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Funding Council Water Systems

and
Other Infrastructure

Could the Government provide zero interest funding for investment in water and waste water infrastructure at no cost to ratepayers or taxpayers?

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History

The new Labour Government, elected in 1935, faced a massive housing and infrastructure problem and shortages in health, education, and other areas.

They found the funds to build 33,000 state houses, invest in health, education, infrastructure, and supported the producer boards without raising taxes. It got New Zealand out of the depression before any other developed nation.

As a result thousands of New Zealanders revered Michael Joseph Savage. His photograph hug over the mantle piece in their homes, and still does in many today.

How did they do it?

<u>Encyclopaedia of New Zealand 1966</u>

1935–49 The Labour Regime
The Government's opponents never tired of inquiring, "Where will the money come from?"; the Government's answers were never explicit, but in fact a good deal of the money came from State credit created by the Reserve Bank. This institution, by an Act of 1936, had become a fully governmental body; where these expensive programmes could not be financed out of current revenue or overseas funds, the Government simply borrowed from its own bank. Neither the housing programme nor the guaranteed price could have been financed without such credit.

<u>Reserve Bank of New Zealand: Bulletin, Vol. 69, No. 3</u>

The policy origins of the Reserve Bank of New Zealand
Labour won more than 70 per cent of the seats in the 1935 election, and the government of Michael Joseph Savage had every intention of realising its own concept of a central bank.

It nationalised the organisation completely*, provided more scope for the Bank to extend credit to government and government agencies, and added a power that allowed the Reserve Bank to vary the reserve requirements on banks* – something that became the principal tool for active monetary management in the post-war period.

As Sutch put it:
(William Ball Sutch - New Zealand economist, historian, writer, public servant, public intellectual)

"*The Reserve Bank now has the power to underwrite Government loans, to extend long-term loans to the Government and to advance to the Government moneys on overdraft for the purchase and marketing of any New Zealand product.*

State credit and reconstruction: the first New Zealand Labour Government

Kerry Raymond Bolton
Academy of Social and Political Research, Athens, Greece

This 1936 Reserve Bank amendment bought the private stockholders out "at a handsome profit," the bank came under complete State control, and the Board of Directors became "the direct servant of the Government of the day" who were obliged to fulfil the policy of Government and were subject to removal.

Of particular interest is that the Bank would underwrite any loan the Government desired to raise, and Treasury was empowered to borrow from the Reserve Bank the complete amount of estimated revenue for the year. The Bank also had complete control over the ownership of sterling exchange, which [John A.] Lee explained was of "vital importance" in controlling the "international movement of gangster financial capital that can occur in times of political emergency" and can "raid a country's external credit" (Lee, 1937, p. 7).

Lee commented in his 1937 assessment that for the State Housing project the State had availed itself the prerogative to issue its own credit. An initial £5,000,000 (Olssen, 1977, p. 93) of state credit through the Reserve Bank was issued for housing (Lee, 1937, p. 10), via the Housing Account of the State Advances Corporation.

Lee cites Finance Minister Nash as stating to Parliament that the credit would be state issued in entirety as "new money" on which the interest earned in its entirety would return to the State as profit, while the houses would remain in State ownership.

This, it is now mostly forgotten, was the basis of New Zealand's famous State Houses which served well (and continue to do so) – with their quarter acre sections and enduring construction – generations of New Zealanders. The credit was advanced to the Housing Department and Local Bodies.

(LEE = John A Lee – Labour MP for Grey Lynn 1935)

Ministry of Works – State Housing In New Zealand 1949 by Cedric Firth –

To finance its comprehensive proposals, the Government adopted the somewhat unusual course of using Reserve Bank credit, thus recognising that the most important factor in housing costs is the price of money - interest is the heaviest portion in the composition of ordinary rent.

The newly-created Department was able therefore, to obtain the use of funds at the lowest possible rate of interest, the rate being 1per cent for the first £5,000,000 advanced and 1.5 per cent on further advances.

The sums advanced by the Reserve Bank were not subscribed or underwritten by other financial institutions. This action showed the Governments intention to demonstrate that it was possible for the State to use the country's credit in creating new assets for the country.

The fundamental premise, then, about housing had undergone a change. Housing was to become a Public Utility, the right to live in a decent dwelling being regarded as on the same level as the right to education, sanitation, to good and abundant water, to an adequate road system, and to a certain amount of medical care. Probably it would be true to say that this premise has now gained fairly wide acceptance.

