Comparative European Politics, **2008**, **6**, (346–364)

www.palgrave-journals.com/cep

Neoliberalism and Financial Change: The Evolution of Residential Capitalism in New Zealand

André Broome
Department of Political Science and International Studies, University of Birmingham, UK.
E-mail: a.j.broome@bham.ac.uk

Access to home ownership has traditionally been the foundation of low and lower-middle income household wealth in New Zealand, and has been the principal source of the country's domestic savings. Like the country's 'big brother' across the Tasman, during the last 9 years New Zealand has experienced an unprecedented boom in residential property prices, initially facilitated by the growth of mortgage securitization, low interest rates, strong economic growth, and the willingness of foreigners to continue to provide domestic financial institutions with easy credit. New Zealand's recent residential property boom has also been driven by new conceptions of wealth among the wider population. These changes reflect a greater desire among existing homeowners to 'invest' in second and third properties to ensure future financial security and the growth of a middle class 'investor culture' as a result of the neoliberalization of the New Zealand economy during the 1980s and 1990s. This article examines how the confluence of a property boom with a neoliberal monetary regime has undermined the competitiveness of the 'real' economy in New Zealand and constrained the policy options available to decision-makers, as well as helping to price new entrants out of the property market.
Comparative European Politics (2008) **6,** 346–364. doi:10.1057/cep.2008.15

Keywords: neoliberalism; housing; monetary policy; institutional change; New Zealand

Introduction

Examining changes in varieties of residential capitalism is important for understanding broader changes in financial behaviour, which can have a significant impact on individuals' political preferences as well as a country's macroeconomic outcomes.[1] In addition, when domestic property bubbles burst this can generate severe consequences for the stability of the international financial system, as became evident when the end of excessive real estate speculation in several East Asian economies contributed to the financial crises in 1997–1998 (Sheng and Kirinpanu, 2000), and as we are seeing now with the current sub-prime crisis (Renaud and Kim, 2007, 9–11). In short, changes in different countries' systems of residential capitalism can engender far-reaching political effects at the national level, the international level, as well as at the more immediate level of people's everyday lives.

This article examines the rapid changes to New Zealand's housing finance system during the 1980s and 1990s, and explores the connections between the evolution of residential capitalism in New Zealand and broader changes in the country's domestic political economy. Changes to New Zealand's system of residential capitalism had a significant impact on the country's tradition of state support for the expansion of home ownership among the population as a social right, rather than simply as a means to generate financial wealth through capital gains. While older age cohorts believe that owning a house rather than renting will help to establish a family's financial security across generations (see Dupois and Thorns, 1996), these changes generated negative social consequences with respect to intergenerational equity while shifts in everyday financial norms interacted with formal neoliberal policy changes to produce unintended outcomes. Because New Zealand has often been held up as a model of reform for other countries around the world, especially small European economies, studying the unintended consequences of neoliberal reforms in New Zealand is more instructive than simply looking at what, why, and how specific policy changes were introduced.

The article proceeds as follows. First, I briefly examine the historical context of New Zealand's 'home-owning democracy', and how this was transformed with the wide-ranging financial reforms undertaken during New Zealand's neoliberal economic policy revolution during the 1980s and 1990s. Second, I explore how radical changes in the country's housing finance system and the emergence of new financial norms drove changes in home ownership patterns in New Zealand, which contributed to worsening the negative effects of broader neoliberal policy changes upon low and lower-middle income groups in society and altered the life chances of younger cohorts of New Zealanders who seek access to the property market. Third, I investigate the emergence of what I term a *housing bubble–monetary policy nexus* in New Zealand during the country's most recent property boom, which has both constrained the policy flexibility available to today's policymakers and further worsened the chances for would-be first-time property buyers to accumulate wealth and gain future financial security through home ownership. The final section concludes by drawing together the potential lessons of the New Zealand case for other small economies undergoing financial liberalization in their distinct systems of residential capitalism. Here I argue that while New Zealand's housing finance reforms have enabled greater access to mortgage credit for middle and higher income earners, they have also contributed to locking out low and lower-middle income households as well as younger households from the property market, or have resulted in first-time home buyers taking on increased levels of debt and financial risk in pursuit of the 'New Zealand dream' of owning one's own home.

Financial Reform and New Zealand's Home-owning Democracy

Domestic financial change is not simply a matter of enacting new formal rules that alter a state's policy settings. To be successful, financial policy changes must also engender a shift in the everyday norms that guide people's financial behaviour, which can often lead to unintended outcomes (Broome, 2009). During the past two decades New Zealand's system of residential capitalism has shifted away from the notion of housing as a social right (Ferguson, 1994) toward investment in housing as a means to generate wealth. Combined with full employment policies and universal welfare provision prior to the 1980s, broad access to home ownership in New Zealand that was facilitated by state intervention in the housing market formed the bedrock of the country's implicit social contract, and was an important source of household savings and financial security. The ideal of owning one's home has remained a powerful aspiration in New Zealand society. As one observer recently noted in a report for the Centre for Housing Research, 'Home ownership remains an integral, and possibly the central component of New Zealand culture', with the maintenance of high levels of home ownership in New Zealand an objective that bridges the country's political divide (Morrison, 2007, 9). What has radically changed over the last two decades, however, are the institutional structures that previously helped to transform the ideal of home ownership in New Zealand into a realizable goal for people of almost all income and age groups, with the percentage of households owning their home declining from 73.8% in 1991 to 66.9% in 2006 (Statistics New Zealand, 1998, 2007).

