

On the announcement that the bank equity fund will be scrapped, the New Zealand Institute asks: what is “Plan B”?

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One of the bolder proposals coming out of the Jobs Summit was the proposal for a bank equity fund to rescue large companies in temporary financial stress. The major trading banks proposed to commit up to one billion dollars in equity funding, on the proviso this would be matched by a similar level of government funding.

We heard this week that the proposal has been scrapped. Confusion reigns over whether the decision not to proceed with the scheme was mainly at the behest of the Government, Treasury officials or the banks themselves. Getting to the bottom of the rationale for its abandonment is not helped by the fact that the Minister of Finance did not provide a media release or any other information outlining the reasoning behind his decision, and whether any alternatives are being considered.

It was always going to be a big call for the banks to contribute one billion to a rescue fund for distressed companies. Speculation that the banks got cold feet because of concerns about the impact on their tier 1 capital sounds plausible – it would be imprudent to design a scheme that risks weakening the balance sheets of trading banks at a time when they need to maintain unblemished reputations in order to shore up foreign funding streams.

However, acknowledging valid concerns with a proposal and making adjustments is one thing – in this case we are left with the impression that the Government has scuppered the proposal at the first hurdle, leaving uncertainty and lack of confidence that there is a plan to deal with some very real risks facing New Zealand.

The problem that the bank equity fund was meant to address has not gone away. The recent slump in earnings of New Zealand companies exposed to the fast imploding markets in the U.S, Europe and South East Asia heightens the risk that companies will breach the narrow terms of their bank debt covenants (these agreements usually contain ratios of cash flow to debt levels that were constructed prior to the unanticipated meltdown in foreign markets). Despite the highly publicised recent public debt raising of some blue chip New Zealand companies, alternative sources of funding for companies that cannot roll over bank debt are still hard to find. This raises the very real risk that a company with good medium term prospects might be faced with no alternative but to declare itself insolvent.

The New Zealand Institute’s earlier publications on responses to the crisis have emphasised the importance of being prepared: a tremendous degree of uncertainty still hangs over the economy. It is vital that the Government has a plan and is prepared for any eventuality – even though we may hope such plans need never be applied.

In looking at alternatives, the Government could refer to earlier New Zealand Institute advice on using the financial assets in the Government’s own balance sheet as a war-chest to help New Zealand companies in need. Whatever approach may be adopted, it should be transparent and managed in a way that is arms-length from government to guard against the

politicisation of decisions on which companies merit support. It is also vital that the help available, criteria and process are well publicised in an effort to ensure that any company in trouble is aware of the help available, and there is public accountability for the way tax payer funds are applied.

It may be timely for the Minister of Finance to have a team talk with his officials, and push them a bit harder by demanding “if not this proposal, what is the Plan B?”. The danger the Government runs in the current environment is that its default programme becomes emergency, ill-thought out measures informed by political judgement, while officials scramble to advise in commercial spheres where they lack the requisite experience to make balanced assessments of which companies do and do not merit support.