

Auckland Economic Quarterly

Chief Economist Unit

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David Norman – Chief Economist
david.norman@aucklandcouncil.govt.nz
021 516 103

Big questions for big money

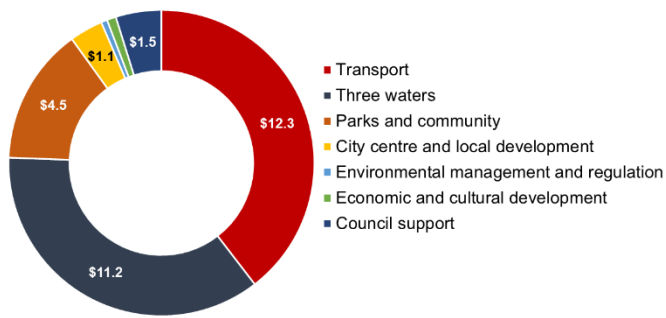
- Auckland's draft 10-year budget is out for public input.
- Auckland is New Zealand's economic powerhouse and biggest population centre, and this budget proposal is commensurately large, including unprecedented levels of expenditure on infrastructure.
- As always, we can't afford everything we want; trade-offs must be made.
- It is vital that the fundamental questions are answered as proposals are made and as the public evaluates and responds to these proposals.
- These fundamental questions include whether an issue is the Council Group's problem to solve, whether the total economic (financial, environmental, social and cultural) benefits of a proposal outweigh the (usually mostly financial) costs, and whether the benefits and costs are equitably distributed.

On 22 February, Auckland Council Group released the Draft 10-year budget, or Long-Term Plan, for public consultation. Some of the key figures from the proposal include \$31 billion in infrastructure spending over 10 years, and \$55 billion in operational spending. Spending on infrastructure being proposed for the next decade is unprecedented in Auckland's history.

There will inevitably be those who would like more funding for their particular area of concern or passion. Some will have wanted more spending on community infrastructure, cleaning up waterways, affordable housing initiatives, tree-planting, climate change mitigation and adaptation, or public transport.

But money (like any resource) is not endless, and so using good economics, trade-offs have to be made given our financial constraints, as in every reader's own household. Rates growth cannot be kept modest while boosting spending across the board. Auckland already has one of the lowest rates per capita in the country and is keeping rates rises low compared to some other New Zealand cities like those [here](#) and [here](#).





Source: Chief Economist Unit, Auckland Council; Auckland Council Group consultation content

It's a bit like buying toothpaste

In putting together a budget, and in evaluating a proposed package of spending for its value for money, we need to consider many of the same questions that you do when you buy toothpaste at the supermarket.

When you stand there in front of a seemingly endless array of options, you're evaluating the pros and cons, which means you're doing a cost-benefit analysis, possibly without even realising it. You've already concluded that, from the multitude of options you saw on the internet for avoiding tooth decay, the short-list includes toothpaste. You've also already determined that a few dollars a month on toothpaste is better than the alternative – toothache and the dentist's drill, and worse, the bill.

But now you're confronted by a mix of flavours, extreme promises about a Hollywood smile, brands that you trust or don't. You're evaluating what benefits each promises, whether you think they'll deliver those benefits, and all against your budget constraint. You reach for a tube as you complete your evaluation.

10 key questions for decision-making

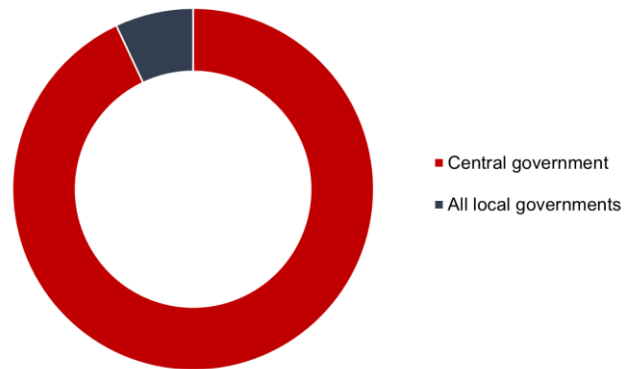
Clearly *more rigour* is required when you're considering a spend of multiple billions across a region than when buying toothpaste. But many of the principles are the same. Primarily, you identify the problem to solve (risk of tooth decay), determine your best solution (twice a day brushing), and that the benefits of action outweigh inaction.

