Reducing public debt: New Zealand

Abstract

In the aftermath of the global economic crisis, many countries have begun the struggle to bring public debts down. New Zealand's experience in the past two decades can shed some light on how to tackle indebtedness in the public sector. Since the 1990s, the country has halved its public debt-from around 60 percent of GDP to 30 percent in 2010. New Zealand also led in fiscal prudence: it was second in the Stanford University's Sovereign Fiscal Responsibility Index rankings in 2010. Difficulties experienced in 1991 pushed the government to adopt new and comprehensive measures. As a result, just 15 years later, the public debt level was brought down below 20 percent of GDP, with a primary budget surplus of more than 3 percent of GDP. How was New Zealand able to achieve such results? First, deep reforms in state finances helped return to primary fiscal surpluses in 1994, after two decades of deficits. The government focused on limiting expenditures, with spending cuts amounting to 7 percent of GDP. These fiscal reforms were comprehensive: the government set up a management framework for a sustainable fiscal policy-using, for example, financial reporting standards similar to private sector accounting rules. Second, New Zealand used privatization proceeds of $NZ 14 billion in1986-96 well, and made operations ranging from air traffic control to postal services competitive throughout deregulation. Third, these steps were part of a broader reform program that included reducing inflation from more than 8 percent in 1986–91 to 2 percent in 1992–97.

New Zealand has halved its public debt-to-GDP levels from around 60 percent at the beginning of 1990s to around 30 percent in 2010. It also leads in fiscal prudence: the country was second in the Stanford University's Sovereign Fiscal Responsibility Index in 2010.

Lessons from the Pacific

New Zealand managed to reduce its public debt from ratios somewhat similar to the United States and Canada in 1989 to a level nearly three times smaller in just two decades (figure 80). And although the public-debt-to-GDP ratio surged in the past three years due to the global financial crisis, it still remains well below the OECD average.[1] Finally, thanks to reforms at home, New Zealand's foreign currency credit rating improved from AA- in January 2001 to AA+ in November 2010.[2]

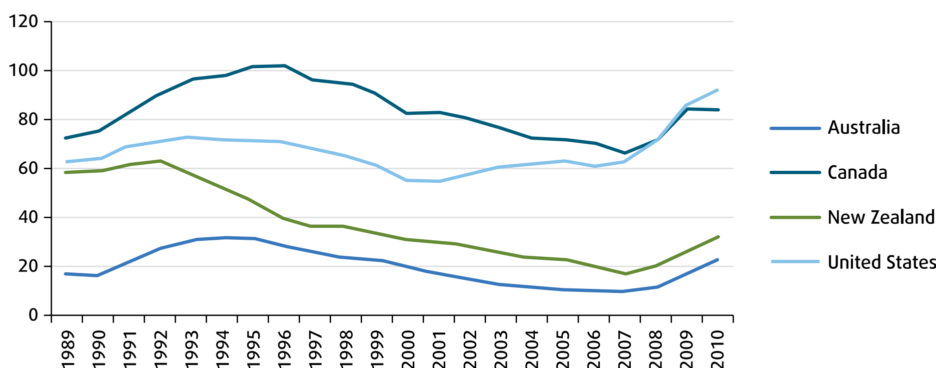
In the 1980s New Zealand faced fiscal deficits and soaring borrowing needs that put the economy in a difficult state. Low tax receipts, increasing expenditures on benefits and high debt-servicing costs were partly responsible for the high debt. Public debt peaked at 71 percent of GDP in 1985, while the budget deficit hit 5 percent of GDP. The consolidation measures adopted in the 1980s fell short in bringing debt levels down or restoring primary surpluses. The economy stagnated after 1987 until finally contracting by more than 1.5 percent in 1991. At the same time, the public debt grew again to around 62 percent of GDP in 1991–92, while the primary budget deficit reached 2.5 percent in 1991. Moody's downgraded New Zealand's foreign currency credit rating from AAA in 1977 to AA- in January 1991.

Reducing debt

The difficulties experienced in 1991 pushed the government to adopt new and comprehensive measures that brought public debt below 20 percent of GDP in 2007. How did New Zealand do

this? First, deep reforms of state finances in the beginning of the 1990s restored primary fiscal surpluses in 1994, after two decades of deficits. The government focused on limiting expenditure: according to OECD (2010), spending cuts amounted to 7 percent of GDP. These reforms were comprehensive, and set up a management framework for sustainable fiscal policy. For example, in the beginning of the 1990s the government increased transparency by adopting scrupulous financial reporting standards, similar to private sector accounting rules.

Figure 80: Gross government debt (% GDP) in Australia, Canada, New Zealand, and the US, 1989-2010



Source: IMF WEO.