New Zealand is usually categorized as a liberal welfare state with limited social housing policies to protect the least well-off households (Doling, 1997, 136; Allen, 2006, 258). While state support to expand home ownership in New Zealand declined after the 1970s, this had previously contributed to improving housing affordability through maintaining low mortgage interest rates and enlarging the supply of housing (Ferguson, 1994, 233). Rather than focusing primarily on the provision of public housing, New Zealand governments sought instead to expand private home ownership throughout the population by providing cheap credit to new home owners and subsidizing the building industry. For instance, the first Labour government elected in 1935 channelled easy credit to the housing sector through the establishment of the State Advances Corporation in 1936 (Holmes, 2004, 9). State intervention in the housing market under successive centre-left Labour and centre-right National governments caused a massive expansion in home ownership rates from 50.5% in 1936 to 68% in 1971 (Murphy, 2000, 395). With bureaucratic responsibility for the country's housing finance system consolidated in the Housing Corporation of New Zealand (HCNZ) that was set up in 1974, the government initially continued to be a major player in the provision of mortgage funds, with subsidized loans to low income and lower-middle income households through the HCNZ accounting for 38% of the mortgage market in 1978 (McLeay, 1992). In addition to government support for home ownership, the HCNZ built and managed publicly owned rental housing that was allocated on the basis of need, which comprised approximately 6% of the residential housing stock in the 1980s and 5% during the 1990s (McLeay, 1984, 87; Sheridan *et al*., 2002, 345).

Home ownership simultaneously endows individuals with a bundle of legal rights, social status and independence, and economic benefits such as a stock of savings and future financial security (Doling, 1997, 152; Castles, 1998, 16; Conley and Gifford, 2006, 56). While it has usually received less attention from political economy scholars than the big ticket changes to the country's macroeconomic policy settings during the 1980s and 1990s, the subsequent evolution of New Zealand's housing finance system stimulated important changes in the distribution of wealth throughout New Zealand society, and especially between different age cohorts and income groups. It also further advanced and helped to lock in fundamental changes in everyday financial norms, which were spurred by the transformation of the policy mould that had shaped the economic agenda of successive New Zealand governments since the 1930s.

After the election of the fourth Labour government in New Zealand in 1984, the new government rapidly liberalized state controls on foreign exchange, the banking sector, wages, prices, and interest rates. Changes included the removal of restrictions on foreign borrowing by domestic financial institutions, allowing foreign-owned firms unfettered access to domestic capital markets, the elimination of controls on mortgage interest rates, the removal of credit guidelines for commercial banks, and the relaxation of bank reserve ratios. These reforms increased access to mortgage credit and intensified mortgage competition among private lenders, and expanded overseas borrowing to the point where New Zealand banks became more dependent on foreign credit than the commercial banks of any other OECD country (Stuart *et al*., 2004, 6–7). The key figure driving these reforms was Labour finance minister Roger Douglas, whose agenda for economic transformation became widely known as 'Rogernomics'.

One particularly important institutional innovation undertaken by the Labour government was the enactment of new legislation in 1989 to govern the objectives and actions of the country's central bank, the Reserve Bank of New Zealand. The key change was the establishment of an explicit inflation target for the Reserve Bank, a world-first that was initially set at 0–2% (later broadened in 1996 to 0–3%, and altered again in 2002 to a 1–3% target). With this significant change from past monetary practice policymakers sought to entrench price stability as the primary goal of monetary policy by raising the credibility costs associated with any future attempt by a government to loosen monetary policy for political gain (Evans *et al.*, 1996, 1863–1864; Dalziel, 1997).

To applause from financial markets and international institutions such as the International Monetary Fund (Broome and Seabrooke, 2007, 586–587), the country's political leaders had quickly moved New Zealand from being one of the most 'closed' market economies in the world to becoming one of the world's most open liberal market economies, which was often held up as a model of rapid neoliberal economic policy reform for other states to follow. Following the meltdown of the fourth Labour government and Labour's subsequent rout at the 1990 election, the centre-right National Party held power through a series of majority and minority administrations until Labour was re-elected to government in 1999. In contrast to the National Party's traditional policy conservatism, however, this period of National government initially involved a further intensification of neoliberal economic policy reforms during 1990–1992 spearheaded by finance minister Ruth Richardson. Her set of far-reaching labour market, housing, state ownership, and social policy changes, popularly termed 'Ruthanasia', prompted widespread public dismay at the breach of National's pre-election promises and its uncharacteristically radical approach to state-driven economic change, and served to strengthen public support for major changes to the electoral system to constrain the capacity of future governments to drive through rapid policy changes against popular opposition (James, 1998, 20–21).

Home Ownership and the Social Costs of Neoliberalism

Every economic revolution has its winners and losers. In New Zealand's case, the neoliberal economic policy revolution of the 1980s and 1990s that radically altered the country's 'cradle-to-grave' welfare state, and decreased the allocative role of the state in the economy in general, generated extensive business failures as firms were allowed to 'go to the wall'. Combined with the prioritization of maintaining a tight monetary policy this helped to stimulate historically high levels of unemployment, which reached 10.5% in 1991 (Brook Cowen, 1998, 345, 348). While housing in New Zealand was never entirely insulated from market forces, those who were shut out from the housing market had been supported by a universal welfare state (Allen, 2006, 258). However, the policy changes undertaken during the second half of the 1980s and the early 1990s served to intensify the commodification of the property market in New Zealand, at the same time as welfare policy shifted from universal provision to more targeted social support.

