important in the future, given strong commodity prices will act to keep the exchange rate high.

Policies to increase national saving and reduce macroeconomic imbalances will provide a foundation for improving economic performance. However, materially narrowing the income gap with more advanced countries, of around 30 to 40 per cent (figure 11), will also require wider policy reform to lift average GDP per capita growth over the medium term. In an increasingly globalised world, improving our international competitiveness is vital. Policy changes are needed to increase incentives to invest and conduct business in New Zealand, raise the productivity performance of firms operating here, minimise the cost pressures they face, and maintain their ability to adjust to changing circumstances. This would entail a wide and ambitious programme of reform across government policies relating to education, welfare, tax, regulation, science and innovation, infrastructure, and the management of natural resources.

The rest of this briefing outlines specific policy priorities to achieve greater resilience and increased trend economic growth.
5 Policy Priorities: A Resilient and Stable Macroeconomic Environment

The short-term focus should be on reducing fiscal risks and rebalancing growth

Returning to fiscal surplus and rebuilding fiscal buffers by lowering government expenditure relative to GDP is the most direct and immediate contribution that the Government can make to reducing New Zealand’s macroeconomic imbalances. It will also allow room for Canterbury rebuilding to take place without putting undue pressure on the tradable sector.

The total Crown operating balance before gains and losses has deteriorated in each of the past six years, even after excluding one-off earthquake-related expenditure. Assuming the economy broadly develops in line with current expectations, our advice is that the Government’s fiscal strategy commits to returning the total Crown operating balance before gains and losses to surplus in 2014/15. This strategy is in line with our PREFU forecasts (figure 12), but would commit the Government to a faster return to surplus than implied by the fiscal strategy outlined in Budget 2011. Committing to a return to fiscal surplus in 2014/15 is a credible fiscal strategy and should provide financial markets with sufficient assurance about the sustainability and resilience of the New Zealand Crown’s financial position. If economic growth turns out to be temporarily weaker, there could be a case for allowing automatic fiscal stabilisers to operate.

The fiscal tightening required to return the operating balance before gains and losses to surplus in 2014/15 is expected to coincide with the pick-up in economic recovery. The tightening will therefore reduce the upward pressure on interest and exchange rates that is likely to come as labour and capital become fully employed.

It is possible that further discretionary fiscal tightening may be necessary if global developments deteriorate to such an extent that the Government’s fiscal credibility is at risk and becomes the focus of adverse financial market attention. In these circumstances, policy changes would need to be aimed at minimising negative short-term demand effects while generating credible fiscal savings over time. In the event that New Zealand’s economic growth surprises on the upside, the Treasury recommends that any positive revenue surprises be applied to strengthening the fiscal position more quickly.

Steps should also be taken to increase the resilience of the wider financial system ...

In addition to restoring fiscal buffers, introducing further measures to improve the resilience of the wider financial system will help to reduce the macroeconomic risks associated with potential future financial shocks. Higher bank capital requirements and an effective resolution regime, such as the Open Bank Resolution, could increase the resilience of the financial sector. Any further increase in bank capital would need to take account of its impact on growth. Internationally, reforms in response to the Global Financial Crisis are evolving and it will be important that overseas developments continue to inform New Zealand’s approach (box 3).
Box 3: Lessons from the Global Financial Crisis for financial stability

In many developed economies, the Global Financial Crisis almost caused financial sector collapse. Internationally, a process of financial sector re-regulation and tighter supervision is under way to address the most obvious problems that led to the crisis. Although there is agreement on the broad principles that should underpin new frameworks, the implementation of policy is progressing slowly. Some fundamental questions, such as the value of a large financial sector and how best to resolve systemic institutions, remain unresolved.

