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

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1. Executive Summary

We are facing a global economic crisis that will hit New Zealand very hard. 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 has been weak and inadequate to provide confidence that New Zealand will both steer through recession well and emerge as strongly and as quickly as possible.

This paper is being released in draft form. The intention is to stimulate a constructive conversation about the best way forward. Public comment and feedback is welcomed. The process for this is outlined in Section 7.

This draft paper outlines the scale of the issues facing New Zealand and puts forward a series of recommendations that we believe will drive New Zealand through this so we emerge re-tooled and as one of the best positioned economies in the world.

In summary form, our key policy proposals are as follows:

A. Immediate priorities - first 30 days

(i) Defer all provisional tax payments for next 24 months. Credit rationing, combined with provisional tax payments and associated uplifts will put companies under pressure and result in significant job losses. Deferring provisional tax will make a positive contribution to keeping firms viable and jobs intact.

(ii) 100% depreciation of capital investment. The speed and strength we come out of the recession will be determined by the amount of capital investment firms make. With credit rationed and cash flow threatened, the recession here will deepen unless capital investment is prioritized and incentivized.

(iii) Bring talented Kiwis home. Create a two-year tax rebate to cap income tax at 20% for returning Kiwis who have been away for over three years. This is the best time to recruit our own back.

(iv) Attract new firms to New Zealand. Firms that are not here do not pay tax. If firms move here, with more than ten people, give them two years of no company tax. Financial, IT and environmental/science-based firms can move easily as they are essentially just people + broadband.

(v) Retain the R&D tax credit, to ensure that R&D investment is made in New Zealand.

B. Short-term priorities - 12-24 months

(i) Create KiwiCo. Commercial SOEs would be put into a new company similar to Infratil in New Zealand or Temasek in Singapore - where world-class managers oversee, via Board representation, the performance and growth of both KiwiCo and a portfolio of companies. This would be a real Kiwi champion that could drive global growth. It could tap capital markets to secure expansion funding and could float partial stakes to finance growth. Strong legislative protection would ensure that any equity capital raising at KiwiCo was limited to 25%, and at portfolio company level was limited to minority proportions. We make a special plea that both parties consider this proposal on its merits, rather than on the basis of leftover arguments from the 80's and 90's - it really is time to move on and address the new realities.

(ii) Create an at-scale taxpayer savings vehicle, using financial assets currently managed by the NZSF, EQC, and ACC. There are a number of organizational options for this that would ensure that certain defined liabilities are recognized, but a material portion of these funds would take a long-term, Warren Buffet style investment approach, with a real expertise and focus on New Zealand - where it should have a real advantage, and really help New Zealand.

C. Longer term priorities

(i) Convert KiwiSaver into a compulsory savings scheme. We must reduce our reliance on foreign capital and grow our savings pool.

(ii) Eliminate the biases in the tax code that promote housing speculation.

There are other ideas and areas addressed in this document (e.g interest rates, personal tax rates). However, either because they are already debated publicly, or because less urgent in nature, they are not summarized in this Executive Summary.

Our intention is to listen carefully to feedback, and to use that feedback to improve this document over the coming weeks. Once this process has been completed, we would like to release a document that reflects broad views, and that can be viewed as a truly national, bipartisan, implementable policy document - one that voters and politicians, regardless of their affiliation, can support as designed to take New Zealand forward.

2. Introduction

As outlined in the Executive Summary, 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.

New Zealand has faced crises before, and adopted different strategies with very different results. In the early 1970's we were faced with the oil shock of 1973, which drove down global growth, and we also lost preferential access to the UK. Our response was Think Big and protectionism. This insular, domestic focus, which ignored the global issues, made the problem much worse. The parallels with the current domestically focused, policy debates are troubling. Our lack of appropriate response then led us to the economic brink a decade later. We now face the same risk

It is our view that the current global financial and economic crisis is of a similar or greater magnitude to the events of the 1970's. New Zealand is now confronted with a choice as to whether and how to respond.

It is our strong belief that an incrementalist or reactive response to the impending impacts of the global credit crisis and economic slowdown will be strongly negative for the New Zealand economy over the next decade and beyond. New Zealand needs a clear and deliberate strategy to guide our response over the next several years. 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. Hope is not a strategy.