Crucial to the process of financial liberalization were efforts to diminish the government's influence over mortgage lending rates. By 1990, the HCNZ share of the mortgage market had dropped from 38% in 1978 to a mere 16.9% and HCNZ mortgages made up only 8.7% of new lending, loans that were increasingly restricted to low income households (McLeay, 1992). With commercial banks taking a much greater role in the provision of mortgage finance, their tighter lending criteria during the 1980s and early 1990s raised the obstacles that low income households that were ineligible for HCNZ loans had to clear in order to purchase their own homes. This contributed to locking low income groups out of the property market, and reflected a weakening of the long tradition of state support for expanding home ownership (Murphy, 2000, 396).

For middle and upper income households, however, access to credit expanded following the financial reforms of the mid-1980s. During the 1990s, commercial banks' methods for assessing creditworthiness were gradually relaxed, with the amount customers were able to borrow increasing from 75% of a home's value to 95% if the borrower purchased mortgage indemnity insurance (which protected banks if a property had to be sold at a value lower than the amount owing on a mortgage). Creditworthiness assessments also became more personalized, with banks approving higher repayment-to-income ratios for couples on average income without children compared with those with dependents (typically approximately 33% compared with around 25% in the late 1990s). Furthermore, because banks calculate mortgage repayment-to-income ratios in nominal terms without taking into account the rate of inflation, when lower inflation rates during the 1990s enabled decreases in nominal interest rates households were able to borrow much larger mortgages (Coleman, 2007, 5–6).

Following the election of the National government in 1990, the state's role in New Zealand's housing finance system shifted further away from direct housing provision to income support. This was undertaken through the introduction of market-based rents in state-owned houses (with eligible tenants receiving financial assistance to pay higher rentals through an accommodation supplement) as well as the privatization of HCNZ mortgages (Murphy, 1996). The government's policy of shifting from direct provision of housing to providing supplementary payments for market-based rents was intended to create a greater degree of equivalence between state-owned housing and private rental accommodation, in order to widen household choice and end the 'dependency' of low income groups on the state rental sector (see Thorns, 2000).

Overall, between November 1991 and January 1999 under the National government 27 tranches of mortgages were sold by HCNZ totalling NZ$2.4 billion in revenue, which made the sale of government-backed mortgages the second largest component of National's policy of privatizing state assets. The transfer of such a large volume of mortgages from the HCNZ to the private sector enabled commercial banks to expand their asset base at the same time as limiting the government's future role in the provision of mortgage finance. In particular, because HCNZ mortgagees had well-established credit histories, the purchase of HCNZ mortgages helped to expand the lending portfolios of commercial banks while offering them stable returns from households that (at the time when their mortgages were sold) presented a low risk of default, because the initial risks involved with lending to low income earners had already been largely absorbed by HCNZ (Murphy, 2000: 396–397). Furthermore, while new mortgage lending by HCNZ totalled NZ$746 million in 1990, this had shrunk by 1996 to a paltry NZ$36 million in new loans (Murphy, 2000, 398).

These major policy changes enacted in such a short period of time combined to wide income inequality through the upward redistribution of income to the wealthiest members of New Zealand society. The downsizing of the state's role in the economy worsened the effects on the poor, with particularly negative consequences for employment levels, wages, and rates of home ownership (Rudd, 2005). As a result, average per capita income declined in real terms for the bottom 10% of the population by 8.71% between 1983–1984 and 1995–1996, while the per capita income of the top 10% increased over the same period by 26.48% (Dalziel, 2002, 44). These changes contributed to restricting access for new entrants to the property market, both prompting individuals to delay home ownership until later in life and lowering the proportion of home ownership among younger age cohorts after they began to enter the property market. This produced a negative impact on intergenerational equity, thereby altering the traditional welfare-trade off for a Settler society (see Editors' Introduction). However, evidence compiled from census data also suggests that the trend in New Zealand has been declining rates of home ownership across *all* age groups except for the oldest between 1991 and 2006 (Morrison, 2007, 45–47).

While the removal of financial controls during the 1980s broadened the growth of (highly selective) private credit, it also served to increase the cost of mortgages for lower income groups whose after-tax household incomes either remained static or declined in real terms. For instance, financial deregulation enabled interest rates to become positive in real terms, whereas inflation-adjusted interest rates had mostly remained negative during the 1970s and the first half of the 1980s. While this had benefited upper income households with larger mortgages, negative real interest rates also made it easier for lower income groups to pay off mortgage debt. With higher real interest rates and the need to purchase mortgage indemnity insurance in order to borrow a greater proportion of a property's value, lower income households were either priced out of the mortgage market or faced spending a higher proportion of their income on mortgage payments.

Until the mid-1980s, commercial banks had operated under strict lending criteria and often required would-be borrowers to establish a significant savings track record before they would be eligible to apply for a loan (Coleman, 2007, 4–5). As discussed above, financial deregulation increased access to mortgage credit for middle and higher income households, and especially those who already owned property and were looking to trade up or to invest in second and third houses for investment. For low and lower-middle income households and first home buyers, new mortgage products that were offered as inducements by banks (such as lower deposit requirements and revolving credit facilities that allowed borrowers to draw additional funds when needed) were initially combined with higher mortgage-repayment-to-income ratio requirements, which served to price many new entrants and especially low income earners out of the property market (Stuart *et al.*, 2004, 7).