New Zealand has maintained financial stability through the crisis. At the same time, high levels of household and corporate debt, reliance on external sources of financing, and elevated house and farm price levels, all point to the need for us to incorporate lessons from countries seeking to ensure financial sector stability. Given uncertainty about the most appropriate policy responses, New Zealand should generally aim to be a fast follower – adopting quickly those policies that prove to be effective. However, given the long lags involved and the infrequent nature of financial instability, it may be costly to wait for additional evidence before acting. Any policy responses will need to carefully balance likely effects on the accessibility and cost of credit. Key areas for policy consideration include:

- **Liquidity risks associated with short-term external financing**: New Zealand has moved quickly, via new Reserve Bank prudential requirements, to reduce the liquidity risk associated with New Zealand’s relatively high levels of short-term external financing. Further choices remain about how quickly to increase liquidity buffers and their final level.

- **Basel Committee recommendations**: New Zealand will need to decide how to implement the Basel Committee recommendations for bank capital and whether we should go further in some aspects given our current vulnerabilities.

- **Resolution of systemic financial institutions**: Countries are currently revising frameworks to resolve systemic financial institutions without large fiscal costs and in a way that reduces moral hazard. The Reserve Bank is in the process of consulting on a process for resolving banks in a manner that maintains the operation of the financial system (Open Bank Resolution). We will need to monitor and assess resolution options put in place in other jurisdictions and their applicability to New Zealand.

- **Macroprudential policies**: Frameworks for macro-prudential policies are being developed, including in New Zealand. Clarity around the objectives, governance, and accountabilities of such a framework is important.

- **Financial Market Supervision**: New Zealand will also need to further embed steps taken prior to the crisis to widen the population of entities subject to supervision to include non-bank deposit-takers and insurance companies.

... and to reduce future cyclical rises in interest and exchange rates

There is also an opportunity to make institutional changes now to help reduce future cyclical rises in interest and exchange rates. In particular, we recommend adding to the current fiscal responsibility principles in the Public Finance Act:

- A fiscal structure dimension relating to the level and composition of government revenue and expenditure. This could help to improve the impact of government revenue and expenditure decisions on economic performance over time.
An explicit macro stability dimension. Such an amendment would help to reduce the risk of procyclical fiscal policy during economic upturns, such as occurred between 2005 and 2008, and the related additional upward pressure on interest and exchange rates.

Policy changes to improve the responsiveness of housing supply are another key way in which future cyclical pressures could be reduced. A more responsive housing supply could reduce house price cycles and the related negative consequences for household saving, interest rates, and the exchange rate.

Restoring New Zealand’s fiscal buffer needs to be the medium-term goal...

Returning the operating balance to surplus by 2014/15 will stop net debt rising as a percentage of GDP, but ongoing surpluses will be required to create a fiscal buffer against potential future economic shocks and to secure the restart of contributions to the New Zealand Superannuation Fund (NZSF). The depletion of the Natural Disaster Fund reinforces the desirability of rebuilding a fiscal buffer as quickly as possible. We recommend that the Government commits to reducing net debt (excluding NZSF) to no higher than 20 per cent of GDP by 2020, which is in line with current forecasts (figure 13), but a faster reduction than implied by the current medium-term debt objective. Pushing the no-higher-than-20-per-cent-net-debt-target out beyond 2020, would be inconsistent with the importance of restoring a stronger fiscal buffer and preparing for the effects of population ageing.

Once net debt falls below 20 per cent of GDP on a sustainable basis, structural surpluses could be reduced by relaxing the fiscal constraint, providing room for additional expenditure or tax initiatives. Alternatively, structural surpluses could be retained to build additional resilience, and either allocated to further reducing net debt down towards the levels achieved in 2008 and/or matching/pre-funding future liabilities, such as adding to the Natural Disaster Fund or NZSF.

Further actions are required to prepare for the fiscal impacts of population ageing

Over time, the fiscal position will come under increasing pressure as the “baby boomers” move into retirement (figure 14). Many other developed countries are facing a similar challenge. New Zealand’s “65 and over” population is projected to grow nearly four times more quickly than the total population over the next 15 years, contributing to a rapid rise in health, aged care and New Zealand Superannuation (NZS) costs in particular. The resulting fiscal challenge is considerable and there is no way to avoid making tradeoffs. Given the potential economic and

Figure 13: Net core Crown debt; 1997-2020

Figure 14: New Zealand’s population age structure; 1990-2060

Source: Pre-election Economic and Fiscal Update 2011

Source: The Treasury
social instability that could result from uncertainty about these tradeoffs, we think it is crucial that efforts be made to build broad public consensus on the way forward. The current acceleration in the growth of the older population means that building this public consensus is a matter of priority for New Zealand.

