

The Economy in Transition:

RESTRUCTURING TO 1989



Economy in transition :
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Economic Monitoring Group.

NEW ZEALAND
**Planning
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Te Kaunihera Whakakaupapa
Mo Aotearoa

The Economy in Transition: Restructuring to 1989

Economic Monitoring Group

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Foreword

Recent reports by the Economic Monitoring Group have been about specific issues such as overseas debt, the government deficit, the exchange rate development and labour-market flexibility. The last general 'overview' by the Group was in *Strategy for Growth*, now nearly five years ago.

Much has happened in the last five years. The changes in economic policies have been unprecedented in New Zealand's history. In this report the EMG sets out the background to those, and earlier, changes in policy. It examines the outcomes — social and economic — which have resulted so far. It discusses whether policy shifts are desirable, to speed the achievement of a faster-growing economy with an eventual return to full employment.

This report, published by the New Zealand Planning Council, was prepared independently by the Economic Monitoring Group. The views expressed are the sole responsibility of the EMG and are not necessarily endorsed by the Planning Council.

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In addition a number of individuals, from all sectors, gave time in reading and commenting on drafts of the report. Their assistance is acknowledged with appreciation.

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Summary

Introduction

Over the past few years New Zealand has experienced a period of change in economic policy unprecedented in its own history and unusual in that of any country. This report of the Economic Monitoring Group is an overview of these policy changes and their results.

The extent and complexity of change in the economy makes it difficult to determine the precise results of the new policies. However it is important to evaluate their success or failure. With unemployment growing to levels not experienced since the 1930s, inevitably pressure has developed for a reversal of the policies. The issue of immediate importance, therefore, is whether the observed behaviour of the economy suggests that there should in fact be a significant policy reversal, or alternatively whether there are other changes that would enhance the outcome of the policies already enacted.

The Purpose and Meaning of Restructuring

New Zealand is a nation heavily dependent on international trade. In addition, the post-war period has been one of unprecedented world-wide technological advance. For both these reasons it is essential that this economy is responsive to the changing external environment. The basic aim of restructuring policies, therefore, is to create a more responsive and adaptable economy. Only by achieving this will the country be able to prosper in the changing environment and be able to satisfy the economic and social aspirations of its citizens.

Past Economic Performance and the Policy Responses

On almost any economic measure, this country has performed very badly over the past two to three decades. Real income per head rose much less than in other OECD countries. Inflation and unemployment rose. The government debt and the overseas debt both reached levels relative to GDP that were causing severe immediate problems and were not sustainable in the long run.

A long-standing basis of policy had been to protect local production and employment by isolating the domestic economy from the overseas changes. As problems became evident, from about 1960 onwards, the initial policy response was for more government intervention, further distorting market signals from abroad. This only served to exacerbate the existing problems. The alternative, of forcing domestic industry to face the reality of the international market, was then slowly adopted from the start of this decade. At the same time the reduction of domestic regulation caused some increases in competition. Both kinds of microeconomic policy change were considerably extended and accelerated from mid 1984 onwards.

1984 also saw a reversal of macroeconomic policy, with the emphasis on both monetary and fiscal policy becoming one of providing a stable environment within which individuals and firms could operate.

The Achievement of Economic Objectives

In considering whether the economic objectives of these new policy thrusts have been achieved, it is helpful to divide these objectives into three parts. These are, firstly, to obtain a more flexible and responsive economy at the microeconomic level; secondly, to satisfy the intermediate macroeconomic objectives of low inflation, fiscal balance and external balance; thirdly, to achieve the ultimate economic goal of sustainable real income growth at full employment.

The economy has become more responsive to changes in its environment. The new policies have left firms and individuals facing international price signals much more directly. At the same time the deregulation of various parts of the economy has increased competitiveness, or at least contestability, so that firms are under greater pressure to respond to these price signals.

Examining the behaviour of the economy at the micro level demonstrates this increased flexibility, both in the goods and labour and capital markets. There is more rapid relative change in these markets, even at an aggregate level. In addition, there are indications of significant increased productivity, in both growing and declining sectors of the economy. This is unusual at a time of economic downturn and is evidence of a real shift in competitiveness that will allow the opportunity for sustained improvement in export performance and in the growth of real income.

The combination of a tight monetary policy and a firm fiscal stance have between them enabled the economy to make very substantial progress towards satisfying the intermediate macroeconomic objectives. Inflation has been brought down to a level that allows stability in planning and continued export competitiveness. The fiscal and external balances are both close to being positive and are in a position that will allow a fall in debt to GDP ratios. As a result the destabilizing influences of these debts is diminishing.

While progress on the first two objectives has been very substantial, it has been negative in the short run on the third objective, of sustainable growth in real income at full employment. Real income has remained static, while unemployment has continued to grow. In part both of these are the inevitable result of the situation of the economy earlier in the decade. The sizes of the internal and external deficits meant that there had to be a difficult period of adjustment until a sustainable position had been reached.

At the same time, the extent of the earlier interventions in the economy had resulted in a structure that was not appropriate for the prices and technology ruling in the rest of the world. Of necessity, any movement towards greater flexibility was going to cause a period of major readjustment in the structure of the economy, whose first effects would be seen as decreased activity and employment in some industries. In this sense part of the increase in unemployment can be interpreted as an indication of the structural change that is taking place.

To make progress towards the ultimate objectives, what is now required is a growth in activity in those parts of the economy that are competitive. Until this happens on a large scale, real incomes cannot grow, nor can unemployment fall. The foundation for such an expansion is now in place, but the expansion itself is only showing early indications of an appearance. That it is not more in evidence is likely to be the result of a lack of confidence in an upturn emerging, or in the continuance of present government policies, rather than because of the value of the exchange or interest rates.

The Achievement of Social Objectives

The achievement of many social objectives depends directly on the level and growth of real income. Sustained improvements in health, housing and education all require a wealthier economy. On the other hand there are other objectives, such as the ability to have access to paid employment and the perceived equity of the distribution of income where a deterioration may occur during the process of obtaining a higher level of income. The recent growth of unemployment may appear to be an example of this.

While some of this increase has been inevitable, a part has certainly been a result of the restructuring policies themselves. Although the result will be a subsequent increase in sustained employment and real income in the longer run, some of those individuals who have suffered during the restructuring process may never be adequately recompensed.

Policy Implications and Conclusions

The main conclusion to be drawn from this overview is that very substantial progress has been made towards turning the New Zealand economy into one that has those attributes of flexibility and responsiveness that are needed to achieve long-term sustained growth of output and employment. In the short run the costs of this transition have been considerable, but these will diminish as economic growth commences.

Given this optimistic view of the prospect for the economy, the Economic Monitoring Group recommends that the present policy approach continues. Some individual markets need to be further liberalized, with particular attention given to reduction of border protection and to the promotion of those changes in labour-market institutions and attitudes which lead to productivity improvement agreements at industry and firm level, of benefit to both employers and workers. Acquisition of skills for much of the labour force and skill upgrading for others is also essential if the workforce is to be sufficiently trained and adaptable to fill the employment slots in the evolving economy. Firm monetary policies need to continue to prevent a recurrence of inflation and thus a loss of the competitive gains made over the past years. At the same time the fiscal stance needs to be tight so as to move towards a lower debt ratio and to help a longer-term fall in interest rates.

Given a continuation of these policies and the considerable achievements to date, progress towards economic growth and falling unemployment depend only on the restoration of confidence. As growth starts to reappear and the effects of the financial crash fade, so this confidence will return. Provided the integrity of the policy framework is maintained, New Zealanders will then be well placed to benefit from the restructuring of the economy that has already taken place. I then be well placed to benefit from the restructuring of the economy that has already taken place.

Introduction

The structure of our economy has been changing rapidly in recent years. Most of the Economic Monitoring Group's previous reports have focused on particular aspects of the economy, such as the public sector deficit, overseas debt, foreign exchange markets, regulatory reform, and labour-market flexibility. The group's last general overview of economic trends and policies was the report *Strategy for Growth* published in 1984.

It is an appropriate time, therefore, for another general review of the changes that have been taking place in the New Zealand economy, the benefits to be expected from those changes, and the costs that have accompanied them.

In the Introduction we discuss what 'restructuring' means, what its purpose is, and the broad policy options available by which governments can assist the process.

Chapter One outlines the economic developments which led to the perception of a need for changes in economic policy. Chapter Two examines actual policy changes over the past ten years and the general objectives of those policies.

The following chapters look at what changes have occurred in the economy in recent years as a consequence of the policy shifts, and provide an analysis of impacts at the 'microeconomic' level -- on individual industries, regions, and households. 'Macroeconomic' policies and their outcomes, for the economy as a whole, are also discussed in some detail.

This leads to an evaluation of how far the objectives of economic restructuring have been achieved to date, including 'social' as well as 'economic' objectives. The report concludes with a discussion of where policies should lead from here.

The Meaning of Restructuring

By the structure of an economy we mean the way economic activities are organised at a given time. For example, the goods and services produced by different industries -- their relative importance and the skills and technologies used; the split of employment between industries -- including unpaid work, often in the home; the kinds of goods and services which households consume and the incomes they receive; the stock of capital assets available and the rate at which it is increasing; trade with the rest of the world; the services which government performs, and so on.

From one day to the next the structure of an economy is virtually unchanged. Unlike the structure of a building, however, it does change over time and even within a few years dramatic changes are possible.

These changes take place in response to the signals constantly being generated by the economy itself or from overseas, in particular the changes in the prices of commodities and of the quantities sold and purchased in the market-place. Households change in size and number and also change their purchasing patterns, affecting production and investment decisions by businesses, and their decisions on employment and

wages, which reflect back on household incomes. This process of signalling information is not only confined to market transactions. In particular there are the non-market transactions made by governments, both central and local, in providing services, many of which are not readily provided by the market, and financing this provision by taxation or other means.

All this takes place in a wider social framework, and is concerned with more than just economic values. Our day-to-day economic decisions are influenced by our social conditioning. Long-term changes in population structure influence production and consumption patterns. Certain central values of our society, for example, beliefs in the rule of law, the right of free speech, opposition to sexism and racism, are taken as more important, in cases of conflict, than other values such as the maximisation of real income.

At a broader level, still human social and economic activities take place in a natural environment endowed with resources such as landscape, air, water, land and minerals, which are finite even where renewable. More than in the past we recognise the need to take account of human impact on this environment.

In this report the focus is on economic performance, but not to the neglect of wider issues. The issue of 'fairness' -- in the distribution of resources, and during the transition to a better performing economy -- is discussed. Full employment is seen as a necessary criterion for a well-performing economy because without full employment some citizens are denied those opportunities to achieve and participate in society that most people enjoy. Social and environmental considerations are a justification for some forms of government intervention. The decisions on some of these issues are not easy because they involve value-judgements, which cannot be provided by the market-place, and values differ from individual to individual and between different sections of society.

What then is a 'better', as opposed to a 'worse', performing economic structure? The question can be broken down into two, one concerning static performance, the other dynamic performance. First, is an economy working 'efficiently' at a given point in time? In other words is it producing the maximum amount of economic wellbeing possible from the available resources, human and other? This includes taking into account the additional gains possible from trading with other countries. (The broader social and environmental values referred to above will somewhat constrain the outcome which would be optimal if maximum output were the only goal.)