Second, lower interest rates reduced the costs of debt servicing significantly. In comparison to the beginning of the 1990s, short-term interest rates halved, from an average of 15.5 percent in 1986–91 to below 7.6 percent in 1992–97. Budget expenditures on net debt interest payments declined from around 4 percent of GDP in 1990 to around 1 percent in 1996. Declining interest rates were reinforced by the government's commitment to put state finances in order as well as overall macroeconomic stabilization. Debt management also improved. A special office within the Ministry of Finance (the New Zealand Debt Management Office) was established in 1998, trained public debt traders manage the government's debt portfolio. The official strategy is aimed at reducing overall balance sheet risk. Thus, the share of debt denominated in foreign currency dropped from 43 percent in 1992 to 22 percent in 2001. Fixed-rate long-term debt increased marginally from 58 percent in 1992 to 61 percent in 2001.

Third, resources from privatization improved state balance sheets. In 1988 the government launched a privatization program that by 1996 brought in $NZ 14 billion. As a part of fiscal consolidation, many operations from air traffic control to postal services were deregulated and turned into competitive and profitable enterprises.

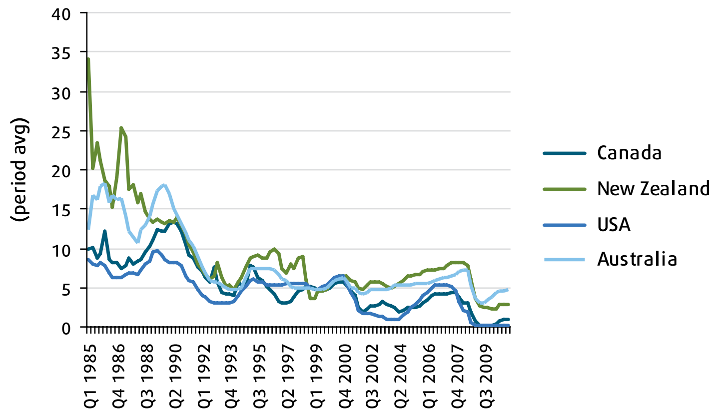
Finally, the reduction of public debt was part of a comprehensive reform program that addressed inefficiencies and improved overall governance in the country. New monetary policy brought the inflation rate from an average of 8.3 percent in 1986–91 to 1.9 percent in 1992–97.[3] The appreciation of real exchange rate between 1993 and 1997 could have helped too (See figure 82, in appendix).

Dealing with aftermath of the crisis

As a result of the recent crisis, public debt in New Zealand surged from 17 percent of GDP in 2007 to 31 percent in 2010 and is forecast to reach 36.5 percent in 2013. In 2009 the government

recorded its first budget deficit since 1994, reaching 6 percent of GDP in 2010. Interest rates remain higher than in Canada or the United States, despite lower debt levels in New Zealand (figure 81).[4]

Figure 81: Money market interest rates (period avg) in Australia, Canada, New Zealand, and the US, 1985-2011



Source: IMF International Financial Statistics (IFS).

Although debt levels surged after the recent crisis, they have not reached the OECD averages yet. The government has already adopted a new fiscal strategy that is supposed to cut operational expenditures across ministries as well as reduce net public debt to 20 percent of GDP by 2022. The IMF estimates that after a peak in 2013 gross government debt will decrease to 31 percent in 2016 . Likewise, it is estimated that the surpluses on government structural balance will return in 2016.

Sources

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Notes

1 General government debt (% GDP) in 2010 according to OECD stood at 30 percent GDP in New Zealand versus OECD nonweighted average (excluding Japan) of 51 percent GDP.

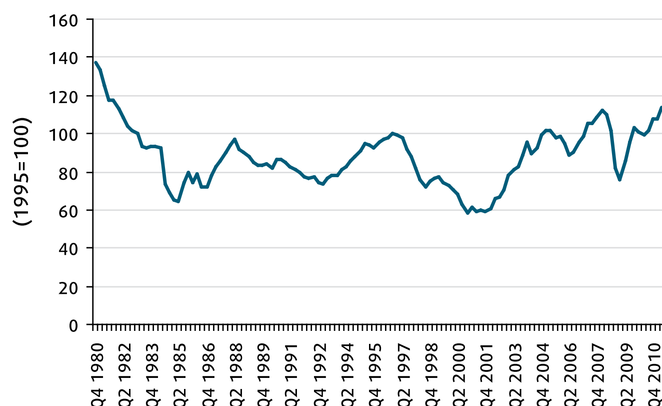
2 Standard & Poor's.

3 Consumer price inflation, OECD estimates.

4 Higher interest rates were also observed in Australia.

Appendix

Figure 82: Exchange rate index (1995=100), 1980-2010



Source: IMF IFS.