Horticulture™ New Zealand

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Submission on:
Capital Review Paper 4: how much capital is enough?

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Introduction

1. Horticulture New Zealand, Apata Group Ltd, Central Otago Fruit Growers Association, Katikati Fruitgrowers Association, NZ Apples and Pears, NZ Citrus Growers, NZ Feijoa Growers Association, NZ Kiwiberry Growers, NZ Kiwifruit Growers, Process Vegetables NZ, TomatoesNZ, Vegetables NZ, Pukekohe Vegetables Growers Association and Potatoes NZ appreciate the opportunity to make a submission on *how much capital is enough?* This submission is made following consultation with members of the above listed organisations who make up some of New Zealand's 5,000 commercial growers of fruit and vegetables.

2. Horticulture employs over 60,000 people, occupies some 120,000 hectares of land and provides critical regional development opportunities in Northland, Auckland, Bay of Plenty, Hawke's Bay, Marlborough, Nelson, Canterbury, Taranaki, Waikato, Manawatu, Wellington, Central Otago and Southland. Horticulture is valued at $5.8 billion, with $3.61 billion in exports to overseas markets. Horticulture is going through a period of significant growth with forecasts to June 2019 predicting a 17% rise to over $6 billion (*MPI, 2019*).

3. In making this submission we note that the rationale for the changes is set out on page 5 of the Review Paper as follows:

"The Reserve Bank is proposing this change to reduce the chances of banks failing in New Zealand. If banks in New Zealand fail, some of us might lose money and some of us might lose jobs. However, there would also be indirect costs on all society that may be harder to see that would negatively impact the well-being of all New Zealanders. In the end, we would bear the cost of bank failures, in one way or another."

Principles

4. Our preparation of this submission involved consulting with our members and in result we develop the following principles:

- Horticulture is an international business with our competitors being growers in other countries; therefore, the cost of capital in New Zealand needs to be competitive relative to the cost of capital for other international producers.
- Business infrastructure growth will be sustained through more certainty of long-term rates.
- Risk protecting the banking systems needs to be balanced against increasing the cost of capital, slowing infrastructural investment and reducing returns to investors.
- Pressure needs to be maintained on the banks themselves to operate prudently.
- Competition between banks needs to be enabled.

Submission

5. We do not support the proposal as currently formulated. We do support Federated Farmers' submission and, based on the above stated principles and our discussion below, recommend that any proposed increases in bank capital be revisited to ensure:

- A more appropriate level of risk tolerance is chosen;
- A robust and independent cost-benefit analysis is undertaken; and
- Transitional arrangements allow for a more measured, gradual pace of change, thereby easing costs of getting to desired new levels for bank capital.

These three proposals were consulted on and unanimously supported by those HortNZ members and affiliated organisations who responded to the consultation.

Discussion

6. For New Zealand horticulture is an international business. Our main earnings are through exports which are underpinned by domestic supply feeding New Zealand. Therefore, our competitiveness in our offshore markets is affected by

the cost of capital in New Zealand. To remain competitive horticulture needs to embrace new technology, robotics and artificial intelligence, and innovate through the development of new varieties and new growing techniques. This all requires significant capital investment. We submit that any tightening of capital in New Zealand will result in capital investment programmes needed to support our international competitiveness being put at risk, resulting in our produce being less competitive and reducing returns.

7. We submit that there needs to be a balance between the costs and benefits of a particular risk appetite. We note that risk can never be completely eliminated, even at great cost, and there will be a point where the added cost of reducing risk begins to outweigh the added benefits of the reduced risk. If the banking system has a margin which is 0.2% - 1.0% higher than the underlying default rate, then all you are doing is adding a tax on the underlying economy. We do not believe that this is an appropriate way to cover a 1 in 200-year event when in practice it is unlikely to be enough in such an event.

8. Banks must be incentivised to operate prudently and to maintain their viability. We submit that any regulatory change should not lessen or weaken the pressure on banks to perform. We submit that a 1 in 200-year "buffer" will not achieve the aims set out in the Review Paper. History shows us that we have, and will repeatedly see, banking crises and that New Zealand will experience bigger ones due our international vulnerability and to the ratio of debt growing.

9. We submit that the perverse effect of strict capital rules will be to protect the large established banks and stifle competition, leading to the possibility that New Zealand would miss out on new innovation in banking systems.

10. We believe that as long as New Zealand has independent monetary policy and the ability to use quantitative easing, future banking crises will be able to be managed.

11. In conclusion we submit that to avoid the taxpayer underwriting lending by banks the following is needed:

    - Enough real risk capital (equity or Tier 1 debt) that is able to absorb any losses prior to the government having to step in; and
    - A clear understanding of what happens **if** and when the government has to get involved. It is this that is usually missing, with the problem only occurring when the government on behalf of the taxpayer steps in to protect bank customers.

12. We support both Federated Farmers' and Business NZ's submissions.