We believe that, while there is little we can do about Northern Hemisphere banks, there is a lot we can do to determine how well the New Zealand economy copes with permanent changes to global credit markets and a global economic slowdown. This is the premise of this document. Specifically, it looks to offer some ideas as to what New Zealand can do to respond to the global financial and economic crisis, and ensure that our economy remains strong. It is written out of a concern that many of the reactions discussed to date are, at best, partial in nature and do not represent a sufficiently material response to what will be one of the biggest economic shocks to hit the New Zealand economy over the past 80 years.

The document is organised as follows: Section 3, Global Financial Crisis: Impact on New Zealand, outlines the magnitude of the challenges the global financial crisis will create for New Zealand. Section 4, New Zealand's Response to Date, describes the nature of New Zealand's current policy response and outlines the characteristics of an appropriate strategy. Section 5, Proposed Solutions, outlines a series of actions that we believe will effectively assist our economy in the changed global economic context. This section addresses both risks and opportunities. Section 6, Conclusion, wraps up the key thoughts in the document, while Section 7, Feedback and next steps, outlines how the public can contribute to this discussion.

3. Global Financial Crisis: Impact on New Zealand

The current global financial crisis is big. It is getting bigger by the day. And it is rapidly becoming a major *economic* crisis, with an impact on the real economy. There is palpable fear among many informed participants and commentators; this has a long way to go, and is looking increasingly likely to be one of the most serious economic crises since the Great Depression.

Global financial markets, and the financial system, have moved to a different footing. 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 an end. This is already feeding through into recession or significantly slower growth in most major market economies. This is not a short-term cyclical downturn, with a return to historical course and speed to follow. Instead, it appears more likely that we will see depressed growth rates in consumption and investment for several years to come.

Many developed countries are significantly exposed through their financial system, particularly the banks. This is much less of an issue for New Zealand, with our financial system reported to be in good shape. But it does not mean that New Zealand is a safe haven.

There are two key channels through which New Zealand is exposed. The first channel is the state of the global economy. Already the U.S. is in trouble and Europe is in recession. Asian growth rates are predicted to slow considerably. Global central banks have cut rates, and the Fed is lending direct to corporates. This is bad news for New Zealand, as an exporter with high dependence on our commodities sector. The impact of the process of de-leveraging and unwinding asset price bubbles is likely to have a serious negative effect on global growth for years to come. Indeed, this week the IMF has sharply revised down their global growth projections.

One key indicator that this is likely to be a long and deep recession in the US is the near 40% fall on the NASDAQ market over the past 12 months. The NASDAQ market is dominated by companies in the business of providing technology to corporates. A significant fall in this market is a strong leading indicator that business investment is expected to decline significantly. Business investment is the critical factor that usually pulls an economy out of a recession.

The second, and in our view, most consequential channel, is the credit channel. We have seen credit markets drying up in global markets, with access reduced and prices spiking (even in the inter-bank market). Early signs of what this may mean for New Zealand have become evident over the past week or so, with the inability of some major investments to get across the line, the tightening of mortgage lending criteria, and credit rationing to certain sectors and businesses. 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 addition, soundings in the New Zealand market and among business leaders over the past week indicate a serious negative turn in sentiment. Leading indicators such as the significant fall in job advertisements in New Zealand (estimated already at a 40% fall compared to the prior period last year) give some sense of how businesses are already reacting to this and what will happen to unemployment rates as a consequence.

New Zealand is one of the most exposed countries to changes in the credit market. New Zealand has consistently run substantial current account deficits, driven by a significant investment income deficit. As a consequence, the New Zealand economy is heavily reliant on importing foreign capital. This reliance on accessing global liquidity on wholesale markets means that changes in the price or availability of this foreign credit. Our real economy, driven hitherto by cheap credit and a housing bubble, as well as an unhealthy dependence on the "white gold" of dairy exports, is highly risked.

Access to abundant foreign credit has propelled the New Zealand economy along over much of the past decade. But no more. We now have to rely on fundamentals.

