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Asymmetric information

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EDITORIAL

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This issue of AI begins with the third in our series of interviews with eminent New Zealand economists: Grant Scobie interviews Sir Roderick Deane. The regular contributions follow from Grant Scobie ('2B Red'), Stuart Birks ('Frames'), Paul Walker ('Blogwatch'), Mark Holmes (NZEP) and Motu. In this issue, 'Fine Lines' is contributed by David Fielding. The subject of the 'Five Minute Interview' is John Gibson. News of the Government Economics Network (GEN) is again included, and the economics department at The University of Auckland provides this issue's report of Research in Progress.

INTERVIEW WITH SIR RODERICK DEANE

KNZM, PhD, BCom (Hons), FCA, FCIS, FNZIM, Honorary LLD

Sir Roderick Deane was appointed a Knight Companion of the New Zealand Order of Merit in the Queen's Birthday and Diamond Jubilee Honours 2012 for services to business and the community. He is currently a Director of Woolworths Limited in Sydney, Advisor to Pacific Road Group in Sydney, Chairman of the New Zealand Seed Fund, Joint Patron with his wife Gillian of NZ's largest voluntary welfare charitable organization, IHC NZ Inc., Chairman of the IHC Foundation, Patron of the Employers' Disability Network (EDN) and is on the Board of the Anaesthesia and Pain Medicine Foundation in Melbourne. He is a Trustee of the Deane Endowment Trust. This trust provides financial assistance to a wide range of arts and culture organisations.

Sir Roderick was the Government appointed Lead External Reviewer for a major Value for Money Review of the New Zealand Defence Forces which was completed in mid 2010 and also Chairman of an Advisory Group on the Review of Special Education, whose work was also completed in 2010. He was previously Chairman of Fletcher Building Ltd, and its predecessor Fletcher Challenge Ltd, Telecom Corporation of NZ Limited, ANZ National Bank Ltd, Te Papa Tongarewa (the Museum of New Zealand), and the City Gallery Wellington Foundation. He was also a Director of the Australia and New Zealand Banking Group Ltd in Melbourne and President of IHC NZ Inc.

Sir Roderick was involved in the executive branch of Government, as Chairman of the State Services Commission, effectively head of the New Zealand public service, Deputy Governor of the Reserve Bank of New Zealand, Chief Economist of the Reserve Bank, and Alternate Executive Director of the International Monetary Fund in Washington DC. He was also Chief Executive and Managing Director of Telecom NZ Ltd, Chief Executive Officer of the Electricity Corporation of NZ Ltd, Chairman of TransPower Ltd and Chairman of PowerDesignBuild Ltd. He has been Professor of Economics and Management at Victoria University of Wellington, a Director of TransAlta Corporation in Canada, a member of the NZ Board of AMP, Chairman of the Mayoral Business Advisory Group in Wellington, a member of the Prime Minister's Enterprise Council, a Board Member of the Centre for Independent Studies, the leading Australian think tank based in Sydney, and a Trustee of MOTU Economic and Public Policy Research, a non-profit research group based in Wellington. He founded the MOTU Research and Education Foundation.

Sir Roderick is a Distinguished Fellow of both the Centre for Independent Studies in Sydney and the New Zealand Association of Economists. He was the inaugural NZIER Economist of the Year in NZ, and has been CEO of the Year, Chairman of the Year, and Executive of the Decade in the NZ Management Awards. As part of these awards, he was also given a Special Leadership Award. He was named a Wellington City Icon in the Wellington City Gold Awards, is a Laureate of the NZ Business Hall of Fame, and with his wife Gillian was honoured with the Patronage Award by the Arts Foundation of NZ. He was an Honorary Member of the New Zealand Business Roundtable and is a Foundation Honorary Member of the New Zealand Initiative. He is a Life Member of IHC NZ and of the Victoria University of Wellington Alumni Association. He received the New Zealand 1990 Commemoration Medal, a medal which was instituted by the New Zealand Government to commemorate the 150th anniversary of the signing of the Treaty of Waitangi. He was awarded an Honorary Doctorate of Law from Victoria University of Wellington.

Q: Let's start at the beginning and think about your earliest formulation as an economist. What were the 'dinner table conversations' when you were growing up that might have shaped your outlook and your thinking?

A: Well they didn't really relate to economics per se, but I think the upbringing that I had involved discipline, respect for one's elders and generosity to others. My parents were interested in mathematics but there was never really any academic pressure from my parents. We didn't tend to talk about the things that I did at school other than my Father helping me with mathematics. There was always a tradition of newspaper reading in the family – a great competition between my father and myself.

Q: You mentioned mathematics, and your initial intention had been to go on and pursue that. What made you change your mind?

A: Oh, that was really just a pipedream. The truth is I just was not good enough at it, and at New Plymouth Boys High School, the Headmaster very generously gave me additional help. I enjoyed mathematics hugely and I worked at it a lot. But I didn't want to just be a mathematics teacher, I realized that there's only one or two in New Zealand who might become real mathematicians… if that.

Q: So when you went on to Victoria and enrolled in a BCom, essentially in accounting, to start with. Was that a deliberate choice or, like so many beginning undergraduates, just a default option?

A: Yes, it was really a default. It was my father's active choice, because he thought that would give me a good trade. He said, 'well this will give you the opportunity to do some mathematics, and you should do accounting as well'. So I went to university to study accounting, but I really was still in the process of discovering what it was I wanted to do. I didn't have any plans to study economics. In fact I only did economics because it was a compulsory part of the BCom degree.

Q: So what was it that then sparked your interest in economics?

A: My first lecturer in economics was Frank Holmes, and by the end of the first lecture, I knew what I was going to do with my life. It was as simple as that. I was just so switched on by his introduction to economics. I had purchased Paul Samuelson's textbook; I read it right through and I read it over and over. I ended up majoring in both accounting and economics, and while I didn't enjoy the accountancy very much, I was determined to do well in it, because my father wanted me to do accounting.

Q: What was it about it that initial course in economics that sparked your interest? Was it the applied aspects as Sir Frank wasn't a theoretician was he?

A: No, he wasn't a theoretician. It was definitely a more applied dimension, but it was the fact that this was trying to understand people's behaviour and firms' behaviour and how they interacted together with the role of government in the economy. For some reason or other, that fascinated me. The fact that economics also facilitated the further development of some interest in mathematics was a wonderful bonus.

Q: You mentioned Samuelson's text, but was there any other particular book or paper that you read that had a significant influence on your early thinking in economics?

A: I think rather than the things I read, it was probably the people I interacted with at university, such as Les Castle and John Zanetti and Peter Lloyd, who helped stimulate my interest. I don't recall any single book. I read a wide a range of books, including Charles Kindleberger's *International Economics*.

Q: The mention of Kindleberger leads me to ask you why you made a decision to stay in New Zealand to do your PhD? Because at that stage, it was far more common for people to go overseas, and you could have gone to Harvard or MIT, and worked with Kindleberger, I guess.

A: I did get the scholarships necessary to do that...

Q: And you could have worked on a New Zealand problem, because I know you were interested in doing that. But what made you decide to stay here rather than take the opportunity to go over to the US?

A: In the first place I was in love with Gillian and I didn't want to be away from her. It would have meant shifting when she was completing her degree. And also, there were financial reasons; I didn't have a house, but I knew that I could generate a reasonable income (I had three jobs) while I was doing my PhD. But above all I wanted to do some research on New Zealand, and the topic in which I was interested would require a large amount of empirical work for which I felt I'd have easier access here. Involving Kindleberger was my idea. The university didn't think he would undertake the role, but Frank Holmes wrote to him and he was willing. So in the end he actually helped me right through the whole process.

Q: So he was much more than just an examiner?

A: Oh yes. I corresponded with him very regularly, and sent him all the drafts of the chapters in the thesis, such that when I had the oral exam, he'd already been through it all in great detail. It really stimulated my academic career in a major way.

Q: Were there particular aspects of your economics training that, in hindsight, were central to your subsequent questioning of the regulatory theology that pervaded New Zealand economic policy prior to 1984? What was it about your economics training that then led you to the way you thought about those regulatory issues?

A: Again, I think it was really the people I encountered and worked with. I started working in the commercial world, and spent three years at the Union Steamship Company, which at that time was the largest company in New Zealand, and I enjoyed that hugely. And then I decided I wanted to be a 'professional economist', so to speak, so I moved to the Reserve Bank where I encountered Phil Coney (he was Jeremy's father, the NZ cricket captain) and Chief Economist at the time. He was a wonderful economist, an exceedingly modest understated man, who read all of the major economics journals. He was very much of the view that New Zealand was very seriously over-regulated, across a whole range of its economic policies. I then had the opportunity to work at the Reserve Bank of Australia for a time, where I met Austin Holmes who was head of their Research Department. He was a fantastic economist, very blunt and very Australian. I saw a lot of him as he volunteered to drive me to work every day. He was very much into the role of markets, very reserved about governments trying to do too many things. So every morning in the car I had the equivalent of an economics lecture and every evening driving home I had a lesson in the pitfalls of governments trying to do too many different things with regulatory policies.