High levels of home ownership in a society can potentially function as an alternative form of social insurance (Conley and Gifford, 2006, 57–58, see Editors' Introduction for a full discussion). As a result, the changes to New Zealand's housing finance system that led to a decline in rates of owner occupancy across-the-board generated highly negative distributional outcomes for lower-income groups because they occurred at the same time as the country's system of social protection was retrenched. In particular, substantial cuts in welfare benefits during the late 1980s and early 1990s were combined with the tightening of eligibility criteria (Rudd, 2005, 421). For a country with a strong tradition of high rates of home ownership, the social risks involved with changes to the housing market such as those experienced in New Zealand during the 1980s and 1990s are substantial. The confluence of rapid neoliberal policy reforms with declining rates of home ownership — concentrated in particular among younger households — can lead to a regressive housing cycle that perpetuates a greater level of exclusion from the property market for groups who would have previously found it easier to gain access to property. When a property boom — largely fuelled in this case by property investors rather than owner occupiers — is combined with a broader trend towards lower home ownership rates this can result in a higher proportion of younger households living in rental accommodation, as well as prompting them to rent for longer periods of time. Although over the last decade rents have tended to increase at a lower rate than house prices in New Zealand, greater demand for rental accommodation driven by net migration has placed upward pressure on rents (Hargreaves, 2007, 13, 18). However, it is the potential for future capital gains, rather than rental income *per se*, that has encouraged more investors to enter the rental property market or to expand their property portfolio to gain higher returns, discussed further below. The result has been rapidly increasing house prices that make it more difficult for would-be first-time buyers to save a sufficient mortgage deposit (Morrison, 2007, 57–58). While some households may defer purchasing a home until a later stage in their lives, others may seek to take advantage of new mortgage products based on lower (or zero) deposits, which may lead to higher debt-servicing costs, slower accumulation of equity, and an increased risk of mortgage distress and 'negative equity' when the property bubble bursts.

The Property Bubble–Monetary Policy Nexus in New Zealand

Following a decade and a half of neoliberal policy activism, the triumph of Helen Clark's Labour Party at the polls in November 1999 came on the back of campaign promises to govern in the interests of social stability, rather than to introduce further radical economic policy changes. Nevertheless, the campaign promised some big ticket corrections to the excesses of the 1980s and 1990s economic reforms under 'Rogernomics' and 'Ruthanasia'. Progressive policy shifts under a Labour-led government from 1999 included a rise in the top rate of income tax by 6–39% (from the comparatively low rate of 33%), linking pensions to 65% of the average wage, and removing market rentals for publicly owned housing by linking rents to 25% of tenants' income. The new government also abolished interest charges on student loans for the duration of tertiary study, and passed industrial relations legislation that in theory reinstated some of the union rights that the National Party had abolished in the early 1990s (Bale, 2003, 205, 207).

Previous property booms in New Zealand in the mid-1980s and mid-1990s have ended in financial disaster, with the stock market crash of 1987 and the Asian financial crisis of 1997–1998 quickly letting the air out of New Zealand's house price bubbles. The country's most recent property boom began in the last quarter of 2001. Following Labour's return to power in 1999, the downward trend in patterns of home ownership across different social groups that had been stimulated by its own economic reforms in the 1980s continued. Based on census data, a brief sketch of the changes in New Zealand home ownership — which indicates significant changes in everyday financial norms — can be outlined as follows. In addition to a 7% drop in overall rates of home ownership since 1991, home ownership has become concentrated in the middle and upper wealth brackets with 61.2% of households that did not own their houses in 2006 earning less than NZ$50,000 (compared with a median annual income, for those aged 15 years and over, of NZ$24,400). The decline in home ownership is also concentrated among new entrants to the housing market. Between 1986 and 1996, the proportion of adults aged 20–34 that lived in rental accommodation increased from 34.5 to 40.5%, while home ownership among people aged 25–44 declined by 44% from 1991 to 2001 (Thorns, 2006, 24).

More recently, the proportion of adults aged below 40 who are owner-occupiers declined from 30.2% in 2001 prior to the property boom to 27% in 2006, indicating the greater difficulties that first-home buyers now have in gaining access to the property market in the first place (Statistics New Zealand, 1998, 2007).

These changes are closely related to the increasing tendency of New Zealanders who already own houses to invest in rental property as a means to provide an additional income stream and as a 'safe' source of retirement savings. For example, a survey of over 900 New Zealand property investors conducted in 1999 found that the overwhelming majority of respondents entered into residential rental property investment for the first time during the 1990s (de Bruin and Flint-Hartle, 2003, 277). This represents a shift from individuals seeking to purchase houses for owner occupancy as a route to a particular lifestyle, to a significant increase in the number of individuals purchasing homes in order to acquire a financial asset that may then be rented out (Morrison, 2007, 6–7). Survey and interview data also indicate that while property investors in New Zealand tend not to undertake formal risk analysis of purchasing rental property compared with other forms of investment, most intuitively view residential property as a 'low risk' investment over the long term (de Bruin and Flint-Hartle, 2003, 280). As everyday financial norms in New Zealand have changed in response to changing economic incentives and increased insecurity about how individuals will provide for their future income requirements, the number of individuals, trusts, or businesses acting as private landlords in New Zealand has rapidly increased since the start of New Zealand's economic policy revolution in the 1980s. As Figure 1 shows, the number of household dwellings owned by private landlords rose by more than one-third from 1986 to 1996, and further increased by over 50% from 1996 to 2006. Public housing owned by the New Zealand Housing Corporation (NZHC) decreased over the same period from 56,091 houses in 1986, to 52,688 in 1996, to 49,419 in 2006. Overall, homes owned by private landlords now make up approximately 20% of the country's total housing stock, with NZHC houses accounting for less than 4% (Statistics New Zealand, 1998, 2007).