Reforming retirement income policy settings is a key way of reducing future long-term fiscal pressures...

A range of potential options for addressing long-term fiscal challenges will be offered in the next Long Term Fiscal Statement, which will be presented to Parliament by October 2013 as required by the Public Finance Act. Reducing the level of government funding allocated to retirement income is one key way that long-term fiscal pressures can be addressed while simultaneously boosting economic performance. Leaving current retirement income settings unchanged would necessitate increases in tax revenue, which would harm growth, or large reductions in other government expenditures, such as health or education.

... increasing labour force participation, and encouraging greater household saving

There are various ways in which retirement income settings could be adjusted to reduce fiscal costs. The evidence, including the last increase in the age of eligibility for NZS from 60 to 65 implemented in the decade to 2001, indicates that reforms can encourage significant increases in labour force participation among older workers. A number of countries have already agreed to future phased increases in the age of pension eligibility as a way of ensuring they can provide other services sustainably and encouraging households to take greater provision for their retirement income (table 1). Certain types of reform can also have an impact on household saving behaviour, which could potentially help reduce persistent saving-investment imbalances and our net external liability. Early signalling of future adjustments to retirement income settings allows households time to adjust and prepare, and, as a result, can also lead to an earlier impact on saving.

Table 1: Pensionable ages, 2010-2050

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<th>2010</th>
<th>2030</th>
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<tr>
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<td>66</td>
<td>67</td>
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<tr>
<td>UK</td>
<td>65*</td>
<td>66</td>
<td>68</td>
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<tr>
<td>United States</td>
<td>66</td>
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</tbody>
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Source OECD

*Women’s pensionable ages in 2010 were 60 and 62 for the UK and Australia respectively

Towards the other end of the age spectrum, the evidence available indicates that the introduction of interest-free student loans is likely to have discouraged saving for tertiary education and failed to significantly increase access to tertiary education. Reintroducing interest on student loans would create greater incentives for students and/or their families to save for tertiary education without significant adverse effects on tertiary education participation.
Changes to the tax system could also help saving and investment imbalances

Further reducing tax distortions is another important way the Government can help to reduce saving and investment imbalances in the private sector. The shift in taxes away from savings and investment and towards consumption, announced in Budget 2010, is likely to have added to the lift in household saving rates that has occurred over the last four years. However, the real effective tax rates that apply to some types of capital income remain high, and there is wide variation in the rates that apply to different investment types, with particularly low taxation on housing (figure 15). Reducing the rate and variation in capital taxation has the potential to both encourage greater saving and increase the attractiveness of non-housing investments, which should support the tradable sectors of the economy. The Treasury is continuing to examine a range of options for taxing capital more evenly, and at lower rates. Key questions that will need to be addressed before making decisions on tax reforms of this magnitude include the size of the economic benefits and fiscal costs, administrative feasibility, and implications for distributional equity.
6 Policy Priorities: A Smaller, More Effective and Responsive State Sector

There is scope to improve the effectiveness of government expenditure and reduce its size as a proportion of the economy.

The state sector has a large impact on the incomes, opportunities and general wellbeing of individuals, and on aggregate economic performance. The quality of New Zealand’s public sector agencies compares favourably with those of other countries, for example with respect to levels of corruption, bureaucratic efficiency, transparency and ability to implement government policy. However, largely as a reflection of government policy decisions, the state sector has grown dramatically over the last decade and this growth has not been commensurate with better results or been targeted to those who need state-funded services most. Restoring fiscal buffers requires a reversal of this growth, but can be coupled with better overall results if resources are better targeted to where they can have the biggest impact. Once fiscal buffers are restored, an ongoing focus on the effectiveness and efficiency of total government expenditure and assets will enable a smaller size of government to be maintained over the longer term, which would support economic growth by providing scope for tax reductions.