So it was people like that whom I encountered. Very early in my career, I was able to meet people like James Duesenberry, Harry Johnson, Lawrence Klein, John Helliwell and Milton Freidman. Several of them came to NZ, or Australia while I was working there. I met Lawrence Klein at the Wharton School and worked with him on the econometric modelling we did at the Reserve Bank. All of those interactions led me to think that people who were regulating things often didn't really know what they were doing. Working in the Reserve Bank, I had the great benefit of exposure to a lot of regulatory structures which we were administering, and it was abundantly clear to me that we were administering these things with a very incomplete understanding of the consequences. Gillian sometimes says she doesn't quite know where I got the evangelical element of...

Q: The High Priest of Monetarism... as Muldoon called you on one occasion...

A: Oh did he?!

Q: Yes, in Parliament.

A: Ah, how splendid.

Q: Economics has broadened a lot since the days that you completed a PhD (1967). From today's perspective, what sort of subsequent developments have you observed in economics that would have been helpful to you?

A: I think the most helpful aspect of economics for me has been that, somewhat like mathematics, it provides a framework of thinking to help one frame up any topic that one is addressing. What is the big picture ? What are the elements within that picture? How do they interact ? How can we influence the outcome? Should we even try to do so ? If we do so, what are the second round effects ?

Q: Well, in fact, that leads me directly to the question about the extent to which your background in economics was useful to you as you moved into the corporate world?

A: It was hugely useful. I discovered the remarkably wide applicability of that framework of thinking combined with understanding the cyclical nature of economic activity, learning more about the role of markets and learning about the too frequent incompetence of governments. While, initially thinking that macroeconomics mattered so much, one came to realize that, of course, macro is just a sum of the micro and that microeconomics is really the place that one should learn about the incentives and sanctions and how they worked. Later when I left the Bank and went to the State Services Commission I became deeply immersed in management, and that fascinated me. But again, it was like a branch of economics in some respects, as it involved understanding people and their behaviours. When I went back into the commercial world - (most people had forgotten that's where I actually emerged from and those three years were instrumental in developing a love of working in the private sector) – I don't think a day went by where I was not conscious of the fact that I was thinking about something using the tools of economics and the framework that had emerged from my economics training. And I think that's something that a lot of young professional economists underestimate - just how applicable economics is in private sector activities. Certainly, young policy wonks in public policy in some of the Ministries who have never worked in the private sector in their lives, but think they know how to regulate it, would do well to spend a few years in the commercial world and really understand it.

Q: There are not many economists with formal training at the PhD level who finish up having been both professional economists and leaders in the corporate sector.

A: And there should be a lot more. I think also, a lot of the modelling work that I did at the Reserve Bank was surprisingly useful in the private sector, whether it be the modelling of the power system at the Electricity Corporation, or the corporate models that we used in other companies, or the quite simple but very interesting modelling that we did when I first joined Telecom of customer behaviour and understanding commercial outcomes. And I think all the staff with whom I worked in the private sector were surprised to find they had a CEO who really enjoyed the modelling side of work. Modelling is such a convenient way of pulling together one's assumptions. These can be debated and the team can then put some judgements around them. So the type of thinking that arose from econometric modelling work was frequently helpful to me.

Q. I presume at the time you entered the Bank, there wouldn't have been a strong background or culture in economic modelling, and yet you were able to build up a very strong team and do a lot of modelling work. What were the factors that lead you to be able to do that in the Bank?

A: When I entered the Bank, I was astonished at the openness of the thinking. As a youngster in my mid-twenties, I had access to the Governor, the Deputy Governor and the Chief Economist. Often because I'd have written a paper I'd be taken along to meet with Muldoon in his early days as Minister of Finance after Harry Lake died. I'd sit in the back row and I'd have to take the notes. The Governor Alan Low, the Deputy Governor Ray White and Chief Economist Phil Coney were intensely interested in economics. They were wonderfully open to conversations around, 'what are the latest trends in economics and economic thinking and the tools of economic policy and how might we try to incorporate them in our thinking?' There was a whole stream of thinking going on in the Bank alongside what was actually happening in the very controlled, very regulated governing of financial institutions. So the most senior people in the Bank were willing to discuss issues such as 'how do we go about freeing up the markets in the financial sector ?' There were lots of conversations around that and a number of people, particularly led by Phil Coney, delved deeply into the theoretical and applied literature. But when we realized that people overseas were endeavouring to pull together their economic data and the economic theory into econometric models, we talked about 'well could we do this?' I played around with some minor equations and took hours to compute them on a calculator. Then it was suggested I go to the Reserve Bank of Australia where they had a team working on models. So the Bank seconded me to the RBA, where I actually facilitated the first simulations of their model which they hadn't been able to get working. I returned to New Zealand with a plan to build the first macroeconometric model of the NZ economy. That's when I decided to go on a recruitment drive. The Bank supported me to set up an improved framework of remuneration and career structures: it was all facilitated effortlessly. And the experience in choosing people was great training that served me well in later life. The development of our research and modelling capacity was embraced and welcomed by the Governors of the Bank, and they would talk to me regularly about it. They were very proud of the fact that we were endeavouring to establish a research base, and supported publications on the work. Now I wouldn't want to overrate the role of econometric models, but they're very useful tools for bringing together one's assumptions, testing policy options and simulating alternatives. They're tools that help one think more deeply, help one to assemble a large amount of data in a more orderly way, and make assumptions explicit.

Q: You mentioned the RBA, but you must have established a lot of other links to other scholars and institutions, to draw on the global intellectual capital?

A: Yes, we had strong links with the central banks in the Netherlands and Scandinavia, and I had the great good fortune to have very useful links with a number of the Federal Reserve Banks, particularly St. Louis, which was doing a lot of modelling work and monetary policy analysis, a la Freidman. We later had contact with Paul Volker as Chairman of the Fed, with James Tobin on monetary issues, George Stigler on regulation, later Lucas's work on rational expectations and Arthur Lewis on development economics. Those were the sort of people who were read a lot, wherever we'd get the opportunity we'd correspond with them. I had a huge correspondence… I dictated, so I was good at writing letters, there was no internet. Then the Canadians, particularly John Helliwell, were very strong influences on us via the RDX series of models. Very early on, I arranged for him to came out here, which then happened several times. I had the good fortune to meet other people – we got Friedman out to NZ and in Australia I met Harry Johnson from Chicago. And then, of course, the Wharton School were fantastic helpers, particularly Lawrence Klein. In fact we became part of the international modelling project, Project Link, drawing together models from a range of countries. So, we had lots of interaction like that. The Bank was very good at facilitating bringing out international speakers, and we would help to pay their fee or their transport costs or whatever and then we'd work with them and they'd do presentations. We would arrange for presentations both within the Bank and with wider groups, including particularly the universities and the Treasury who did not have the funding resources of the bank for modelling research work but who were enthusiastic participants in that process. The Bank and the Treasury had very strong levels of interaction.

Q: There are many examples of your work that were actually presented at conferences, particularly in the New Zealand Association of Economists conferences, and I gather that the Bank was encouraging and supportive in presenting work from the Bank at these professional conferences?

A: The Bank was wonderfully supportive, yes, and I was always encouraging other members of my team to present as well. The trick always was to get the balance right between what we really thought about policy, and what we could say in public. It was a different world then, so in a lot of sessions one could rely on 'Chatham House Rules', and you could have a free and frank exchange, which wouldn't be leaked. Indeed it didn't leak, and so things one said then one would never take for granted today, I guess. Henry Lang, the then Secretary of the Treasury, protested on a couple of occasions to the Governor, Alan Low, that I was overstepping the mark, but I always continued to have Alan's support.

Q: I'm going to wrap up the economics part of our discussion. Is there any example of your thinking in economics, about which you subsequently changed your mind?

A: Yes, I changed my perspective especially with respect to the importance of macro versus micro economics. During my early career I thought monetary economics and fiscal policy were hugely important. True, they were important; but I came to realise that fundamentally microeconomics and microeconomic policy were really overwhelmingly important. So that's why I became more and more reserved about the pervasiveness of regulation, and worried about the lack of real economic analysis and understanding around regulation – that too often, regulation is just a political or a popularist reaction. The costs of regulation, the second round effects of regulatory interventions, and the burden on the private sector are seldom fully understood. It is the individual behaviour of firms and households and how they respond to the incentives and sanctions created by policy that really matters.

Q: I'm going to switch to some questions about policy. You were obviously in a rare position to directly influence policy and, reflecting on the many instances of changes in which you were involved, is there a single one that stands out?

