NEW ZEALAND: REBUILDING FISCAL BUFFERS AFTER THE GLOBAL FINANCIAL CRISIS

Prudent policies enabled New Zealand to deal with simultaneous global financial and domestic seismic shocks, says the country’s Finance Minister. He explains why it responded so well and how it is preparing to cope with future shocks.

**Hon. Bill English, MP, in Wellington.**

Mr English is New Zealand’s Minister of Finance and Deputy Prime Minister. He has been a Member of the House of Representatives for the National Party since 1990. A former Leader of his party from 2001 to 2003, he has held several government and opposition Front Bench positions, including being Minister of Finance and of Revenue and then Treasurer in 1999. He was Minister for Infrastructure from 2008 to December 2011 when he became Minister of Finance.

Being at the bottom of the world did not spare New Zealand or New Zealanders from the negative fallout of the global financial crisis (GFC). In the two years until the end of 2009, our economy’s output took a 4-per-cent hit and the unemployment rate more than doubled to peak at around 7.0 per cent.

After a decade of strong consumer spending, many households cut back and focused instead on paying down their debt. New Zealand exporters experienced a decline in sales volumes, although our primary industry exporters were partly sheltered by on-going resilience in the prices of New Zealand-relevant commodities which have been underpinned by the country’s expanding trade links with dynamic Asian economies.

New Zealand-registered banks had little direct exposure to the United States financial crisis; but they were reliant on global short-term wholesale markets for funding. As activity in these markets collapsed after the failure of Lehman Brothers, some banks feared the prospect of being unable to rollover their debt.

And in addition to dealing with the effects of the global financial crisis, the New Zealand economy faced its own domestic shocks, most notably the severe earthquakes in Canterbury, a major exporting province, in 2010 and 2011.

**Strength from prudent fiscal planning**

New Zealanders responded well to the challenges posed by these multiple adverse shocks.

Gross domestic product has been expanding at a modest but steady pace since the beginning of 2011. In the final quarter of 2012, the economy expanded by 1.5 per cent compared with the previous quarter and by 3.0 per cent compared with the same quarter of the previous year.

I believe that one of the reasons why New Zealand has emerged from this difficult period relatively well is the country’s fiscal policy framework. For over two decades, governments have been required by law to maintain a transparent spending and tax framework and to maintain prudent public sector debt levels.

It means that when the country was struck by a cocktail of external and internal shocks, the government had scope to respond appropriately to support economic activity in the short term, and to lead efforts to rebuild devastated Canterbury in the longer term.

The government allowed the automatic stabilizers to operate fully during the global financial crisis and after the Canterbury earthquakes.

The government’s operating balance before market gains and losses (OBEGAL) shifted from a surplus of 3.0 per cent of GDP in 2007/08 to a 9.2 per cent deficit in 2011/12, as the government responded to the aftermath of the earthquakes in Canterbury and protected New Zealand families from the worst effects of the recession.

Where expenditure cuts did occur, they were concentrated in areas considered to have a relatively limited negative impact on private sector spending, such as suspending the government’s payments to the New Zealand Superannuation Fund in 2009.

**Temporary measures and longer-term efficiencies**

Core government net debt rose from a low point of 5.6 per cent of GDP in the financial year to June 2008 to nearly 25

112 | The Parliamentarian | 2013: Issue Two
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to reduce net government debt to
As economic conditions stabilized
and household confidence started
to recover, fiscal policy moved into
a consolidation phase, reducing the
degree of economic stimulus. Key
targets are to return the operating
balance to surplus by 2014/15, and
to reduce net government debt to
20 per cent of GDP by 2020. This is
aimed at reducing core government
expenses from around 35 per cent
of GDP in 2012 to around 30 per
cent of GDP by 2016/17. This
slowdown in expenditure growth
is being achieved through a number
of policies, including reductions in
the size of new spending allowances
and efficiency gains across the state
sector, changes to welfare policies
and restraint in public sector wage
growth.

To stabilize the financial sector
during the height of the GFC, the
government of the day introduced
a temporary and optional insurance
scheme called the Crown Deposit
Guarantee Scheme.

It provided a government
guarantee on retail deposits in
New Zealand banks and finance
companies that paid fees to
participate in the scheme. This
guarantee expired in December
2011, with the government having
paid out around NZ$1.8 billion to
deposit holders.

Facing future financial risks
With this experience in mind, the
government has tried to reduce the
risk of future taxpayer-funded bailouts
after institutional failures.

To provide an alternative policy
option after a bank failure, the
Reserve Bank has worked on
developing an Open Bank Resolution
(OBR) policy to deal with the failure
of a systemically important financial
institution. The OBR policy aims to
minimize the disruption of a bank
failure on the wider financial system
and reduce the cost of a bailout to
taxpayers.

In addition to the OBR policy,
the Reserve Bank has also worked on
developing a macro prudential
policy strategy, which should allow
it to better manage the risks to the
financial system from excessive asset
price growth and the rapid build-up
of debt. The Reserve Bank has
identified several macro prudential
policy tools which could play a role
in maintaining a sound financial
system. They include: counter-cyclical
capital buffers, which form part of
the Basel III framework; adjustments to
sectoral capital risk weights and core
funding ratios, and restrictions on
high loan-to-value lending by banks.

A Memorandum of Understanding
between the Reserve Bank and the
government will formalize the policy
framework.

Growing national savings and
the economy
Over the longer term, other policy
challenges lie ahead.

Since the mid-2000s, the largest
contribution to economic growth
has come from the non-tradables
sector, with many tradable industries
contracting. In addition, New
Zealand’s external indebtedness
remains high by international
standards, raising concerns about
our vulnerability to conditions in
international capital markets.

Understanding the drivers of
these trends is a key policy focus. For
example, a government-appointed
working group explored many of
the issues around New Zealand’s
relatively low rate of national saving.

Work on these issues should
ultimately help rebalance the
economy, shifting resources back
towards the tradable sector and
towards greater reliance on domestic
rather than foreign savings to fund
investment.

New Zealand’s long-run growth
performance is also an important
focus, as its average growth rate
and its productivity performance
have lagged behind many other
Organization for Economic
Co-operation and Development
economies over several decades.

This ongoing reduction in New
Zealanders’ average income relative
to other better-performing countries
has contributed to New Zealand’s
large migration outflows to other
countries, particularly Australia.

As a result, the government has
introduced a Business Growth
Agenda, an integrated programme
of several hundred policies that
aims to help firms develop and to
ultimately lift New Zealand’s standard
of living. The Agenda focuses on six
main workstreams to assist growth
by creating a more productive and
efficient economy — growing
export markets, building innovation,
improving infrastructure, expanding
capital markets, sustainably
developing natural resources and
developing a more dynamic and
flexible labour market.

For example, the target of lifting
the ratio of exports to GDP to 40 per
cent by 2025 is based on improving
access to international markets,
increasing earnings from tourism
and growing exports of education
services.

New Zealand’s recovery is being
helped by our stable and efficient
financial system. The government’s
intention to consolidate its financial
position and return debt to prudent
levels has been well signalled in the
Fiscal Strategy Report, published in
the annual budget each May.

With New Zealand now in its third
year of recovery, the government is
working hard to build up the strength
of the Crown’s financial position as
a buffer against the next shock that
could come our way.