ANZ RESEARCH

NEW ZEALAND ECONOMICS
LABOUR PARTY POLICY PROPOSALS

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CONTRIBUTORS

Cameron Bagrie
Chief Economist
Telephone: +64 4 802 2212
E-mail: cameron.bagrie@anz.com

Mark Smith, Senior Economist
Telephone: +64 9 357 4096
E-mail: mark.smith@anz.com

Sharon Zöllner, Senior Economist
Telephone: +64 9 357 4094
E-mail: sharon.zollner@anz.com

MIXED THINKING

- **The Labour Party has this morning unveiled five new policy proposals, some of them directed at monetary policy:**
  - The Reserve Bank Act would be changed so that the "primary function of the Bank with respect to monetary policy is to enhance New Zealand's economic welfare through maintaining stability in the general level of prices **in a manner which best assists in achieving a positive external balance** over the economic cycle, thereby having the most favourable impact on the stability of economic growth and the level of employment."
  - **KiwiSaver is to be universal** for paid employees, starting at 6% (3% individual, 3% employer) **with annual increases in contribution rates** of 0.5% or 1.0% **until it reaches 9%.** As in Australia, the scheme is optional for the self-employed.
  - **The RBNZ will be granted an additional tool, the Variable Savings Rate, where they can vary (or request the Government to vary) KiwiSaver contribution rates over the cycle.**
  - **Capital gains taxes on property other than the family home would be introduced, and tax losses on property investment would be ring-fenced.**
  - Non-resident foreigners would be banned from buying existing New Zealand housing and farmland.
- **The policies are aimed at alleviating NZ's low savings rate, persistent current account deficits, structurally high interest rates, and an overvalued exchange rate.**

ANZ VIEW

- **We like some of the proposals**, including a capital gains tax on second properties and the ring-fencing of property investment losses. The policies also hit all the right notes in regard to preserving the RBNZ's independence and running fiscal surpluses.
- **We support making KiwiSaver universal.** The evidence in regard to compulsory savings schemes is mixed in regard to aggregate savings performance (Australia still runs current account deficits), but it would lead to a better allocation of capital so we support it.
- **There are problems galore with using KiwiSaver contribution rates as a monetary policy tool, with politics being number one.** If it were practical for the RBNZ to control KiwiSaver, why not give them the NZ Super Fund too. That doesn't pass the smell test.
- **The RBNZ can be a supporting actor, but not play the lead role in regard to lifting savings and economic performance across the economy.** We don't think including the external balance in the objectives for the RBNZ is workable. New Zealand's poor external position is far from solely a result of New Zealand's high currency and low savings rate.

LABOUR PARTY POLICY PROPOSALS

COMMENT AND ASSESSMENT

The Labour Party has this morning unveiled some new – and some old – policy proposals with implications for monetary policy. **The problems these policies are intended to alleviate are a low savings rate, persistent current account deficits, structurally high interest rates, and an overvalued exchange rate.**

There are five key points:

- The Reserve Bank Act would be changed so that the "primary function of the Bank with respect to monetary policy is to enhance New Zealand's economic welfare through maintaining stability in the general level of prices **in a manner which best assists in achieving a positive external balance** over the economic cycle, thereby having the most favourable impact on the stability of economic growth and the level of employment." The primary focus on inflation targeting is unchanged.
- **KiwiSaver is to be universal** for paid employees, starting at 6% (3% individual, 3% employer) **with annual increases in contribution rates** of 0.5% or 1.0% **until it reaches 9%.** As in Australia, the scheme is optional for the self-employed. During the transition phase, this will represent a significant drag on the economy.
- **The RBNZ will be granted an additional demand-side management tool. Referred to as the Variable Savings Rate, this would enable the RBNZ to vary – or at least request the Government to vary – KiwiSaver contribution rates over the cycle.** This is designed to limit the pro-cyclicality in household spending, without using the OCR lever. In our view, the Reserve Bank would need to be granted the power to change the rate itself if it is to be seriously considered "a big new tool". Otherwise it is analogous to them asking the Government to consider hiking the income tax rate – seldom popular with politicians. It would represent a huge politicisation of monetary policy. But the alternative of giving such power to an unelected official comes with issues of its own.
- **Capital gains taxes on property other than the family home would be introduced, and tax losses on property investment would be ring-fenced.** These previously announced policies seem eminently sensible.
- **Non-resident foreigners would be banned from buying existing New Zealand housing and farmland.** This policy is at the populist end of the spectrum. In our view it would be relatively easily circumvented and have a limited impact on economic outcomes, but could damage New Zealand's prospects of securing free trade agreements, as it represents a non-tariff barrier.