Survey evidence suggests that most landlords in New Zealand are relatively small-time investors, with 42% of landlords owning one rental property and 20.6% owning two. The expansion of the property investor class in New Zealand during the recent property boom has been concentrated among the upper middle and higher income groups, based on the widespread perception that property is a safe investment, and in pursuit of the higher returns that can be gained from investing in housing in New Zealand relative to other forms of investment. From 1988 to 2006, for example, returns on rental housing have been above average returns on financial savings such as shares, bonds, and bank deposits. In part this is because capital gains from housing are not taxed,

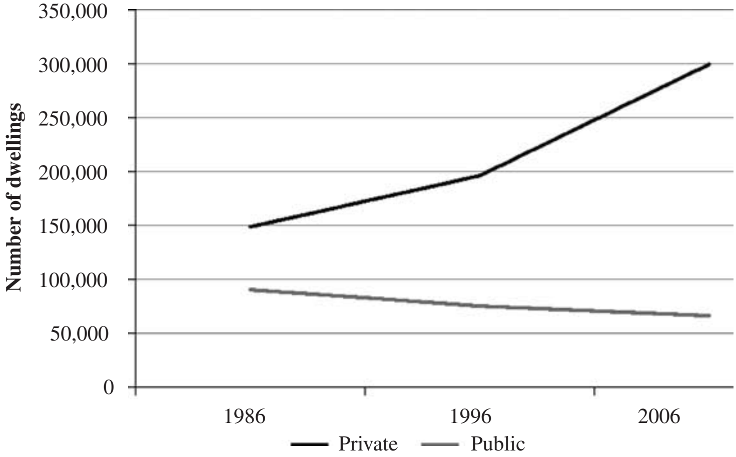

Figure 1 Public and private landlords in New Zealand, 1986–2006. Source: Statistics New Zealand (1998, 2007).

while investors are able to offset rental property losses from the cost of interest payments, local rates, repairs, and insurance by reducing their tax payments on other income. Therefore, rental income does not need to cover the full costs associated with purchasing property to let because investors are able to reduce their overall income tax liabilities, and will accumulate any capital gains untaxed (a similar phenomenon has occurred across the Tasman, see Mortensen and Seabrooke in this issue). Most private residential landlords are now couples over the age of 45, who earn more than NZ$70,000 per year (Burns and Dwyer, 2007, 7–8).

Similar to the UK (see Watson, this issue), during New Zealand's recent property boom households have taken on greater debt levels and have spent more than they earned in income, with greater consumption fuelled by borrowing against higher residential property values helping to generate increased inflation levels despite rises in interest rates to the point where New Zealand has one of the highest official cash rates in the OECD (Burns and Dwyer, 2007, 3). Freed from the tight regulations that previously governed their lending decisions and the amount of funds they could raise on capital markets, the decline of HCNZ mortgage lending and the rising proportion of commercial bank loans in New Zealand's mortgage market during the 1980s and 1990s is reflected in banks' balance sheets. From 1984 to 1999, commercial bank lending to manufacturers declined from 24.5% of their total loan portfolio to only 4.4%, while lending for residential mortgages increased rapidly over the period from 13.6% of total bank lending to 42.8%. Moreover, with comparatively high interest rates and low inflation in New Zealand relative to many other OECD economies during the last 15 years, commercial banks have found it easy to raise overseas funds to fuel the domestic property market (Badcock, 2004, 60–61). In 2001–2002, the Household Savings Survey in New Zealand showed that households collectively owned NZ$444 billion of assets and had $68 billion of liabilities, with owner-occupied homes forming the largest percentage of assets (36%) while rental properties now formed 4% of total household assets. To provide a point of comparison with investment in homes and rental properties, 8% of total assets were held in superannuation and life insurance, 6% in bank deposits, and 4% in shares and funds. With respect to liabilities, 80% of household liabilities were mortgage debt (Burns and Dwyer, 2007, 6–7).

At its peak, New Zealand's recent property boom drove residential property prices in urban centres up rapidly. In Auckland, the country's largest city, the annual rate of house price increases was 19.3% in 2003, compared with 16.2% for the country as a whole (Badcock, 2004, 62). As Badcock (2004, 67) points out, New Zealand policymakers now face a 'monetary "catch 22"' during a housing bubble. On the one hand, the Reserve Bank may wish to increase interest rates in order to ease house spending and property speculation, while on the other hand such policy actions risk undermining the growth and export competitiveness of the 'real' economy.

This problem can be termed a *housing bubble–monetary policy nexus*. When a small open economy such as New Zealand experiences a property boom in a housing finance system that is overwhelmingly characterized by fixed-term interest rates rather than floating rates (around 80% of mortgage interest rates are now for fixed terms), this creates a time lag where households may choose to increase consumption based on nominal increases in house values. This need not involve greater borrowing: home owners may simply choose to consume more in anticipation of further increases in property values (de Veirman and Dunstan, 2008, 4). Even when interest rates start rising, home owners may still choose to refinance their mortgage at a new fixed-term rate based on higher house values to protect their spending power against future rate rises. Furthermore, homeowners with revolving credit mortgages may simply choose to draw down more funds — up to their existing credit limit — based on a perception of higher net household wealth.