Cost pressures will make it challenging to achieve a 2014/15 surplus, and even more challenging to achieve 20 per cent net debt by 2020.

More effective and efficient use of public resources will be important for delivering the fiscal strategy, which will be increasingly challenging over time. The required allowances for new spending or tax initiatives are much lower than they were during the last decade, while cost pressures, such as those relating to the ageing population structure, are rising. The magnitude of the challenge can be illustrated by state sector personnel costs, which account for 20 per cent of total Crown expenses. The PREFU forecasts baseline personnel costs to grow by an annual average of 1.4 per cent between 2011 and 2016. This growth compares with average annual growth of just over 8 per cent between 2003 and 2009, and 2.8 per cent over 2010 and 2011 (figure 16). Although some of any increase in personnel costs above these forecasts can be funded from operating allowances for new expenditure, the lower level of allowances means there will need to be a greater focus on finding efficiencies and reprioritisation.

Stronger economic growth alone will not solve the fiscal challenge.

A sustained lift in New Zealand’s trend economic growth rate would make it easier to achieve the fiscal strategy. But higher growth alone, even under a highly optimistic scenario, will be insufficient, partly because growth also boosts expenses such as NZS and public sector wages as well as revenue. The Government will therefore need to continue to take an active approach to managing costs in order to deliver the fiscal strategy while enhancing priority services.
Delivering the fiscal strategy while protecting priority services will require a reform strategy with three complementary and overlapping dimensions

1. Driving further efficiency savings

The Government has generated substantial efficiency savings in recent years by making long-term constraints clear and encouraging departments and other entities to take responsibility for adapting to them. A number of innovations, such as the Performance Improvement Framework, Four-year Budget Plans, 10-year capital intentions, and Workforce Strategies are encouraging departments to take a longer-term view of their priorities and capabilities to deliver on priorities within funding constraints. There is potential to build on these initiatives through better definition and measurement of performance, particularly around the balance sheet (box 4). Continuing to keep agencies focused on efficiencies will play a key role in managing cost pressures.

2. Encouraging innovation in service delivery, including greater contestability

More substantial innovations in service delivery would help deliver additional savings, as well as better outcomes. A practical and recent example is the shift in ACC’s focus since 2009 toward early intervention and contracting private providers to manage clients. These changes have generated both significant improvements in rehabilitation outcomes and substantial cost savings (figure 17).

Contestability is a key tool for achieving greater innovation, by providing incentives to continuously improve the price and quality of services, and by focusing the state sector on doing only what it can do more efficiently than non-government providers. The Government has been moving toward more contestable approaches, most notably with: the introduction of public-private partnerships in prisons and schools; increasing the use of private sector and NGO delivery in social services, including Whanau Ora; and the use of non-government providers for social housing. We see faster progress on the reform of social housing, involving the growth of alternative providers, as a continuing priority that has the potential to transform the efficiency and effectiveness of government support for families, and achieve more affordable and fit-for-purpose housing for New Zealanders.

In our view, there is considerable scope to build on the progress that has been made and encourage further innovation and contestability in service delivery. Agencies should look at market testing their services in areas where competitive pressure is likely to offer significant benefits (for example, where there are interested alternative providers, or where the scale of change is potentially large). To help make good decisions and develop capability in these areas, agencies also need to be better supported with functional leadership in all commercial aspects of third party expenditure, including commissioning, best sourcing analysis, market engagement, strategic partnerships, commercial legal advice, contract development and contract management. In some areas, making public service delivery more contestable will also require policy changes to introduce efficient pricing methods within the public sector, to reduce barriers to entry (such as changing funding settings that disadvantage third parties) and to establish appropriate regulatory frameworks.

