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What's the game plan?
BusinessNZ Election Survey

October 2011

Some battle lines clearly drawn

We in business are eternally optimistic. Each election year we have high hopes for incoming governments, and each time we are disappointed they do not deliver all that we wish for.

This time will be no different. This should come as no surprise; we just don't have enough votes to matter. Not that this prevents business from having a view on what's required to make New Zealand a better place to live, work and invest. And as it is only business, in all its different forms, that creates the wealth that enables New Zealanders to enjoy the standard of living to which we aspire, our views matter.

The Deloitte-BusinessNZ Election Conference is the premier forum for business and party political leadership to engage on the things that matter to business. The survey of BusinessNZ members provides excellent insight into the issues and opportunities across the government environment, investment, innovation and sustainability, infrastructure, trade, skills and productivity, and employment.

The responses from business reflect a broad satisfaction with current directions but also identify some elephants in the room that parties of most persuasions are reluctant to confront. If the exigencies of the current time do not provide the imperative to do so, what is required?

Overwhelmingly business would like to see a coordinated plan to raise New Zealand's economic performance. Disturbingly nearly two-thirds of businesses surveyed do not believe or are unsure that there is one. Often governments call for business to get behind their efforts to grow New Zealand's economy – it helps if business has a clear line of sight on the pillars and levers of growth.

Not surprisingly business would like to see further commitment to a low rate, relatively flat tax structure with few if any tax breaks. Not only are new taxes unpopular but so too is the reintroduction of a research and development tax credit. The latter was only third on the list of preferred research and development initiatives, behind the development of stronger connections between business and science, and more money for applied scientific research.

There is a strong call for greater private sector involvement in infrastructure including the use of public private partnerships. But only 45% of survey respondents thought the ultra-fast broadband initiative would bring productivity gains.

Businesses have highlighted concerns at the lack of investment in skills and productivity measures. Nearly three-quarters believe not enough is being done to support apprenticeships and formal industry training, while over two-thirds believe school leavers are not well prepared for the workforce and only a quarter think the immigration system currently meets the needs of business. With unemployment, particularly among our youth, elevated there is clearly much more to do here.

The current Government gets a big thumbs up for its mixed ownership model for State-owned Enterprises with over 80% of businesses generally supportive of this proposal. This is seen as crucial to the development of our capital markets, improving performance, reducing the risk to taxpayers, and providing greater options for investment of the growing savings pool.

But business has also identified some issues which might cause some discomfort for the politicians. Over 80% of businesses feel that the Government should be signalling options and timeframes for changing the eligibility for NZ Superannuation, joining a similar call from the Retirement Commissioner. There is a growing realisation that current settings are unsustainable. This will be even more so should KiwiSaver become compulsory. Further reform of KiwiSaver cannot be undertaken in isolation from an overall savings strategy that also encompasses NZ Superannuation and the NZ Superannuation Fund. The main political parties have ruled this issue off limits. Business is clearly signalling that it's time for a more responsible approach.

More than two-thirds of business would also like to see further changes to the interest-free element of the Student Loan Scheme, with nearly 80% of those supporting reductions. The current approach favours the well-off and crowds out funding that could more reasonably go to facilities and teaching capability.

Nearly 60% of business would also like to see changes to Working for Families, with over three-quarters of those wanting reductions.

The responses from the main political parties reveal similarities and differences. National and Labour are both committed to encouraging economic growth and reducing debt, and neither is prepared to deal with these elephants in the room.

They part company on the mixed ownership model for State-owned Enterprises, foreign ownership of land, and tax. Labour would reintroduce the 39% top marginal tax rate for incomes over $150,000, take GST off fresh fruit and vegetables, introduce a capital gains tax, and reinstate a research and development tax credit. Capital gains tax deserves more serious consideration in the context of a savings strategy, but increasing the top marginal tax rate and the GST change are populist measures.

Business should be very concerned at the stated intentions of Labour as they relate to the industrial relations and employment environment. They are signalling a return to regimes that have been tried and failed in the past, and foreshadow an increased role for unions. Additionally, the significant increases in minimum wages will bring bad news for youth seeking to enter the labour market.

These do reflect some real differences in philosophy. National has more faith in markets and entrepreneurialism, and in people responding positively to incentives to participate in the workforce and to progress. Labour prefers more direction, places more faith in government ownership of assets, and is more concerned about redistribution of wealth.

The minor parties are able to differentiate themselves more. ACT goes much further than National in invoking the private sector and notions of personal responsibility. The Green Party shares many of Labour's economic policy positions but goes further on environmental issues such as the ETS and the Resource Management Act. United Future broadly aligns with National.