A: Floating the dollar, which stands out because it was filled with such high drama, and I had the great good fortune to be right in the middle of it. Of course, we had the foreign exchange crisis in mid-1984 at the time of the election, and we didn't float the dollar until early March 1985. We'd had a second foreign exchange crisis just before we floated and Richard Prebble on the political side, and myself on the economics side, were the two who endeavoured to get everybody, particularly the Treasury, up to speed. When it was decided that we really had to move to a float because the markets were reacting so sharply, I was sent off to London to persuade David Lange as Prime Minister who said "well, I had expected to see you on this subject months ago". He wanted me to stay on and accompany him to the Oxford debate. I said "I don't know about that", and while we were having that conversation, Roger Douglas rang up and said "what's Roderick doing, he's meant to come home again?", so that's what I did. I was in London for 24 hours. The drama around the election in mid 1984 would stand out equally. I can remember I dictated in my dining room at home at 3 am some of the papers which we wrote to the government when the election was announced.

Q: New Zealand is currently debating whether our current monetary policy regime and the associated level of the exchange rate are appropriate. Are there any lessons from those earlier days that you might point to, to guide the current debate?

A: Yes. I think that the big lesson is that you can't use an instrument, such as monetary policy, which has quite limited influence, to achieve a range of objectives. I would have thought we had learnt that lesson thoroughly, but we are on the verge of forgetting it.

Q: So, the message is: go back and rethink that?

A: I think the message is that the type of monetary policy regime we've got at the present time, if you look at the last few decades, has been hugely successful both overseas and in New Zealand by helping to get inflation down and keeping it down. Sitting alongside that, there have been other policies, like reasonably sensible fiscal policies and deregulation of the labour markets that have helped create much improved adaptability and flexibility. I think the lesson for me of that past experience is, as Graeme Wheeler has been basically saying, that we should only change our present arrangements with great caution.

Q: Essentially, while you were at the Bank, you were a civil servant. Can you reflect on the role of a civil servant in our Westminster-type system? Because it seems like your involvement as a spokesperson, explaining economic policies, gave you much greater visibility than we observe from civil servants today.

A: Yes, I think it did. And that was true when I was both at the Reserve Bank as an economist, and then as Chief Economist and Deputy Governor, and equally when I was Chairman of the State Services Commission. While Chairman the government was pushing me to be more of an advocate for the policies that they were introducing, and I was resistant to that, and reluctant to be their spokesperson. So we had some quite vigorous debates at the Cabinet Committee level around just what the role of a senior civil servant ought to be. But nonetheless, my view always was that it was critically important to be upfront with free and frank advice to politicians. I paid a severe price for that, in terms of not becoming Governor of the Reserve Bank on two occasions despite the Board of the bank unanimously recommending that I be appointed as Governor. The Board was over-ruled by Muldoon who was quite upfront with me as to why he would not appoint me as Governor. I believe that I was as frank as anybody in the civil service with politicians, and some senior politicians thought that was my problem. But equally, we never talked to the media in an inappropriate way. In private, we would tell people in the public service what we really thought, but not in a situation where that might get into the media.

Q: To what extent did you feel any sense of conflict between the need to support Ministers' positions, while at the same time disagreeing with government policy and advising changes and serious reforms?

A: I didn't feel conflict. I felt frustration, at times a bit irritated. But on the whole I was well brought up, in a civil service sense. I was properly trained through a comprehensive training programme within the Bank. Part of that training with the most senior people was not to overstep the mark. It was to be frank and courteous with the politicians and to give the best policy advice, but never to leak anything and never to talk inappropriately to the media. We were very careful not to be seen criticizing our Ministers, even where we disagreed with them. But it was a different world then with different sorts of respect and courtesies from today, and I think one has to see it in that context. And the media were much more careful about taking leaked documents and using them. So, I didn't feel a conflict. I was well trained to be respectful to my political masters and I hope I always was. And it was drilled into us: the government makes the policy, we give the advice. I could live with that, and I made sure that my staff lived with that as well, despite the frustration of it from time to time. Some of those frustrations were very severe, but I don't think we ever let the side down.

Q: What were the fundamental reasons that induced you to leave the Bank and a very successful career as a professional economist, and delve into the morass of public sector management by going to the State Service Commission?

A: Well first, I had missed out on being Governor on two occasions because Muldoon overode the unanimous recommendation of Bank's Board. Secondly, I had become fascinated by management because I'd had the good fortune as Deputy Governor to be in effect the Chief Operating Officer of the Bank. Both Governors I worked with while I was Deputy, Dick Wilks and Spencer Russell, were fantastic to work with and both of them said to me "you run the Bank", I mean, just like that. And so, everything came through me. It was a wonderful opportunity for a younger person, and it lead me to become fascinated by management and operational issues. Of course I always enjoyed economics, but I enjoyed sitting alongside that, doing things and getting things done. So when the government said 'would I become Chairman of the States Services Commission?' I initially said no. But then several of the Ministers really put the screws on me – Geoffrey Palmer, Roger Douglas, David Caygill, Richard Prebble – and David Lange actually said to me one day, "if you really want to become Governor of the Bank, you better do this job as Chairman of State Services". Then Spencer Russell as governor of the Bank said to me "take leave from the Bank and go and do this - so much needs to be done", and he had confidence I could do it. So, the combination of all of those things led me to say yes, I would do it. I had an agreement with the government over half a dozen things I would do and then I'd feel free to part company. And five out of the six, I think, got finished in the short time that I was there. And the government actually volunteered, very generously, that when Spencer left, I would go back to the Bank as Governor – and indeed, when Spencer did retire, I was asked to go back as the Governor but declined.

Q: Your stay at the State Service Commission was rather short. What were one or two major things you think you achieved during that time?

A: Well I never saw myself as staying there for a very long period of time. I was always quite explicit that that would be the case. I didn't see myself as a natural civil servant. What did we achieve? First, the creation of the nine new State Owned Enterprises. Secondly, the huge reforms of the pay fixing and employment conditions, including a lot more flexibility, Thirdly, the commencement of the very large down sizing. The public service staff numbers declined by 25,000 from 86,000 under my watch and eventually to 35,000 under Don Hunn, my successor. The Forestry Corporation went down from 6,000 to 2,000, the railways went down from well over 20,000 to about 5,000 and the Electricity Corporation went down from 6,000 to 3,000. In addition there was a lot of work on the later re-crafting of the State Sector Act. In the end I felt I had achieved that which I had been appointed to undertake and I knew I had a splendid successor who could take over in the form of Donald Hunn. The temptation of re-entering the commercial world again in a hands-on way, was an attractive, exciting opportunity.

Q: We talked about what contribution economics made to your thinking in the private sector, and now I want to turn it around and ask what lessons were there for economic policy that you would draw from your experience in the private sector?

A: First, politicians often induce a great deal of uncertainty by speculating about what they're going to do, and speculating around regulatory possibilities. That's very damaging for private sector companies. They also create uncertainty by chopping and changing their policy stances from time to time, and that leads to variability in economic activity...

Q: And discourages investment?

A: Yes. For example, there's been speculation around regulatory structures on building product pricing which would be very damaging. Telecom was a really interesting case because initially the government decided that they would not go down the route of unbundling and announced that as formal policy position. But a year or so later, they changed that completely, and on the day that that was announced, three billion dollars was written off the share market value of Telecom overnight. Uncertainty and inconsistent policy decisions over time are very damaging for the private sector. Secondly, I think having seen it from the private sector view, the cost of regulatory interventions are almost always underestimated by politicians and government officials. Moreover, they also are not good at recognising all the side effects of regulatory structures, which invariably leads them to more rather than less regulation.

Q: You refer here to the unintended consequences?

A: Yes. The unintended consequences can sometimes be mind-blowing. I think my advocacy would be for a lot more thoughtfulness and a lot more economic analysis around proposed regulatory interventions. It's not, as some people might portray me, that there should be no intervention. I'm not in that position at all. It's just that when regulatory interventions seem warranted, they need to be thoughtfully considered, and have good economic analysis underpinning them - and that's rare. Too often they are done for popularist reasons, and then when problems emerge, more regulations are introduced, and then you just start to lose the plot completely as to what are the true impacts. So I have become an evangelist around reduced intervention, and while I might sound like an extremist, it's because I can just give you so many anecdotes, so many examples, of where regulations have been very costly in time and effort and dollar terms. For example, the costs to Fletchers of all the climate change work over almost three years was huge. Then the government abandoned the policy that it was going to pursue, and adopted something else. Furthermore there is the costs of delays in reaching decisions – up to five years in some cases.

The best example that I know of with respect to the power of economics from my private sector experience was the restructuring of Fletcher Challenge, for many years the largest listed company in the country by far. It was in serious decline for a decade, with the return on equity declining almost every year for a decade. We undertook a massive restructuring by selling off the pulp and paper and energy businesses for almost $10 billion between them, and re-launched the company as Fletcher Building. That was in 1999-2001; to do that today would be a nightmare. We were able actually to do all that quickly and efficiently within a year or two because of the relatively benign deregulated environment. We relisted Fletcher Building in 2001 when it was number seventeen on the New Zealand stock market, and by the time I retired as Chairman in 2010, it was again number one, and it's number one today. When undertaking restructuring like that, the best thing politicians can do is keep out of the way. Too often today... politicians will go in and say "oh, we'll buy into the company", or "we'll support it in some way". I mean, look at Air New Zealand. Look at what we've done with all the finance companies - and so you get either a costly investment for the taxpayer or a terrible mess.

