

Capital Market Development Taskforce Does a Good Job

The recent report of the Capital Market Development Taskforce, chaired by respected investment banker Rob Cameron, contains excellent analysis of the state of our capital markets – the sources of business funding – and makes many sound recommendations.

Upfront, it recognises that “The quality of the broader economic environment is more important in determining how well capital markets function than are many of the capital market-specific settings.”

This point cannot be over-emphasised. Policy backsliding in recent years harmed both capital markets and the broader economy.

An interesting chart in the Taskforce’s July Progress Report showed that the ratio of stockmarket capitalisation to GDP peaked in 1996, coincidentally with the decline in New Zealand’s score for economic freedom and the introduction of MMP.

There has been much commentary about the anaemic state of our public capital markets.

Some commentators (Brian Gaynor in particular) have put the problem down to insufficient regulation. However, the last government’s moves to heavier-handed regulation in areas such as takeovers, insider trading and disclosure did not arrest the decline, suggesting this diagnosis was wrong.

The Taskforce stresses the importance for investment of protecting property rights, criticises the intervention in Auckland airport, and recommends that “There should be no expropriation of property rights without compensation.”

Adoption of this principle would have had major implications for the Labour government’s forced unbundling of Telecom, which wiped some billions of dollars off its market value.

The NZX's market capitalisation was also hit by the renationalisation of Air New Zealand (which has generated poor returns for taxpayers), the buyback of Ports of Auckland by the Auckland Regional Council, and the delisting of major companies such as Carter Holt Harvey in favour of private equity.

Contrary to Gaynor's views, the Taskforce observes that "New Zealand has a reputation as an honest and transparent country with high levels of integrity in the rules and regulations around our capital markets."

It notes that factors which better explain the size of our listed markets include the extent of central and local government ownership, of cooperative structures (such as Fonterra) in agriculture, and of investment in branches and subsidiaries by foreign companies.

The report recommends partial privatisation of government-owned businesses, partly to deepen capital markets. However, the economic case for full privatisation is stronger, and would do more to increase market size.

The Taskforce might have noted that New Zealand's experience with partial privatisation has not been entirely happy, as the cases of the BNZ (which the government had to step in and rescue) and Ports of Auckland (which the ARC has used as a cash cow) demonstrate.

The Taskforce helped dispel other myths. It gave no credence to the incessant 'New Zealanders are poor savers' mantra as an explanation of capital market deficiencies. Implicitly, however, it endorsed KiwiSaver and the Cullen Fund without engaging with the 2025 Taskforce's argument that both should be scrapped.

The July Progress Report said that the Taskforce would examine performance indicators for the NZX such as capital raisings, total capitalisation, liquidity and transactions costs. It is a pity that this work was not taken further: as recently as October the major multinational Rio Tinto delisted, citing "increasing listing costs and reporting obligations".

The report does not discuss the possible case for the NZX merging with another exchange, as some have advocated, and related public policy issues such as shareholding restrictions.

On regulation, the Taskforce makes an important observation: “Market discipline’, where bad practices are driven out by competition or transparency, or ‘self discipline’, where participants have their own capital or reputation at risk, are the front-line and most powerful tools for a sound capital market.”

Investor protection is primarily about cracking down on fraud and misrepresentation, not about protecting investors from business risks or folly.

The report goes on to stress the importance of enforcing laws. The Securities Commission has often been criticised for weak enforcement, most recently in the case of actions by Guardian Trust. The report recommends a consolidation of regulatory functions into a possible Investment and Securities Commission.

The Taskforce was clearly uncomfortable with features of the Financial Advisers Act, noting that “implementation could cause as many problems as it solves if not done well”. As things stand, the costs to the banking sector alone are estimated to be in the order of tens of millions of dollars.

It also makes many thoughtful proposals concerning issuer documents, investment literacy, financial products and regulation of exchanges. The tax section is excellent, reinforcing once again the virtues of a broad-base, low-rate structure instead of the complexities introduced in the Cullen years.

The report marks a clear departure from the regulatory thrust of Ministry of Economic Development advice on capital markets in recent years. It supports the operation of the unregistered exchange Unlisted, which MED sought to rub out. It opposes the idea of placing additional financial reporting obligations on large private companies, which MED has recently revived.

It is to be hoped that government moves in the direction of the Taskforce recommendations. Scaled up, they would contribute to its goal of reaching income parity with Australia by 2025.

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