New Zealand: new Labour-led government under pressure for more market reform

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New Zealand's new Labour-led government has begun its term in office under increasing pressure to implement a new round of austerity measures aimed at attacking the living standards of working people while handing out tax breaks to business and the wealthy.

Over the past fortnight, a series of reports has painted an increasingly gloomy picture of the state of the economy. Despite divisions in ruling circles over how to manage the gathering problems, there is general agreement that a further onslaught on the social position of the working class is needed.

On December 8, Reserve Bank governor Alan Bollard raised the official cash rate (OCR) by 25 basis points to 7.25 percent in a bid to curb rising inflation, subdue the booming property market and sharply reduce household spending. Timed to hit just before Christmas, it was the second interest rate hike in two months and the ninth since the start of last year. At 7.25 percent, the OCR is the highest in the industrialised world, as compared to 5.5 percent in Australia, 4 percent in the US and 2.25 percent in the euro zone.

High interest rates are pushing the NZ dollar to its highest levels against the key Australian and US currencies since it was floated 20 years ago. Every rise in the dollar erodes exports and export profits. New Zealand's current account deficit is already one of the worst in the OECD—nearly $12 billion or 8 percent of GDP in the year to June. To make matters worse, world prices for the country's main exports including dairy and beef have started to fall.

US-based global investment bank Goldman Sachs last week warned its clients to sell the New Zealand dollar—saying it was 20 percent overvalued—and buy Brazilian currency instead. According to the bank, any sign of a decline in New Zealand interest rates will immediately see foreign investor support "rapidly disappear". The ANZ Bank concurred, saying that when the NZ dollar turns, it will "decline aggressively". Ratings agency Standard and Poor's warned that if the current account deficit increased further, New Zealand's international credit rating was at risk.

While the Reserve Bank is seeking to curb inflation, local business spokesmen are pushing for reductions to personal and corporate taxes to boost business confidence. A National Bank Business Outlook survey released in October revealed that business confidence had slumped to the lowest level since 1988, citing expectations of further interest rate rises and a potential economic slowdown. A new OECD report warned that New Zealand may be heading for a "hard fall" with growth rates expected to be 2.8 percent this year, down from 4.4 percent last year.

The election in September was fought precisely on the question of tax cuts. The campaign was a bitter affair, with business and the media throwing their weight behind the opposition National Party's demand for lower taxes for the rich and cutbacks to public services. National's populist campaign attempted to exploit widespread frustration over falling living standards as a lever to ram through a new raft of socially regressive policies.

Despite its own anti-working class record in office since 1999, Labour won a narrow victory by promising to oppose further inroads into living standards. The final counting of special votes in early October saw Labour pull ahead to 41.1 percent of the party vote, against 39.1 percent for the Nationals. The combined vote for Labour, the Progressives, the Greens and the Maori Party represented a rejection by a majority of voters of the policies promoted by the opposition National Party and its allies.

However, over the course of three weeks of closed-door bartering, Clark negotiated alliances with two right-wing minor parties—the anti-immigrant NZ First Party and the "family values" United Future. Her decision to do so, at the expense of the Greens and the Maori Party, effectively repudiated the election result and foreshadowed a sharp turn by Labour to the right.

Clark made an extraordinary concession to both parties—to hand key ministerial posts to their leaders but allow them to remain outside cabinet and therefore not bound by its discipline. New Zealand First leader Winston Peter, who is notorious for his anti-Asian racism, now represents the Labour-led government as its foreign minister. United Future leader Peter Dunne, who campaigned for a 10 percent cut to corporate taxes, a two-year tax holiday for new businesses and the abolition of the carbon tax, is the new revenue and associate health minister.

Even before the election outcome had been settled, the push for the rejected agenda of the Nationals continued. In what were described as "unusually blunt" briefing papers for the incoming government, Treasury and the Inland Revenue Department (IRD) insisted that tax cuts were absolutely necessary to promote economic growth and make the economy "competitive". Treasury called for large reductions in the top and middle personal tax rates, cuts to corporate tax, the dumping of the "carbon tax", further cuts to government spending and a revival of the stalled sale of state assets.

The IRD argued that New Zealand's corporate tax rate was now higher than most other OECD countries. As most major companies were foreign-owned, it stated, the incentive was for profits to be sent overseas, eroding the government's tax base. The differential between the New Zealand and Australian corporate tax regimes needed to be addressed as a "matter of priority".

As coalition negotiations were being conducted, the Reserve Bank fired a warning shot. In a speech to the Credit and Finance Institute, the bank's governor Bollard said that the present economic conditions were unsustainable, blaming government and household spending. With the overseas debt the highest in 20 years and households among the most indebted in the OECD, Bollard warned that a "major correction" was inevitable. Such a process, he said, would not be "painless".

Labour's finance minister Michael Cullen dismissed Treasury's prescription as an "ideological burp", declaring that "nobody elected Treasury". At the opening of parliament in mid-November, the government declared major tax cuts were off the agenda for the next three years. It did, however, give the green light for a proposed review of the corporate tax structure proposed by Revenue Minister Dunne, and foreshadowed a "broad restructuring" in the area of corporate taxes was likely.

The government's rejection of the Treasury advice provoked immediate criticism in business circles with the Business Roundtable declaring that Treasury had not gone far enough. Business NZ chief executive Phil O'Reilly said Treasury's advice was "completely mainstream" and reflected "best practice" required to stimulate the economy. Federated Farmers waded in, saying Treasury had been "moderate and sensible".

The government, publicly at least, has ignored the criticisms as well as the warnings of an economic downturn. Late last month Cullen declared that the country was not facing "some kind of crisis or some kind of major depression". He said the government needed a tight fiscal policy, could not afford to loosen the purse strings to pay for tax cuts and needed to keep public spending in check.

However, Cullen's remarks amount to little more than wishful thinking. As the economy slows and the housing bubble bursts, Labour will quickly fall into the line with the demands of business for further economic restructuring. The inclusion of Dunne and Peters as top ministers with the freedom to castigate the cabinet from outside amounts to a pledge to the corporate elite.

Treasury, the government, business and the unions are in complete agreement on one thing—that workers have to further increase productivity. On October 19, the day after Clark's new cabinet was sworn in, Air New Zealand announced it would close its Auckland maintenance facility with the loss of 600 jobs and warned of a 57 percent fall in profits this year. Cullen declared that the decision was entirely a "matter for the company" and that the government, which holds 80 percent of Air New Zealand shares, would do nothing to save the jobs.