Secondly, on a broader level, is the economy performing efficiently over time and reacting continuously to changes in the global economic environment? That is, is there economic flexibility with continuous adaptation to change so that in some sense aggregate wellbeing is maximised over time, rather than just at a single point in time?

The second criterion is more important. The New Zealand economy appeared to be well structured in the immediate post-war period, giving high average incomes and full employment. But by the 1960s, if not earlier, it was becoming apparent that New Zealand was not adapting to the changes taking place in overseas markets, and that economic performance, in terms of relative income per head, was deteriorating.

An appropriate or 'efficient' economic structure then, is that which above all is characterised by adaptability and flexibility. It changes readily in response to the signals provided by the economy. In general, if not always, these signals are best provided by the market-place -- hence the requirement that for adaptability an economy should be 'market oriented'.

Although flexibility is highly desirable, perfect flexibility is not possible. Market-place signals can be obscured, by market failure or uncertainty or by government intervention, for example, through the protection of domestic industry. But even where signals are not obscured, resources are not always readily transferable.

Existing labour-force skills may not be suited to new job vacancies, and some fixed assets are not convertible to new uses. An adapting economy is likely, therefore, particularly if change is rapid, to have unemployed resources. An important policy question is what steps should be taken to reduce unemployment and to enable people to take up new opportunities with speed.

Nevertheless an adaptable changing economy will generate less unemployment in the long run than one which is unable to adapt to changing economic circumstances. This is why it matters that the New Zealand economy be 'well-structured' in the sense of being able to adapt to change. Change has its problems but they are less painful than the economic impoverishment which eventually results from a refusal to adapt.

Policies for Restructuring

Adaptability is the ability to react quickly and effectively to external signals. When overseas trends suggest that changes are required in New Zealand, the government may decide that it should promote adaptability or that it should take the responsibility of deciding that the overseas change is a short-term phenomenon which is not to be responded to. The tax encouragement of increases in livestock numbers from July 1976 was an example of the latter which was probably successful, while the Supplementary Minimum Prices subsidy (SMP) scheme of the late 1970s was an example where most people now think the government was unwise.

When the government wishes to promote a response to overseas trends and signals, it adopts *restructuring* policies. These can be put into two categories.

First, there are those policies in which the government takes an initiative, by interpreting the signals and deciding in which direction change should take place. An obvious example was the decision taken in 1979 to implement major growth projects ('think big') to utilise the indigenous resources of natural gas, ironsands, and hydroelectric capacity following a rise in the world price of oil. Such interventions are microeconomic, in that their initial impact is on individual businesses and industries rather than being intended to immediately influence all sectors of the economy. Because of the size of the projects, however, there were macroeconomic implications, significantly affecting the overall efficiency with which resources were used.

Governments can also use macroeconomic policies to promote restructuring directly, for example, by setting an exchange rate at a preferred level, although their ability to sustain their decisions over a long period is open to doubt.

Secondly, there are those policies in which the responsibility of interpreting market signals and acting on them is left to private decision-makers. In this case, government's role is to ensure that market signals are allowed to reach economic agents with as little distortion as possible. This involves macroeconomic policies since monetary growth itself may distort price signals.

Intermediate between the two categories is the situation where government reinforces signals but leaves action on them to other economic agents. An example was the policy in the 1960s of paying incentives to those who developed non-traditional exports, where the underlying signals were the relative growth of international trade in manufacturing.

In recent years, the emphasis has moved towards the second category. This represents a choice about the kind of role to be adopted by government, not an abdication of responsibility. Government's own functions, the provision of services and income transfers, guarantee that government will influence parameters such as monetary growth and the exchange rate, and it has to consider whether appropriate signals are transmitted. Furthermore, in any economy there are inflexibilities, not because signals are not received, but because the short-term costs of change are high. In such circumstances the government, on the grounds of economic efficiency as well as of equity, may try to facilitate change, for example, by reallocating some of those short-term costs. An example of such a policy is funding for retraining or relocating workers. The important point is that policy should aim not at protecting against the need to change but rather in encouraging an appropriate response to external change.

Governments have to allow for the way that people respond to policies. Most people look to their own interests rather than to what the government wants. Governments therefore have to harness the energy which individuals and groups use to identify that information which is important to them and to act on it.

That is why the Economic Monitoring Group favours restructuring policies of the second type where, as far as possible, governments allow decisions to be made by businesses, households, and other groups such as iwi, while endeavouring to ensure that the information needed by each group reaches it with minimal distortion. Where individuals are not fully aware of broader social, economic and environmental consequences of their decisions, it can be appropriate for government to either modify the signal or constrain individual actions.

In summary, the best kind of restructuring policy is one which aims at creating a more adaptable and flexible economy, and one which is quickly responsive to a changing external environment.

The Objectives of Restructuring

Within the overall objective of *responsiveness*, or *adaptability*, it is helpful to be more precise about specific sub-objectives. 'Restructuring' can be interpreted in terms of improving economic performance, usually as a consequence of changed relative patterns of resource use. Or it can be taken more broadly as the whole process of social and economic change, whose outcome is judged, and, if need be, modified according to community criteria of 'fairness' (or 'equity') and other social objectives, as well as on the grounds of economic efficiency. (For a comprehensive list of social and economic objectives see *Social Policy Options*, New Zealand Planning Council 1987, Chapter One.) The sub-objectives considered are real income growth, full employment of resources, fair income distribution, resources for disadvantaged groups and opportunities for participation.

Real Income Growth

The purpose of an adaptable economic structure is to allow real income per head to increase at the maximum rate sustainable over time. To be sustainable, account must be taken of the effects of economic growth on the physical environment. (It should be noted also that there are aspects of wellbeing which are not well comprehended in the standard measures of growth such as real Gross Domestic Product.)

Full Employment of Resources

The income objective could conceivably be met with the incomes of the majority increasing, while a minority are permanently unemployed. The social tensions and the waste of human resources this entails, mean that such an economy cannot be described as 'well-structured'.

An objective of restructuring policies should therefore be that all labour and capital resources, but particularly labour, should be fully utilised. This of course is a counsel of perfection. There will always be 'frictional' short-term unemployment as people move between jobs, and the restructuring process itself can create interim unemployment until new employment opportunities are opened up. The important objective is that there should not be persistent long-term unemployment of a kind which seriously weakens the self-regard and lifetime prosperity of those affected.

'Fair' Income Distribution

Attainment of full employment would itself go far to assure that most households have a reasonable income. But most societies regard the 'market outcome' as too inequitable and require further redistribution of income by means of taxes, benefits and the public provision of 'goods' such as education and health. (See *The April Report*, Royal Commission on Social Policy 1988, and *For Richer or Poorer*, Income Distribution Group 1988.)

Income redistribution may be achieved at a cost in economic efficiency. A value judgement, obtained in some way for society, as a whole, is required as to what is a 'fair' distribution of disposable income, and by what means it should be reached.

Adequate Resources for Disadvantaged Groups

Some groups in society do not have equal access to opportunities because they have fewer resources than others. Maori people, for example, have been disadvantaged in this way. This resource constraint on opportunities for development can mean that the gap in economic wellbeing does not close, or else is seen as closing too slowly. An appropriate objective of economic policy is to assist in equalising opportunities between different groups in the population.

Opportunities for Participation

Perhaps the most important objective of a well-structured economy should be that all people have the opportunity to participate in society to the best of their ability. Fairness in economic distribution is one aspect of this, although not the only one. Participation in decision-making is another important component of wellbeing for many individuals, and is an aspect which should be encouraged, through devolution of governmental powers, and encouragement of community participation, for example.

CHAPTER ONE

Past Economic Developments

The radical shift in economic policy, particularly from 1984 onwards, arose from a perception that the economic policies which had served in the past were no longer effective. In consequence the living standards of New Zealanders were undergoing a gradual long-term deterioration relative to the rest of the world. The evidence for this perception is examined in this chapter.

Economic Ranking

Gross Domestic Product (GDP) measures the net output of an economy during a given period and, therefore, the total income to be shared amongst the population as a whole.¹

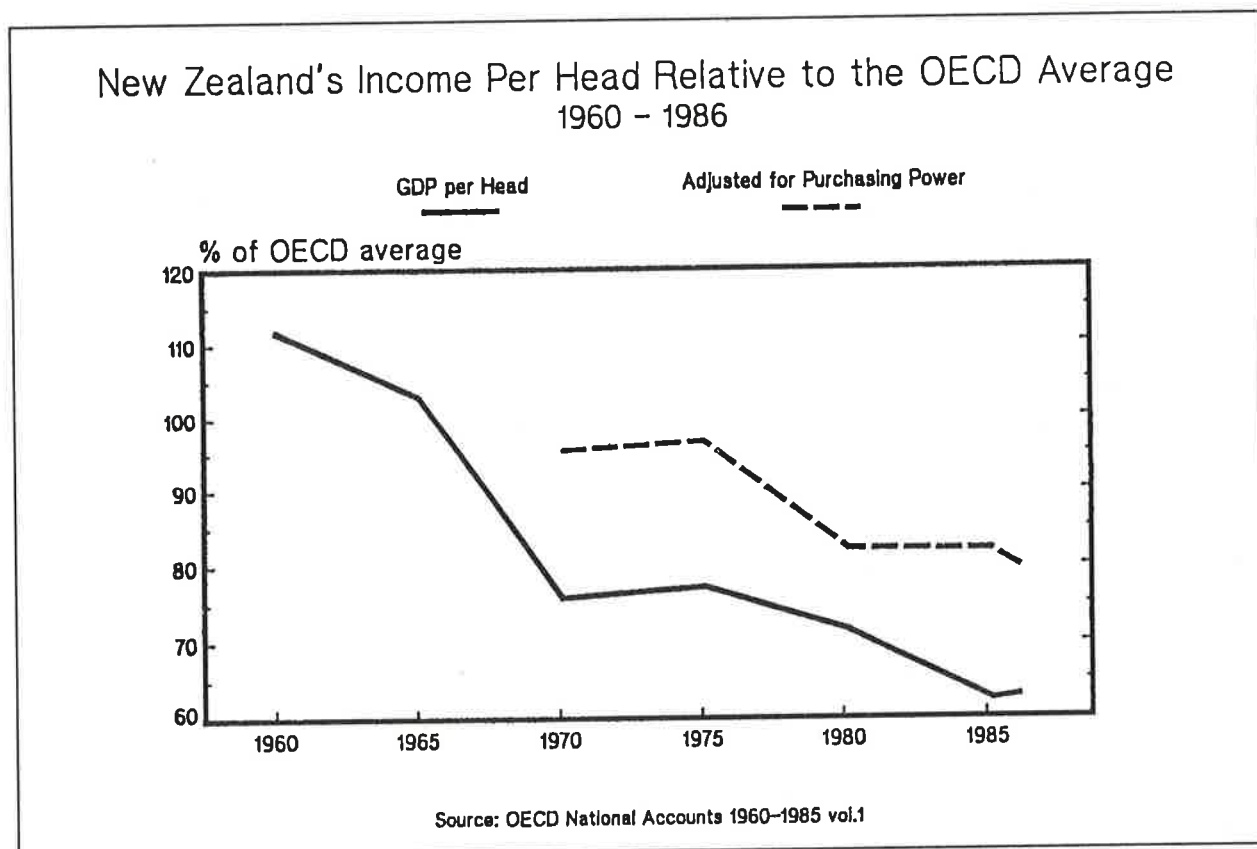
In the early 1950s New Zealand's GDP per head is generally thought to have ranked amongst the top three or four nations. Infogram 1.1 shows the deterioration in New Zealand's relative ranking from 1960 onwards. The bold line measures New Zealand's GDP per capita as a percent of the overall average for member countries of the OECD, at five-yearly intervals. In 1960 New Zealand's GDP per head was above the OECD average by about 10 percent, but by 1985 it had fallen to under 65 percent of the OECD average. The relative decline was particularly rapid in the late 1960s. A recovery in the 'commodity boom' years of the early 1970s was followed by a further continuous decline relative to other rich countries over the decade from 1975 to 1985. The decline over the 25-year period is equivalent to the GDP per head of other OECD countries having grown 2 percent per year more rapidly than that of New Zealand.

