Background Thinking - Rotorua Economic Recovery Plan

Whakahouhia te Whare Ohanga – Build Back Better

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Purpose

This document details some of the literature and information from Government that has shaped the development of Council’s ‘Rotorua Economic Recovery Plan: Build Back Better’.

The intent is to provide Councilors with an overview of the considerations which underpin the recovery plan itself, but which will also need to be taken into account in determining the 2020-21 Annual Plan.

Executive summary

This paper notes that:

- Recovery plans must respond to the social, economic, environmental, and cultural well-being of communities in the present and for the future.
- Learnings from the GFC identify that the effectiveness of economic or fiscal stimulus in recessionary conditions is enhanced when the 3Ts (targeted, timely & temporary) are applied.
- Government spending (projects and consumption) and targeted transfers to those most in need have the greatest multipliers of any economic or fiscal stimulus.
- Councils have a role in supporting Government economic stimulus by maintaining spending to local suppliers and businesses.
- Rates freezes are not targeted and are difficult to apply for a short-time, potentially delivering significant risks to debt levels, economic recovery action and creating larger rate rises in the future.
- The intergenerational impacts of rates freezes should be considered given the potential for a relative shift in burden to future generations (including those currently young). In this context, the potential distributional impact should be noted given the disproportionately young composition of the Maori population.
- The Rotorua approach is intended to maintain flexibility in short, medium and long-term action and to work closely with Central Government, Te Arawa and business leaders to respond to an unclear future.
- Partnering with Central Government, Te Arawa and local business leaders is intended to ensure actions will be effective and improve confidence to invest.
- Flexibility will need to be retained to support the progressive development and delivery of projects, actions and support – initially in the short-term (remainder of 2019/20 financial year) and then into the 2020/21 Annual Plan and 2021-2031 Long-Term Plan.

Guidance on Annual Plan decision making is provided in the areas of;

- Responding to circumstances but maintaining direction,
- Provide for cushioning the blow,
- A prudent approach to rating,
- Directly investing in recovery,
- Prudent use of debt funding,
- Planning to adapt & managing risk,
• Responding to emerging adverse impacts, and
• Economic recovery planning.
Section 1: Key Considerations

Role of Local Government in recessionary responses

The purpose of local government is –
- To enable democratic local decision-making and action by, and on behalf of, communities.
- To promote the social, economic, environmental, and cultural well-being of communities in the present and for the future. (Local Government Act 2002, section 10 (1)).

The role of local authorities is to lead and represent their communities. They must engage with their communities and encourage community participation in decision-making, while considering the needs of people currently living in communities and those who will live there in the future.¹

This clearly means that while councils are considering how to respond to the impacts of Covid-19 now, they should not lose sight of the importance of community well-being in the future.

There is an understandable tendency at times of recession for Council’s to retrench, limiting spending, reducing rates increases and even ceasing what are seen as ‘non-essential’ services. Whilst such action may be perceived as being financially responsible, the counterfactual is that negative impacts are likely be observed across the social, economic, environmental and cultural well-being’s. To illustrate, grants to community groups and community events could easily be perceived as discretionary activities. During recessionary times it is probable that alternative funding support for these activities will be more difficult to attain. The challenge for, in this example, would be to either increase funding or to see the loss of important community services and activities.

Intervention approaches - the 3Ts and economic stimulus multipliers

There is a significant body of international research and learnings from the GFC that can be used to inform responses to Covid-19.

It is already clear that the economic impacts of the Covid-19 pandemic are likely to be larger and to extend for a much longer period than the GFC.