The Treasury, in their Pre-Election opening of the books, estimate that nominal GDP will be $1.5bn smaller than previously thought by mid 2010. That's a lot of money to lose in a little over five months. More concerning is that these estimates were made before the real extent of the impact on the US economy, Europe, and global consumption began to emerge. As Treasury said, the risks are to the downside.

For New Zealand this creates both risk and opportunity. The risk is that the economies of our trading partners will slow, and stay that way for a while. The opportunity is the quick delivery of strategies that increase investment in New Zealand over this period and have us emerge stronger and much more competitive relative to peers who have surged ahead of us in most economic indicators over the last decade.

4. New Zealand's Response to Date

We do not believe that there is a full appreciation of the scale of this challenge for New Zealand. Or, if there is, the political parties are choosing to focus on sideline issues. As far as we can tell, there is no publicly articulated strategy for responding. The focus has been on the pace of tax cuts to support consumption, the appropriate nature of the government's borrowing profile, the need for fiscal prudence, and discussions as to whether or not bank deposit insurance is required. But this has not crystallised into a coherent strategy that is proportionate to the scale of the challenge.

The lack of a coherent, strategic policy response at this juncture by the major political parties is understandable. It is the middle of an election campaign, and markets and events have moved significantly and quickly over the past few weeks. But, given the severity of the economic and financial crisis, a change of tack is needed. Under these circumstances it is important that the government can communicate a clear strategy and hence provide a sense of confidence and control. How we deal with this could well be the single biggest issue that New Zealand faces over the next three years.

Our view is that the strategy needs to be characterised by three factors:

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 overseas jurisdictions, with the Paulson Plan in the U.S., bank guarantees throughout Europe, and the U.K. bank support plan. Closer to home, Australian banks are tapping into long-term credit from the Future Fund because of difficulties experienced in global markets, and the RBA is aggressively cutting interest rates.

Second, New Zealand's response needs to have strategic coherence rather than being reactive and opportunistic. If the reaction is a series of short-term fixes as issues emerge, the final outcome will be akin to a painful belly flop. The key challenge is to develop a comprehensive plan to ensure that good New Zealand firms continue to invest and grow. To enable New Zealand firms to expand without being starved of credit requires a pro-active and forward-looking response.

Recall that GDP is comprised of Consumption + Investment + Government + (Exports - Imports). The debate as it currently exists in New Zealand is focused largely on the viability of tax cuts to support the Consumption plank of GDP. While support to Consumption is necessary, it is not close to sufficient in this changed reality. The strategy needs to be broader, and have a particular focus on supporting investment levels.

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. New Zealand has real choices open to it that will influence whether we manage well, or very badly, through these new conditions. We can emerge at the end of this global tumult with an economy that has re-tooled, invested in productivity when the world has stalled, and taken this opportunity to grow faster than our OECD peers.....or not.

The Chinese character for crisis is said to comprise the symbols for danger and opportunity. The appropriate policy response for New Zealand should involve both.

5. Proposed Solutions

Having issued a challenge for more leadership in response to this crisis, we felt a responsibility to put a draft strategy into the public domain. This section makes a series of recommendations as to how New Zealand could best respond.

The draft strategy breaks its proposals into two sections: the Real Economy, and the Financial System and Monetary Policy. The Real Economy section is divided into three parts: measures that can be adopted immediately with impact over the next 12-24 months; measures that will take a year or so to implement and will have an impact on the economy that may take 24-36 months to arrive; and longer-term structural measures that will better position the New Zealand economy over the next decade and beyond.

The focus of the proposed solutions on the real economy is deliberate, and reflects the particular nature of New Zealand's exposure to the global crisis. Unlike many other developed economies, our immediate exposure is to the impact of the credit crunch on the real economy rather than the liquidity and solvency of the banking sector. The proposed New Zealand response is therefore fundamentally different to the measures recommended in other countries.