Infogram 1.1 also compares New Zealand's GDP per head with the OECD average from 1970, on a Purchasing Power Parity basis.² On this measure, the gap between New Zealand and the OECD average is reduced. New Zealand's income per head is about 20 percent less in 1985, as against 35 percent less on the traditional measure. Of the 25 OECD member nations, however, New Zealand's ranking in 1985 on either measure was 19th, above only the Southern European countries (Spain, Greece, Portugal, Turkey, Yugoslavia) and Ireland.

¹ Some of the income accrues to overseas persons or companies. Adjusting for this, and also for income earned by New Zealanders from overseas sources, gives Gross National Product (GNP). In the case of New Zealand, GDP and GNP have usually shown very similar trends, with GNP about 98 percent of GDP, because of payments to overseas investors. As overseas debt increased in the early 1980s, however, the gap widened with GNP falling between 1982 and 1985 to about 95 percent of GDP. However this ratio has since stabilised and recovered somewhat. In general it is satisfactory to work with GDP as a measure of real income trends.

² These figures are obtained by the traditional approach of converting countries' GDP figures, expressed in domestic currencies, to a common United States dollar basis using current exchange rates. This would be satisfactory if all goods and services were traded freely across international boundaries. However, this is not the case for a large proportion of commodities and it is known that comparing income per head between countries on an 'exchange rate' basis gives distorted comparisons in terms of the real purchasing power of that income. In particular, differences in real purchasing power between countries tend to be exaggerated considerably. To overcome this, recent research has derived measures of GDP on a standard 'Purchasing Power Parity' basis.

Infogram 1.1



Growth and Productivity

Some indications as to the cause of New Zealand's poor relative economic performance are provided by an analysis of productivity trends. Infogram 1.2 summarises OECD calculations of productivity growth from the 1960s for New Zealand and selected other countries.

Infogram 1.2

PRODUCTIVITY GROWTH
business sector: average % change at annual rates

Total Factor Productivity	average % change at annual rates					
	average	New Zealand	US	Japan	Germany	Australia
1960s to 1973*	2.8	0.6	1.5	6.1	2.8	2.1
1973-79	0.7	-2.5	-0.1	1.8	1.8	0.6
1979-86	0.6	0.6	0.0	1.7	0.8	0.5

Source: OECD Economic Studies, No.10, Spring 1988
*Note: Starting year: New Zealand 1963, U.S. 1960, Japan 1967, Germany 1961, Australia 1961

Productivity growth, as measured in terms of Total Factor Productivity (TFP) was significantly worse in New Zealand. Indeed in the late 1970s productivity fell sharply. Only for the period from 1979 to 1986 has New Zealand's output and productivity growth matched that of the OECD as a whole, and this was at the cost of the growth of significant internal and external imbalances.

A crucial question, unanswered by these figures, is what is the cause of poor productivity performance. Slow-growing overseas markets are part of the answer, but this raises the question of why New Zealand producers have not adapted more rapidly as producers in other countries have, to changes in overseas demand and prices. It takes time to switch labour, capital and land resources to new lines of production, but this again is true for other economies. TFP measures growth of output relative to the growth of combined inputs of labour and capital -- alternative measures try to identify the separate productivity contributions of labour and capital, but are sometimes a doubtful guide. However, New Zealand's 'capital productivity' performance has been poor, and this undoubtedly reflects misdirected investment decisions and inefficient use of the capital stock.

Overall, the conclusion must be that productivity performance was poor principally because of lack of flexibility in adapting to changing world market conditions. This lack of flexibility was itself a result of economic structures which tended to hinder the response to these changing conditions rather than providing sufficient incentives to meeting them.

Internal and External Balance

The first really sizeable fiscal deficit occurred in 1975/76 as a consequence of policy responses to the world recession initiated by the 1973/74 oil price increases. Relative balance was restored, until the 1978/79 recession. From 1980 onwards there was a steady increase in the fiscal deficit which rose to its peak values in 1984 and 1985. There were corresponding movements in the public debt ratio, rising from under 10 percent of GDP in 1974/75 to 48.5 percent of GDP in 1985/86. The greatest part of this increase was over the three years from 1981/82 to 1984/85. (See Infograms 10.3 and 10.4 in Chapter Ten for the central government deficit and the public debt as a proportion of GDP from 1971/72 onwards.)

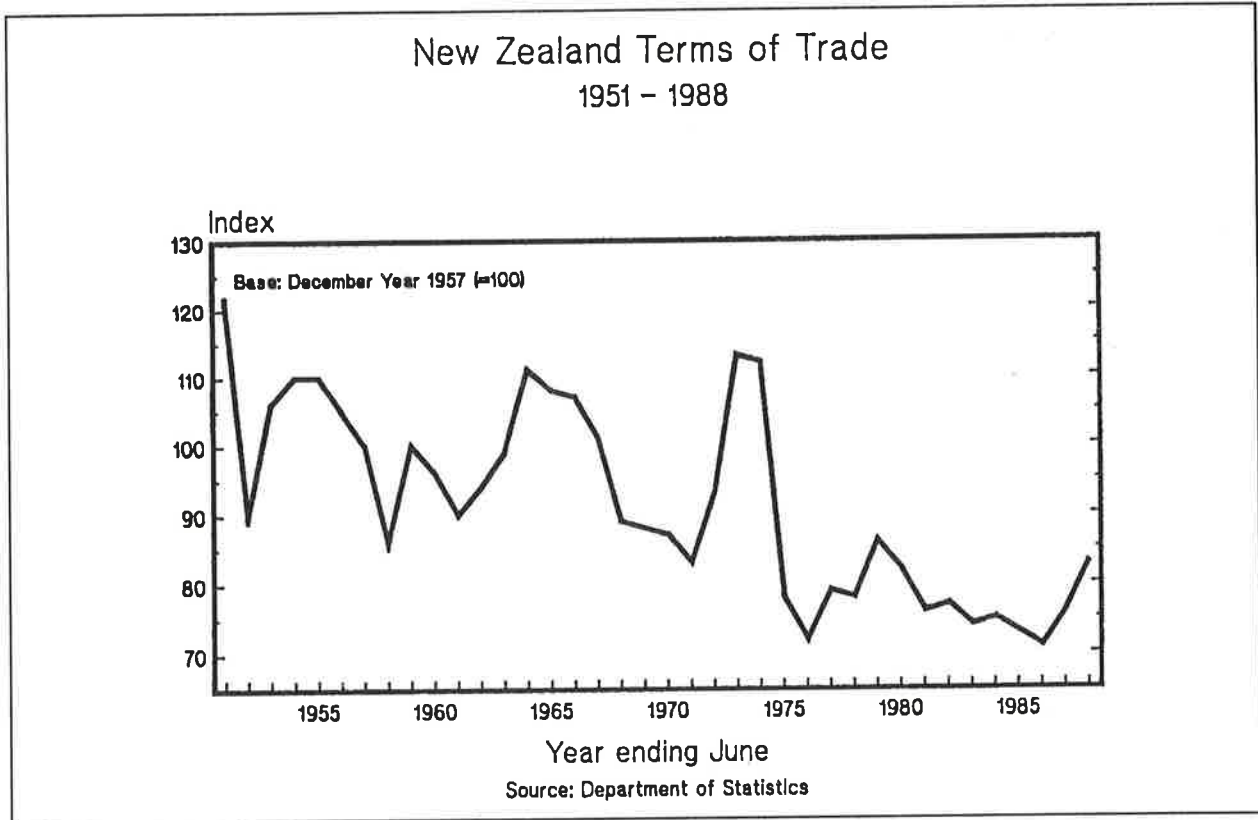
Infogram 1.3 shows the terms of trade index (ratio of export to import prices) from the early 1950s to the present. The index appears less volatile in recent years, perhaps because of the broader export-mix with traditional pastoral products less dominant. The 'break' to a much lower average level in 1974/75 as a result of the first round of oil price increases is apparent.

Trends in the current account and external trade balance are shown in Infogram 1.4. Up until 1973/74, New Zealand customarily ran a surplus on the trade balance, offset by a net deficit on 'invisibles' transactions, for an overall sustainable current account deficit rarely in excess of 4 percent of GDP.

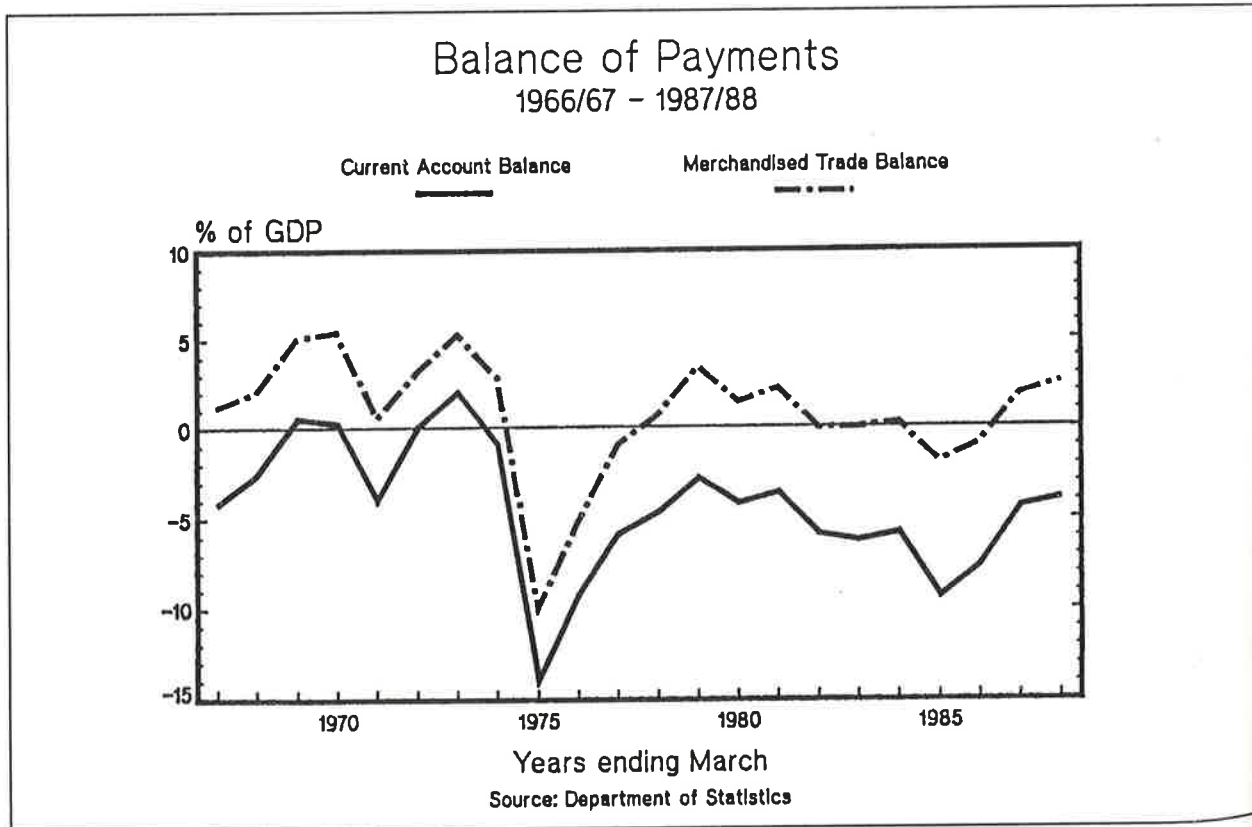
The first round of oil price increases and the consequent effect on the world economy led to a very large current account deficit in 1974/75. This was gradually reduced up until 1980, with the trade account moving again into surplus. However, there was a renewed deterioration through the early 1980s until 1984/85.