Economic or fiscal stimulus is a discretionary, temporary measure aimed at increasing an economy’s economic activity level and employment level during an economic downturn. For an economic or fiscal stimulus to be effective, it has to be:
- Timely
- Temporary
- Targeted²

² Three Keys to Effective Fiscal Stimulus Douglas W. Elmendorf and Jason Furman, Saturday, January 26, 2008
“To have the greatest impact with the least long-run cost, the stimulus should be timely, temporary, and targeted. **Timely,** so that its effects are felt while economic activity is still below potential. **Temporary,** to avoid raising inflation and to minimize the adverse long-term effects of a larger budget deficit. Finally, well **targeted,** to provide resources to the people who most need them and will spend them: for fiscal stimulus to work, it is essential that the funds be spent, not saved.”

As a further explanation of the concept of timely - “Any steps that policy-makers take must be ‘**targeted**’; helping those who most need to be protected from the downturn and achieving the maximum bang-for-the-buck in added output for a given budgetary cost. Fortunately, these are complementary, as the households most in need of money are also the families most likely to spend it —thus boosting aggregate economic activity.”

The International Monetary Fund in their analysis of 2009/10 responses to the GFC noted that the multipliers from government investment and consumption (stimulus), which are roughly similar in size, are larger than the multipliers from other stimulus responses, such as transfers, labor income taxes, consumption taxes and corporate income taxes. Only targeted transfers come close to having multipliers similar to those of government spending.

Therefore the biggest bang-for-buck in economic stimulus is Government spending or consumption, followed by targeted transfers to those in need. The IMF noted that much of the spending done by Governments as stimulus projects was too slow after the GFC. In many cases these projects began when the economy was already starting to recover and was therefore of little value. A failure of **timeliness.**

The South Australian Centre for Economic Studies in a report commissioned for the Local Government Association of South Australia post-GFC noted, “Council’s do support many local suppliers and contractors through the delivery of services in the community. This can provide a baseline of activity to lessen business impact.” In addition, “Contrary to the views of some, local governments can effectively promote local economic development, it is important that they do so and the place-based approach is a particularly valuable way in which to do so.”

Infometrics economist Brad Olsen shares a similar view in relation to the Covid-19 response, “Just like central government, local government has a key role to play in times of economic downturn. When the
private sector stops spending, local government needs to keep spending to keep the economy going and provide stimulus back into local communities.”

In a talk by economist Shamabeel Eaqub for Economic Development NZ, he expressed similar views on the role of Local Government in a recessionary environment. He also urged caution in setting the level of rates rises in the short-term.

On the topic of rate freezes, Brad Olsen noted they could “... cripple economic recovery”. That’s because many councils would have to borrow money to achieve a zero per cent rates increase this coming year. The Wellington City Council rates freeze option forecasts a rates hike of 17% in the 2021/22 year. A general reduction in rates or a freeze on increases fails to target those in need or those experiencing the adverse impacts.

Significantly reducing the funding available to local government or a reduction in a wide range of services can have a detrimental effect in the longer-term. In examining the impacts of austerity on Local Government in the UK, researchers noted that “…changes have increased territorial inequity and injustice in the UK. Citizens’ access to public services is increasingly conditional upon the health of the local tax base—where poorer places provide fewer public services and less basic infrastructure. The increasing importance of local taxation to fund local spending, with a shrinking redistributive element coordinated by central government, is likely to lead to a downward spiral of disinvestment in people and places in some communities, while others thrive.”

In this austerity period, UK life expectancy declined, something unprecedented in peacetime.

There is particular value in citing the impacts of austerity approach in the UK. In a NZ local government context, the impacts of UK like austerity would erode well-being of communities in the present and for the future.

Those advocating for a rate freeze are also ignoring the potential that like the Great Depression, economic recovery will take many years and what is promoted as a short-term action, will potentially create longer-term damage to council balance sheets and their capacity to effectively support well-being in the futures. Reducing the quantum of rates is not targeted in anyway. It does not differentiate between a household or business severely affected and one that remains almost completely unaffected.

The consequences of holding rates at extremely low levels through the GFC, without subsequent corrections or the reduction in services are evident the Rotorua Lakes Council’s recent history.

