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Taxpayers Down the Drain on Government Investments

The past year was a dismal one for taxpayers and ratepayers in respect of investments made on their behalf by the government and councils.

Start with the biggest of them all – the New Zealand Superannuation Fund. It lost \$1 billion in value in 2007/08 and a further \$3.1 billion in the first four months of 2008/09. At 31 October the Fund's net assets were \$12.7 billion. Without these losses, they would have been at least \$16.8 billion, or 32% higher.

Since the Cullen Fund was launched in September 2003 it has returned just 4.86% a year – 2.06% less than the risk-free rate.

The managers of the Fund are not necessarily at fault. Most private investment funds have also lost money in the past year, and over time the Fund may do better.

Rather, the question that should be asked is why taxpayers were forced to bear these risks.

The Business Roundtable argued that a better way to provide for future superannuation costs was to continue to repay debt. The household analogy applies: it is not prudent for households with mortgages to invest in the sharemarket.

Councils that have set up investment funds, often from the proceeds of sales of other investments such as shares in port or power companies, have also lost money.

They too would have done better to repay debt or return the proceeds of sales to ratepayers via lower rates.

Another problematic investment is the government's shareholding in Air New Zealand.

This was acquired following the collapse of Air New Zealand's Ansett operation in Australia.

The failure was due to a risky business decision, Australian government actions and competition. It was not a failure of privatisation, and there was no need for the government to take back ownership.

Since the buy-back, the return has been close to zero, in a period when the NZX 50 Gross index returned 31%. The opportunity cost to taxpayers is therefore of the order of \$250-300 million.

Again this is not a reflection on the management of the company, which seems to have done well in a difficult industry.

Rather, Michael Cullen should have heeded Warren Buffett's warning about investment in airlines: someone would have done airline investors a favour if they had shot down the *Flyer* when the Wright brothers put it into the air.

Perhaps the most foolish investment of all was the government's buy-back of rail from Toll Holdings earlier this year.

Market observers were stunned at the price of \$690 million which the government paid. Since then the value of KiwiRail has been written down by \$242 million or more than a third – a loss of \$160 for every household.

Neither Toll nor Tranz Rail was able to make rail a profitable operation in New Zealand. It is highly unlikely that a government-owned company will do better.

The drain on taxpayers could be large, as it was when rail was previously in government ownership. The new government has already signalled the need to cut back on unprofitable capital expenditure.

Another dubious investment was Kiwibank. No sound case was made that privately owned New Zealand and Australian banks were failing to provide competitive services.

Kiwibank is now reported to be making profits but I have seen no evidence that, having regard to the time taken to reach profitability, the investment

has yielded commercial returns. Commentators have also suggested that the bank has been cross-subsidised from other New Zealand Post operations.

A further disaster is ACC, with a blowout of close to \$1 billion in the non-earners' account that the previous government failed to disclose.

ACC appeared to lift its game when it was briefly exposed to partial competition, but has reverted to its monopoly habits.

The record of the Clark/Cullen government as an investor has been the worst of any government since the Think Big era.

The point is not that privately owned businesses never lose money – clearly they do. Rather it is twofold.

First, the evidence is clear that, on average and over time, the financial performance of private enterprises is superior to that of government enterprises.

Secondly, in the case of private enterprises it is for investors to decide themselves whether they can afford to take business risks. Businesses are always risky to some degree.

The problem with government entities is that taxpayers have no choice short of migrating: governments make the investment decisions whether taxpayers like them or not.

The government has said it will not sell its interests in entities like KiwiRail or Kiwibank this parliamentary term.

But it needs to recognise that holding on to them is not a good long-term policy. And there is no reason why it could not give away its shares to their true owners, taxpayers, and let them decide whether they want to carry the risks of retaining them or not.

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