Infogram 1.5 shows the consequence in terms of overseas debt. The ratio of net debt increased from about zero as a proportion of GDP in 1973/74 to almost 70 percent by 1984/85. The periods of particularly rapid increase were 1973/74 to 1975/76, and from 1980/81 to 1984/85. (See D. Webber, *Overseas Debt - An Assessment*, New Zealand Planning Council 1988.)

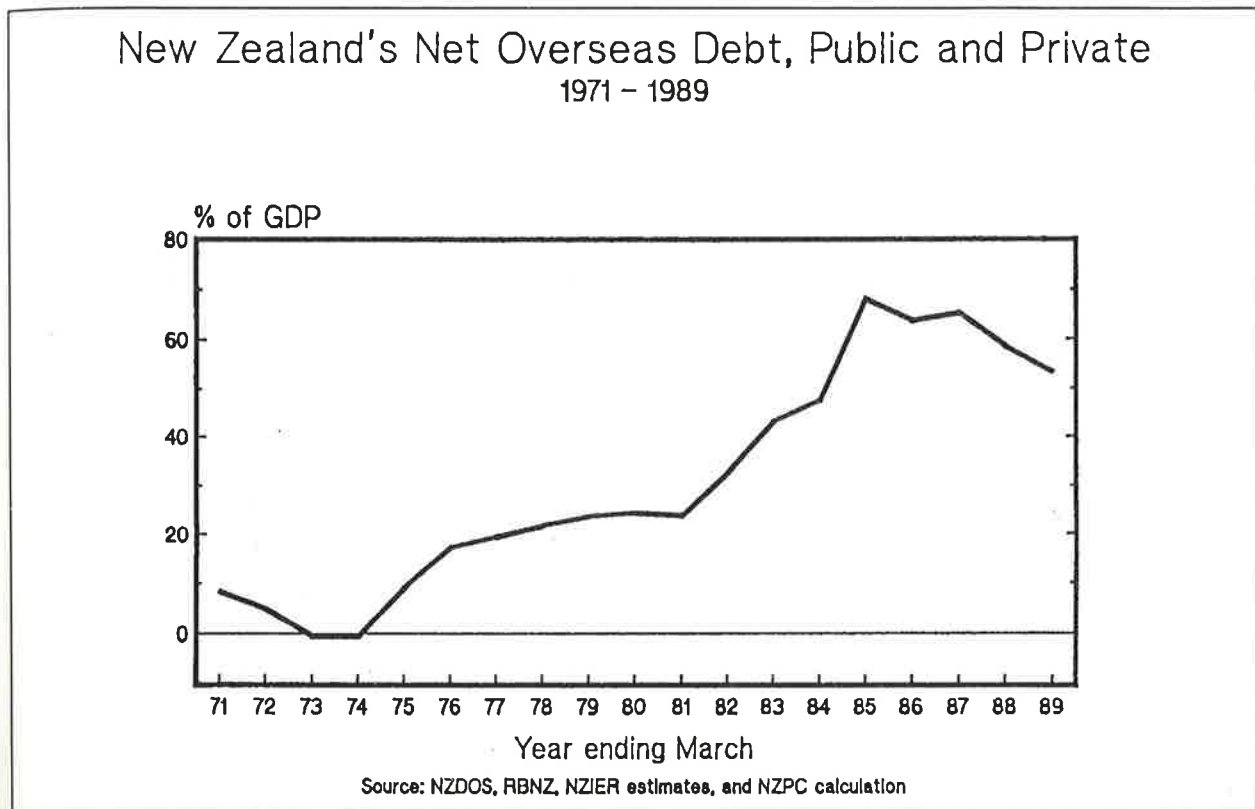
Infogram 1.3



Infogram 1.4



Infogram 1.5



Unemployment and Inflation

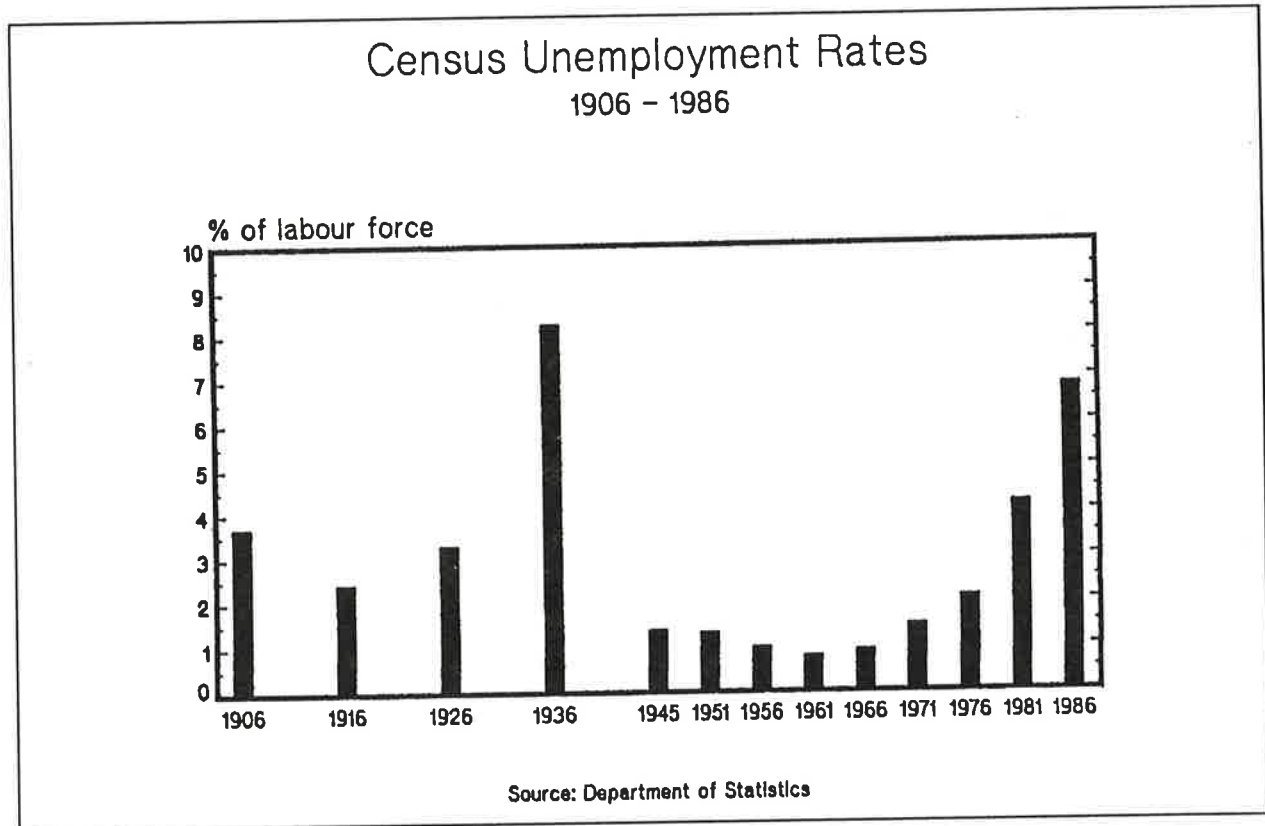
The rate of unemployment and the rate of inflation are two standard measures of economic performance.

Infogram 1.6 shows the unemployment rate from 1906 to 1986, as measured at the five-yearly censuses of population. It should be noted that 1936 was not the peak year for unemployment during the 1930s depression. The unemployment rate as defined in the census has increased steadily, from less than 1 percent at the 1961 Census, and then more rapidly from 1976, to reach almost 7 percent of the labour force at the time of the 1986 Census.

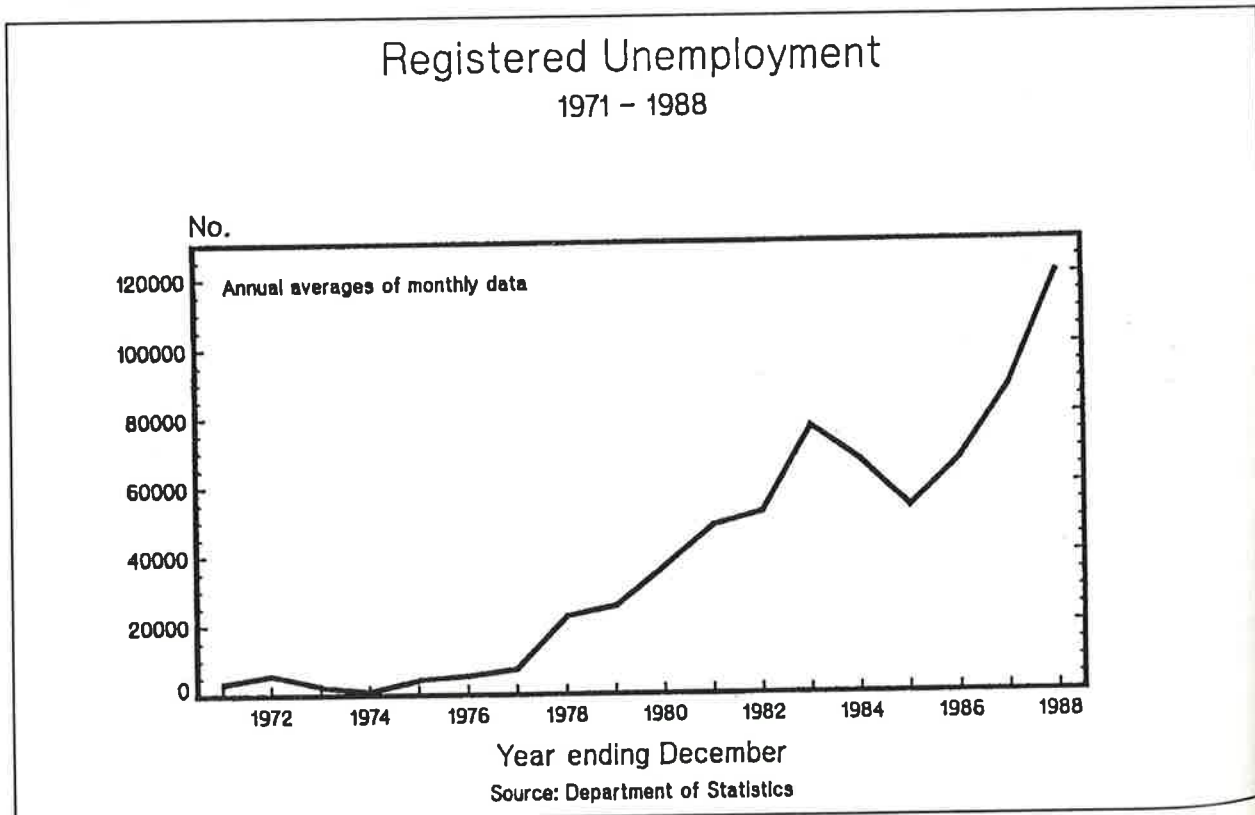
Infogram 1.7 tracks the numbers of registered unemployed from 1971. Up to the mid 1970s registered unemployment significantly understated actual unemployment. Unemployment figures did fall between 1983 and 1985 to an average of approximately 55,000. For the period as a whole, however, there was a strong upward trend in the number of unemployed to a level in the mid 1980s which was high by comparison with that of the post-war period.