Overall the impression is that for the main parties at least there remains broad agreement on many economic and social policy settings, with differences as to means of achievement, especially in tax and the role of government in ownership and delivery. These differences matter for business.

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A secret plan to improve the economy

One of several key results from the Deloitte-BusinessNZ Election Survey that should be of real concern to the current National-led Government is that business leaders are looking for a plan to lift the country's economic performance, but they're not sure the Government has one.

Close to 100% of respondents thought it was important for the Government to have a coordinated plan to raise New Zealand's economic performance. However, only a third thinks the Government has any such plan and even more are unsure, while the rest think they don't have a plan at all.

Whether the Government has a detailed economic plan may be somewhat moot. What is not is that the business community is generally unaware of it and by implication their desire is to understand the detail behind any government strategy to grow the economy and how it will be implemented, and not just that it has a "goal" to do so.

The responses to the survey also provide some key ingredients that business would like to see wrapped into any plan development and implementation. First and foremost, 95% of respondents want a clearly articulated set of principles to guide fiscal and regulatory decision-making and the implementation of policies.

Moving from this abstract into something more tangible, more than half of respondents are concerned about the uncertainty that exists around what constitutes tax avoidance and 77% thought that the Government should be doing more to provide certainty in this area.

This isn't surprising given the recent actions of Inland Revenue to take the avoidance boundary to places traditionally thought to fall far from it. More concerning is probably that the department's views as to where the boundary should be pushed are still evolving.

It's not unreasonable for business to be looking for upfront clarity from regulators, with the avoidance boundary simply being one example. This clarity is principally obtained through regulators ensuring that Governments enact laws that clearly define the relevant boundaries. It's also about setting out clear signposts as to how they view those laws should be applied. Both can be the subject of criticism in the present case.

In fact, the tax avoidance example underlies an age-old problem: the gap between government statements about what is or is not being achieved to improve the climate for business in New Zealand, and what is occurring in reality. And in terms of what is happening in reality, this is often far removed from Government Ministers and totally at the whim of public servants that serve irrespective of the Government of the day and therefore any broader economic plan it may have.

Moving on to the role tax could play in any plan to boost New Zealand's economic performance, the results of the survey indicate that business is comfortable with tax policy playing a more active role with 82% of respondents being in favour of the tax system "often" or "occasionally" being used to influence economic behaviour. This falls foul of the traditionally held view, at least by officials, that tax should be in the background, hardly visible and certainly not influencing behaviour to bring about change that otherwise wouldn't occur.

Going against this traditionally held view however, the National-led Government has signalled that it is at least willing to consider using tax as an economic lever, by passing specific tax legislation to facilitate the development of New Zealand as a financial hub.

This example is still the exception rather than the norm noting also that 65% of the respondents still believed that the Government should be working towards a reasonably flat tax structure with no/few exemptions or tax breaks. In saying that, only 52% of the respondents continued to hold this view if, by aspiring to a flatter tax regime, a capital gains tax or a further rise to GST was required.

Finally, in terms of the tax policy debate and the changes put through as a consequence of the Tax Working Group deliberations, 35% of respondents felt that their businesses were not better off with 43% believing that they were. Is that surprising given all businesses benefited from a drop in the corporate tax rate that in many cases should have far outweighed the depreciation and other changes that went the other way? Possibly not if you also factor in the effect that the GST rise may have had on the demand for goods or services produced by those businesses. In any event, as far as the respondents were concerned, the Tax Working Group initiatives were not a clear winner or potentially the final word on macro tax policy design.

Now, the political landscape for the next three years has yet to be determined. But whatever the outcome of the general election, New Zealand business needs a Government for the next three years which provides clear direction, articulates a clear plan, and implements sound policies that will help to encourage investment in New Zealand and grow the economy – and a Government that can take officials with them on that journey.

Time will tell the extent to which tax plays a role in future plans for economic reform. At least as far as the current Government is concerned, while tax reform has the ability to play a major part in any future plans, it is not something that is being currently signalled.

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Plenty of water to go under the bridge

Cynical observers might suggest that the Deloitte-BusinessNZ Election Survey results would be relatively easy to predict, particularly the way in which the political parties line up on various issues.

In fact, I'd usually be among their number. However, on closer inspection the 2011 responses provide some interesting insights, particularly in the infrastructure area.

The various party responses on the use of PPPs show a surprisingly similar stance being taken: namely that PPPs should be taken on their merits and pursued if they can provide demonstrable better value than a publicly procured alternative.

This is encouraging but the devil is, as always, in the detail. If PPPs are only to be pursued if they are "in the public interest" or Government support will be "evidence based", what does this mean? How is the public interest defined and what "evidence" will need to be provided?