3. Expenditure reprioritisation

It will be feasible, but challenging, to return to operating surplus in 2014/15 through efficiency gains and service delivery improvements. Thereafter, reducing net debt to 20 per cent by 2020 will require an ongoing programme...
of efficiency savings and innovations in service delivery, together with targeted expenditure reductions. Protecting priority public services will require clear prioritisation of the services and transfers that the Government wishes to maintain, as well as decisions about how and to whom they are provided.

An explicit articulation of the Government’s medium-term expenditure priorities, linked to broader outcomes, would help to support these decisions, especially if it were built into fiscal responsibility provisions in the Public Finance Act. In particular, a medium-term expenditure strategy would help bring greater consistency in prioritisation across and within votes, support better integration of operating and capital expenditure decision-making, and assist in communicating the Government’s rationale for expenditure choices. In general, the Treasury recommends an approach that prioritises expenditure with clear public good benefits and that is focused on improving living standards. Specifically, we recommend that the Government prioritises expenditure that: (i) lifts trend economic growth; (ii) invests in young New Zealanders; and (iii) protects the vulnerable.

Expenditure prioritisation across the state sector can both better direct expenditure to those who need it most and improve social and economic outcomes

Treasury analysis indicates that much of overall government expenditure, and recent increases in it, is not well aligned with these three priorities, and that there are opportunities for much better expenditure prioritisation. For example, government spending on social services (ie, health, education and income support) increased by almost 20 per cent more for households in the top half of the income distribution than for households in the bottom half of the income distribution between 1997/98 and 2009/10 (figure 18). The spending increases for higher-income households have been primarily driven by higher education, health and NZS expenditure. Better targeting of these social service expenditures could both improve overall social outcomes and reduce fiscal costs.

Box 4: Further improvements are needed in balance sheet management

The 2010 Investment Statement of the Government of New Zealand, together with a range of other recent initiatives, has lifted the profile of better balance sheet management. However, these initiatives need to be better embedded into the budget process and regular fiscal reporting. Deficiencies in the quality of performance information and monitoring of social assets also need to be addressed.

In addition, the Government has committed to more active consideration of how capital can be released and reallocated across the balance sheet. To follow through on that commitment, decisions are needed about the likely level and mix of public services that will be needed in the long term, which assets will be needed to provide those services, and whether the Crown is the best owner for those assets.

The Government’s mixed-ownership programme is a step in this direction. The programme will free up capital for higher-priority areas while at the same time promoting sharper commercial disciplines on Crown commercial entities. In the longer term, the Government should continue to seek to maximise the value of commercial assets through performance improvements and releasing capital with, or without, changes in current ownership. We also see considerable scope for more effective and efficient use of capital in areas such as health, education, justice and defence.

Figure 18: Average cost of social services by household income level; 1997/98, 2009/10

Source: The Treasury

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There are opportunities to get better value for money across all government sectors, through a mix of efficiency savings, service delivery innovation and reprioritisation. Improving the way the core public sector works will be critical to achieving these changes (box 5). The welfare and education sectors are the two particular areas where we see the greatest opportunity for reforms to directly contribute to economic performance, while simultaneously improving social outcomes and delivering fiscal savings.

**Strengthening intended welfare change with wider reforms will improve labour force outcomes and reduce benefit expenditure**

The Government has recently agreed to a fundamental shift in the welfare system, away from managing short-term costs towards an investment approach that focuses on improving long-term outcomes. The Treasury supports the general direction of the reforms. The proposed timeframes for further detailed policy decisions, legislative processes and implementation are very ambitious. It may be necessary for Ministers to prioritise certain areas of the reform agenda, and to push out some of the implementation dates. A fundamental part of the reforms is a new accountability regime, which is based on regular, external valuation and reporting of the long-term costs of the system, to create clear incentives on Work and Income.