Greater consumption can place stronger pressure on inflation even if the central bank tightens monetary conditions through a series of interest rate increases, because borrowers are locked in for a set period to mortgages on lower rates of interest. This is especially the case with respect to fixed-term interest rates of 5 years or more which tend to be funded from offshore capital markets that are 'out of reach' for the Reserve Bank (Drew *et al.*, 2008, 10). The problem was deemed sufficiently serious for the Reserve Bank and the

Treasury to come up with a 'Mortgage Interest Levy' proposal, which would aim to increase the costs of mortgage borrowing to help ease a property boom without increasing the returns to short-term foreign investors that could serve to push up the exchange rate (Reserve Bank of New Zealand, 2007). In these circumstances, simply raising the official cash rate might result in a higher exchange rate because increases in short-term interest rates generate stronger incentives for speculators in the currency carry trade to exploit interest rate differentials between low-interest and high-interest economies. As an economy that is heavily dependent on commodity exports, and which has experienced a rapidly widening current account deficit in recent years, a stronger exchange rate that makes imports cheaper and exports less competitive risks doing serious damage to New Zealand's economic growth and macroeconomic stability.

With the housing bubble in New Zealand rapidly overheating, the Reserve Bank began raising the official cash rate in 2004, which was increased from 5% at the end of 2003 to 8.25% by the third quarter of 2007. During this period the exchange rate of the New Zealand dollar against the US dollar reached record highs since it was first floated in 1985, while the average consumer price index was 2.8% from 2004 to 2007, only just within the 1–3% inflation target range mandated for the Reserve Bank (Drew *et al.*, 2008, 1). Overall, compared with the 1990s when average house prices rose by 50%, house prices in New Zealand doubled on average from 2000 to 2007, rising from four times average household disposable income to six times disposable income. While servicing a standard mortgage on a median-priced house required 40.2% of average after-tax income at the start of 2002, by February 2007 this had increased rapidly to 71.4% (Dalziel, 2007, 3). Commercial bank practices also served to intensify the housing bubble–monetary policy nexus in New Zealand, with banks relaxing lending criteria as the property boom showed signs of slowing in order to remain competitive in a tightening mortgage market (Dalziel, 2007, 13).

While changing everyday financial norms among New Zealanders helped to generate strong support for lower levels of income taxation during the 1990s, and a sharp political divide over income tax cuts *vs* higher levels of social spending was the central issue in the 2005 election that Labour narrowly won by a margin of 1% over National, the picture here is not as clear cut as it might at first appear. Public support for increased social spending rather than income tax cuts was strong during the 1999 election campaign, which Labour won despite a policy to increase the top rate of income tax from 33 to 39%, and remained strong during the 2002 election (Broome, 2006, 67–69). A brief but sharp surge in support for income tax cuts even if they involved cuts in social spending did occur during 2005, which was framed by the National Party and the news media as a way to provide relief to home owners servicing increased mortgage payments as interest rates continued to rise (Broome, 2006, 70–73).

Nevertheless, recent opinion polling evidence indicates that a majority of voters have returned to the pattern of the past decade in preferring increased spending on health, education, and public infrastructure over having a few extra dollars in their pocketbooks each week (Research New Zealand, 2007a). With 48% of poll respondents in favour of increased spending on social services and public works against 35% in favour of tax cuts, the level of continued support for increasing social spending is striking given that opinion polls also indicate increasing levels of financial insecurity among home owners with respect to the country's high interest rates (Research New Zealand, 2007b). Although only indicative, this suggests that while the liberalization of New Zealand's housing finance system has prompted widespread changes in everyday financial norms, and has contributed to broad support for the maintenance of the country's current low rates and flatter thresholds of income taxation, it has not resulted in a permanent new conservative majority in favour of an ongoing programme of reducing income taxation and the state's involvement in the provision of social services like the policy platform that continues to be offered by the National Party at election time.

Eighty-two percent of poll respondents in 2007 opposed a capital gains tax on profits from property sales in New Zealand. When the question was altered to whether respondents would support a capital gains tax that was only levied on the sale of investment properties rather than family homes, however, the support increased to 41% (Research New Zealand, 2007c). Despite evidence of significant public support for government action to differentiate between the tax treatment of investment property and owner-occupied homes, the fifth Labour government focused primarily on providing assistance to households in public housing, with policies such as income-related rents for state house tenants, and to assist households that were only just below the home ownership threshold, rather than taking on the expense involved with attempting to increase the overall rate of home ownership in New Zealand. In this respect, the National government's policy of privatizing the HCNZ mortgage portfolio during the 1990s removed a large source of capital that could potentially have been used for this purpose, thereby constraining the room for future governments to move back towards directly financing the low and lower-middle household mortgages (Stuart *et al.*, 2004, 10).

Home ownership rates in New Zealand are predicted to fall further over the next decade, with one projection suggesting that overall home ownership will decline to 63.7% by 2011 and 61.8% by 2016 (Thorns, 2006, 24). If these projections are realized this will represent a major reduction in the proportion of households owning their home from the 1991 high of 73.8%. Along with falling rates of home ownership, many households now also experience greater financial insecurity. Among the middle and higher income earners who already own houses, this is partly reflected in their strong preference for investing in rental property as a safe source of savings, which during the past two decades has offered a good rate of return compared with other forms of investment in New Zealand because of the higher (and untaxed) capital gains from rental housing as well the potential to offset losses by reducing tax liabilities on other sources of income. In particular, housing is widely believed to offer New Zealanders a secure form of savings and financial stability to ensure their future security, a concern that has increased with the belief that current state-funded pensions (which remain universally available at age 65) will prove to be insufficient in the long run and that people must make their own provisions to ensure adequate living standards and income in retirement.