The documents also outlined a range of other policies, mostly previously announced, including changes to the electricity sector, and increasing the supply of lower-priced housing. Some other ideas were also kicked around, such as changes to the tax regime regarding the treatment of foreign capital, and counter-cyclical migration policy.

THE SPIRIT

The heart of the policies looks to be in the right place. New Zealand has a saving shortfall that leads to sub-optimal economic outcomes. The NZD is overvalued, the external position poor, and our interest rates higher than peers.

It's at this juncture that the thinking becomes a bit blurred.

MIXING YOUR DRINKS

On some levels we like what has been communicated.

The old common sense chestnuts – running fiscal surpluses and having an independent central bank – are paramount. No quibbles from us here – though they are such mainstays that anything else would be political *hari-kari*. However, if you are serious about lifting national saving and taking pressure off the currency you need to be aiming for fiscal surpluses of >5% of GDP. That's a long way off.

We're for a capital gains tax. And ring-fencing losses from property investment.

We'll likewise put in a plug for making KiwiSaver universal. The international evidence on compulsion is somewhat mixed; while the impact of Australia's compulsory super scheme on national aggregate saving is in fact highly debated and they still run a current account deficit. However, we'll side with compulsion on the grounds it'll lead to a better allocation of capital. It also has the potential to take the pressure off the currency, though the extent of this in the medium term is far from conclusive; a stronger and deeper savings pool used effectively augurs for stronger economic performance, stronger productivity – and a stronger currency.

However, the proposed new monetary policy tool – changing the Variable Savings Rate – has political bun fight written all over it. Will a Government really step up to the plate and alter

LABOUR PARTY POLICY PROPOSALS

KiwiSaver contribution rates if asked to by the RBNZ? Let's frame the question another way; imagine the RBNZ asked the government of the day to alter tax rates to help with monetary policy. This would alter public saving as opposed to private saving, but would have similar economic effects. What do you think the response would be?

How would the signaling channel of monetary policy work if you had such uncertainty over how or whether your new tool could be utilised? The only way tweaking KiwiSaver contributions would be a useful tool would be for it to be fully delegated to the RBNZ. Do we really want the RBNZ playing god with KiwiSaver? This was a **vehicle set up with long-term structural goals in mind (lifting savings, retirement certainty) as opposed to short-term demand management.** If the RBNZ can play god with KiwiSaver, let's give them the NZ Super Fund to control as well, and let them alter the Government's contribution rates to that too.

Indeed, **the idea of giving the Reserve Bank the power to set – or at least influence – what would feel remarkably like a tax rate in practice represents a blurring of fiscal and monetary policy that could prove problematic when it comes to implementation.** While a change in interest rates is psychologically at arm's length for most people, a change in take-home pay is highly personal. For low income earners in particular, the fact that they will get the money back in for several decades time will be to all intents and purposes irrelevant. Politicians, as a rule, hate raising taxes, particularly in an election year. **Even if delegated fully to the Reserve Bank, every change to the KiwiSaver contribution rate would be far more politically charged than a change to the Official Cash Rate would be.** Ultimately this would lead to more uncertainty over the direction of monetary policy and could create greater volatility.

There is an irony within the policy prescription: trying to lift national savings by keeping interest rates lower than would otherwise be the case. One does wonder how much of the lift in compulsory saving would simply be offset by a decrease in voluntary saving, should the policy succeed in lowering interest rates. Raising the OCR redistributes income from borrowers to savers. **Raising KiwiSaver contribution rates but keeping interest rates lower sees borrowers win and savers lose**, and those not in KiwiSaver win – at least in the short to medium term. Those on low incomes would feel the pain most acutely. They may be excluded from the policy for this reason, which would water down the policy's effectiveness.

The RBNZ can be the supporting actor but not play the lead role in regard to lifting saving and economic performance across the economy. There are a range of reasons for NZ's external imbalances that go beyond issues that these policies can address. New Zealanders seem to have a deeply ingrained preference for consumption today over consumption tomorrow, even at interest rates that are high compared to most nations of a similar income level. We have a legacy of investment underperformance and poor choices. New Zealand's capital markets and regulatory framework have been somewhat lacking over the years. **Getting the right economic incentives in place falls under the umbrella of government policy, not monetary policy.**

It would be cleaner for fiscal policy to be a "friend" to monetary policy**, perhaps tweaking the timing of the increases in KiwiSaver contribution rates to take the state of the economy into account**, and generally trying to resist the understandable temptation to start throwing more money around when there is plenty to be had. **Restrained – and ideally countercyclical – fiscal policy leads to lower interest rates than otherwise.** It is clear that the Labour Party understands this well. But deliberately blurring fiscal and monetary policy is getting into problematic territory.

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