Initial estimates suggest that the reforms agreed to date could lead to a reduction in working-age benefit recipient numbers by up to 45,000 in 2016, a corresponding increase in the workforce, and savings to the Crown of around $1 billion between 2013 and 2016. How the reforms are implemented will be critical to their success. We recommend that certain proposals should go further, especially given income support remains poorly targeted to those families most in need of financial help (figure 19), and creates weak work incentives for many recipients. Areas requiring particular focus are:

- Ensuring sufficient capability within Work and Income to deliver a new service delivery model, including more extensive contracting-out to external providers where appropriate.
- Making the payments simpler and more aligned with work expectations, so they can better target those in need.
- Reducing the age of the youngest child to 2-3 years at which work testing for sole parents begins and tightening the eligibility criteria for the Supported Living Payment.

In addition, it is important that wider labour market settings support welfare reform. For example, large increases in the minimum wage would limit employment opportunities for people transitioning from welfare to the labour market and for youth.

**Changes across the education system will improve educational attainment and free up funding**

The formal education system plays an important role in developing human capital, which is strongly related to both economic performance and a wide range of other dimensions of living standards. Overall, the evidence suggests that the highest returns to public education expenditure relate to investments in the earlier years, especially for lower socioeconomic groups. Despite large increases in government expenditure, early childhood
education (ECE) participation rates for children in the lowest income brackets have not increased (figure 20), with the expenditure instead supporting a greater volume of hours and higher proportions of registered teachers. Given the gains that can be made, we recommend further targeting of existing ECE funding to children from lower socioeconomic backgrounds.

New Zealand’s compulsory education system produces good outcomes for most students, as evidenced by our strong performance in international tests. However, despite large funding increases, achievement levels remain unacceptably low for some groups. Student achievement can be raised by improving the quality of teaching, which the evidence shows is the largest in-school influence on student outcomes. Increasing student/teacher ratios, and consolidation of the school network, can free up funding that could be used to support initiatives to enhance the quality of teaching, such as more systemic use of value-add data and a more professionalised workforce.

Recent policy changes in tertiary education have moved towards better targeting of funding. However, the level of public funding remains high relative to other advanced economies, and to public expenditure on ECE. There is scope to achieve fiscal savings, primarily through reintroducing interest on the student loan scheme. In the medium term, we would also recommend greater targeting towards younger tertiary students and higher-level qualifications.

**Box 5: Better Public Services**

Improving the way the core public service works will be critical for helping the Government to manage cost pressures, while improving overall outcomes. The Better Public Services Advisory Group reported to the Government after the 2011 election with advice on the strategic direction, key components and desired end-state for New Zealand’s public services. [2]

New Zealand’s business environment has become less competitive

New Zealand’s business environment ranks relatively well internationally on a variety of measures. However, our advantage has eroded over the last decade as other countries have aggressively implemented business-friendly reforms. The relative increase in New Zealand’s unit labour costs, especially since 2000, shows that wages have been advancing ahead of labour productivity (figure 21) and have contributed to a loss in our international competitiveness. This loss partly reflects macro-economic and state sector performance, but it also highlights the need for wider reforms to increase incentives to invest and conduct business in New Zealand, raise the productivity performance of firms operating here, minimise the cost pressures they face, and maintain their ability to adjust to changing circumstances.

A Policies to Improve International Connections

Policies to promote international connections are important to overcome the disadvantages of size and remoteness

The acceleration of globalisation adds urgency to this agenda and highlights the need to take a stronger international lens to our policy settings, so they are best aligned to facilitate the flows of trade, people, capital and ideas. These resource flows are vital for New Zealand as a small and distant economy for achieving economies of scale, stimulating competition, and for accessing international knowledge, technology and resources. There are three main policy dimensions to improving New Zealand’s international connections: building external relationships, reducing “at-the-border” barriers in New Zealand and abroad, and improving domestic “behind-the-border” policy settings.

1. Building external relationships: New Zealand’s focus should be on our three largest trading partners - Australia, China and the United States - as well as India, given its significant future growth potential.

