

# Playing the long game

05 August 2020



Photo / iStock



**David Skilling**  
Director of Landfall Strategy Group

---

*In a three-part series commissioned by New Zealand's leading investment and advisory group Jarden for its clients, Dr David Skilling examines the impact of Covid-19 on New Zealand's economy from a global perspective. This op-ed is a summary from the final part in that series and has been provided exclusively to The Herald. Over the three-part series, Skilling explores our Covid-19 response in relation to other countries, whether we are better positioned for economic recovery, and what the longer-term reconstruction and economic recovery phases ahead will involve.*

Covid-19 will have a substantial impact on New Zealand's economic performance and wellbeing, despite New Zealand's success in eliminating community spread. GDP contracted by 1.6% in the first quarter, and there will be worse to come in the June quarter. Treasury's Budget forecast in May was for a 10% GDP contraction in 2020 and for unemployment approaching 10% this year. Things will turn out better than this because of the quicker than expected exit from lockdown, but 2020 will still be a very bad year.

Beyond this, a gradual economic recovery process is likely over the next few years. The economic costs from the lockdown period will become more apparent over the next few months, particularly as government support measures are phased out. The ongoing border closures will impose significant ongoing costs in terms of reduced inflows of international tourists, students, and migrants. And the global economy is set to contract significantly in 2020 (-6% according to the OECD, -5% according to the IMF) which will weigh on demand for New Zealand's exports.

But at least as importantly, the severity and duration of the Covid-19 shock means that it will have a significant structural impact on the functioning of the economy, business, and society. Covid-19 will strengthen and accelerate pre-existing trends in areas from globalisation and geopolitics to technology and new business models. And the impact of Covid-19 will also interact with long-standing economic weaknesses in New Zealand, such as low investment, innovation, and productivity. The government policy response needs to play the long game, responding to these longer-term issues as well as the immediate impact of Covid-19.

The international experience shows that strategic policy judgements in response to structural dynamics make the difference for long-term performance. New Zealand needs to deliberately incorporate a structural response into its Covid-19 response. Otherwise, we will build back the same economy for a very different post-Covid context – and will have heavily constrained fiscal resources and policy options to adapt to a changed world in a few years' time.

The initial policy response has been well handled in New Zealand, but a stepped-up policy focus on these medium-term changes is now required. There are three types of change that will require a policy response.

First, different sectors will be advantaged or disadvantaged by Covid-19. Technology and healthcare are well-positioned, for example, relative to sectors that are heavily exposed to cross border flow of people. In New Zealand, international tourism will be deeply impacted. Beyond the immediate negative impact on demand due to closed borders, the weakened financial position of international airlines and changing preferences of consumers are likely to mean significantly reduced levels of passenger traffic into New Zealand over the medium-term.

Policy has an important role in supporting the transition of workers and capital across the economy, from structurally challenged sectors to sectors with better structural growth prospects. Caution should be exercised in providing support to challenged sectors that will not return to pre-crisis levels of activity. Although some short-term support is appropriate, the primary policy focus should be on supporting a reweighting of the economy to reflect the changed growth outlook across sectors. This will involve significant investment in skills and training initiatives so that people can move into new areas of the economy, including New Zealand's digital and technology sectors that have relatively better prospects in a post-Covid-19 world.

Second, Covid-19 is likely to strengthen key structural themes in the global economy. For example, many governments around the world are announcing green initiatives as part of their Covid-19 response to accelerate the transition to a low emissions intensity economy. New Zealand has a legislative commitment to net zero emissions by 2050, which will require transformational change in the economy. If infrastructure projects are to be funded as part of the Covid-19 response, there should be a bias to a green agenda rather than reinforcing the current structure.

Similarly, investing in digital capability is being treated as a Covid-19 recovery priority in several leading economies. Digital sectors have been advantaged by Covid-19, and are likely to be a source of jobs and economic activity in the future. For New Zealand, investing in digital capability and infrastructure (e.g. 5G) should be a strategic priority to create new opportunities.

Countries are also acting to strengthen resilience to changes in the global system that have been reinforced by Covid-19. In addition to the growing protectionist frictions on globalisation, the big challenges for New Zealand relate to the growing geopolitical tensions between the West and China. These will increasingly have an impact on international commerce, with more restrictions likely on trade and investment involving China. New Zealand's heavy economic exposure to China creates risks for New Zealand, as has recently been observed in Australia. Active economic diversification will be important for New Zealand to manage this exposure.

Third, Covid-19 will likely have a significant impact on New Zealand's growth model. New Zealand's GDP growth has been driven heavily by growth in hours worked with a much smaller contribution from labour productivity growth. The migration-fuelled growth in the labour force has created strong incentives for New Zealand firms to expand through hiring labour rather than investing in capital, technology, and R&D.

This has created a low investment, low wage, low productivity model in New Zealand. New Zealand has one of the lowest levels of business investment in the OECD, including advanced economies with similarly-sized domestic markets. But the severity and duration of the impact of the border closures on migration will place pressure on New Zealand's labour-intensive growth model, and may be sufficient to create incentives for firms to invest more in productivity-enhancing capital.

This can be a long-term positive, but the transition will take time and will need sustained policy support – particularly during a period when unemployment is high. But this is an opportunity to invest in skills upgrading, capital and technology investment, to move to a higher productivity, higher wage economy. A shift to a new economic model could be a silver lining for New Zealand to the black Covid-19 cloud.

The scale of these structural changes means that a deliberate strategic response is required. New Zealand's economic policy response to Covid-19 needs to move beyond near-term support measures and focus on positioning New Zealand to perform in a very different post-Covid world. And we should also take the opportunity to address the persistent weaknesses in the New Zealand economy. A longer-term strategic focus is needed to ensure that New Zealand builds back stronger and better.

*Dr David Skilling is Director at Landfall Strategy Group, formerly Chief Executive at the New Zealand Institute and a senior advisor to the New Zealand Government.*

This article reflects the opinions and views at the time of publication, and is not to be relied upon as a basis for making any investment decision. Please seek specific investment advice before making any investment decision. Jarden is an NZX Firm, a broker disclosure statement is available free of charge at [www.jarden.co.nz](http://www.jarden.co.nz). Jarden is not a registered bank in New Zealand.