The Chief Economist Unit developed a "10 questions" approach to evaluating the benefits and costs of infrastructure and policy proposals in 2018, which is pertinent. It is a simplified, but not simplistic, version of best-practice cost-benefit analysis methodologies used by the New Zealand Treasury and numerous agencies globally.

It's against the light of these questions that we need to hold up each pot of spending to determine whether it delivers economic benefits (rightly defined as financial, environmental, social, cultural and every other "al" that constitutes wellbeing) that outweigh what is usually a financial price tag, without worsening inequity over time.

- **Question 1: What is the problem we are trying to solve?** Without a clear understanding of the problem, we run the risk of doing something because we can, and not because we need to or because it is the best solution to fix a real problem.
- **Question 2: Is this problem the Council Group's to solve?** New Zealand has one of the most centralised tax systems in the OECD. Central government gets 93% of tax revenues, compared to 7% across all local governments. The Group neither has the mandate, nor the money to meet every social, cultural, or environmental need that we'd like. And if we try to, we run the risk of crowding out work that should be done by central government or, if a profit can be made, by the private sector.

Centralised: Share of total national tax revenues



Source: Chief Economist Unit

- **Question 3: What are our long-list options to solve this problem?** The most easily do-able option may not be the most cost-effective or create the longest lasting answer. We shouldn't leap to conclusions.
- **Question 4: What are our short-list options?** Having worked through and eliminated ways to tackle a problem that are clearly batty or unaffordable, what are the most feasible remaining options?
- **Question 5: How much would the short-listed options cost, and who would pay?** This is getting to the crunchy end. Have we got a realistic idea of what the best couple of options would cost? In the case of infrastructure, where construction costs are rising fast, this question is particularly important. Also, are there non-financial costs of the proposal, such as noise, congestion or loss of visual amenity?
- **Question 6: What benefits do we anticipate, and to whom?** Governments deal in intangibles, not profits. They provide safety, social cohesion, cleaner beaches. It is hard to measure the value of these things (we will try in question 7), but at very least, we must articulate *what* the benefits are and who gets them. If we can't, we shouldn't spend the money. Do the benefits broadly go to the people who pay? Is it an equitable distribution?

- **Question 7: How much would these benefits be when quantified?** We need to try and put the benefits identified above in numbers that we can evaluate against the (usually) financial costs. If we can get them in dollars, that makes the comparison easiest. But we should always be able to provide at least a sense of scale – number of people affected, number of tonnes of CO₂ equivalents avoided, percentage increase in tree canopy cover, or percentage increase in public transport coverage for instance.
- **Question 8: Do the benefits outweigh the costs?** This question is the holy grail. Not asked often enough, and for governments dealing in intangibles, often challenging to answer. Weighing up dollars of spending against a non-monetary benefit (or sometimes benefits for which we can't even provide a proxy figure) is hard, but we must make the call explicitly and transparently, on the best available data. If there are many unmeasured benefits, the rationale needs to be watertight. If the answer to this question is “no”, we should go back to the drawing board.

- **Question 9: How reasonable are our assumptions?** We're all prone to thinking our idea is the best. If we moderate our benefit expectations, do the benefits still outweigh the costs? Are our assumptions based on a reasonable base of facts and evidence, or are they pure conjecture?
- **Question 10: Which option do we put forward?** Having determined which short-listed option stacks up best, is affordable, doesn't create a mismatch between those who pay and benefit, we finally need to think about affordability and equity before we proceed. Theoretically, a solution may deliver great benefits to those who pay but leave others behind altogether. Inequity comes back to bite, so should be explicitly considered in determining the best option.