2. Reducing “at-the-border” barriers in New Zealand and overseas: New Zealand exporters continue to face high formal and non-formal barriers in most international markets. Progress is continuing to be made through trade agreement negotiations, which need to remain a key focus. On the other hand, New Zealand’s formal at-the-border restrictions are generally low. The exception is our investment screening regime, which
has become both more restrictive and less transparent in recent years, while most other countries’ regimes have become less restrictive (figure 22).

3. Domestic “behind-the-border” policy settings: domestic policy settings are critical for international connections because they affect:
   - the attractiveness of New Zealand for internationally-mobile people, business and investment, and
   - the international competitiveness of firms located in New Zealand and their ability to interact with the world.

Reforms to domestic policy settings therefore need to take account of both international and domestic contexts. Although OECD and other international organisations assess many of New Zealand’s policy regimes to be at or close to best practice, our geographic disadvantages and relative vulnerability to global shifts in investor sentiment mean that our domestic policies need to be ahead of other countries’ with whom we compete.

B Policies to Improve the Domestic Business Environment

In addition to maintaining a stable macroeconomic environment and improving state sector performance, the five most pressing domestic policy areas (each with international dimensions) for reform are the tax system, the regulatory system, science and innovation policy, network infrastructure, and natural resource management.

i Further reform can make the tax system more efficient and competitive

New Zealand’s tax system is generally regarded as well-run and efficient. The “tax switch” reforms introduced in 2010 helped to improve the efficiency of the tax system, and enhanced incentives to work, save and invest. However, there is potential for further reforms to enhance economic performance. In particular:

▶ The increasing mobility of global capital and workers (New Zealand workers appear to be especially mobile), together with the downward trend in international company tax rates, continues to apply pressure to the competitiveness of New Zealand’s personal and company tax rates (figure 23). This pressure adds to the rationale for further reductions in these tax rates to improve incentives to work, save and invest. Reductions in these rates could be funded by more base broadening or by additional cuts in low-value government expenditure without compromising fiscal targets.

▶ As noted, there is wide variation in the tax rates that apply to different types of capital, and potential for capital tax changes to encourage a more productive allocation of capital.
With specific respect to Australia, we recommend continuing to push for mutual recognition of imputation and franking credits to promote the free flow of capital across the Tasman. This would expand trans-Tasman investment and assist in the movement towards a trans-Tasman single economic market.

**ii Regulatory improvements are needed at both the regime and system level**

New Zealand has lost ground over the last decade compared with other countries in terms of the quality of the regulatory framework for business (figure 24). There are a number of specific regulatory areas, noted in other parts of this briefing, where reforms are likely to have material benefits for the business environment. These include regulatory regimes relating to chemicals and new organisms, investment screening, resource management, local government, housing supply and the minimum wage.

Improving regulatory quality also requires continuous improvement of the broader regulatory system. Regulatory impact analysis requirements introduced in 1998, and refreshed and extended in 2008, provide a solid foundation for improving the system, and have helped lead to an improvement in agency performance. The focus for future system-level changes should be:

- promoting principles of best practice regulation including minimising barriers to, and maximising benefits from, cross-border flows, backed up by regime assessments
- improving regulatory scanning and planning, and adding a medium-term perspective
- building regulatory goals into performance expectations of chief executives and agencies, and
- supporting cross-agency collaboration to develop and share best practice.

**iii Science and innovation policy should focus more on Firm-led R&D and commercialisation**

Many aspects of New Zealand’s research and science system, which is mostly government funded, appear sound but the level of business expenditure on research and development (R&D) is particularly low compared with other OECD countries (figure 25). This indicates there is scope to improve innovation performance with respect to business R&D and the commercialisation of government-funded R&D. There are three priorities for enhancing economically-beneficial innovation:

- increasing the proportion of government expenditure on R&D that is business-led
improving incentives on research and tertiary education institutes to undertake more firm-relevant research and transfer knowledge to firms, and

ensuring there is an appropriate balance between managing environmental and public health risks, and opportunities for economically beneficial innovation in relation to new organisms and chemicals.

iv Better prioritisation of investment and management of existing assets is required to maximise the contribution of network infrastructure, especially roads