Q: In terms of your intellectual curiosity, what other areas apart from economics have interested you?

A: I think one of the major ones would be technology. The development of the internet has fascinated me, and I've had the great good fortune to work extensively in the area. I've got the most amazing array of friends, and that's a huge strength in my life, and accounts for the fact that we still live in Wellington. We've often had propositions to move elsewhere with very interesting jobs, but have always chosen to remain here. And developing an interest in the arts and music was a great driver for me for a long period of time. That was enabled by Gillian, no question. For example I used to be quite reserved about ballet, but now I just love going and we've been able to support some ballet dancers to further their studies.

Q: You've said that your association with the IHC was perhaps one of the most rewarding things you've done in your life. Can you expand on that?

A: Yes, it may have been the biggest driver of all, outside of economics. It was special because it's so people-orientated and it's so rewarding to see how one can improve circumstances for people with disabilities. When I became involved with the IHC, it was in terrible shape financially and I helped to get that resolved. And later, it had another crisis where it almost went bankrupt, but today it's in strong and sturdy financial shape, thank goodness, and that's partly because we took some very tough decisions around how to make that happen and because the government's got a regime now for disabilities that's much more sensible than it had been. But, the real driver for me was when I visited almost all of the psychopedic institutions in New Zealand where people were in effect incarcerated in these so-called 'hospitals.' I was a participant in the process that had them all closed down, and moved everybody into the community. The IHC borrowed $35m with initially minimal security to buy 700 houses. Beyond that, one of the big drivers for me was when I realized that in New Zealand, we were the last country in the Western world to provide by statute a free education for all children. I just couldn't believe that we didn't provide free education to all children. So, it meant that lots of kids with disabilities were being denied school. Muldoon told me personally the government would withdraw a substantial amount of funding from the IHC if we continued to advocate a change in the Education Act. At an even later stage, getting the Labour government to change the Education Act was tough work. I saw senior ministers all the time... in fact they probably got sick and tired of hearing me go on about the Education Act. It didn't get changed until the late 80s, and the final turning point really, was when I wrote an open letter to David Lange when I was Chairman of the State Services Commission, and then I spoke to him about it - he had not really realized how serious it was. He said he'd commit to getting it changed. I can still remember him walking around the office with the letter saying "hey this is not New Zealand!" In the end being part of working with wonderful people to have the Education Act changed. Getting kids into regular school, having people moved into regular houses in the community, creating work for intellectually handicapped people along with an interest in rare disorders, has been the most emotionally satisfying things that I've ever done in my life.

Q: Finally what advice would you give to a young economist at an early stage of their career?

A: I think my advice to any young person seeking a career would be to try to do really well at that you're doing, and not to fret too much about the future career structure, because if you do your present job really well, then the career takes care of itself. That's been my experience, and that would be my advice to a young economist as well: get the highest level of qualification you can, develop your talent to the greatest extent you possibly can, get the best training you possibly can in economic analysis, learn about the role of markets and try to get a sense of balance about the role of markets and the role of government. Finally, understand that economics applies to every walk of life, and that it's just as important in the private sector as in the public sector. Don't think that just because you're an economist you can't have just as much fun with economics in the private sector. You can migrate between the two, as I had the great good fortune to do.

FROM THE 2B RED FILE

by Grant M. Scobie
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On top of my holiday reading pile this summer was **Alan Bollard (2012) *The Rough Mechanical: The Man Who Could* (Xlibris Corp.).** Most readers, even the minimalist of grammarians amongst you, will be struck by the title, apparently containing an article and two adjectives – and immediately wonder (as did your correspondent) whether a noun was missing. But a little further research (together with guidance from the editor of *AI* who is unquestionably better read than I am!) pointed me to Shakespeare, and relieved my literary ignorance. It turns out to be based on the Rude Mechanicals. So (with the help of Dr Google), I quickly found that:

The original Rude Mechanicals were the players from Shakespeare's *A Midsummer Night's Dream*. Puck calls them that:

> *A crew of patches, **rude mechanicals,***
> *That work for bread upon Athenian stalls,*
> *Were met together to rehearse a play*
> *Intended for great Theseus' nuptial-day.*

They're "Mechanicals" in that they're common working men, not actors. And they're "rude" because they're really lower class[1].

Apparently, the good Governor thought that changing *rude to rough* would avoid his book being listed amongst the erotica (and doubtless to avoid any hint of plagiarising the Bard).

And now for a trivial pursuit question: name one other central banker who wrote fiction?[2] But is this really fiction? To the non-economist reader it may well seem so. To the economist (especially Kiwi ones) it will appear to be a thinly disguised biography of A.W.H. (Bill) Phillips. There is nothing at all wrong with that, as with the "fictional" tweaks, it makes a good yarn. Our "fictional" hero's dalliance with a Russian spy even adds some fictional "spice". The politics of WW II and the economic giants of the time are all woven into the context, albeit at times fleetingly. Occasionally the economic discourse may strike the economist reader as being a little contrived – the exchange with the Russian prisoner on the virtues of the market versus Soviet planning being an example. In the end however, the Governor's encyclopaedic knowledge of the life and work of Phillips combines with his fertile imagination and creativity to produce a book that will have special appeal to Kiwi economists, and be a good war story for the less economic literate.

The ramifications of the global financial crisis (GFC) are manifold. One of the emerging themes is that today's economists trained in the standard mould are ill equipped to predict or manage the crisis. This has lead to a call for updating our economic models and above all, training the next generation of economists in the hope they might be better equipped for the next (inevitable) crisis. The essence of the case rests on the adjective "financial" in the term GFC. If it was a "financial" crisis then we economists might have needed to know something about "finance" – snap!

Last February I was invited to attend a Bank of England-Government Economic Service conference in London[3]. The conference was entitled: *What post-crisis changes does the economics discipline need? Are graduate economists fit for purpose?* For readers pressed for time, the short answer to the first is: Quite a lot, especially understanding and modelling financial markets; and to the second: Graduate training in macroeconomics has not kept up with changes in the real world.

Within 10 months of the conference (laudable rapidity) an edited volume synthesising the findings and bringing together key papers: **Diana Coyle (ed.) (2012) *What's the use of economics: Teaching in the dismal science after the crisis* (London: Publishing Partnership)**. The starting point is to castigate the economics profession for its poor record in not giving loud and clear warnings in 2007 of the impending crisis. Sure there were noises from some about a housing bubble and some scepticism of the euro – but where the voices raising concerns about the forthcoming collapse of major financial institutions? Coyle argues that since the crisis the gap between reality and what is taught in standard macroeconomic courses "has become a chasm" (p.ix).What follows is an impressive array of papers by leading UK economists analysing these shortcomings. More financial economics (most academic macroeconomists couldn't read a balance sheet) and a greater sense of history are seen as two elements needed in economics curricula.

Peter J. Boettke (2012) *Living Economics: Yesterday, Today and Tomorrow* (Oakland, CA: The Independent Institute) is also unhappy about "mainstream" teaching of economics and wants us to return to the "mainline." He traces the latter from Thomas Aquinas in the thirteenth century, though the Late Scholastics at the University of Salamanca, the Scottish Enlightenment; the early Neo-classicists (Manger, von Mises, Hayek); the neo-institutionalists (Alchian and Demsetz); the new historians (North); the law and economics (Coase); public choice (Buchanan and Tullock); and governance (Ostrom and Williamson). And in case you are in any doubt of what is NOT included then let me quote from Chapter 1: " An important unsubtle point should be stressed in every economic conversation with peers, students, policymakers, and the general public concerning the great recession of 2008. John Maynard Keynes was wrong in both his analysis of capitalist instability and reasons for persistent unemployment in 1936, and he was wrong in 2008 ... Keynesian economics is simply bad economics" (p.1). This is a great way to start a book if you want to grab the reader's attention, so read on and a compelling story of mainline economics follows. The punch line: "The central message of the superiority of economic freedom compared to the tyranny of government is what emerges from the study of the economic thinking that is valid for yesterday, today and tomorrow" (p.13).

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1 Source: http://www.quora.com/The-Rude-Mechanicals/What-are-The-Rude-Mechanicals#

2 Answer: Kenneth Graham, *Wind in the Willows.* This children's classic was published in 1908, the year Graham retired as Secretary of the Bank of England. However any of the following (according to the Governor) will qualify for a partial credit: TS Eliot worked for Lloyds; John LeCarre for The Foreign Office; Douglas Herd was Foreign Secretary, and Stella Rimmington ran MI5.

3 For the report see: http://www.economicsnetwork.ac.uk/events/ges_boe2012

"FRAMES"

by Stuart Birks, k.s.birks@massey.ac.nz

White sliced bread: the changing nature of economics and other academic disciplines.

