NZ - POOR POLICIES, POOR OUTCOMES - TICKING BOMBS!

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Having successive three-term New Zealand governments has highlighted their ineffectiveness. The evidence is compelling! The most important policy goal is higher living standards for New Zealand residents, with a reasonable distribution. But policy has been poor, dominated by political objectives. Consequently, New Zealand's Global ranking has steadily declined from top ten to the mid-twenties and social, economic and environmental problems have become much more pervasive, debilitating and dangerous.

Tick, tick, tick! Who needs terrorists? Forget the mythical Rock Star economy; this is reality – and New Zealand's future!

The serious consequences of having no clear and sound strategic framework for policy are evident and New Zealand as we know and value it is being fatally damaged. Think about it:

- Auckland is booming but it's the struggling regions that contribute most exports and tourist destinations – the critical determinants of living standards.
- Excessive, low value immigration is a disaster. It boosts GDP, so is politically attractive, but increases housing demand and prices, is causing serious social problems, puts pressure on Government spending AND, most importantly, reduces the living standards of New Zealanders. Building more houses for more people who don't add economic value just digs a deeper hole!
- Immigration inflates house prices but much of the increase in house prices reflects the large tax subsidy to investors in housing, compared with savers.
- High volume - low value tourism is destructive. It adds little economic value but puts serious pressure on the environment and fundamentally erodes New Zealand's desirable features.
- Deliberate policy targeting of savers and savings is politically expedient but bad policy, and damaging, economically and socially.
- Low productivity is a critical weakness, contributing to low incomes, low tax payments and low living standards - and welfare dependency.

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- The windfall gains from Auckland house prices should be substantially taxed, to fund critical National projects, such as restoring river water quality and more effective social programs. River water quality is a disgrace!
- The Public Service needs to be sorted, urgently. It has too many serious policy and performance failures. It has too many weaknesses and is too much a lap dog rather than a source of leadership and free and frank advice and information. “Better Public Service” is dead in the water!
- And so on!

It’s not a “housing crisis” but a comprehensive failure of policy crisis. The Minister of Finance acknowledged this, that policy was ill founded and unsustainable, (public comment, 7 June, 2016) when he stated that slowing immigration would put house prices at risk!

Tick, tick, tick, tick!

The flag change process was not a waste of time and money, but a valuable showcasing of how inept we can be, in terms of policy design and implementation. Experts – who needs them!

Most of the current economic policy problems were addressed in the Government’s Savings Working Group Report (SWG, 2011), but largely ignored.

So, a few specific policy issues:

Strategy

Most policies have interdependencies with other policies and long term implications. So, effective policy needs an overall, strategic framework, which New Zealand lacks. Instead, policy is ad hoc, piecemeal and lacks coherence - and the results reflect this. The critical living standard growth engines of productivity and exports (foreign exchange earnings and savings) remain weak and there is a disconcerting aura of complacency and disingenuousness.

Immigration

The high rate of immigration is a national disaster. It is lowering the present and future living standards of New Zealanders by serious adverse economic, social and environmental consequences.

The critical criterion for policy is impact on the living standards of New Zealand residents. The impact on the immigrants is irrelevant. But, the political view is a simple and misleading “quantity” based one – more immigrants means population growth and more jobs, houses and infrastructure spending, so GDP increases. This suggests a strong, well-managed economy - which is a nonsense in New Zealand’s case with an export dependent economy.

In terms of national benefit the “per capita” impact is the important one. Unless immigrants increase New Zealand’s exports and foreign exchange earnings and savings per capita, or bring particularly valuable skills to the economy, they simply impose substantial additional costs on and reduce the living standards of New Zealand residents.

Having a job, even in an export industry or tourism, is not enough, and many immigrants lack the particular, high level of skill and productivity to add the necessary value. Using them to fill low skill, low productivity gaps in the labour market, eg. building houses for our excess population (other than on a temporary basis), is damaging to New Zealand’s interests, in the short and long term. So, we scramble to build more houses and ignore the fundamental policy problems.