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7 Councils are grappling with the financial response to the Covid-19 pandemic. By: Georgina Campbell Wellington issues reporter, NZ Herald, 9 April 2020
8https://zoom.us/rec/play/upd5dOqvrW83HNyTsQSDAKJwW427e_6s0XAY8qBYy0m0AHEGYwXzMOZANLChXBBy_ToKFYWeewfMrPV8?continueMode=true&_x_zm_rtaid=NkeZ6dHIR6mXt2R5Z81jg.1586301680722.62f6383b15d7c949df7283fb1311016a&_x_zm_rhtaid=451
9 Councils are grappling with the financial response to the Covid-19 pandemic. By: Georgina Campbell Wellington issues reporter, NZ Herald, 9 April 2020
The Rotorua Lakes Council held rates levels artificially low during the GFC (under 1%). Consequently, there was an increase in debt levels as operating expenditure was supported by borrowing. Underinvestment also occurred in many assets (described at the time as ‘sweating the assets’) creating a substantial legacy to address. The actions taken by the Rotorua Lakes Council around the GFC were a failure to effectively deliver local stimulus that met the 3Ts (targeted, timely & temporary).

For Council, rates levels were not corrected post-GFC and this compounding shortfall in rating revenue resulted in the need for:

- major restructuring of the organization
- significant cuts in planned capital expenditure across several years
- recovery investment in asset renewals
- significant rates corrections in 2013/14 year (particularly around core infrastructure).

The impacts on the financial sustainability of the Rotorua Lakes Council was detailed in a PWC report in May 2014. 12

Unlike a business, a significant portion of a council’s activity is essential or required by law e.g. legislation/statue, asset management or regulatory requirements. Examples include:

- Essential or core infrastructure services (waste water, water, storm water management, local roading and refuse collection and disposal)
- Regulatory and statutory services or activities (health, building, RMA & planning, dog control, bylaws)
- Civil defense / emergency management
- Community governance
- Asset management.

Other core services are important to the well-being of the community and include parks, reserves, sportsgrounds, library services, halls, sports venues, stadiums, museums, arts venues, pensioner housing and aquatic facilities.

An unclear future and the need for flexibility

The duration and on-going impacts of Covid-19 on the NZ and global economy is not clear. Many countries, including NZ, are currently trying to manage or eliminate the spread of Covid-19 and to stamp it out by ‘flattening the curve’. While this is occurring significant damage is accruing to the local, national and the global economy.

What is clear is that the effects are likely to be profound. The International Monetary Fund has slashed its forecasts for global growth in response to the Covid-19 pandemic and warned of a slump in output this year unparalleled since the Great Depression of the 1930s.\(^\text{13}\)

Infometrics data shows that in 2019, tourism accounted for 22.7% of employment in Rotorua. The same figure for New Zealand as a whole was 9%, showing our region’s comparatively higher exposure in the tourism sector. The accommodation & food services sector is strongly dependent on the visitor economy, employing 10.8% of the region’s workforce. These comparators provide a point of comparison for measuring the impact of the virus in the short and medium term and also indicate areas where the impact on jobs is likely to be the greatest.

Damage to some sectors and on-going global disruption may result in differential rates of recovery. Cumulatively, this damage may mean the some local or national economies may not return to previous GDP levels in a recovery and potentially, track at lower growth rates. These scenarios displayed in the diagram below.

The implication is that to generate the most optimal recovery, additional effort will be required to consider how severely affected sectors can be supported to change focus and increase value, or for new

sectors to be developed to replace them. This reinforces the need for a ‘build back better’ approach to improve future resilience and improve wider community outcomes.\textsuperscript{14}

Strategic consultants like McKinsey and Company recommend adaptive strategy development for businesses based on an evolving picture of the impact on economic activity (GDP), the public-health response and economic policies (i.e. How effective have we been in managing and eliminating Covid-19 and how effective has the government economic stimulus been?) The relationship of these two factors and a range of potential scenarios is shown in the diagram below.