When white sliced bread was introduced it was seen as a real boon ("Chorleywood: The bread that changed Britain," 2011). We could have large quantities at low cost, and it was initially seen as superior, being more refined. It was able to out-compete all the traditional breads and it took many years before people decided that they wanted something of higher quality. Now we again get more specialist breads and people are prepared to pay perhaps twice as much for them.

It may be that a parallel can be drawn with core university courses now. In universities, there is a major global market in core papers with increasing numbers of people wanting tertiary education. It has become a big business with significant economies of scale. The result is packaging of course material in a way that drives out smaller scale alternatives. This is centred round the textbooks. Taking the example of economics, core books are provided along with study guides, online resources, test banks, instructors' notes and PowerPoint presentations.

It is easy to put someone, perhaps a graduate student, in front of a body of students to present the course. All the material is ready prepared and there can be little more to do than read out the material that is provided. More could be done, but at greater effort and consequently greater cost. Provision of materials may "free up instructors' time", allowing them to focus on the more intellectually challenging aspects of the syllabus, but the additional subtleties which can be conveyed will not be incorporated into the packaged, homogenised assessment. There are two reasons for this. First, the extra insights are likely to be specific to individual lecturers, so cannot be expected in all presentations of the material. Second, the method of assessment does not lend itself to such issues.

A promotional video giving points in favour of the approach can be seen at: http://connect.customer.mcgraw-hill.com/about/. In practice, given resource pressures on universities, the result may simply be reduced time allocated to instructors or reduced background knowledge required of instructors. Assessment, based primarily on test banks of true/false and multiple choice questions, is set up for quick and easy processing. To fit this type of assessment, the courses themselves tend to emphasise simplified points and arguments that are framed to suggest certain things are right and others are wrong. This means that it is very easy for work to be marked electronically, dramatically reducing the costs of assessment and of processing results. There may be benefits, but these are by no means guaranteed.

What are the implications for the nature of teaching? Universities are competing against each other for students. Competition is based partly on cost. Here is a product, like sliced white bread, which is much cheaper than the alternatives. Even if the quality is not quite as good, it may have such a strong price advantage that it can dominate the market. A small number of successful products can benefit also from international brand recognition and associated standardisation. With uniformity across universities, the issue of cross-crediting is largely removed. Conversely, where there is great diversity in teaching, with individual lecturers putting their own stamp on courses, cross credits can become far more problematic. There are strong incentives for this major standardisation in a rapidly growing global market with great demands for mobility and recognition of results across institutions. However, the result would arguably be a dumbing down of the discipline (in our case, economics).

A specific focus on the discipline is likely to become dominant. As Fairclough (1995) suggested with "ideological-discursive formations", if there is a dominant discourse which drives out all the alternatives, it becomes seen as "the truth", "the way to view the world". Any alternative is then "ideological" and highly questionable. If he is correct, we are likely to find ourselves increasingly locked in to highly stylised versions of the affected disciplines, including economics.

The development may change economics in other ways also. Gabriel Egan, in a comment (Coughlan, 2013a), distinguished between the sciences, which have many right or wrong answers, and the social sciences which do not. While this means that the sciences are better suited to this form of assessment, the social sciences may be reframed and repackaged to suit, giving students the impression that they too contain many absolutes.

There is a further development which gives cause for concern. The BBC has recently published several articles on the theme of online universities (see Coughlan, 2013a; Coughlan, 2013b, 2013c). These appear to be growing very rapidly and are associated with prominent universities such as Stanford, Harvard and MIT. They can build on the foundations set through the standardisation of courses and associated additional resources, including the electronic processing of assessment. Instead of just test banks, students are now offered feedback based on the answers they give, and even guided learning designed to identify and remedy deficiencies in required skills. This is very impressive, as long as it works as promised and reflects the nature of the discipline. It is not so desirable if it requires a transformation of the discipline to fit the technology. In any event, the end result is a homogenised product with selected factoids assuming great significance, and heavy emphasis on simplified methods of thinking. The nuances, subtleties and complexities of the world would be largely set to one side, thereby becoming invisible.

Is this the future that we can expect for universities? How can New Zealand universities respond to this? As an outlier in the world system, can we afford to ignore these trends? Clearly not, if we are reliant on the international sale of education to fund our universities.

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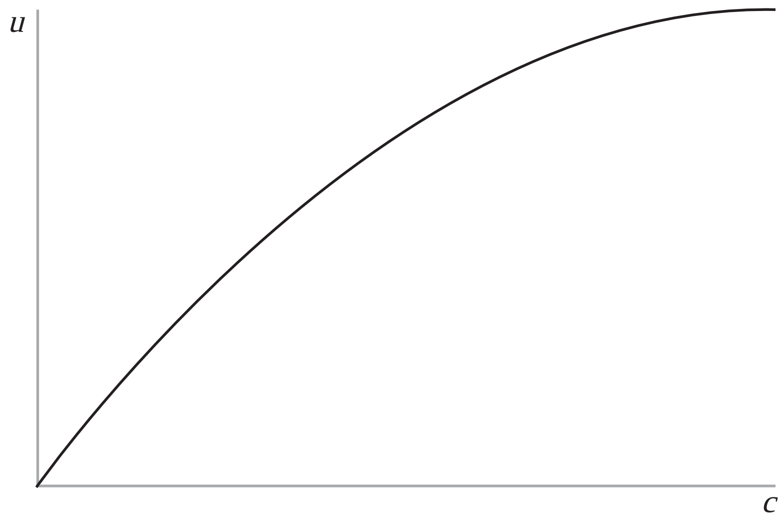
FINE LINES: DIMINISHING MARGINAL UTILITY

by David Fielding



This is the first graph I ever came across in Economics at school, when I was in Year 11. It illustrates the hypothesis that more consumption (c) leads to a higher level of welfare (u for utility), but that each incremental unit of consumption has less effect. This hypothesis has its origins in the work of Bentham (1789) and Mill (1863). Bentham and Mill realised that if the hypothesis is correct then it has substantial implications for the way we understand wellbeing in human society. For example, if u represents a common measure across all individuals (as Bentham and Mill intended), and if the shape of u (c) is similar for all individuals, then a transfer from the rich to the poor is likely to increase the total level of utility in society.

What I particularly like about the theory of diminishing marginal utility, apart from its clarity and lack of ambiguity, is the fact that it is testable. There are three main ways of testing the theory.

1. *Statistical analysis of psychometric survey data*. In applied psychology there are now robust ways of measuring individual wellbeing using a battery of survey questions. Observed correlations between these measures and estimates of individual levels of consumption can be used to infer the shape of u (c); see for example Layard et al. (2008)[2].

2. *Behavioural experiments.* The shape of u (c) can be inferred from the decisions of subjects in laboratory experiments. Experiments involving choice under uncertainty are especially popular in this literature. The value of early experiments is limited by their assumption that subjects maximise their expected utility, but this drawback has been overcome in more recent studies; see for example Fennema and Van Assen (1998).

3. *Neurological experiments*. Innovations in neuroscience and in brain scanning techniques have made it possible to examine the correlation between the subjective measures of wellbeing in (1), the experimental behaviour in (2), and activity in specific parts of the brain. This provides a scientific basis for measuring a person's utility level by scanning her brain; see for example Glimcher *et al*. (2005) and Pine *et al*. (2009)[3]. Neurological experiments come close to fulfilling the expectations of Bentham and Mill that one day it would be possible to analyse human wellbeing using the natural sciences.

Testable theories like this are what make economics a science: if a theory isn't testable then it has little claim to be scientific, however mathematically elegant it is (Popper, 1959), and it adds nothing to our objective understanding of the world around us. The challenge for 21st century economics is to live up to this high standard: to develop testable theories that deepen our understanding of how human society is ordered, and then to test these theories directly.

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[1] Later on, I also learned to say that $u'(c) > 0 > u''(c)$, although this didn't really add very much to my understanding

[2] However, one potential drawback of many existing papers in this literature is the focus on income rather than consumption as the main argument of $u(.)$.

[3] This approach can also be used to study utility functions in other primates; see for example Lee (2009).

BLOGWATCH

by Paul Walker (paul.walker@canterbury.ac.nz)

2013 has started badly for the economics profession with the deaths of two of the giants of the field: James Buchanan and Armen Alchian. Both deaths were well covered in the blogosphere. On Buchanan see, for example, Tyler Cowen who asks "What made Buchanan special as an economist?" http://marginalrevolution.com/marginalrevolution/2013/01/what-made-buchanan-special-as-an-economist.html, Shruti Rajagopalan who gives "An Appreciation: James M. Buchanan (1919-2013)" http://thinkmarkets.wordpress.com/2013/01/22/an-appreciation-james-m-buchanan-1919-2013/ and Richard McKenzie who also writes a tribute to James Buchanan http://marginalrevolution.com/marginalrevolution/2013/01/richard-mckenzie-writes-a-tribute-to-james-buchanan.htm and notes in it that "When I was in Professor James Buchanan's microeconomics class in the fall of 1969, he taught me very little."