Rents: Rents for State houses were worked out originally on such a basis that the resultant revenue over the whole of the Dominion was sufficient to provide adequate reserves for depreciation, maintenance, insurance, losses and vacant tenancies, and to cover all interest charges and management expenses and to yield a small surplus. It was part of the policy to build up a depreciation reserve which in sixty years would cover the estimated cost of construction so that when complete rebuilding became necessary sufficient funds would be in hand for that purpose. At the present time, however, rents are not based on the cost of the dwellings but are assessed according to their area and location.

Leading economists and commentators are proposing a similar thing today.

Ganesh Nana, Senior Economist and Research Director of BERl, Productivity Commission Chairperson - Otago Daily Times 04.05.20
Dr Nana describes the Reserve Bank's suggestion that it could finance government debt directly as a "no-brainer". "It's been in the textbook a long time ... It's just another tool in the toolbox to use when sensible. And now is the time to use that, very definitely."

Dr Geoff Bertram, former Senior Lecturer in Economics at Victoria University - BERL website 06.04.20; & NZ Herald 13.04.20
"Issuing money in the current circumstances has impeccable support from mainstream economic thinking. In the current context it is the correct, most efficacious way to proceed. [Govt] should not be prisoners of outmoded, arch-conservative political doctrines."

Jordi Galí, Macroeconomist, Research Professor, Barcelona School of Economics 17.03.20
"There is an alternative to a strategy based on higher taxes and/or more government debt - namely, direct, unrepayable funding by the central bank. A transfer from the central bank to the government." "Central banks have the ability to create money.......and credit the government's account. Money-financed fiscal interventions are a powerful tool".

Adair Turner, businessman, former chairman Britain's Financial Services Authority
"We are going to simply say we want $40 billion this year, and $20 billion next year of direct fiscal stimulus to the economy, which, we, the central bank, are printing the money to provide. It doesn't have to be borrowed money."

Bryan Gould, Rhodes Scholar, UK diplomat, Oxford law don, former vice chancellor, Waikato University - Blog 21.03.20
"A sovereign country need never be short of money. We may, in particular instances, be short of the materials, skills, and labour needed for production, but governments can create money whenever we want and wherever it is needed."

The Reserve Bank has already created approximately $60 billion in the last two years

Reserve Bank Deputy Governor, Christian Hawkesby confirmed the bank is doing this on TVNZ's Seven Sharp programme on April 30th 2020.

"We're creating electronic money to buy government bonds", he said. "Through this process we create money." "Twenty years ago this would have been considered unconventional monetary policy". "Now, with Covid-19, effectively every developed country around the world is undertaking this sort of practice".

This was confirmed by RBNZ chief economist Yuong Ha on August 14th "We create money … which is what central banks do, and have always done, but we then exchange it for assets but those sit on our balance sheet."

Because of the crazy money-go-round of Quantitative Easing that it's used (digital money printing to buy existing government debt (bonds or IOUs) off the commercial banks), it has cost taxpayers billions in premiums over and above the price of the actual debt. At least the interest payments taxpayers are funding on that government debt is now going to the Reserve Bank.

That interest will be funnelled back to the government, which owns the Reserve Bank, as profit for it to spend - instead of into the pockets of the overseas shareholders of the commercial banks (Bank of America and Chase Manhattan for example) that it would normally go to.

<u>Treasury and Reserve Bank Report – May 2020</u>
An aide-memoire, titled "Quantitative Easing and Monetary Financing Compared", was presented to Finance Minister Grant Robertson in May last year. The report, jointly written by Treasury and the Reserve Bank, lays out the benefits of monetary finance (the Reserve Bank creating money and putting it straight into an account for the government to spend) and quantitative easing or QE.

The report says that Monetary Finance could be used to "meet specific funding needs of the Government at lower cost and with greater certainty than QE".

It pointed out that it would have been much more efficient for the government to avail itself of 'direct monetary financing'..

China makes extensive use of that mechanism for its infrastructure programme and Japan and Indonesia have begun using it too.

Could that credit creation capability of the Reserve Bank be used to fund not only council water and waste water, but housing, infrastructure, and other government investments?