Conclusion

This article has shown that neoliberal policy changes to New Zealand's system of residential capitalism led to substantial benefits for middle and upper income households that already owned their homes or were able to take advantage of expanded access to mortgage credit to gain a foothold on the housing ladder. For younger and poorer households, however, New Zealand's neoliberal financial reforms have served to pull the ladder up. This has made it increasingly difficult for these households either to gain access to the housing market or to accumulate equity when faced with the higher costs of servicing a mortgage. This is important because home ownership remains the principal source of household savings in New Zealand, as well as providing benefits such as intergenerational equity, social status, and future financial security. This suggests the need for further research into the social consequences of financial liberalization in small economies, and points in particular to the potential benefits of further studies of the relationship between housing finance, monetary, and tax regimes; the link between social norms and financial behaviour; and the longer-term impact of neoliberal policy changes on intergenerational equity.

At first blush, contemporary New Zealand has become the asset-based society that was one of the outcomes intended by the designers of the country's neoliberal financial reforms. But as this article has shown this has not come without significant social costs. More importantly, changes in New Zealand's housing finance system during the 1980s and 1990s transformed the country's implicit social contract, which had helped to establish the wider social legitimacy of political institutions in New Zealand. In general, this turned existing homeowners into the winners from neoliberal reforms. Many of these housing market insiders were able to expand their investment in property at the expense of outsiders who were shut out of the property market or entered it on much less advantageous terms than their parents had (see also Mortensen and Seabrooke, this issue). Financial liberalization in small economies, as the New

Zealand case shows, requires continued government action if it is not to lead to a regressive housing cycle that redistributes wealth upwards and the emergence of a housing bubble–monetary policy nexus that inhibits the effectiveness of a country's macroeconomic framework. New Zealand's financial reforms succeeded in enabling more flexible access to credit and greater credit growth, funded by foreign capital inflows. However, the expansion of mortgage finance through access to cheap foreign capital rapidly drove up house prices in response to excess demand, which significantly raised the barriers to home ownership for low and lower-middle income households as well as younger age cohorts of first-time buyers.

Unlike more newsworthy changes such as the privatization of state assets, fiscal reform, labour market reform, or benefit cuts, many of the formal changes to housing policies in New Zealand largely slipped under the radar, with the general population slow to recognize the negative consequences of the decline of state-subsidized mortgages. Over time, however, the political effects of these changes have become all too visible. By serving to both stimulate and reinforce broader changes in people's everyday financial norms, the changes to New Zealand's housing finance system during the 1980s and 1990s generated broader political support for a low-taxation and low-inflation policy regime. Yet support for *maintaining* the country's new conservative tax and monetary policy settings has not translated into support for further tax cuts funded by additional cuts to social spending. Rather, the opposite has been the case. During the last decade, New Zealanders have strongly supported spending increases on health, education, and social assistance to families — at least while these could be funded from large budget surpluses achieved in a period of sustained economic growth, low inflation, and while the country's property bubble continued to inflate. This might suggest that while centre-left governments in New Zealand have scope to increase social spending in economic 'good times' when home owners feel they are becoming richer as they see the value of their homes increasing, the political tide should be expected to turn more firmly in favour of conservative fiscal policies now that the property boom party is over.

About the Author

André Broome is Lecturer in International Political Economy in the Department of Political Science and International Studies at the University of Birmingham. His research explores the changing role of the International Monetary Fund in the global political economy and the comparative politics of taxation and monetary reform, and includes journal article publications in *Journal of International Relations and Development, Law in Context,* *New Political Economy*, *Review of International Political Economy*, and *The Round Table*.

Note

1 My grateful thanks go to the editors of this special issue, as well as to Chris Beer and Alexandra Homolar-Riechmann for their helpful comments on earlier drafts of this article.

References

Allen, J. (2006) 'Welfare regimes, welfare systems and housing in Southern Europe', *European Journal of Housing Policy* 6(3): 251–277.

Badcock, B. (2004) 'Global exposure and Auckland's housing market', *Urban Policy and Research* 22(1): 59–68.

Bale, T. (2003) 'Pricking the south sea bubble: from fantasy to reality in labour-led New Zealand', *Political Quarterly* 74(2): 202–213.

Brook Cowen, P.J. (1998) 'Neo-liberalism', in R. Miller (ed.) *New Zealand Politics in Transition*, Auckland: Oxford University Press, pp. 341–349.

Broome, A. (2006) 'Setting the fiscal policy agenda: economic news and election year tax debates in New Zealand', *Law in Contex* 24(2): 60–77.

Broome, A. (2009) 'Money for nothing: everyday actors and monetary crises', *Journal of International Relations and Development* 12(1), forthcoming.

Broome, A. and Seabrooke, L. (2007) 'Seeing like the IMF: institutional change in small open economies', *Review of International Political Economy* 14(4): 586–601.

Burns, J. and Dwyer, M. (2007) 'New Zealand household attitudes towards savings, investment, and wealth: phase one', (Reserve Bank of New Zealand), available online at www.rbnz.govt.nz/research/econresearch/3198451.pdf (accessed 15/04/08).

Castles, F. (1998) 'The really big trade-off: home ownership and the welfare state in the new world and the old', *Acta Politica* 33(1): 5–19.

Coleman, A. (2007) 'Credit constraints and housing markets in New Zealand', Discussion Paper Series DP2007/11, Wellington: Reserve Bank of New Zealand.

Conley, D. and Gifford, B. (2006) 'Home ownership, social insurance, and the welfare state', *Sociological Forum* 21(1): 55–82.

Dalziel, P. (1997) 'The Reserve Bank Act', in B. Roper and C. Rudd (eds.) *State and Economy in New Zealand*, Auckland: Oxford University Press, pp. 74–90.