On Armen Alchian see Robert Higgs who wrote on Alchain as a teacher http://blog.independent.org/2013/02/19/armen-alchian-april-12-1914-february-19-2013/, Thomas N. Hubbard who notes "A Legend in Economics Passes" http://www.digitopoly.org/2013/02/20/a-legend-in-economics-passes/ and Doug Allen's remembrance of Alchian http://organizationsandmarkets.com/2013/02/19/doug-allen-on-alchian/.

Economists are famous for not agreeing, but is the claimed level of disagreement real? As it turns out economists can't agree on whether its real or not! An NBER working paper by Roger Gordon and Gordon B. Dahl http://papers.nber.org/papers/w18728 uses data based on responses to a series of questions posed to a distinguished panel of economists put together by the Chicago School of Business and finds a broad consensus on many different economic issues, particularly when the past economic literature on the question is large. Justin Wolfers argues http://users.nber.org/~jwolfers/Papers/OpinionsofEconomists.pdf that the results were obtained because a founding idea of the IGM Expert Panel seems to be to showcase the consensus among economists and thus the panel isn't the right dataset to test for "Consensus". At the "EconLog" blog http://econlog.econlib.org/ Bryan Caplan asks, Who is right: Dahl and Gordon, or Wolfers? http://econlog.econlib.org/archives/2013/02/me_on_economist_1.html His answer: it heavily depends on whether or not your sample includes the broader public. Compared to non-economists, economists enjoy an amazing consensus. But if you only compare us to one another, economists are a contentious tribe. Dan Klein disagrees with Caplan's claim that "compared to non-economists, economists enjoy an amazing consensus". Klein counters by drawing attention to data from a survey he helped administer which suggests that the economics profession exhibits greater ideological diversity than other fields http://econlog.econlib.org/archives/2013/02/an_amazing_cons.html. Caplan counters this by asking what do Klein's empirics really show? While there is an ideological divide among economists Caplan argues that if Klein were to give his survey to the U.S. public, there is good reason to believe that the typical economist would seem very libertarian by comparison http://econlog.econlib.org/archives/2013/02/amazing_dan_kle.html.

Over at the "TVHE" blog http://www.tvhe.co.nz/ Matt Nolan makes the simple but important point that exchange rates are just prices http://www.tvhe.co.nz/2013/02/27/the-exchange-rate-as-a-price/. Nolan notes that the exchange rate is a symptom of things that are happening in the real economy and any suggested policy adjustments need to be focused on where these fundamentals may be hit by market and/or government failure instead of being a blanket criticism of the price itself.

At the "Groping to Bethlehem" blog http://gropingtobethlehem.wordpress.com/ Bill Kaye-Blake says "Let's get the taxes right". http://gropingtobethlehem.wordpress.com/2013/03/13/lets-get-the-taxes-right/. Kaye-Blake wants fringe benefit taxes extended to all the little perks and compensations given to people in lieu of money, such as things like free car parking, employer supplied cellphones and laptop computers. Eric Crampton writing at the "Offsetting Behaviour" blog http://offsettingbehaviour.blogspot.co.nz/ agrees but argues that Kaye-Blake doesn't go far enough. Crampton askes "What happens if, after you've negotiated your job and salary, the employer chisels on the non-pecuniary side by sticking you in an open plan shed for a few years before moving you into a much-smaller-than-expected office in another building? Or if the work conditions deteriorate substantially? Shouldn't the employer get a FBT credit for those kinds of things that they might then provide compensation to the employees and prevent their departure?" http://offsettingbehaviour.blogspot.co.nz/2013/03/tax-all-things.html .

Also at "Offsetting Behaviour" Seamus Hogan posts on the efficacy of using a nightwatchman in cricket http://offsettingbehaviour.blogspot.co.nz/2013/03/declarations-and-nightwatchmen.html. Hogan explains that "We wanted to compare the cost to a team of changing the batting order to the benefit of a reduced probability of dismissal for a top-order batsman, to calculate when and if the benefits would outweigh the costs. As it turned out, the benefit-cost calculation turned out to be completely uninteresting for an unexpected reason: We could find no evidence in a database of 200 test matches that having to make a second start in any way increases the probability of a top-order batsman being dismissed early in his innings. That is, the key variable that determines a batsman's probability of being dismissed is how many balls he has faced in that innings, not how many he has faced that morning. The cost-benefit calculation then becomes irrelevant, as there is simply no benefit from using a nightwatchman to balance against the costs."

Continuing on with the sporting theme, Sam Richardson at the "Fair Play and Forward Passes" blog http://fairplayandforwardpasses.blogspot.co.nz/ looks at the effect that a labour stoppage can have on a sports league. Will the fans not come back? In this particular case he considers the NHL in the U.S. and Canada and argues that "Absence makes the heart grow just as fond as it was before - the puck drops..." http://fairplayandforwardpasses.blogspot.co.nz/2013/01/absence-makes-heart-grow-just-as-fond.html. Richardson notes that while there may be some short-term effects of a labour stoppage the evidence shows that attendances bounce back very shortly after the end of a stoppage. So in the end there is little or no effect on attendances. Sports are a drug and the fans are hooked.

Finally, I note this Call for Abstracts for papers on *Economics of the Undead: Blood, Brains & Benjamins*. http://thinkmarkets.wordpress.com/2013/03/11/economics-of-the-undead/. "The editors seek abstracts for essays exploring the relationship between economics and the undead, especially zombies and vampires. The chosen essays will appear in a collection to be published by Rowman & Littlefield" and the editors add that "Possible topics include: supply and demand in the market for blood; the operation of zombie labor markets; the political economy of responding to undead threats; macroeconomic recovery after a zombie apocalypse; what zombie and vampire behavior tell us about rational-choice modeling; etc."

Motu Economic and Public Policy Research

EXCHANGE RATE PASS-THROUGH

Richard Fabling and Lynda Sanderson

A recent Motu, New Zealand Treasury and Reserve Bank Working Paper, "Export Performance, Invoice Currency, and Heterogeneous Exchange Rate Pass-Through", by Motu Senior Fellow Richard Fabling and the Treasury's Lynda Sanderson, uses comprehensive, shipment-level trade data from Statistics New Zealand's Longitudinal Business Database (LBD) to examine the extent to which New Zealand exporters maintain stable New Zealand dollar prices by passing on exchange rate changes to their foreign customers.

From 2004–2012, the New Zealand dollar experienced substantial fluctuations in bilateral exchange rates. Swings of 20 to 30 percent were not unusual, and in large-scale business surveys conducted in 2007 and 2011 exchange rate levels and volatility were the two most commonly cited challenges for firms with foreign income (Statistics New Zealand, 2012). However, there is little empirical evidence on the ways variations in the exchange rate affect New Zealand export performance.

For an exporter, when exchange rate pass-through (ERPT) is incomplete – that is to say, when changes in exchange rates are not perfectly mirrored by pricing changes – some part of the exchange rate movement is absorbed by the exporting firm. There are a number of reasons why firms may choose not to pass exchange rate fluctuations on to their customers. Some, such as pricing-to-market and explicit contracts with existing customers, have direct implications for an export firm's profitability, while in other cases export firms may be able to mute the effect of exchange rate changes on their profits, such as through exchange rate hedging.

Fabling and Sanderson examine the extent of ERPT by New Zealand exporters, building on two recent microeconomic papers, Berman et al. (2012) and Gopinath et al. (2010). Berman et al. show that high-performing firms tend to absorb exchange rate changes into their margins, while low-performing firms tend to pass changes on to their customers and, in turn, experience changes in sales volumes. Meanwhile, Gopinath et al. examine differences in ERPT according to whether the sale is invoiced in the exporter currency or in the importer currency, and find that price adjustment differs across currencies.

Fabling and Sanderson used Statistics New Zealand's LBD to combine both the Berman et al. and Gopinath et al. approaches, examining ERPT across a number of dimensions: between the short run and long run, according to specific firm and product characteristics, and the invoice currency used in the export transaction. Over the period April 2004 to December 2010, the LBD provided observations of almost 1.8 million price levels reported by 14,415 exporters over 164 export destinations and 8,072 distinct goods, giving a comprehensive picture of New Zealand exporter behaviour.

In the short run, Fabling and Sanderson find that estimated ERPT appears to be intrinsically related to the invoice currency. Firms invoicing in the New Zealand dollar (NZD) on average adjust the New Zealand dollar prices of their goods to reflect only 9 percent of the exchange rate fluctuation, with the remaining 91 percent being passed through to the importer. In contrast, when firms invoice in the importer (local) or a third country (vehicle) currency, price rigidities in the invoice currency mean that the exporter absorbs a much greater share of the exchange rate fluctuation into their NZD-converted return.

These differences across invoice currencies generate a relationship between firm characteristics and pass-through behaviour, due to differences in invoicing practices across firms. In particular, firms with relatively high or diverse export receipts are more likely to invoice in foreign (non-NZD) currencies. As a consequence of price stickiness in the invoice currency, these firms then experience a relatively stronger impact of exchange rate fluctuations on their NZD-converted unit values. Conversely, NZD invoicing is more common among foreign-owned firms and exporters of differentiated products, leading to a milder average impact of exchange rate changes on received unit values for these groups. When currency choice is directly controlled for, firm characteristics cease to show any relationship with pass-through.