On the 14 April, Treasury released its projections of the possible impacts of Covid-19 on the NZ economy.

“There are a wide range of possible impacts depending on which scenarios you look at. Annual average GDP growth is shown to fall by as little as 0.5 percent or as much as 23.5 percent in the fiscal year

\textsuperscript{14} Build Back Better in recovery, rehabilitation and reconstruction. UNISDR 2017
ending 30 June 2021, and estimates of the unemployment rate in the June 2021 quarter range from 5.5 percent to 22 percent. Two of the scenarios illustrate the cushioning effect of greater fiscal support on GDP and unemployment.”  

These are indicative scenarios, based on assumptions and estimates subject to considerable uncertainty. They were provided to give an insight into some of the possibilities that the Government are considering as they develop responses to COVID-19 and plan for a solid economic recovery. It is expected that actual outcomes will depend on a range of factors, including the success of containment measures and the economic response, both in New Zealand and internationally.

Alignment therefore exists between the broad ranging Treasury scenarios and the best and worst case scenarios of the Mckinsey & Company and Tomas Pueyo graphics.

**NZ Government Action to date**

So far, the NZ Government has sought to ‘cushion the impact’ and moved quickly to increase targeted benefits to those in the most need and likely to use it immediately. These benefit changes being:

- Winter energy payment doubled (from 1 May)
- Increase to all benefits of $25 per week (from 1 April)
- Wage subsidy to try to save jobs where employers have suffered a greater than 30% revenue change
- Student packages.

In addition to the wage subsidy Government has also identified $2.8b to be invested in business tax changes to free up cash flow. This will include a provisional tax threshold life, the reinstatement of building depreciation and writing off interest on the late payment of tax.

The Government has announced a range of new support measures for small and medium-sized businesses, including a $3.1 billion tax relief package.  

Government is currently compiling a list of infrastructure projects and programmes across the country that are ‘shovel ready’ and could be fast tracked as part of an economic stimulus package. These projects will be considered in the context of any potential Government response to support the construction industry, and to provide certainty on a pipeline of projects to be commenced or recommenced, once the COVID 19 Response Level is suitable for construction to proceed.

In addition to reviewing current Government projects, Local Government has been asked to submit potential projects to stimulate local economic activity and help support jobs.

It is worth noting that two of the Treasury scenarios increase fiscal support (already $20b committed) by a further $20 billion and $40 billion, which mitigate the falls in activity and employment to some extent.

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Government is likely to try and ensure the effectiveness of economic stimulus by ensuring it is well targeted, temporary and timely (e.g. shovel ready!).
Section 2: Implications for 2020-21 Annual Plan Decision Making

The Covid-19 pandemic has created an extremely challenging and dynamic environment within which to plan. Council is nevertheless required to consult and adopt an Annual Plan for the 2020-21 year over the next two months.

In responding to the current environment, eight strategies are proposed on which to base the development of the Annual Plan. These being;

1. Responding to Circumstances but Maintaining Direction

Dr Ganesh Nana suggests that “the most valuable commodity required by all now is a clear head”.\(^{17}\) He notes that even though we are in unprecedented times our “kaupapa remains unchanged”.

For the Rotorua Lakes Council, the focus has been and remains clear. The community vision (Vision 2030) and the goals being pursued for the district, should remain central to the work of the organization.

“It will be a world that is different, and will require different thinking, different behaviours, and different models. But this kaupapa need not change.”\(^{18}\)

2. Cushioning the Blow – Rates Relief

With an immediate focus, part of ‘cushioning the blow’, Council has already implemented a rates deferment mechanism for the next rates demand (20 May 2020). The deferment strategy meets the 3Ts in that it is targeted to those who meet the Government’s criteria for support, provides timely relief when it is needed and is temporary in nature.

The economic impacts of the current crisis are likely to be long lasting but differentially felt across various business sectors. Moreover, increased levels of unemployment may place significant financial stress on many households. Both of these factors will require a mechanism to provide continued targeted rates relief during the 2020-21 Annual Plan year.