A. Risk management and strengthening the economy

1. IMMEDIATE PRIORITIES FOR ACTION

These policies can be implemented immediately, and can reasonably be expected to have a short term effect on the New Zealand economy

(i) Provisional tax deferral

Currently provisional tax is required to be paid in advance on estimated profits, and penalties for incorrectly estimated future profits are high. In addition there is an automatic uplift between years for 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 light. Regardless, profits will be significantly reduced for businesses over the next 24 months. Much more important, however, is that in this environment, where credit is scarce and business is declining, firms are likely to face real cash-flow issues which threaten their viability. Eliminating provisional tax is recommended for this period. A next-best policy would be to eliminate provisional tax entirely for firms with revenues under $100m, and eliminate the uplift component for firms with revenues over $100m. This policy, allows firms some wiggle-room in managing their cash-flows - which is critical with the risk of capital rationing from the bank sector, and a high cost of capital for those firms that make it through the credit rationing hurdles.

We therefore propose that for the next 24 months provisional tax be paid in arrears, at the end of the year, by businesses. This means that high interest charges will not apply, which will give small businesses some breathing space by not removing the need to pre-pay tax and crunching their already tight cashflow. We see this as an easy, quick, effective way to help business survive credit restrictions, without bailing out bad businesses or subsidising their operations.

The cost to the government will simply be interest earned on the timing of revenue received by IRD. The benefit to the government will be that more jobs survive, fewer welfare payments accrue, and productivity increases at firms who are not spending scarce time and resource on tax compliance and scrambling for expensive credit to finance cash-flow. While not as dramatic as the Fed lending direct to corporates, this will, system-wide, be more effective.

(ii) 100% tax depreciation on capital investment

Given New Zealand already faces deep productivity issues, a reduction in capital investment when capital is scarce is a real risk to our medium term competitiveness. Firms are already cutting capital investment. Without any incentives to accelerate such investment, any delay will in turn delay the timing and strength of the economic recovery. The opportunity is to accelerate that process, and thereby strengthen our new champions.

We propose that for the next 24 months (through to 31 December 2010) capital investment and IT spending be allowed a 100% depreciation write-off for tax purposes. For firms to invest meaningfully in capital, they either have to have been well managed with strong cash flows, or still have access to credit or equity. We can therefore expect that the firms that take advantage of this tax window will be the ones who will drive the economy forward, and around whom the economy should recalibrate.

(iii) Compete aggressively for talent and bring talented Kiwis home

Ex-pat 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 propose 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%. 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 sides of GDP.

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

We have a real opportunity to attract meaningful new investment to New Zealand. Globally, firms will be under intense pressure. Firms with depressed profits will be looking for any way to minimise *the* downside. Firms that have the ability to quickly relocate operations will seek to do so if it maintains or grows profitability.

Industry that doesn't exist in New Zealand currently doesn't pay any tax. Providing tax incentives to locate here will not cost the taxpayer anything, but could see the development of meaningful businesses in certain sectors in New Zealand.

Firms in weightless economy sectors are relatively mobile. They require little in the way of infrastructure beyond a good broadband connection with the rest of the world – and they bring the potential to significantly upskill New Zealanders and provide job opportunities for those returning home. There is a real 24-month window of opportunity here for New Zealand. We propose that new firms in the investment, environment and IT sectors that set up in New Zealand, that move more than 10 people here, and that did not previously have any New Zealand presence, be given a two-year income tax holiday. In fact, the GST on their purchases, the income tax paid by their employees and the services of other New Zealand firms they use will mean this is positive for the tax revenue overall.

A tax break like this 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.

(v) R&D tax credit

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. This credit should not be repealed, or if it is to be repealed, it should only be done after a three year period so the retraction of a tax credit that firms have relied on in business planning (including hiring and capital raising), does not financially threaten the high growth firms that have relied on it. If this credit is repealed in 2009 then it will place the firms that have relied on it, in real peril.

2. SHORT-TERM PRIORITIES (12-24 MONTHS)

We believe that the government should more actively use its balance sheet 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. We believe that there is scope to use both the liability and asset sides of the balance sheet to both manage risks and the economy so that we emerge from the current crisis in even stronger shape. It is in its current strong shape, presumably, so that it can be used when needed. That time is now.

Three proposals are made. The first is a conventional recommendation, relating to the ability of the government to borrow to finance infrastructure projects and other productive investments. The next two recommendations relate to the more active use of the asset side of the balance sheet. There are 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 has the best borrowing capacity in the country. Although care should be taken not to over-extend the government's balance sheet in the current environment, it remains important that the government use the balance sheet to finance investment in productive infrastructure such as broadband and transport networks.