Infrastructure investments have a long life and in order to persuade private capital to invest in such projects the investment environment needs to be stable, which essentially means free from Government interference and intervention. New Zealand's track record in this respect is not good. Interference in markets and transactions by Government has occasionally been alarmingly ad hoc and has often rattled foreign investors' confidence, colouring their view of New Zealand as an investment destination. The fallout from the previous Government's intervention in the Canadian Pension Plan bid for a stake of Auckland International Airport, for example, has been much more extensive than is generally appreciated.

Political parties will always reserve the right to change direction and dismantle the policies of their predecessors. While our short electoral cycle aggravates this problem, it is nonetheless normal in Western democracies and investors understand that. What would not be normal would be to cancel transactions which have already been entered into or where investors have made substantial investments in lengthy and expensive bid processes, such as PPPs.

The ultra-fast broadband roll out is another example where commitments have been made by investors based on an expected regulatory environment. Views on how good that environment is are mixed but at least it is set for a 10-year period and provides a stable environment for investment (and, in the case of Telecom, radical change to its corporate structure). Notwithstanding the merits of what has been done, comments from Opposition parties that the scheme is flawed and anti-competitive are likely to cause alarm among those companies committed to building the network, particularly if the parties concerned make the next step and commit to taking some action on their concerns were they to become part of the next Government.

One area where active regulation is essential is in water which, interestingly, is seen by both the political parties and the private sector respondents as being the lowest infrastructure priority. This is surprising given that it is alone among the infrastructure areas considered most able to directly impact on economic growth through greater availability of irrigation. The current environment for water projects is fragmented and inconsistent over time and while some progress has been made with smaller scale irrigation schemes, large scale commercial schemes have largely failed to make much headway. This is disappointing as irrigation offers an opportunity for a true partnership between public and private sectors outside the confines of a traditional PPP.

A large irrigation project is a major undertaking on almost every front and faces a number of challenges, including securing consents to take and store water. This can become a highly emotive issue, particularly if handled poorly.

The other major challenge of course is finding the money to pay for building and operating the project. The key issue here is demand risk. How many farmers in the area to be irrigated will actually be willing to pay for water and how much will they actually be prepared to pay?

This is often quoted as a reason for Government delivery of such a project but the private sector is actually quite adept at managing this type of risk. In commercial property, for example, it is dealt with through pre-sales before a project is committed to construction. Similar principles can be applied to irrigation where commitments from farmers to take water could be used to underwrite the capital cost of a scheme.

Clearly the on-farm economics would need to stack up, including any on-farm investment needed to use the water. It is incumbent on the scheme promoter to understand these in determining the pricing of the water they supply and its affordability to its prospective customers. All this analysis can, and should, be carried out before significant capital is committed.

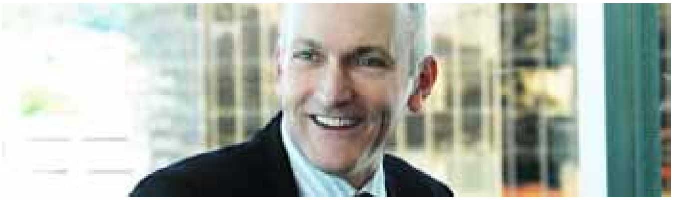
The crunch comes when the revenues a scheme is expected to generate are insufficient to support the capital needed for its development. There may still, however, be a worthwhile economic, as opposed to financial, pay off and it is here that Government has a role to play.

Government has a range of ways in which it can support marginal projects or those which provide an insufficient rate of return to attract a private investor. It can either provide part of the capital without requiring an economic return or it can subsidise the cost of water to end users. Either will provide adequate support but can lock Government into a financial position which may prove undesirable at a later stage. Government appetite for this type of arrangement is unlikely to be high, particularly when faced with pressing financial needs elsewhere. It needs a smarter way to invest.

Studies have shown that irrigation schemes often have a slow initial take up but as the benefits are realised by those who invest, others join the scheme. A lot of landowners will "wait and see" and commit only to off-take when they have seen the benefits reaped by others, particularly where land use change is needed. The price differential between irrigated and dry land usually gets their attention but takes time to emerge and develop.

What this means is that revenue the scheme generates will grow over time but there is considerable risk around when and if this will happen at the outset. Ultimately a scheme which needed Government capital to get off the ground may be self-sustaining in due course. What Government needs is a flexible model in partnership with the private sector where it maximises risk transfer to the private sector partner.

Getting irrigation right, and indeed infrastructure more generally, is critically important and the Government is likely to always have a role. That role needs to be restricted to facilitating projects, with capital if necessary, but with a clear exit route and prices set by market processes. Major infrastructure projects are not easy to deliver. They are expensive and have a high public and political profile but if we are to grow our economy, particularly in agriculture, we need to deliver them in scale and find smarter ways to do so.



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