As we look ahead to the next 10 years, and to every year, these are the questions to keep front of mind as we seek to make informed decisions.

You can [have your say on the 10-year budget](#) by clicking here.

Economic Commentary:

Level 3, take 3

Shyamal Maharaj

Economist, Chief Economist Unit

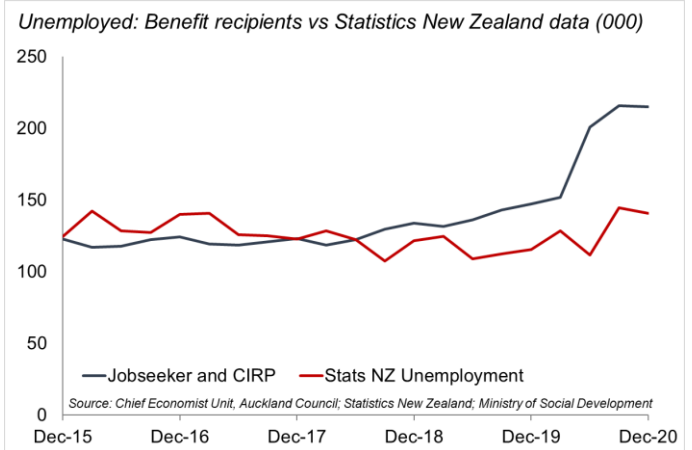
- Auckland was recently thrust back into a Level 3 lockdown, followed by a quick change to Level 2 and now Level 1.
- Data shows that typically in level 3, the number of people in town centres and the city centre falls by roughly 20-50%, and around 190 jobs were lost each day at Level 3 last time around.
- Economic data since May 2020 shows remarkable resilience to the ups and downs of the pandemic.
- The housing market is on a hot streak, with prices and new dwellings consented breaking records.
- But all eyes will be on how the government and Reserve Bank address the distortions and spill-overs from unprecedented levels of stimulus, including widening wealth inequality.

Wave Three of lockdown brought further uncertainty to Auckland as we shuttled quickly to Level 3, Level 2 and back to Level 1 again. The emails I continued to receive from businesses saying they could still sell me things provided my purchase is “contactless”, together with data from previous lockdowns, provides insights into the impact of lockdowns on business activity.

An immediate raising of alert levels, according to medical experts, is the golden rule in such community outbreaks. This gives time to determine an origin for the infection, contact trace and stave off further community transmission. But these choices incur economic costs. August 2020's Level 3 cost around 190 jobs a day in Auckland, and data from our [earlier work](#) shows that in Level 3, visits to the city centre and other destination centres drop around 20-50%.

Still, our economy has demonstrated a level of resilience that has surprised many. And this was largely because people could continue to work and businesses that could operate online, did so. September Quarter GDP has our national economy back up to pre-pandemic levels (Auckland experiencing more weakness due to the second lockdown), but looking ahead, 2021 will bring other challenges. As the yearly effects dissipate, the question arises as to whether the domestic economy can pick up the slack, with borders expected to remain shut for most of this year as the most optimistic scenario.

The official unemployment rate for Auckland fell (yes that's right, fell) from 5.6% to 5.5% for the December 2020 quarter. But questions remain on how well this figure reflects the reality of the labour market. Comparing the



Statistics New Zealand estimate of unemployed with jobseeker data shows a clear divergence.

Statistics New Zealand defines unemployment strictly as those without a job who are actively seeking a job. And the job losses are mostly concentrated in the areas exposed to part-time work such as those in the tourism and retail sectors.

Additionally, the people that usually work in sectors hardest hit are young (aged 15-24) and they are often students and renters. The Chief Economist Unit estimates the true unemployment rate to be closer to 6%. It has nevertheless been encouraging to see Jobseeker figures flattening off as well.