Infogram 1.8 charts inflation as measured by annual increases in the Consumer Price Index. From what, at least in retrospect, were tolerable inflation rates in the 1950s until the late 1960s, there was a steady increase in inflation. This peaked at a rate in excess of 15 percent in the late 1970s. From then on inflation has fluctuated above the 10 percent level until it was brought down sharply by the wage-price freeze in June 1982, to below 5 percent in 1983/84.

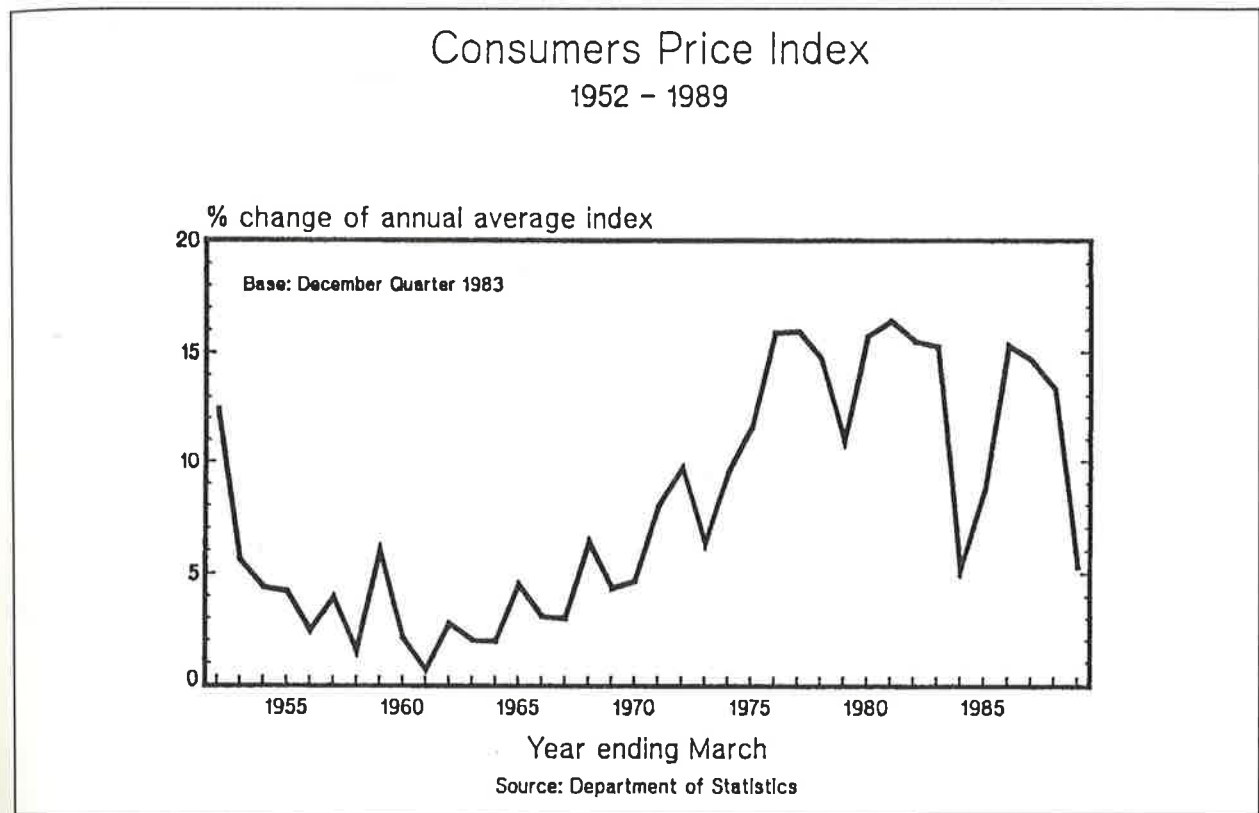
Infogram 1.6



Infogram 1.7



Infogram 1.8



Conclusion

The overall picture of New Zealand's economic performance since the 1950s is one of long-term deterioration. It was perhaps from the late 1960s that the poor growth performance became generally apparent, and in 1967 unemployment at greater than 'frictional' levels first appeared.

Despite relative deterioration in real terms, the internal and external balance (fiscal and current account deficits) was maintained until the mid 1970s when the consequences of the first oil price 'shock' were felt. The policy objectives of reducing the internal and external deficits through the late 1970s resulted in a deterioration in the achievement of growth and employment objectives.

From about 1980 onwards, there was less concern with controlling the fiscal deficit and GDP growth resumed, resulting in an eventual reduction in unemployment. (The reduction in real wages during the 1982/84 freeze may have been equally or more significant.) By 1984/85 the consequent increases in public debt, and also in net overseas debt from the deteriorating current account deficit, had reached worryingly high levels. It was evident that a macroeconomic policy orientation based on stimulating growth through a large fiscal deficit, could not be sustained much longer. At the same time unemployment, although somewhat reduced from the 1983 peak, was still much higher than experienced in the 1950s and 1960s.

It is easy to form the impression that some of the current economic difficulties, such as the increase in unemployment, are a result of the switch in macroeconomic policies from 1984 onwards and the 'regulatory reform' measures, such as reducing border protection, from the late 1970s onwards (also applied with increased determination from 1984). This chapter has shown that not to be the case. A proportion of current unemployment has been caused by 'restructuring', but far from all.

In general the economic difficulties which concern New Zealanders now are not a recent phenomenon: they are largely the result of a steady deterioration in economic performance going back to the 1950s. That steady deterioration led the Economic Monitoring Group in its last general overview in 1984 to call for a major change in the direction and style of economic management. What this overview seeks to assess is whether the changes that have occurred are leading to improved economic performance and to a reversal of that steady long-term deterioration.

CHAPTER TWO

Policy Responses to Deteriorating Economic Performance

Policy Changes in an International Context

By 1984, there was widespread recognition that existing policies needed improvement. The economy was not producing the higher standard of living available in other countries. In December 1983 the Economic Monitoring Group observed:

The issues the Monitoring Group is addressing are sometimes summed up by saying there is a persisting gap between payments and earnings of foreign exchange. The gap is the result of the ways we organise and manage our economy. Simple solutions to close the gap, such as raising the price of foreign exchange (i.e. devaluation), are unlikely to be fully effective as long as we continue to organise and manage our economy the way we do. The traditional solutions of subsidising exports and protecting local manufacturing have been shown to be equally inadequate. Attempts to increase the earnings of foreign exchange by expanding production for export, lead through higher incomes to increased expenditure on imports, and hence to failure to close the gap. Similarly, attempts to expand production from import replacing industries also lead through higher incomes to increased expenditures on imports and hence - surprisingly as it may seem to many people - to failure to close the gap. Raising the price of foreign exchange will probably ultimately be necessary in a permanent solution to close the gap, but this only makes sense if our economic organisation and management themselves work towards closing, rather than maintaining the gap. (*Foreign Exchange Constraints, Export Growth and Overseas Debt* p.2.)

New Zealand could not easily survive as an isolated community, and the impact of the oil crises on the international economy posed problems. Not all of the difficulties which New Zealand experienced were the result of mistakes by New Zealanders, government or otherwise. But it was foolish to think that our problems would all be solved by changes overseas. While world events like successive oil crises had indeed been adverse to our interests, the appropriate response was to reorganise our own economic activity so as to make the best possible use of our resources. New Zealand had to align its production with trends in the world economy, not look backward to earlier years when decisions had been easier for us. Achievements in this direction such as the Closer Economic Relations (CER) agreement with Australia, and regulatory reforms such as liberalisation of restrictions on transport facilities or investment in new meat-processing plants, had not been sufficient. Attempts to meet New Zealand's problems through means such as direct controls on interest rates had not worked.

The notion that higher living standards should be sought through an emphasis on efficient allocation of resources was shared with many other countries. So was the experience that policy instruments such as budget deficits no longer had such simple effects as had once been the case. Responses to policy interventions were much more important than they had seemed in the 1960s and early 1970s, and they could nullify policy interventions rather than produce the desired result. Policy-makers therefore gave less emphasis to designing specific interventions and more to the interaction of government and private decision-making. They attempted to make use of the incentive facing private decision-makers to achieve as

much output as possible from the inputs available to them. In this way, average living standards could be increased. At the same time, policy-makers had to be concerned about conflicts between public and private interests, so words like 'framework' and the 'general environment for private activity' became much more prominent. Private decision-makers should be encouraged to use resources well, but induced to avoid inconsistency with public policy objectives. Deregulation, reduction of tax rates (but not of tax revenues), privatisation of public enterprises, and industrial restructuring away from inefficient industries were characteristic of countries as varied as Australia, Japan, the United Kingdom and the United States, and indeed of the OECD as a whole.

In some countries, such as the United Kingdom and the United States, this policy thrust was accompanied by a conservative political trend which favoured measures to revive traditional values and wished to promote individual reliance over collective activity. The link was not universal; it was not present in Australia, a number of European countries or in Japan. In Japan the economic policies just described are part of a broader movement towards raising the emphasis on quality of life, and of promoting the consumer society against a traditional emphasis on savings and family-based security, almost the reverse of the social context in Britain and the United States. In New Zealand, some people have a political desire to reduce public activity relative to private. Commentators have asked whether an increased reliance on decentralised decision-making will necessarily be accompanied by a decline of 'compassion' relative to self-interest. These are issues to be debated, not necessary concomitants of the economic policies which have been followed. Simply characterising those policies as Rogernomics, and assuming that they have all the same connotations as Reaganomics and Thatcherism, is based on far too narrow a range of international comparisons.

Micro and Macro Economic Policy Objectives

It is convenient to distinguish between policies aimed at influencing economic outcomes at the microeconomic level and those more directly influencing macroeconomic outcomes.

Microeconomic policy is to do with influencing the decision-making behaviour of individual households and businesses. Microeconomic outcomes, through lack of detailed data, are usually observed at a more aggregated industry or market level.

Macroeconomic analysis and policy deals with whole economy aggregates such as economic growth, employment and unemployment, inflation, the fiscal balance and the external balance.

In an obvious sense microeconomic and macroeconomic policies and outcomes are linked. The sum of all the decisions continually being made at the microeconomic level determines the macroeconomic outcomes. It follows that an important part of an economic policy aimed at generating better performance at the macroeconomic level should be policies which encourage appropriate decision-taking and the efficient use of resources at the microeconomic level.