The power for government to borrow from the Reserve Bank is still on the statute books

Public Finance Act 1989

47. Minister may borrow on behalf of the Crown if in public interest

(1) The Minister, on behalf of the Crown, may borrow money if it appears to the Minister to be necessary or expedient in the public interest to do so.
(2) The Minister may borrow money from any person, organisation, or government (either within or outside New Zealand).
(3) Except as otherwise provided in any Act, all monies received as a result of money being borrowed under subsection (2) must be paid into—
(a) a Crown Bank Account; or
(b) if the Minister directs, a Departmental Bank Account.

So if the government can borrow ”from any person, organisation [bank], or government (either within or outside New Zealand)” it could do so from it’s own bank, the Reserve Bank, or simply use monetary finance to “meet specific funding needs of the Government at lower cost and with greater certainty than QE” as the Treasury report laid out.

All that inhibits our current government from using this technique is the fear that some will disapprove and regard it as taking risks with inflation. But, as John Maynard Keynes observed, “there may be good reasons for a shortage of land but there are no good reasons for a shortage of capital.” He went on to say that, if an increase in the money supply is applied to productive purposes so that output is increased, it cannot be inflationary.

Instead of the tried and proven method of using Reserve Bank credit as the 1935 Labour Government did to build state houses, infrastructure etc, the current government borrows from commercial banks and private investors (and the National Party, the Greens, and ACT all propose to do likewise).

The new water entities the government proposes to create will borrow the money to do the **job from private sector investors** (speculators) and pay interest, and that will cost ratepayers and water users dearly.

This follows earlier announcements in other areas of government:-

During the debate on the NZ Infrastructure Commission Bill in 2019, the Hon. Phil Twyford signalled the decision to introduce legislation later in the year about “the work I’ve been leading with Treasury on establishing new ways of funding and financing the infrastructure that’s needed .....that will allow **private financing** [through PPP’s] to be invested in infrastructure for new urban growth, paid back over the lifetime of the asset...to allow us to tap into a limitless supply of investment capital to build the infrastructure that our cities need.”

The Infrastructure Funding and Financing Act 2020 provided Te Tūāpapa Kura Kāinga - Ministry of Housing and Urban Development access to **private capital** for the provision of new infrastructure for housing and urban development.

The website of the local government funding agency says the LGFA in 2011 won an award for their contribution to the **development of capital markets** in New Zealand. 'We provide investors with a new source of securities rated at AA+ by international credit ratings agencies'.

Surely ratepayers should expect the money they pay to go towards providing services in their area, not to be the source of a significant contribution to the development of Capital Markets for wealthy investors to profit by a charge on ratepayers pockets.

Kāinga Ora, formerly Housing NZ and Kiwibuild, can now borrow up to $7.1 billion to scale up land acquisitions, to boost housing supply, and refit existing properties. This $7.1 billion will be sought **from debt capital markets**. Bernard Hickey, Newsroom, January 2020.

New Zealand's roads are often built with funding **from debt capital markets.** The NZTA uses PPPs (Public Private Partnerships where the developers access the finance) to build major roading projects like Transmission Gully and Puhoi to Warkworth motorways.

PPPs have also been used to build Waikeria prison, maximum security Auckland Prison, Wiri prison, refurbishment of Paremoremo Prison, and more than a dozen schools.

Government itself, for investment in other areas has currently borrowed approximately $60 billion by issuing bonds to banks and other investors.

Funds from the debt capital markets, borrowed directly by government institutions and local bodies, or through PPPs or SPVs (Special Purpose Vehicles) are virtually all created by commercial banks in the first place and therefore involve an increase in the money supply – exactly the same as if the Reserve Bank created the money.

If it was going to cause inflation, it would do so regardless of where the money creation occurred (Keynes was adamant it wouldn't cause inflation anyway).

The difference is that Reserve Bank created money costs taxpayers and ratepayers zero interest and in many cases does not need to be paid back, where-as commercial bank created money requires both and provides a gold plated profit to already wealthy bank shareholders and investors – a transfer directly out of the pockets of those who can least afford it. That means projects are often paid for several times over instead of just once. This starves other needed projects of funding.

Capital markets might be an appropriate source of funding for profit making businesses but not for state housing, water supply, waste water treatment, roads, rail, hospitals, schools and the other public necessities required for people to live.

The lowest cost funding for those things can be sourced from the bank we all own – the Reserve Bank - and taxpayers would be saved enormous sums of interest.