An Australian Productivity Commission study estimated that a 50% lift in skilled migration would reduce productivity generally, but increase GDP per capita slightly – but with most of the gains going to the migrants themselves - which doesn’t count as a national benefit. We can’t save the World!

Moreover, New Zealand data indicates a close, long term relationship between house prices and migration flows. A net inflow, equivalent to 1% of total population (the current level is higher than that) increases house prices by about 10%, indicating that the current Auckland (and spreading) housing problems are largely demand driven, not supply – again reflecting bad policy.

Auckland and the Regions

The regions are critical in the economy, and for our living standards. They produce a high proportion of exports and are the main tourist destinations. But, they are struggling because the NZD is too strong, they are less valued politically and their competitiveness and quality of life is being undermined, mainly by poor policy which doesn’t recognise their paramount role in the economy.

Auckland is increasingly a millstone around New Zealand’s neck: “its economy is inwardly focussed, driven by consumption, real estate and domestic services”; “measured internationally it’s performance is poor – ranked 69 of 85 OECD metros”; and “ it must shift from import to export-led, but is not a centre of export excellence or innovation” (source: The Auckland Council Plan).

It’s population growth is increasing the negatives: more spending on infrastructure and government services; more agricultural land for housing; a less attractive living environment for existing residents; more demand for urban water use at the expense of more productive uses; greater population pressure on the environment generally; **and an increasing dependence on the rest of New Zealand to subsidise it’s weak export performance – which reduces the living standards of everyone else.**

The scale argument (bigger is better) is a typically wrongheaded quantity not quality political argument; and the innovation centre argument is not economically viable – if it depends on Auckland's size then the national benefits are inadequate to justify the cost.

The tax free wealth gains on Auckland property is a major opportunity lost in terms of national benefit. In a rational world the gains would be taxed to fund important national programs, such as: a rejuvenated regional development program; or a major blitz on the adverse environment consequences of agriculture; or a major program to reduce the vulnerability and decline of the conservation estate; or a major program to develop future jobs and a more effective transition to a more innovative economy.

The tax would also partly compensate the Regions for their export based subsidy to Auckland!

Savings

Savings have a critical role in the National Economy. So, it is surprising that savers are being targeted and victimised by the Government and Reserve Bank, in contrast to borrowers, tax payers and the protected species - Auckland property owners.

Savings finance productive investment. Since the 1970s New Zealand's savings have been inadequate to fund its investment, constraining investment and leaving foreign savings to fill the gap. This has led to a large Net Foreign Liabilities position and two serious economic problems:

- The economy is more vulnerable to external shocks; and
- Too little productive investment has led to low capital intensity (capital per employee), low productivity and low living standards.

There are a number of related policy issues:

- Low interest rates make savings less attractive. Nominal interest rates have declined since the early 1990s, but more sharply recently.
- Monetary policy has been damaging for savers: pre GFC when credit growth was excessive but interest rates low higher interest rates would have had a useful moderating influence on the economy; and since then very low interest rates have been deliberately used to encourage economic growth. Thus, savers have lost out twice, due to deliberate policy decisions!
- There is a strong argument that a more balanced and targeted policy approach with more emphasis on fiscal policy would be more effective in stimulating economic activity and less discriminatory against savers, given that the fundamental problem is insufficient demand.
- In fact, monetary policy, based on low interest rates and easy supply has largely lost credibility, fuelling asset price inflation, not growth.

- Incompetent regulation and oversight of financial markets, particularly since early-2007, resulted in very large losses of savings and a loss of confidence in many institutions, advisors, regulators and politicians.
- **Tax policy is distortionary and seriously penalises savers. Savings are double taxed – as income and then as interest earned. And, the real effective tax rate on investment in rental housing is half that on simple saving products. This is inequitable and ridiculous.**
- **However, the favourable tax treatment of property investment is estimated to account for 50% of house price increases (source: Savings Working Group); and the inflation in house prices accounts for most of the increase in the wealth of New Zealand households, which makes it a sensitive political issue.**

The Government's Savings Working Group recommended policies to increase National Savings, reduce the tax distortions and boost productivity and exports, all in the interest of raising living standards, but to no avail.