Without such a mechanism Council will likely have difficulty in recovering rates from distressed businesses and homeowners. The rates deferment option provides immediate relief without compromising Council’s revenue base.

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3. A Prudent Approach to Rating

It is indisputable that Council will need to minimize any increase in rates for the 2020-21 Annual Plan year.

At the same time, Council will also likely experience over coming months a significant reduction in revenue from service charges, external funding, and also potentially rates as, for example, businesses close.

Some commenters believe that in the current environment a rates ‘freeze’ is the correct response. It is important to consider that, such an approach would adversely impact the Council’s balance sheet and hence reduce the organisation’s ability to cushion the blow and to contribute to the recovery programme.

In the Rotorua context, the proposed rates rise for 2020/21, prior to the Covid-19 lockdown, was driven predominantly by the need to meet increased costs of essential services, these being:

- Waste water service change, maintenance, meeting new regulations and land development
- Water charges to meet evolving water quality standards and demand
- Refuse collection to address demand, costs of regulations ETS.

The Council is committed to providing these services, therefore significantly compromising options for cost mitigation. Similarly, past experience dictates that adequate funding must be retained to support the maintenance and renewal of existing assets, this further restricting opportunities for cost reductions.

On top of this, the additional costs of cushioning the blow and the recovery programme are likely to be significant and will not be able to be met by simply increasing rates. This creates an imperative to secure significant operational cost reductions during the 2020-21 year.

There has been a large amount of work undertaken over recent weeks and a number of areas have been identified where savings are possible. These include, but not limited to;

- An organizational wide salary freeze
- Only filling absolutely essential vacancies
- Removal of any inflation adjustment
- Redeployment of staff.

It should be noted however that the majority of areas where savings have been identified would be unable to be sustained over future years without a deterioration in the levels of service provided to the community.

The changes brought about by the Covid-19 pandemic are likely to have far-reaching consequences for the nature and shape of Council services in the future. This will trigger the need to reconsider the shape of the organization going forward from which some efficiencies are likely to be identified. Unfortunately, the precise impacts of the pandemic are still rapidly evolving and it is highly unlikely that significant organizational change will be completed in time to have any impact in the 2020-21 year.
4. Directly Investing in Recovery

It is also important to consider the implication of Council not only failing to ensure adequate funding, but also retrenching planned capital projects. The vast majority of the work of this nature is undertaken by contractors who provide local employment and also support a large allied service industry.

The recovery plan instead focusses on recommencing all current projects and bringing forward further projects that drive increased employment. This is completely aligned with Government’s recent request for ‘shovel ready’ projects. There is a “... need for a flexible and fleet-footed response from government. ... Now would be a great time to start shoveling”.  

Maintaining and/or enhancing the Council’s capital work programme will place additional financial pressure on the 2020-21 Annual Plan budget. The criteria of affordability will ultimately determine the level of capital spend able to be made available in the 2020-21 Annual Plan.

5. Prudent use of Debt Funding

Council has maintained a AA- credit rating which now places its assessed credit risk as lower than the majority of the commercial trading banks. This reflects a strong balance sheet with a forecast of sound financial sustainability.

It is worth noting that Government’s intention to invest in infrastructure via the Crown Infrastructure Partners fund (CIP) may remove some capital costs from the Long Term Plan and thereby further improve Councils financial position.

Given the extraordinary circumstances20 Council has the ability, should it so choose, to debt fund one off expenditure and thereby mitigate the associated costs which otherwise fall in the Annual Plan year. It would be important to consider such debt as temporary, and to plan to pay it off over the next few years. Implementation of the Waste Water partnership, or special circumstances funding for a CCO are examples of where this debt funding strategy could be applied.

