

This article was first published in the *Otago Daily Times* on 22 May 2009

New Zealand's Shrinking Sharemarket

Remember the claims about New Zealand's 'wild west' sharemarket when the Labour government came to office in 1999?

It was languishing, so the story went, because of insufficient regulation. New Zealanders lacked the confidence to invest in publicly listed companies.

The story was always nonsense. World Bank research around this period ranked common law countries in general, and New Zealand in particular, very highly for their legal systems and protection of creditors and shareholders. The New Zealand Stock Exchange had worked over a long period to put its own house in good order.

Undeterred, the Labour-led government brought in additional poor quality regulation on takeovers, insider trading, information disclosure and much more.

It was urged on by the Securities Commission, the NZX and others.

The collapse of Enron and WorldCom gave a new impetus to regulation. In the United States, a key response was the Sarbanes-Oxley legislation. This seems to be universally recognised as an over-reaction which damaged the New York market.

Many of the proposals for new regulation in New Zealand were resisted by the business community and informed commentators.

The NZX had the wisdom to back off proposals for compulsory chairman/CEO role separation, independent directors, director certification, audit committees, independent directors' remuneration and quarterly reporting.

Nevertheless, the upshot is that New Zealand now has a much more regulated capital market. In addition, broker fees have risen significantly.

Other moves by the last government had a major impact on the sharemarket.

Its interventions in Telecom and Auckland International Airport wiped large amounts off their market value.

The decision to renationalise Air New Zealand and the repurchase of Ports of Auckland by the Auckland Regional Council further reduced market capitalisation.

Private equity became an attractive means of avoiding public markets. Carter Holt Harvey was lost to the sharemarket and became a private company.

The Labour government also misinterpreted the emergence of large current account deficits as a savings problem rather than a problem of declining international competitiveness. There is no robust evidence that New Zealanders are poor savers, and initiatives such as the Cullen Fund and KiwiSaver have not prevented the sharemarket decline.

More generally, policies of high government spending, taxation and regulation have discouraged private capital formation.

What has been the end result? Hardly the rebound in the sharemarket that the 'wild west' critics were counting on.

In 1999, the total value of listed companies in New Zealand stood at around \$55 billion. By 2008 it had shrunk in real terms (deflated by the CPI) to \$31 billion.

As a percentage of GDP, it shrank from 51% in 1999 to 22% in 2008.

Although Australia's market capitalisation has also fallen relative to GDP (from 105% in 1999 to 82% last year) with the recent decline in world sharemarkets, which of course also affected New Zealand, it has grown by

10% in real terms since 1999 (compared with the 44% decline of our market).

Despite the sorry saga of interventions we are likely to see more regulation following the financial crisis and the collapse of a number of finance companies.

The Securities Commission reported on the disclosure documents of 30 finance companies in 2005 and found that some failed to meet statutory requirements. Thereafter it appears to have sat on its hands, even though “enforcement related to finance companies” was one of its stated priorities.

To its credit, the Securities Commission did not join the rush of overseas regulators to ban short selling of shares in response to the financial crisis. However, many see the intended regulation of financial advisers as wasted effort.

Bruce Sheppard of the New Zealand Shareholders Association has argued that we should give up adding to statutory regulation and focus on education for financial literacy instead.

The case for much regulation beyond general laws against such things as fraud and misrepresentation is weak. We would do better to improve enforcement of those we have.

Perhaps partly realising the regulatory overkill and its consequences, the previous government established a Capital Market Development Taskforce which is to report this year.

Its initial recommendations have focused on reducing regulatory costs to issuers through, for example, simplified requirements for prospectuses. Even these, however, are being resisted by regulatory bureaucrats.

In fact the Taskforce needs to go much further and evaluate the whole panoply of regulation of recent years; the trend to nationalisation rather than privatisation; the case for merging the NZX with an overseas exchange; and mistaken interpretations of our problems.

Public capital markets are not everything – private companies, cooperatives, partnerships and sole traders are a major part of the economy.

Moreover, many things affect the performance of sharemarkets, notably the profitability of listed companies and the general state of the economy.

But ‘wild west’ explanations were never credible, and questions need to be asked about the general impacts of the interventions of the last decade.

Roger Kerr (rkerr@nzbr.org.nz) is the executive director of the New Zealand Business Roundtable.