There are also opportunities around how borrowing is conducted. From a long-term investment perspective, including infrastructure, it is difficult to assess any long-term project's expected returns accurately because of the lack of a long-term risk-free benchmark. While there would not be enormous demand for a 20-year and 30-year New Zealand Government Treasury Bond, there would be sufficient demand and liquidity to establish a proper long-dated price and hence a full yield curve.

Also, in the near term, 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. The main investment grade product available to this point has been bank bonds, which people are more reluctant to take on in the current environment for obvious reasons. With the demise of the finance company sector, there is a real paucity of quality yield product, to which the SOEs' current local capital-raising profile contributes.

Similarly, local authorities and councils should be encouraged to follow the lead of Western Bay of Plenty Council that issued a very successful bond product last year. A lot of people are currently holding cash for lack of such products. As ratable values for homes are falling, councils can also benefit their investment programmes from such an approach.

(ii) Create KiwiCo - an SOE Holding Company

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). These assets do not return an adequate rate of return (last year, they returned just 6.6%, about 2% lower than the OCR.). They are not subject to commercial disciplines, and do not have a full ability to invest and expand – despite announcements from ministers. But this substantial pool of businesses has significant latent potential to contribute to strengthening the New Zealand economy.

We propose the formation of an SOE Holding Company (KiwiCo). The commercial SOEs (e.g., Meridian, Mighty River Power, Solid Energy, New Zealand Post), and potentially 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, and would have a mandate to grow these companies aggressively where appropriate. It could, for example, have a mandate to invest in NZ infrastructure assets (such as the proposed broadband funds) and other strategic investment opportunities.

To this extent, KiwiCo would be organized 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. The best way to achieve the twin goals of growth, long-term New Zealand ownership, and productivity, would be for the whole organization to be self-funding, and with capital raising to be achieved at both directly a portfolio company level, and also at the KiwiCo level.

The goal is to raise $4-5 billion in fresh capital that either KiwiCo, or any of the portfolio companies can use for investment. This capital could come from floating up to 25% of KiwiCo, or a minority stake in the portfolio companies - as the Board of KiwiCo, on recommendation of the Boards of the portfolio companies, could determine.

This area is currently one that is politically, rather than outcome defined. Recognizing this strong legislative protection would be imposed. They would ensure that equity capital raising at KiwiCo itself could not go beyond a 25% level and minority level at any portfolio company. This secures permanent New Zealand government ownership, improves performance and will create a Kiwi champion to really drive growth, be the vehicle for infrastructure investment, and go global at scale.

This solution retains certain, long-term government ownership, but frees the SOEs to grow, raises new capital for desperately needed investment - which will also help with the recession.

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.

(iii) Re-directing taxpayer funded savings institutions

The government owns financial institutions that control in excess of $30 billion of financial assets (NZ Super Fund, EQC, ACC etc). These assets exist to fund specific liabilities, and are managed according to orthodox investment and portfolio allocation criteria. However, the current crisis creates a case for examining whether these assets are being invested in a way that maximises the national interest. Given that New Zealand firms will find it more difficult to access credit for investment, directing these financial institutions to place a specified proportion in New Zealand investments seems appropriate.

Our proposal is a bold move that could make a real long-term difference to our economic growth and individual wealth, without sacrificing performance. This investing vehicle would have a longer-term view, and therefore greater resilience, than the market currently does. With its investment horizon and firepower, as well as local connections and advantage, it would be uniquely placed to take meaningful funding stakes in strong New Zealand corporates in need of fresh capital. Overseas Buffet-style strategic investments recently made into Goldman Sachs and GE, and the Future Fund in Australia's recent provision of capital to the banks. This new entity would be a real local champion, would create scale where there is currently none, and would develop distinctive local knowledge designed specifically to result in outperformance over the long-term. This structure could be organized in a number of ways that respects the liabilities profile of each underlying obligation. Feedback is requested on this.