National spending on network infrastructure has increased rapidly over the last decade, with investment in electricity transmission, roading and telecommunications in particular helping to provide a stronger platform for future economic growth. Nevertheless, survey measures continue to suggest there is substantial room for improvement. The National Infrastructure Plan 2011 provides an overarching strategic direction for the planning, funding and building of infrastructure over the next 20 years. The key priorities for enhancing the contribution of infrastructure to economic growth are:

- ensuring that Auckland has a robust and realistic plan for transport, in which people and businesses have confidence, and which optimises the future network through new investment and measures to manage demand, including network pricing
- using rigorous, consistent and transparent benefit-cost analysis for developing Auckland’s transport plan and for other transport investment – unfunded projects with net economic benefits should be accelerated through a range of funding mechanisms including increases in fuel excise and road user charges, and
- ensuring that the Christchurch rebuild is focused on future needs and is prioritised to support infrastructure that is growth enhancing (box 6).

Box 6: Canterbury earthquake recovery

Since the immediate response phase to the major quake events, the Government’s focus has been on progressing the restoration of infrastructure and government services, and on providing property owners with the best available information about the state of their land so they can plan their futures with a degree of certainty. This has required detailed geotechnical investigations across large areas, leading to difficult judgments. These prolonged investigations, coupled with continuing seismic activity, have affected the level of confidence that insurers have about providing cover immediately, which in turn has delayed reconstruction. With land decisions now substantially taken, and provided seismic activity declines as predicted, insurance and reconstruction should begin to free up in the near term. For the central city, although wide scale demolition has proceeded, the city council has been working on a draft strategy for its rebuild.

With the status of land becoming settled, the focus will shift to the longer-term recovery. This will involve an interplay between various state and private sector institutions, the availability of human and financial resources, and confidence in the future. The Government will need to ensure that economic recovery can occur in a timely manner and that markets – most notably insurance, financial, property and labour markets – can resume operating normally. This will include ensuring the rebuild strategy is realistic, achievable, economically viable and based on robust assessments of benefits and costs. The Government will need to consider how it might leverage its presence as a significant employer and tenant to act as a catalyst for commercial revival. As the recovery will be a process that runs over several years, the Government, along with the private sector and the city council, will need to maintain and build confidence in the city’s future.
More efficient management is required to increase the economic contribution of natural resources, while managing degradation and scarcity challenges.

Primary production accounts for a large proportion of New Zealand’s economy, partly because of our natural advantages in climate and geography. New Zealand is facing increasing challenges with respect to the degradation of natural resources, managing scarcity as sustainable limits are being reached (especially for water) and system efficiency. These problems necessitate changes in a number of areas, including:

- **The Resource Management Act (RMA)**
  
  We recommend continuing to build on recent progress to improve speed and efficiency, and to articulate the national interest. Refining the principles of the Act to give greater explicit recognition to economic growth alongside ecological protection and other values is also important. Beyond this, further gains will come from focusing on better implementation of the system, including looking more deeply at the role, capability and incentives on local government to plan for and manage infrastructure, growth and environmental protection.

- **Freshwater Management**
  
  Freshwater (volume, flow and quality) is an essential resource for our economy and society. The paramount challenge is to set up a system with the versatility to cope with growing demands. A shift is needed to create incentives in the administrative structures and the market that will communicate the true value of water and facilitate its highest valued use. The Land and Water Forum is spearheading development of options to progress towards such a system. The Government should be closely involved in this process. Clarification of Maori interests in water will also provide for greater certainty.

- **Climate Change**
  
  New Zealand’s climate change policy will continue to be informed by international developments, given the global nature of this challenge. A legally binding global agreement is unlikely to immediately follow the 2008-2012 Kyoto Protocol period, providing an opportunity to reconsider some key Emission Trading Scheme (ETS) design settings. The Government’s response to the 2011 ETS Review will provide an opportunity to reduce short-term costs imposed by the ETS, while positioning the economy for the longer-term risks and potential opportunities associated with climate change.