A major objective of microeconomic policy is to improve economic efficiency. As microeconomic policies help to determine macroeconomic outcomes so too do macroeconomic policies shape decisions at the microeconomic level, and determine their quality. Some of the most vexed controversies in recent economic debate have been about the mechanisms by which macroeconomic policy influences the decisions taken by individual economic agents, and whether it is possible for governments to exploit these links to reach an overall outcome better than would otherwise have occurred.

It is generally agreed, however, that macroeconomic policy has a part to play in reducing uncertainty for decision-making at the microeconomic level. This can be achieved by consistency in policy objectives, and stability in macroeconomic outcomes.

An important objective of macroeconomic policy should be to provide consistency in policies and stability in the economic environment. (Whether macroeconomic policy should have objectives additional to these is discussed further on.)

In brief, it is convenient to discuss the policies associated with the objective of economic restructuring under two headings:

- microeconomic policies -- aimed at improving economic *efficiency*
- macroeconomic policies -- aimed at providing a *stable* environment conducive to better micro-economic decision-making.

Microeconomic Policy and the Efficiency Objective

The question is, what kind of microeconomic policies best achieve the objective of maximising overall economic efficiency?

It can be shown that where there are artificial barriers to the free exercise of consumer choice, or which prevent competition, then the removal of these will normally improve economic efficiency. Hence the microeconomic policy reforms have focused on removing such barriers and increasing competitive pressures. This is intended to lead to gains in economic efficiency, similar to those predicted by theory, from removing barriers to the operation of perfectly competitive markets in various markets.¹ These gains comprise:

- lower selling prices to the consumer or purchaser in general -- or in some cases lower cost to the taxpayers, where the 'barrier' being removed is a government subsidy
- more efficient use of inputs, including factor inputs such as labour and capital.

Efficiency

The concept of efficiency used here is that of 'allocative efficiency'. This means the allocation of the stock of available resources, both physical (including natural resources) and human, so as to maximise the output which can be produced from those resources. Output in this context has a wider meaning than it is usually given. It includes leisure, and also the wellbeing gained from unpaid work, as well as the wellbeing gained through consumption of goods and services paid for from employment income. It includes also the value associated with the conservation of the environment and natural resources along with the value of goods produced from such resources.

This concept of efficiency is different from some more commonly used meanings of efficiency, for instance, 'managerial efficiency' or 'cost-minimising efficiency' -- the most effective use of resources within a firm to achieve a given output or profit objective. Even without competitive pressures the objective of profit-maximisation should in theory lead to maximisation of within-firm efficiency. In practice, however, some 'resting on the oars' can be expected where competitive pressures are not strong. The resulting inefficiency in resource use is sometimes known as 'x-inefficiency'. If competitive pressures are increased, a reduction in x-inefficiency can be expected, in addition to any gains in allocative efficiency.

A more general concept than allocative efficiency is that of the effectiveness with which wider social goals are achieved. An example could be the achieving of what is regarded as a fair distribution of resources. Some ways of improving allocative efficiency can work against fair distribution. The underlying belief of this report is that there is no incompatibility between achieving a more efficient economy, leading to increased economic welfare in aggregate, and achieving other social goals such as a fair (however defined) distribution

¹ In some circumstances, making some markets more competitive, or contestable, while competitive pressures are constrained in other markets, can be shown to lead to a reduction in overall efficiency. The usual assumption is that such cases are not of great practical significance, and should if possible be tackled by removing competitive constraints more generally.

of income and wealth. In other words, most ways of improving efficiency can also be used to improve the fairness of distribution.

The Case for Some Market Interventions

The presumption underlying restructuring policies aimed at reducing artificial interventions in the market and at increasing competition is that these policies will lead ultimately to increased efficiency and output. This presumption is well founded in economic theory.

There are, however, a number of qualifications to this argument. Not all 'interventions' in the working of the market economy can or should be abolished. In some areas the market does not function, and in others only imperfectly. Interventions which might be justified can be categorised broadly under the headings which follow.

Interventions to improve the operation of market forces

Markets can fall short of the competitive ideal in a number of ways which lead to reduced economic efficiency. A general role for government is that of providing contract-enforcement institutions, and so increasing market certainty. Relevant information may be withheld from some market participants, justifying regulations compelling the disclosure of information. Market 'externalities' such as environmental degradation may occur because the polluter is not required to pay for such costs. To some extent these can be internalised by assigning property rights but often regulation in some form, for example, that embodied in the Town and Country Planning legislation, is required. There can be barriers to competition as a result of excess concentration of market power, and/or collusion between major producers. Hence the case for regulations preventing exploitation or undue concentration of market power, for example, those operated by the Commerce Commission. A recent development in economics has been the theory of contestability where the threat of entry into a market by a potential competitor (including imports from overseas) can be sufficient to prevent the exploitation of monopolistic market power. To be effective this requires that entry and exit by a potential competitor be costless or relatively low-cost. This condition does not always apply. (The concept of contestability is discussed in more detail in Appendix One.)

Interventions to encourage supply of goods not adequately supplied by the market

Some commodities, so-called public goods, cannot easily be supplied through market competition, and are provided by government. Classic examples are defence, and law and order. Financing the provision of these justifies the 'intervention' of taxation. In addition there are merit goods -- those which society decides should be provided in greater quantity than would be demanded by consumers as individuals, and which again require a degree of public financing. Possible examples include education, housing, and health services, and income redistribution and the provision of 'social insurance'. Conversely, intervention may be used to deter the production of 'demerit goods', for example, the employment of minors, drug use, etc. Such interventions require moral and ethical judgements about desired social outcomes. It is wrong to think that such judgements do not have a place in social and economic policy. In implementing them, however, it is important to realise that there is a possible cost in the less efficient use of economic resources, such as through the distorting effects of taxation, and that some attempt should be made to weigh this cost against the social benefits, and also to implement policies in ways which do make the most effective use of resources.

Interventions to encourage institutional arrangements to increase economic efficiency

Another issue is that of deciding which institutional arrangements provide the best incentives for individuals, whether in private enterprise or the public sector, to improve the efficiency of their organisation. The role for intervention here is to encourage the supplanting of less effective institutional arrangements with ones more effective. Recent examples include the move to employment contracts linked to performance in much of the public sector and, more generally, the legislative changes affecting the labour market.

Summary

The assumption behind the 'more-market' direction of recent microeconomic policy is that the New Zealand economy has in the past been subject to over regulation. There seems to be general agreement with that assumption. This does not mean, however, that there is no place for government intervention in the economy. We are discussing the outcome from moving towards a less regulated, not a non-regulated, economy.

Even so, the case for retaining government interventions always needs careful consideration. As has been stressed in recent theoretical debate, the existence of 'market failure' often reflects the presence of high transactions costs, which prevent the attainment of the perfectly competitive ideal. In this sense the outcome provided by the market falls short of that theoretically delivered by the perfect competition model. But government intervention also has transactions costs associated with it. It needs to be established in each case of intervention that the expected benefits outweigh the costs of intervention (admittedly acknowledging that the quantifying of benefits and costs can be very difficult).

Microeconomic Policy Changes

Appended to this report is a chronological listing of the significant microeconomic policy changes which have taken place, roughly from the early 1960s onwards. The broad categories used in the listing are as follows:

- trade liberalisation -- includes reductions in border protection and reduced barriers to trans-Tasman trade
- reductions in assistance to industry -- removal of export subsidies and of subsidies in general, including SMP subsidies on pastoral agriculture output
- regulatory reform -- for example, removal of barriers to entry to the transport and financial services industry, removal of price controls, relaxation of constraints on shopping hours, deregulation for specific commodities such as milk and eggs, removal of barriers to occupational entry, and changes to the Commerce Act
- changes in the taxation system, and in the composition of government expenditure -- broadening of the tax base, removal of tax exemptions etc, separation of social and commercial expenditure objectives
- labour-market reform -- the Labour Relations Act 1987, and the State Sector Act 1988
- agency reform -- corporatisation of state-owned enterprises, and changes affecting producer boards.

Most of the listed policy changes fall into one of two time-periods, from 1976 to about 1982 and from August 1984 onwards.

1976 to about 1982

A number of regulations controlling the financial markets were removed -- road and rail transport was deregulated, and the first tentative steps were taken to reduce border protection, initially by putting up a proportion of import licenses, increasing over time, for competitive tender. Preliminary negotiations also began on the creation of a trans-Tasman free-trade area.

From 1982 to 1984 some of these changes continued, for example, the signing of the Australia-New Zealand CER treaty, and continuing gradual reduction in border protection. In other areas there was a reversion to

earlier policies. A 'freeze' on prices and wages, including non-wage incomes, was introduced in 1982. Ceilings were imposed on interest rates, and other stringent controls were imposed on the financial sector. Export subsidies were maintained, despite pressure from overseas trading partners for their abolition. Subsidies to pastoral farming, such as SMPs, now became a very significant budgetary expenditure item as world markets for pastoral produce weakened.

Also during this period the construction of a number of major industrial projects to utilise natural gas or iron-ore resources were pushed ahead. These large-scale plants almost all had major government share holdings, and/or government backing, guarantees of markets and an adequate return.

August 1984 onwards

The controls imposed in the previous two or three years were abolished, and the earlier steps towards a less regulated economy were resumed and much accelerated. Initially the stress was placed on deregulation of the financial and foreign exchange markets, and on the removal of subsidies and a continuing reduction in border protection. The impact of these moves was initially felt most by the tradeable-goods industries, and in particular the primary sector export industries. More recently, from 1987 onwards, the emphasis of microeconomic policy reform has tended to move to labour-market issues, and to making the operation of government more efficient.

Macroeconomic Policy and the Stability Objective

In the section on Micro and Macro Economic Policy Objectives (p.16) it is stated that an important objective of macroeconomic policy is a consistency of stance so as to promote stability in the economic environment. This is spelled out a little further in Infogram 2.1.

As a provider of services the government must influence the economy, even if those services are limited to income transfers rather than extending to provision of services directly. Government uses resources to provide services and it obtains those resources mostly by taxation. In recent years there has been renewed emphasis on the efficiency with which the government uses resources, and on designing tax systems which interfere as little as possible with the efficient use of resources by the private sector. Those aspects of government policy relate closely to the microeconomic policy changes directed towards economic efficiency in general.

There are, however, further aspects to government's activities which relate to broad economic aggregates and so are treated as macroeconomic issues. When government expenditure has been scrutinised as to whether it is an effective use of resources, and when the design of tax policies is settled, the government must consider the balance of revenue and expenditure. Is it contributing to total savings, or using savings, in a manner which is optimal? In recent years, the government's problem has always been whether it can tolerate the deficit which is likely to emerge from its expenditure and revenue plans. Because the level of debt reached by 1984 was larger than was acceptable, the government has had to reconsider expenditure and revenue plans so as to provide projected totals compatible with management of the public debt. (See *Foreign Exchange Constraints, Export Growth and Overseas Debt* 1983.) There has therefore been a repetitive process between designing expenditure and revenue in accordance with the general microeconomic desire for efficiency, and reaching a projected balance compatible with giving an assurance that the debt issue is under control. We explore this further in Chapter Ten.

Unlike private citizens and corporations, governments can finance expenditure in excess of revenue by requiring central-bank credit creation. However, to do so adds to inflationary pressures, and inflation is not consistent with the desire to have decision-makers respond to relative price changes. The government has therefore chosen to fund its shortfall of revenue by borrowing from the New Zealand public. Monetary policy has been directed towards the reduction of inflation.