In the long run, the role of stickiness in the invoice currency weakens and NZD-denominated returns absorb a lower overall proportion of the exchange rate change. While received unit values of importer-currency pricers still respond quite strongly to the bilateral exchange rate, vehicle-currency pricers become indistinguishable from NZD pricers. Increasing pass-through to foreign prices, combined with a higher share of producer-currency invoiced observations, leads to a substantial reduction in the average impact of exchange rates on received unit values in the long run. However, despite this adjustment, pass-through remains low among some groups of firms (particularly those invoicing in the local currency), suggesting that, in the absence of offsetting effects, exchange rate fluctuations affect profitability. The implied variability in export returns increases the risks associated with exporting, which may in turn reduce firms' incentives to enter and develop export markets.

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by Joey Au (GEN Committee), (info@gen.org.nz)

2012 GEN ANNUAL CONFERENCE

The Government Economics Network (GEN) ended the 2012 year with another well-attended and informative annual conference. The conference was held at Te Papa, chaired by Philip Stevens and opened by Girol Karacaoglu who is the Chairperson of GEN.

Tim Maloney from the Auckland University of Technology presented on the long-term scarring effects of unemployment followed by our first keynote speaker, Trevor Huddleston from the UK Department for Work and Pensions. Trevor talked extensively about the latest developments in welfare reforms in the UK and offered some lessons for NZ.

Martin Weale from the Bank of England, our second keynote speaker, provided a lot of good food for thought on household behaviour and policy analysis.

After a short break and one or two sausage rolls it was time for the Chief Economist's panel discussion on New Zealand's Productivity Paradox. Paul Conway, Girol, Vicki Plater and Roger Procter all provided views on NZ's poor performance and highlighted the existing cross-agency efforts to improve the contribution of policy to productivity growth under the auspices of the recently-formed "Productivity Hub".

Our final speaker, Norman Gemmell from Victoria University presented on the top income tax rate in NZ - how high is too high?

2013 GEN COMMITTEE MEMBERS

Congratulations to the following individuals below who were re-elected or elected to the 2013 GEN Committee at the Annual General Meeting on the 14th December 2013.

- **Girol Karacaoglu** (*Chairperson*) – Treasury
- **Veronica Jacobsen** (*Deputy Chairperson*) – Ministry of Business, Innovation and Employment (*MBIE*).
- **Joey Au** – Treasury
- **Tony Booth** – IRD
- **Heena Chhagan** (*Administrator*) - GEN
- **John Creedy** – Treasury and VUW
- **Bronwyn Croxson** – Ministry of Health
- **Andrea Fromm** – Statistics NZ
- **Peter Gardiner** – Statistics NZ
- **Richard Hawke** – MBIE
- **Rob Hodgson** – MBIE
- **Joanne Leung** – Ministry of Transport
- **Linda Simpson** (*Treasurer*) – Treasury
- **Philip Stevens** - MBIE

PRODUCTIVITY HUB: UNPICKING NZ'S PRODUCTIVITY PARADOX - SYMPOSIUM

The Symposium, led by the Productivity Hub, will:

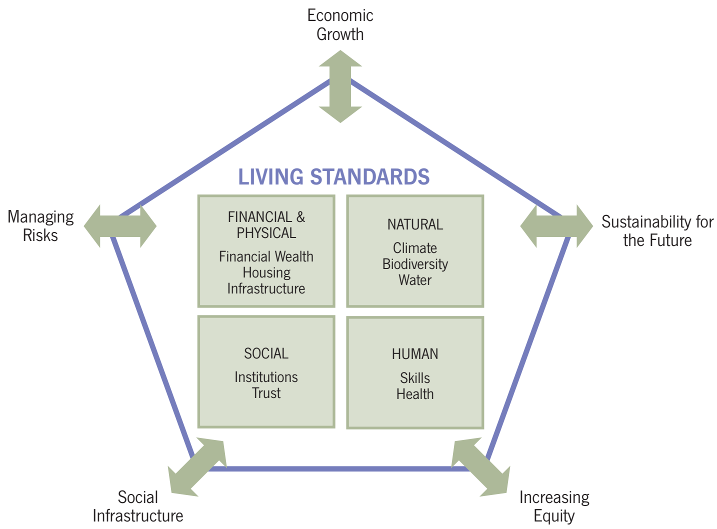
- bring together evidence, analysis and interpretations of New Zealand's productivity paradox to generate robust insights and advance collective understanding of New Zealand's productivity performance; and
- gather ideas for research and policy work that will most effectively contribute to improving New Zealand's productivity performance.

The Productivity Hub invites the submission of papers for the Symposium. For more information please email: hubsecretariat@productivity.govt.nz

LAUNCHING THE LIVING STANDARDS HUB

The Living Standards Hub, similar to the Productivity Hub on the GEN website, provides a vehicle for people to share their policy-relevant research and analysis; connect with other researchers and policy analysts; and discuss their work and ideas on living standards. This Hub will go live on the 2nd April and you can register now by emailing: Joey.Au@treasury.govt.nz

This Living Standards Hub will be on the www.gen.org.nz website and was created to meet the desire from the participants to work together following the joint Treasury and Statistics NZ workshop on living standards involving 19 different organisations (government agencies, universities, regional councils etc).



We invite you to join us, contribute to the knowledge base and help us as we try to enhance our understanding of each of the five living standard dimensions and continue to apply the living standards framework in our policy advice.

THE FIVE-MINUTE INTERVIEW WITH... JOHN GIBSON

1. **When did you decide that you wanted a career in economics?**
   In my first year at Lincoln. I had arrived hoping to become a plant breeder to "feed the world" but then learned in a first year B.Ag. Sci course that the Green Revolution and plant breeding efforts hadn't eliminated poverty and that many of the problems were distributional and income-related. So although the course was taught by an agronomist, George Hill, it helped put me on a road towards economics.
2. **Did any particular event or experience influence your decision to study economics?**
   See #1.
3. **Are there particular books which stimulated your early interest in economics?**
   Not really.
4. **Did any teachers, lecturers or supervisors play a significant role in your early education?**
   I'll always be grateful to Bert Ward at Lincoln for not letting me drop out of econometrics when I tried to. And from Scott Rozelle, I learned a lot about fieldwork and humility when we intersect with people whose lives are much less fortunate than our own.
5. **Do you have any favourite economists whose works you always read?**
   I try to keep up with most things that both Angus Deaton and Martin Ravallion publish. But since they are both so productive it is hard to keep up, even just as a reader.

6. **Do you have a favourite among your own papers or books?**
   I like my EDCC paper on poverty and access to roads in PNG, which was jointly written with Scott Rozelle. I knew a lot about the data and context so the starting paper was already quite good but the referring process pushed us hard on identification and resulted in a more compelling set of estimates, that arguably have broader applicability.
7. **What do you regard as the most significant economic event in your lifetime?**
   The Household Responsibility System (the end of collective farming) in China, beginning in Anhui province in 1978. No single event has done more to reduce misery and improve prosperity for so many people so quickly.
8. **What do you like to do when you are not doing economics?**
   I like building things, even at implicit returns to time of probably zero. But I limit myself to decks and non-structural things. Also I don't mind tedious things like painting (we imported all the wood for our house from Canada and the downside is that all the walls and decks need an annual coat of stain, so lots of opportunity for doing tedious stuff), which gives a chance to reflect on how fortunate we are as economists to have interesting work lives.

ANNOUNCEMENT
THE A R BERGSTROM PRIZE IN ECONOMETRICS: 2012

We are pleased to announce award of the **A R Bergstrom Prize in Econometrics** for 2012 to Isabelle Sin, for her paper "The Gravity of Ideas: How distance affects translations". An early version of Isabelle's paper appeared in her Stanford University dissertation, and this Bergstrom prize paper was completed during her employment as a Fellow at Motu Economic and Public Policy Research.

The object of the Prize is to reward the achievement of excellence in econometrics, as evidenced by a research paper in any area of econometrics. The Prize is open to New Zealand citizens or permanent residents of New Zealand who, on the closing date for applications, have current or recent (i.e. within two years) student status for a higher degree. The Prize is awarded once every two years, with a value of NZ$2,000.

The citation that accompanies the award reads as follows:

Isabelle Sin's paper is an innovative study of how various measures of distance affect the international transmission of ideas, as one potentially important component underlying growth and development processes. The approach relies on a series of meticulously-compiled data sets, the most prominent of which incorporates newly digitized data on over three hundred thousand book translations for the period 1949-2000. The equation specifications emanate from augmented multiplicative gravity model forms, and preferred results utilise the pseudo-maximum-likelihood (PML) method of Santos Silva and Tenreyro (2006). New results are reported for the elasticity of book translations with respect to physical distance, for both more developed and less developed countries. These results are then shown in interesting contrast to distance elasticities for trade in goods drawn from the existing literature.