As well as the large impact such an investment approach would have, the scale of this institution would be both a global talent magnet, and allow, for example, the Fund to force (as others do) those who want their business to staff offices in New Zealand.

3. LONGER-TERM PRIORITIES FOR ACTION – LEGISLATE NOW FOR ACTIVATION

The current crisis has highlighted some structural flaws and exposures in the New Zealand economy that need to be addressed in order to strengthen its long-term health. The priorities outlined below are unlikely to have an impact on New Zealand's ability to respond to the current crisis, but are important to our longer-term economic viability.

(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 is 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 into a compulsory scheme over time is appropriate.

(ii) Eliminate housing speculation bias

The investment biases that exist toward property need to be removed from our tax system. 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 incented 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.

B. Financial system and RBNZ actions

(i) Deposit insurance and banking supervision

The RBNZ has an important role in banking supervision and ensuring financial stability. New Zealand has a banking system that comprises only a few banks, rather than the thousands that exist in the US, making the monitoring easier and the information both simpler to collect and rely on. The New Zealand banks, regulated by the RBNZ, have not engaged in the same type of derivative speculation that the US investment banks have, and their reported profitability remains strong. The Governor has indicated that he has confidence in our banking system. They are clearly monitoring the situation closely, and we should trust what he says.

Accordingly, the best course of action on deposit insurance or related matters is to leave it to the RBNZ. We would also be confident that, regardless of who forms the next government, they will work effectively with the RBNZ should there be any need to take action in the banking sector.

(ii) Interest rates

More broadly the RBNZ clearly has an important role to play in terms of decisions around interest rates and infrastructure. There is scope for very significant cuts in interest rates given that inflation risks are dissipating rapidly and New Zealand's currently high interest rates. The type of aggressive rate cutting seen globally gives a sense of the type of actions that may be needed in New Zealand over the next six to twelve months.

6. Conclusion

Our view is that 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 deliberate, serious, and proportionate.

The response must be about more than battening down the hatches. It is about ensuring that New Zealand firms and farms can continue to grow and to invest, and ensuring that New Zealand is well positioned into the future. We should see this as an opportunity to position the economy for the longer term, as well as manage the risks. But this will require real seriousness of purpose. UK Chancellor Alistair Darling has noted that the UK should now be on a 'war-time footing' and New Zealand should adopt a similar perspective.

This document is a "Draft Strategy". It is draft because these ideas are for the public to pick up and complete. It is draft because to complete it, would be to turn it into reality through decisive policy action. This document favors no party - instead we hope that these ideas to be picked up in a non-partisan way by all parties, major and minor, despite the complications of election season.

These ideas are certainly not the only ones out there, but we believe that, taken together, they address the parts of the risk and opportunity equation around which there is silence right now. They are focused on ensuring that New Zealand can support its good firms and farms, to ensure they survive the crunch, support capital investment in the economy going forward, and encourage new industry development. We also believe that there is little fiscal or economic downside to implementing the ideas that we have proposed.

We're sure that Treasury and MED will be able to work up these proposals, or come up with their own set. We challenge them, and the politicians to not wait until the crunch has really hit and New Zealand firms and the broader New Zealand economy is groggily stumbling to its feet before starting to think about them. The extent of the economic slowdown will depend in large measure on how we choose to respond.

The challenge is for New Zealand to agree on a strategy and timeline as soon as possible. We would like to see the programme of action being rolled out aggressively by the end of Q1 2009.

7. Feedback and next steps

This paper is being released in draft form. The intention is to stimulate a constructive conversation about the best way forward. In that spirit, feedback is welcomed from all. NZX is launching a blog where comments can be posted and there is online space for public comment and discussion (www.blog.nzx.com). The New Zealand Institute (feedback@nzinstitute.org) and NZX (strategy.feedback@nzx.com) are also happy to receive private e-mail feedback. The NZX and the New Zealand Institute are happy to discuss these proposals with interested parties.

Our intention is to listen carefully to feedback, and to use that feedback to improve this document over the coming weeks. Once this process has been completed, we would like to release a document that reflects broad views, and that can be viewed as a truly national, bi-partisan, implementable policy document - one that voters and politicians, regardless of their affiliation, can support.