There is another serious risk to savers. They have been specifically targeted to meet the costs of restoring any registered bank in New Zealand to solvency, in the event that one fails and taxpayers and the bank's borrowers are excluded. Why? That is a very good question.

It's called OBR – Overnight Bank Resolution, which sounds benign but actually means a "haircut" for all depositors (savers who don't rely on "under the mattress"), taking as much of their hard-earned funds in the bank as are needed to restore it to solvency and meet all of the costs and risks involved.

But, the savers/depositors have no say in the running of the bank or its prudential management and governance. They have no say in the selection of managers or directors and no influence on the RBNZ's oversight of the banks – all critical factors in the solvency of a bank. And, the Reserve Bank is not close enough to the banks and their directors, managers, policies and processes to be confident of their oversight capability. Banks are genuinely complex and challenging to operate, especially in uncertain times.

Banks typically fail because they misjudge risk in the pursuit of higher profits. So, why should savers/depositors compensate a bank for it's failure to manage its affairs astutely. In a national policy context, given the national role that banks have, it should be taxpayers who carry the risk. There is also a good argument that borrowers should be included if depositors are – ranked pari pasu!.

Given the risk to depositor from OBR I am amazed that it is not highlighted with warnings in all bank customer service facilities and documents, particularly in deposit related documentation. Clear and comprehensive disclosure should be mandatory - but the highest priority is to abandon OBR.

Meanwhile, the most effective response for savers is portfolio - based risk management, with minimal savings held in the New Zealand banking system, in cash or near cash. Make sure you know which bank-related instruments are exposed to OBR, and minimise this risk. You are likely to want some cash or near cash in NZD and readily accessible, but look seriously at blue chip offshore options.

The Public Service

There are some excellent Public Service organisations and people but, it is notable for its numerous, costly failures. There are hundreds of examples – the media reports them daily and weekly, but just a few: leaky buildings; the failure to regulate financial markets and health and safety effectively; Solid Energy; Pike River; Cave Creek; the Fox River aircraft accident investigation; sub-standard building products (eg steel mesh); Child, Youth & Family; Government procurement; Corrections/Serco/etc; the vetting of foreign investment for national benefit; Defence acquisitions; the State Services Commission; and so on.

There is a common, fundamental cause of these: it is the failure of top level management to lead effectively, starting with, in my view the SSC. It should lead the Public Service, but hasn't done so effectively for a long time. It is a pity that it's confidential settlements are not made public.

Top level public servants now have substantial power and authority, but are not properly held to account for their performance and are more often than not reappointed, when the appropriate action would be dismissal. Many are promoted for their technical ability when the role needs leadership and management skills which they lack. Better Public Service is the latest attempt at improvement, it was well designed but is going no where!

The Future – Tick, Tick, Tick, Tick!

Because of poor policy there are now a number of bombs ticking. For example:

- Too many low skill, low productivity residents, on low incomes and substantially subsidised by others, diverting expenditure from more nationally productive uses, such as innovation, exports, water quality, etc.
- An aging population.
- Auckland is not economically viable; the rest of New Zealand would have a higher living standard without it.
- The critical Regions, and important export industries in them, are not sufficiently valued and are under pressure.
- Too much debt; too many loans at high loan to income ratios, which won't be viable at long term average (more normal) interest rates.
- Inflated house prices and many barriers now to home ownership.
- The finance sector has a number of serious exposures.

- Regulators, in all areas, have a very poor track record. Now they are overreacting to compensate.
- Current spending is inadequate to maintain and protect the environment, let alone to remedy existing serious damage eg river water quality.
- Climate change is a major challenge to an already, fundamentally weak economy and society.
- Politicians do politics, not national benefit!

What is the answer? It is effective leadership, and recognition that good policy, in a sound strategic framework, is critical.

It must be the wind! I thought I heard someone whistling!