The Adjudication Committee for the 2012 Award comprised Professor John Gibson of Waikato University, Professor Viv B Hall of Victoria University of Wellington, and Professor Peter C B Phillips of Yale University, the University of Auckland, the University of Southampton and Singapore Management University.

V.B. Hall & P.C.B. Phillips
December 2012

The Prize is supported by funds provided by the following sponsors:

Institutional Sponsors:

The New Zealand Association of Economists; The School of Business and Economics at the University of Auckland; The Department of Economics and Finance at the University of Canterbury; The Victoria Business School at Victoria University of Wellington; Lincoln University; The Economics Group, Commerce Division at Lincoln University

Personal Sponsors:

C.R. Wymer; A.D. Brownlie, H.A. Fletcher, J.A. & D.E.A. Giles, V.B. Hall, K.B. Nowman, P.C.B. Phillips; R.J. Bowden, R.H. Court, Anonymous, D.M. Emanuel.

In addition, royalties from the Festschrift Volume *Models, Methods and Applications of Econometrics: Essays in Honour of A.R. Bergstrom*, P.C.B. Phillips (ed.) Blackwell, Cambridge MA and Oxford UK, 1993, and from *A Continuous Time Econometric Model of the United Kingdom with Stochastic Trends*, by Albert Rex Bergstrom and Khalid Ben Nowman, Cambridge University Press, 2007, are applied to support the prize.

RESEARCH IN PROGRESS...

Continuing our series on the research projects currently underway in Economics Departments and Economics Research Units throughout New Zealand, in this issue we profile the research currently being undertaken by economists at the University of Auckland. The objective of this section is to share information about research interests and ideas before publication or dissemination - each person was invited to provide details only of research that is new or in progress.

Current Research in Progress by the Department of Economics, University of Auckland

Dr El Hadj Bah
El-hadj's primary area is growth and development. He is interested in factors that affect income and total factor productivity differences across sectors and across countries. He is currently working on identifying the constraints to the growth of micro-firms in Myanmar.

Professor Ananish Chaudhuri
Ananish's primary area is experimental research on the evolution of social norms including the role of trust, reciprocity and altruism in economic interactions. He is currently working on the impact of diverse incentive schemes on worker productivity and also working with colleagues in psychology on the role of religion in promoting pro-social behaviour in humans.

Professor Tony Endres
Tony's main areas of research are concerned with the history of ideas on international monetary arrangements, Austrian capital theory and its overlap with complex systems theory, and entrepreneurship. He is currently working on the concept of international monetary symmetry and the dynamic interactions between interventionism, entrepreneurship and capital formation in less developed countries.

Professor Prasanna Gai
Prasanna's research focus is on financial stability, bank regulation, and open economy macroeconomics. He is currently working on projects concerning the reform of the international monetary system, the systemic risk consequences of breakdowns in secured and unsecured funding markets, and the analytics of bank resolution.

Dr Daryna Grechyna
Daryna's primary research interests are Quantitative Macroeconomics, Public Finance, Financial Development, and Economic Growth. She works on the political economy of public debt determination and the design of optimal fiscal policy. She also studies the role of financial development in amplifying systemic risk and how the public sector can play a role in harmonizing economic growth and stability.

Professor Arthur Grimes
Arthur is working on a number of grant-funded research programmes. The first is a Marsden Fund grant on assessing the validity and robustness of national wellbeing and sustainability measures. The second and third are MBIE (MSI)-funded grants, the first dealing with the relationship betwen infrastructure and urban change, and the second with economic impacts of the Christchurch earthquakes. He is also preparing a set of public lectures on central banking topics (inflation targeting, exchange rate systems, and macroprudential policies) that he will deliver in London later in 2013.

Professor Tim Hazeldine
Tim Hazldine is following two main lines of research, namely transport economics and its links with trade and urban development, and the causes and effects of income inequality.

Associate Professor John Hillas
John Hillas works almost exclusively in noncooperative game theory. He has worked for a number of years with Elon Kohlberg and John Pratt from the Harvard Business School on looking at the relation between Nash equilibrium and correlated equilibrium when the game is considered from the perspective of an outside observer. He is also working with Dmitriy Kvasov from Adelaide University on defining sensible version of backwards induction solution concepts for games without perfect recall. More recently he has started work with Dov Samet of Tel Aviv University on epistemic approaches to game theory, and in particular a definition of a non-probabilistic definition of correlated equilibrium.

Dr Bilgehan Karabay
Bilgehan's main research area is international trade, with a specific focus on the political economy of protection. He is also interested in the economics of information and uncertainty, and in industrial organisation with particular reference to the effects of globalization.

Dr Taesuk Lee
Taesuk Lee's research interests are econometrics, time-series, applied econometrics, financial econometrics. His current research is on realized variance estimation and forecast, jump test, and bootstrap inference.

Associate Professor Sholeh Maani
Sholeh's research is primarily in the area of economics of the labour market, in particular the effects of human capital and mobility. In a recent project she scrutinises New Zealand's OECD ranking in the private returns to higher-education, and in another project the occupational attainment of skilled immigrants. She is currently writing a book on international lessons and economic policy question in higher education, and also working with colleagues at ANU on the effects of student loan policies.

Professor John Panzar
John Panzar's research has focused on network infrastructure industries such as airlines, railroads, electric power, telecommunications, and postal service. The emphasis has been on pricing and costing issues impacting public policy toward multi-product network industries. He is currently working on the analysis of vertical separation policies for liberalized network industries.

Professor Peter Phillips
Peter Phillips has ongoing research in nonlinear and nonstationary time series econometrics with applications in finance, macroeconomics and forecasting. He is currently working on dating and predicting exuberance in financial markets.

Dr Alan Rogers
Alan's areas of current research are econometric theory including geometric aspects of the linear regression model, theory of choice under uncertainty and, most recently, historical aspects of Australasian economic thought.

Associate Professor Matthew Ryan
Matthew's main areas of interest are decision theory and auctions. He is currently looking at applications of abstract convexity (e.g., notions of convexity for discrete environments) to issues in decision theory and social choice. This is a large and inter-disciplinary project involving other members and affiliates of the Centre for Mathematical Social Science (CMSS; http://cmss.auckland.ac.nz/) at the University of Auckland. On the auctions front, He is working with Flavio Menezes (University of Queensland) on the design of tenders for PPP contracts. He is also currently working with colleagues at Massey (Albany) to establish a Research Network for Applied and Theoretical Economics (ATE; http://ate.massey.ac.nz/) – new members are always very welcome!

Dr Erwann Sbai
Erwann's main research interest is structural econometrics for empirical games (e.g. auctions). He has studied applications, for example, for Treasury auctions or electricity spot market.

Associate Professor Robert Scollay
Robert's area of research is trade policy and regional economic integration, with particular emphasis on the regional trade architecture of the Asia-Pacific region and individual initiatives including APEC, the Trans-Pacific Partnership (TPP), the Regional Comprehensive Economic Partnership (RCEP) and other initiatives relevant to New Zealand. He also works on agricultural trade policy, the trade policies of individual Asia-Pacific economies, and Pacific Island trade issues.

Professor Basil Sharp
Basil is currently working on projects associated with oil and gas development and electricity demand side management. He is also working with Nan Jiang at AUT on firm choice of IP and the possible relationship between IP and productivity.

Associate Professor Susan St John
Susan's research interests focus on retirement policy including the funding of long-term care and annuities, accident compensation, tax reform and family economics

Associate Professor Rhema Vaithianathan
Rhema is a health economist and director of the Centre for Applied Research in Economics (CARE) at the University of Auckland. CARE undertakes multi-disciplinary translational projects across a wide range of topics of relevance to New Zealand. CARE is currently working on the Government's Vulnerable Children Policy to improve early identification of vulnerable children; together with the Woolf Fisher Centre in Education, CARE is exploring mechanisms for introducing cost-effectiveness research into education and is about to commence a project on the impact of management skills on productivity in New Zealand.

NZEP

by Mark Homes

NZEP has a keen interest in research on important issues relevant to New Zealand, Australia and the Asia-Pacific. The journal also publishes survey articles, book reviews and welcomes articles that explore important policy initiatives affecting the region and the implications of those policies. Authors are invited to submit their manuscripts to NZEP online (http://www.tandf.co.uk/journals/rnzp).

Mark Holmes (holmesmj@waikato.ac.nz), *Editor-in-Chief.*

ABOUT NZAE

The New Zealand Association of Economists aims to promote research, collaboration and discussion among professional economists in New Zealand. Membership is open to those with a background or interest in economics or commerce or business or management, and who share the objectives of the Association. Members automatically receive copies of New Zealand Economic Papers, Association newsletters, as well as benefiting from discounted fees for Association events such as conferences.

WEB-SITE

The NZAE web-site address is:
http://nzae.org.nz/
(list your job vacancies for economists here).

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