Dalziel, P. (2002) 'New Zealand's economic reforms: an assessment', *Review of Political Economy* 14(1): 31–46.

Dalziel, P. (2007) 'Housing, monetary policy and economic development in a small open economy', Paper presented at the New Zealand Association of Economists Annual Conference, Christchurch, 27–29 June 2007.

de Bruin, A. and Flint-Hartle, S. (2003) 'A bounded rationality framework for property investment behaviour', *Journal of Property Investment and Finance* 21(3): 271–284.

de Veirman, E. and Dunstan, A. (2008) 'How do housing wealth, financial wealth and consumption interact? Evidence from New Zealand', Discussion Paper Series DP2008/05, Wellington: Reserve Bank of New Zealand.

Doling, J. (1997) *Comparative Housing Policy: Government and Housing in Advanced Industrialized Countries*, Houndmills: Macmillan.

Drew, A., Karagedikli, Ö., Sethi, R. and Smith, C. (2008) 'Changes in the transmission mechanism of monetary policy in New Zealand', Discussion Paper Series DP2008/03, Wellington: Reserve Bank of New Zealand.

Dupois, A. and Thorns, D.C. (1996) 'Meanings of home for older home owners', *Housing Studies* 11(4): 485–501.

Evans, L., Grimes, A., Wilkinson, B. and Teece, D. (1996) 'Economic reform in New Zealand 1984–1995: the pursuit of efficiency', *Journal of Economic Literature* 34(4): 1856–1902.

Ferguson, G. (1994) *Building the New Zealand Dream*, Palmerston North: Dunmore Press.

Hargreaves, B. (2007) 'What do rents tell us about house prices?', Paper presented at the Pacific Rim Real Estate Society Conference, Fremantle, 21–24 January 2007.

Holmes, F. (2004) 'The quest for security and welfare in New Zealand: 1938–1956', IPS Policy Paper 19, Wellington: Institute of Policy Studies, available online at http://ips.ac.nz/publications/files/debc1acc5ec.pdf (accessed 15/04/08).

James, C. (1998) 'The Policy Revolution 1984–1993', in R. Miller (ed.) *New Zealand Politics in Transition*, Auckland: Oxford University Press, pp. 13–24.

McLeay, E.M. (1984) 'Housing as a political issue: a comparative study', *Comparative Politics* 17(1): 85–105.

McLeay, E.M. (1992) 'Housing Policy', in J. Boston and P. Dalziel (eds.) *The Decent Society? Essays in Response to National's Economic and Social Policies*, Auckland: Oxford University Press, pp. 169–185.

Morrison, P.S. (2007) *On the Falling Rate of Home Ownership in New Zealand*, Wellington: Centre for Housing Research Aotearoa New Zealand, available online at www.chranz.co.nz/pdfs/falling-rate-home-ownership-in-nz.pdf (accessed 28/04/08).

Murphy, L. (1996) 'Whose interest rates? Issues in the development of mortgage-backed securitization', *Housing Studies* 11(4): 581–589.

Murphy, L. (2000) 'A profitable housing policy? The privatization of the New Zealand government's residential mortgage portfolio', *Regional Studies* 34(4): 395–399.

Renaud, B. and Kim, K.-H. (2007) 'The global housing price boom and its aftermath', *Housing Finance International* 22(2): 3–15.

Research New Zealand (2007a) 'More public spending preferred over tax cuts', Media Release, 29 October.

Research New Zealand (2007b) 'Rising interest rates worrying Kiwis', Media Release, 01 October.

Research New Zealand (2007c) 'Significant support for capital gains tax on investment properties', Media Release, 01 March.

Reserve Bank of New Zealand (2007) *Mortgage Interest Levy, a Detailed Option*, Wellington: Reserve Bank of New Zealand, available online at www.rbnz.govt.nz/monpol/about/2950448.html (accessed 25/04/08).

Rudd, C. (2005) 'Welfare Policy', in R. Miller (ed.) *New Zealand Government and Politics*, Auckland: Oxford University Press, pp. 418–427.

Sheng, Y.K. and Kirinpanu, S. (2000) 'Once only the sky was the limit: Bangkok's housing boom and the financial crisis in Thailand', *Housing Studies* 15(1): 11–27.

Sheridan, T.J., Manley, J., MacDonald, C. and Flynn, B. (2002) 'Sliding scale of support: government intervention in housing', *Housing Studies* 17(2): 337–347.

Statistics New Zealand (1998) *New Zealand Now: Housing*, available online at www2.stats.govt.nz/domino/external/pasfull/pasfull.nsf/0/4c2567ef00247c6acc256b6d0002826e/$FILE/housing.pdf (accessed 24/04/08).

Statistics New Zealand (2007) *QuickStats About Housing: 2006 Census*, available online at www.stats.govt.nz/NR/rdonlyres/2471D004-399D-472D-95DA-9020B30C9386/0/quickstatsabouthousingrevised2.pdf (accessed 24/04/08).

Stuart, I., Badcock, B., Clapham, A. and Fitzgerald, R. (2004) 'Changing tenure: housing trends, financial deregulation and housing policy in New Zealand since 1990', *Housing Finance International* 18(4): 3–10.

Thorns, D.C. (2000) 'Policy review: housing policy in the 1990s — New Zealand a decade of change', *Housing Studies* 15(1): 129–138.

Thorns, D.C. (2006) 'The remaking of housing policy: the New Zealand housing strategy for the 21st century', *Housing Finance International* 20(4): 20–28.