Notwithstanding Government’s CIP decision making, regardless of any decision to use this technique or not, it is likely that the costs of the recovery strategy will inevitably result in some lift in debt levels for the 2020-21 year, beyond that projected in the LTP. This will be carefully modelled and, if needed, plans identified to mitigate any negative long term impact.

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19 https://www.berl.co.nz/birds-eye-view/autumn-2020
20 The IMF has categorized the Covid-19 pandemic as equivalent to the Great Depression making it therefore a 1 in 100 year event.
6. Planning to Adapt & Managing Risk

Scenario modelling by Treasury and Mckinsey and Company highlight the significant uncertainty that exists around the impact on the economy, with many assumptions being made about the success of health responses and the effectiveness of Government economic stimulus.

It is essential that the Council’s recovery strategy remain flexible to ensure actions and interventions can be adapted as a clearer picture of the future emerges post-lockdown.

As noted previously, the real economic and financial implications of the Covid-19 pandemic will unfold over time. In order to manage worst case risk scenarios Council will need to continually monitor the ongoing impacts and be prepared to adjust direction accordingly. It will therefore be important to plan for a progressive release of capital projects the contingent staging of commitments.

7. Responding to Emerging Adverse Impacts

Council will also need to closely track the nature and ongoing impact of the Covid-19 pandemic on the Rotorua community across the four well-beings. Whilst Central Government and social service agencies are likely to take the central role in responding to the adverse social impacts of the Covid-19 pandemic, Council also has an obligation to respond if needed. Any response would invariably be in the form of Council supporting and working in partnership with social sector organizations.

Maintaining a level of capacity to respond to emerging adverse impacts will be essential. This may be as simple as retaining some ability to increase funding for community groups, to more significant contributions such as the provision of direct community support (e.g. as provided by the ‘navigator’ roles established following the 2018 flood emergency).

8. Economic Recovery Planning

The intention to focus on Rotorua’s strengths is also important. Rotorua experienced several decades (1990-2012) of zero growth and limited investment. The Mckinsey and Company model highlights what could occur if targeted interventions are not well constructed and optimism does not exist to encourage people to move here and for businesses and Iwi to invest.

Government stimulus and on-going Council spending can only achieve so much. Locally, there is also a need to create a positive climate among businesses and investors to support a strong bounce back and the strengthening of the economy through a recovery.

The Council’s strategy to establish an effective partnership with Central Government, Te Arawa and business leaders to shape recovery action across the short, medium and long-term here is of critical importance. The business leaders are best placed to lead recovery in their sectors and support longer-term change. They will also build confidence, critical to lift optimism and support investment decisions.
As part of a build back better approach it is important we recognize Māori values and principles in shaping longer-term responses. Economic recovery action that can reach this portion of our community (especially if it is leveraging Iwi investment) will have a significant multiplier effect in boosting economic recovery and change wider social and community outcomes.

Longer term, the impact on Māori will be acutely felt by their currently young population. The different demographic structure of Māori is important when considering the inter-generational aspect of decisions made now. In particular, decisions to defer infrastructure spending (whether on social networks, community facilities, or physical and natural capital) will impact disproportionately more on Māori. Should it be neglected now (or ‘kicked down the road’), the population of young Māori will bear more of the load of restoring, repairing, and overhauling infrastructure in the future.

In this context, the growing role of government (both local and central) will also be a factor in the impact on Māori. With Māori at the table, a longer-term horizon for decision-making may be encouraged.

The task of recovery planning is currently being facilitated by Rotorua Economic Development (RED). Given the scale of this work Council may need to provide some additional support for RED and also be open potentially to providing capital funding for emerging projects.
Section 3: Endorsements

Officers seek endorsement that Council

1. Note the background information provided in Section 1 of this document;
2. Agree that the strategies outlined in Section 2 be used to inform the creation of the 2020-21 Annual Plan;
3. Agree that a communication plan will be developed to keep the community informed of the Annual Plan development, its key messages and key dates for release of a consultation document and final adoption of the Annual Plan 2020-21.