The consequence of this has been high interest rates. In one sense, monetary policy has been responsible for high interest rates. In another sense, the high interest rates flow from the government's judgement that the community requires expenditure in excess of government's revenue. The cost of past borrowing, along with the demand for public services, means that there is a demand for income now rather than in the future, and high interest rates are therefore needed to induce people to save sufficiently to bring demand and output into balance. The insistence that this dilemma not be evaded by allowing the money base to expand reflects the decision that the policy stance should be credible, so that private decisions are not based on an expectation that future policy changes will validate poor decisions made now. Monetary policy is discussed further in Chapter Eight.

Infogram 2.1

THE COMPONENTS OF ECONOMIC RESTRUCTURING POLICIES AND THEIR OBJECTIVES

MICROECONOMIC

Broad objective	Improving the efficiency and responsiveness of decision-making by individual firms and households
Means of achieving objective	Removing barriers which prevent signals of market conditions reaching firms and households
Initial goals	Shifting of capital and labour resources into those activities seen as more profitable

MACROECONOMIC

Broad objective	Providing stability i.e. an environment conducive to good decision-making at the microeconomic level
Means of achieving objective	<p>Consistency of policy</p> <p>Stability of outcomes</p> <ul style="list-style-type: none"> - price stability - fiscal balance - external balance <p>Restoring policy sustainability and credibility</p> <ul style="list-style-type: none"> - halting the real growth of public and external debt <p>Active demand management (this is more controversial)</p> <ul style="list-style-type: none"> - moderating short-term aggregate fluctuations in demand

ULTIMATE GOALS — MICRO AND MACRO

An improved growth performance, leading to an across-the-board growth in real incomes

Full employment

The New Zealand economy is necessarily linked to other economies throughout the world. By allowing exchange rates between the New Zealand dollar and other currencies to find their own levels, the government relieved the central bank of the need to buy and sell New Zealand dollars at predetermined rates. This gave government the control of the money base needed for a monetary policy aimed at countering inflation. But high interest rates also made New Zealand attractive to overseas lenders. That assisted with the supply of resources needed for a level of public expenditure in excess of tax revenues, but it also caused a rise in the relative value of the New Zealand dollar with consequential problems for exporters and gains for consumers of imports. In order to provide assurance that exchange rates were being determined by the relationship between the rest of the world and the New Zealand economy, the government declined to intervene in the exchange market. It wanted decision-makers to be guided by international trends and New Zealand's reaction to them, not by guesses about the actions of the monetary authorities. Exchange rate policy and its outcomes are discussed further in Chapter Nine.

As the principal objective of macroeconomic policy, stability is to be seen in the context of the traditional linkages between fiscal policy, monetary policy and exchange rate policy. The stability objective can be broken down into sub-objectives under the headings below.

Consistency of Policy

This is required so that households and businesses can reasonably predict the general monetary and fiscal stance of government, including the tax regime applying to their activities, and the exchange rate regime which will apply. With greater certainty about future policies, households and businesses are able to make better forecasts of the economic outcomes and the effects on their own activities. Uncertainty can never be completely removed of course, particularly in the face of major external 'shocks' -- such as a sizeable shift in the external terms of trade -- although a consistent policy setting does reduce the uncertainty.

Stability of Outcomes

Policy consistency in itself is insufficient unless it leads, or is expected to lead, to stability in economic outcomes. The outcomes of relevance to decision-makers at the micro level are:

- price stability, so that signals of market changes are not distorted by the 'noise' of inflation
- fiscal balance
- external balance.

The indicators of fiscal and external balance are levels of public debt and external debt (both public and private) respectively, which can be seen to be 'under control'. In other words they do not show a tendency to increase steadily in a manner which calls into question the long-term credibility of existing policies.

The three factors -- price stability, fiscal balance and external balance -- are discussed in more detail in Chapter Twelve and are distinguished from the ultimate policy objectives of an economy with an improved growth performance leading to full employment. Achievement of such intermediate objectives -- providing a more stable and sustainable economic environment -- is expected to facilitate the achievement of ultimate policy objectives. Given a more stable economic environment, important real aggregates such as output and employment, and prices such as the interest rate and the exchange rate should also follow a more stable path.

Restoring Policy Sustainability and Credibility

In the early 1980s the existing economic policies were manifestly unsustainable. Internal and external debt levels rose inexorably and inflationary pressures, although suppressed by controls for a time, were high. In such a situation the introduction of policies to restore stability and credibility is itself a major shock to the economic system, and will lead to deviations from the long-term stable growth path until 'balance' and policy credibility are restored. This is of course very much the history of the last few years, with significant initial instability or departures from expected long-term levels, in variables such as the interest rate and the exchange rate.

Active Demand Management

In the post-war era an important role seen for macroeconomic policy was that of active management of aggregate demand. Governments were expected to 'manage' the economy, intervening through monetary and fiscal means to influence the level of aggregate demand, and thereby the level of the 'real' variables of output and employment. In a time of recession, government would seek to boost demand, for example, by increasing expenditure or reducing taxes. When inflationary pressures increased, the prescription was for a tightening in monetary and fiscal policies.

Whether this is still a desirable role for macroeconomic policy has become perhaps the most controversial issue in economic policy-making in recent decades. From the 1960s onwards such policies appeared to become less and less effective. Some reasons for this are listed below.

- The tendency for governments to boost demand in recession, but to fail to restrain demand in booms.
- The difficulty in timing interventions because of lags in information, implementation and response, so that they produced the desired effect when required. (This became a major criticism of so-called 'fine-tuning' measures.)
- The arguments of some economists that government actions could have very little influence on the 'real' path of economic activity, except for the worse.
- The influence of expectations. As businesses, unions and households gained in knowledge of the likely economic consequences of government policies, and took these into account in their own decisions, the consequence was to change actual outcomes away from those formerly expected. Also it was observed that government policies designed to influence outcomes in a given direction were frequently later reversed under political pressures so that policy announcements came often to lack credibility. For example, government commitments to disinflationary policies, when repeatedly abandoned after a short period, led to a disbelief in the government's ability to persist in any such policy, and resulted in maintenance of high inflationary expectations. These expectations tended to become self-fulfilling.

These developments explain recent tendencies in New Zealand and elsewhere, to 'lock-in', by legislative or constitutional measures, government commitments to long-term objectives such as price stability and ceilings on fiscal deficits.

Theoretical macroeconomic models now often try to take account of expectations amongst other variables, but in consequence have become much more complex and difficult to apply in policy formulation. This does not mean that active demand management should be totally abandoned but it does explain why it has become much less important than formerly. It also explains why the tendency in most countries has been to put more emphasis on simple policy rules aimed at long-term stability, in preference to attempts at short-term stabilisation.

Changes in Macroeconomic Policy

The change between pre-1984 and post-1984 macroeconomic policies is more clear-cut than for the microeconomic policies of regulatory reform. The main elements of the new policies were initiated in 1984 and 1985. The changes to macroeconomic policy are detailed under the headings below.

Fiscal policy

Steps were taken to reduce the government's fiscal deficit beginning with the 1984/85 Budget. Progress towards this aim has been more or less continuous since then (see Chapter Ten). Much of the initial reduction was achieved by eliminating subsidies, but government expenditures have continued to increase, and the main factor in reducing the deficit has been an increase in tax revenues achieved by broadening the tax-base.

Monetary policy

In 1984 the significant decision was taken to 'fully fund' the government's deficit by borrowing at market rates. (The tender system for sale of government bonds had been introduced earlier, but was subject to a politically-imposed ceiling on yields.)

In addition the former 'reserve ratios' and 'credit growth limits' on financial institutions were abolished. Instead the policy approach from early 1985 became the maintenance on average of a constant volume of primary liquidity, together with firm limits on the daily cash balances of the banking system.

Foreign exchange and external debt policy

The New Zealand dollar was devalued 20 percent in July 1984. Following the removal of various controls on foreign exchange transactions later that year, the dollar was allowed to float freely from the beginning of March 1985, its value being determined by market supply and demand. The float has been a 'clean float' since that date -- that is with no direct intervention by the Reserve Bank in the foreign exchange market.

From March 1985 the government also adopted a policy of not allowing any increase in net official overseas debt. Continued overseas borrowing was for the purpose only of 'rolling over' existing debt. (An apparent exception to this policy was the assumption by government in 1986 of 'major project' debt. In fact, through various guarantees, the government was already implicitly liable for this debt.)

Outcomes

The outcome of these firm or 'disinflationary', fiscal and monetary policies, was that interest rates rose (although there was an offsetting influence from the fiscal deficit reduction). The resulting capital inflows led to a strengthening of the New Zealand dollar from 1985 to 1988. These outcomes have had important microeconomic consequences.

The Transition Path and its Costs

The economic restructuring policies summarised above have been in operation as a whole now for almost five years, and some individual policies for longer. Yet the New Zealand economy is still demonstrably far from achieving the ultimate economic objectives of restructuring -- a better growth performance and full employment. (Actual performance thus far is examined in detail in later chapters.) This raises two questions:

- What impediments are there which are likely to slow the transition to a better growth path?
- Have there been inconsistencies in the policies followed so far which have made restructuring more costly, in terms of lost employment and output, than it might otherwise have been?

Impediments to the Restructuring Process

A first point to note is that a number of restructuring policies have been only partly implemented, such as the reduction of border protection, and increasing labour-market flexibility (see Chapter Twelve). Perhaps more directly relevant, however, are the following factors.

Lack of mobility of resources

Capital and labour resources in a declining industry often have characteristics *specific* to the needs of that industry which are not readily transferable to other, expanding industries. Capital assets may have to be written off, and workers become unemployed, and/or require retraining.

'Sticky' markets

Both markets for goods and the market for labour can be sticky, in that the response to changes in demand takes the form not of changes in prices (or wages) but of changes in output (or in employment). In other words such markets can be described as *quantity-responsive* rather than *price-responsive* to changing demand. Thus when demand falls for the output of a given industry the result is a reduction in capacity utilisation and reduced employment in the industry.

There are a number of reasons why such markets should not 'clear', through adjusting prices to changes in demand. In particular it can be shown that for goods markets the existence of uncertainty about the future, combined with transactions costs involved in price-changing, can quite rationally lead to prices being sticky. Research in recent years has led to a better understanding of the complexities of the labour market, and has produced models in which rational behaviour by workers and employers leads to sticky wages, even at the cost of increased unemployment.

This does not mean that there are not further gains to be made from making both goods markets and the labour market more competitive, and approximating better to the 'market-clearing' model. It does mean that there are probably limits to the gains which can be expected, and that during a period of structural change some losses in output and employment are unavoidable.

Expectations and policy credibility

As commented earlier, the role of expectations in the economy is now better recognised by policy-makers and the expectations themselves seem to have become more important in determining economic outcomes. Expectations are important not only in the context of government policies -- those concerning the outcomes of private investment decisions are of major importance, and clearly underwent a significant change as a result of the sharemarket crash in October 1987. The main interest here is the conflict which can arise between government policy objectives and individual expectations of the outcome of those policies. In par-

ticular this conflict arises if government policies are designed to reduce inflation, but there is general scepticism as to whether the policies are able to achieve lower inflation or whether the government has the political will to maintain such policies. This scepticism, or lack of credibility of government policies, may be based either on past history, or on the recognition that there will be gains for government in eventually departing from its declared policies (the so-called 'time-inconsistency' problem of policies). If in consequence economic agents make their decisions on the presumption that inflation will be higher than the stated objectives of government policy, while the policies continue to be followed then price- and wage-setting will continue to be at levels above those which will allow markets to clear.