With much better than anticipated employment outcomes, low interest rates, no loan-to-value restrictions (LVRs), no capital gains tax, a housing shortage (~28,000), a very real fear of missing out and a desire to own a place in a market that does not favour renters, house prices have continued to surge. Prices increased 17% in 2020.

While the Reserve Bank has announced that it will reinstate LVR restrictions on investors from March and raise deposit requirements to 40% from May, some banks have already reintroduced LVRs. But before it is official, investors have dominated the market, with CoreLogic showing an average of [around 40% of all purchases were by investors in the time LVRs were removed](#). First-home buyers averaged around 26%.

But rising prices also stimulate more development, as profitability rises faster than construction costs. Dwellings consented in Auckland closed 2020 at a record high of 16,592 (an 11% increase in 2020) and most of these were in the multi-unit category, demonstrating that Auckland is accommodating much more density.

Nevertheless, a battle remains, with an ongoing housing shortage and a housing market seemingly bursting at the seams from all the cheap money exchanging pockets. Policy announcements from the government call for further up-zoning.

The Chief Economist Unit agrees that more up-zoning close to jobs and public transport is good, but previous work showed that [flooding the market](#) with more development capacity doesn't in itself cut property prices dramatically.

All eyes will be on how the government and Reserve Bank address the distortions and spill-overs from unprecedented levels of stimulus. In their efforts to stave off economic disaster, a spotlight has been shone on how important the domestic economy is to overall wellbeing and importantly why the challenges we are facing need pragmatism.

Data summary provided by [Ross Wilson](#) – Economic Analyst, Research & Evaluation (RIMU)

Indicator	Dec-20 quarter	Sep-20 quarter	Dec-19 quarter	5-year average	Rest of New Zealand Dec-20 quarter
Employment indicators					
Jobseeker support recipient growth (%pa)	57.7%	54.0%	14.1%	14.4%	38.1%
Annual employment growth (%pa)	0.0%	-0.8%	2.0%	2.6%	1.0%
Unemployment rate (%)	5.3%	5.6%	4.1%	4.6%	4.7%
Unemployment rate among 20 to 24 year olds (%)	11.6%	10.4%	9.5%	9.4%	9.1%
Unemployment rate among 15 to 19 year olds (%)	21.0%	17.5%	17.6%	19.4%	20.3%
Earning and affordability indicators					
Annual nominal wage growth (%pa)	3.4%	2.4%	3.1%	2.7%	3.2%
Annual geometric mean rent growth (%pa)*	6.6%	3.6%	1.0%	3.5%	6.3%
Geometric mean rent to median household income ratio (%)*	28.3%	27.7%	27.5%	27.7%	25.6%
Annual median house price growth (%pa)*	15.7%	12.6%	3.0%	5.7%	18.6%
Mortgage serviceability ratio (relative to Dec-06)*	1.9%	4.5%	4.3%	-0.3%	12.7%
Construction					
Annual new residential building consents growth (%pa)	9.9%	5.7%	17.8%	12.5%	1.3%
Annual m2 non-residential building consent growth (%pa)	-32.0%	-29.1%	-11.3%	-4.0%	-12.9%
International connections					
Annual Auckland Airport int'l passenger movements (%pa)	-75.2%	-49.2%	0.7%	-20.9%	NA
Confidence					
Annual retail sales growth (%pa)	0.1%	0.0%	4.4%	4.3%	0.6%
Quarterly Survey of Business Opinion (net optimists)	-18.2%	-32.1%	-12.4%	-13.8%	-0.9%
Westpac Consumer Confidence*	106.9	91.6	112.9	107.7	106.0

Sources: Chief Economist Unit, Auckland Council; Statistics New Zealand; Ministry of Business Innovation and Employment; Real Estate Institute of New Zealand; New Zealand Institute of Economic Research; Westpac; Reserve Bank of New Zealand; Ministry of Social Development. * Rest of New Zealand figures are for all of New Zealand including Auckland. Data is not seasonally-adjusted.

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