Recent surveys commissioned by the Reserve Bank show that business and household expectations of the rate of inflation have been well above the actual inflation rate. This divergence between policy intention (and outcome) and community expectations has contributed to the increase in unemployment.

If policy credibility can eventually be achieved it will improve the flexibility and speed of response of the economy to external change. To achieve this, however, it could be necessary to maintain disinflationary policies for a prolonged period, at considerable real cost.

Depressed demand

A proportion of lost potential output and employment during the process of structural change is accounted for by the 'supply-side' phenomena just described -- the slowness of supply responses to demand changes. A further proportion of lost potential output has resulted from the 'demand deflationary' policies which have been associated with restructuring policies since 1984. There are readily apparent difficulties in distinguishing between demand-caused unemployment and unemployment caused by supply-side stickiness. A narrow definition of supply-side unemployment would be unemployment caused by the slowness of markets in adapting to changes in the composition of demand, as signalled by changes in prices, orders, etc. Demand-caused unemployment would be that induced by changes in aggregate demand levels. Under this definition a proportion of the demand-induced unemployment could also be attributed to the existence of avoidable constraints on supply-side flexibility.

Domestic demand has been depressed below what it would otherwise have been by the rise in nominal and real interest rates, and the strengthening of the exchange rate following from the general tightening in monetary policy.

The objective of reducing the deficit has been to halt the previous level of debt accumulation. That of monetary policy has been disinflation. Both come under the objective of restoring policy sustainability and credibility (see the section on Macroeconomic Policy and the Stability Objective p.20).

In other words the drive to correct previous economic imbalances has driven the economy away from the ultimate goals of growth and full employment. It also drove two very important price-signals -- the rate of interest and the exchange rate -- well away in the interim from what could be presumed to be their normal equilibrium setting. These consequences have deterred investment and output expansion and have been a barrier to moving towards the long-term growth path.

Conflict Between Objectives

Microeconomic policies have had the objective of increasing economic efficiency. One cost of moving towards this objective has been a shedding of labour, particularly in the primary and manufacturing sectors, and in government services and trading enterprises. The immediate objectives of macroeconomic policy have been:

- the containment of debt levels (internal and external)
- disinflation.

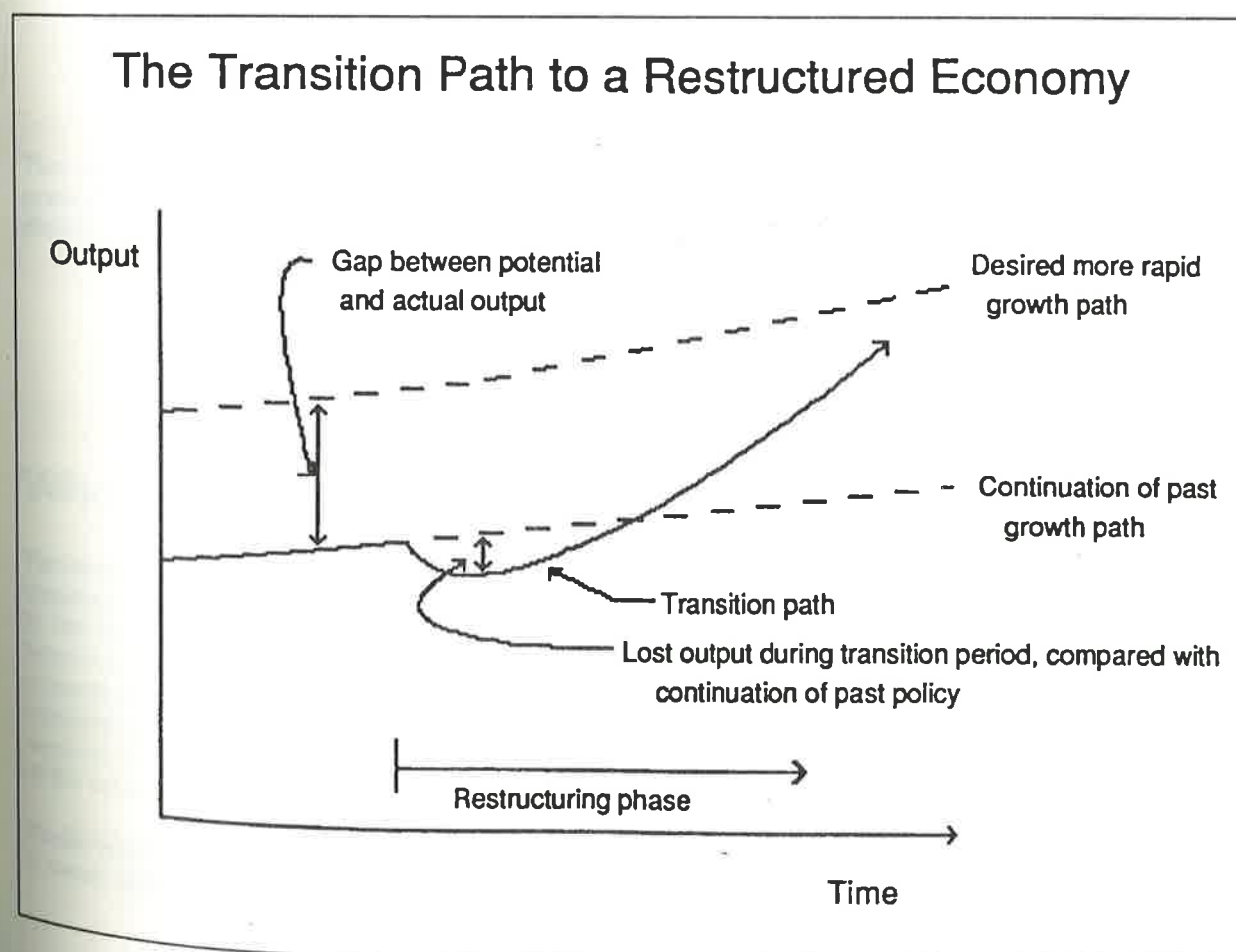
These objectives, in particular the pursuit of disinflation, have also led initially to a slowing in economic growth and an increase in unemployment. In other words those policies which have the ultimate objective of increasing output and reducing unemployment initially had the effect of taking us further from those goals.

Infogram 2.2 shows an initial dip in the transition path of output between the unsatisfactory growth path followed in the past, and the better growth path hoped for in the future. The infogram can also be interpreted as representing employment growth paths, with the gap between actual and potential growth paths corresponding to unutilised labour resources. The dip in the transition path would be more severe for employment, because of the gains in labour productivity.

There are a number of questions which can be raised.

- Is such a transition path the necessary way to achieve a better-performing economy?
- To what extent do the various components of restructuring policy contribute to the route taken by the economy during the transitional restructuring period, and are all the components equally necessary?
- Can it be argued that the pursuit of some of the intermediate goals of restructuring has been taken too far and has deferred the achievement of ultimate economic goals? More specifically, has policy been too 'single-focus' on reducing inflation, with the consequence of introducing new price-signal distortions such as 'over-valued' interest rates and the exchange rate, which are serious impediments to new investment and increased employment?

Infogram 2.2



These issues are discussed further in the concluding chapters. Briefly, however, it can be said that the experience of other countries which embarked earlier on restructuring exercises similar to that taking place in New Zealand is that the transition period is of some years, with unemployment increasing initially and then falling, for example, in the United Kingdom and Spain.

The Distribution of Transition Costs

The cost in aggregate of restructuring the economy is that output, or income, is lost in the initial stages of restructuring, compared with the output which would have been achieved had earlier policies been persisted with. Associated with this lost output is the reduction in employment and the increase in unemployment, compared with what would otherwise have been achieved.

The motivation for restructuring is the belief that this initial cost will be more than offset by the eventual benefits. This is after discounting future benefits in order to compare their present value with current costs -- in the same manner as investment decisions are evaluated in terms of benefit/cost ratios or the rate of return on investment. Explicit numerical calculations have not been carried out for the restructuring policies as a whole -- it is almost certainly impossible to do such calculations, given the uncertainty about overall outcomes.

The costs of restructuring are distributed unequally although the eventual benefits may be more equally distributed. It is doubtful whether any major economic policy change could be implemented without an unequal distribution of the costs inherent in the change. The fact that the costs of restructuring are distributed unevenly, however, and fall largely on those with fewer resources, does raise the question of appropriate policy responses. These should be shaped in terms of how best to ensure that those bearing a disproportionate share of the present costs of restructuring are enabled to share in the eventual benefits, by using policy instruments which facilitate the restructuring process.

CHAPTER THREE

The Expected Microeconomic Outcomes of Policy Changes

The Policy Changes

The changes in microeconomic policy listed in the previous chapter fall under the following headings:

- trade liberalisation
- reduction in assistance to industry
- regulatory reform -- for example, in the transport and finance sectors
- changes in the taxation system, and in the composition of government expenditure
- labour-market reform
- agency reform -- the corporatisation of state-owned enterprise.

The macroeconomic policy changes also have effects at the microeconomic level. These are in addition to the general impact of the 'deflationary shift' in monetary and fiscal policy, occasioned by the endeavour to disinflate the economy and to eliminate fiscal and external deficits. The effects are:

- high interest rates
- a 'strong' New Zealand dollar.

Whole Economy Consequences of Policy Changes

For relatively minor policy changes, for example the partial deregulation of egg production or the easing of constraints on the granting of meat-export work licenses, the consequences are largely limited to producers in the industries immediately concerned, and their immediate consumers. Recent regulatory reforms, however, have had sweeping effects on large sectors of the economy, for example, the reductions in border protection have had an effect on most tradeable goods. Even where the reforms have focused on one industry, such as transport, or on specific markets such as the labour market or the market for financial services, the consequences for these industries or markets have widespread ramifications through the rest of the economy.

These 'whole economy' (or 'general equilibrium') consequences of major restructuring policy changes make it more difficult to identify the effects of restructuring on any one market or industry. The effects at

microeconomic level arise not just from microeconomic restructuring policies but also from macroeconomic policies. The interest rate and exchange rate consequences of the firm, post-1984 monetary policies have been of particular importance. Such general changes can dominate and obscure the changes happening as a result of specific regulatory reform measures.

The Real Exchange Rate

A useful bridge between macroeconomic policy outcomes, and their impact at microeconomic level, is provided by the concept of the Real Exchange Rate. This measures the ratio of prices of *non-tradeable* commodities to the prices of *tradeable* commodities. The concept is explained in more detail in Appendix Two, together with other exchange rate measures. The point about the Real Exchange Rate is that it is strongly influenced by shifts in the actual exchange rate of the New Zealand dollar against foreign currencies, and also in New Zealand's inflation rate relative to that of other countries. It provides a benchmark against which to compare the actual price and profitability outcomes for individual industries. However, there is difficulty in making a definitive classification of industries into those producing non-tradeable, and those producing tradeable, commodities.

Expected Microeconomic Outcomes

The expected microeconomic outcomes of general policy are listed under the policy headings below.

Regulatory reforms to create a more competitive environment for specific industries

- lower prices to consumers
- the elimination, by competition, of excess profits in formerly protected areas
- increased output in general, but possibly reduced output where the increased competition is from overseas
- productivity increases at firm and industry level, with increased competition forcing the more efficient use of inputs, perhaps initially via a shake-out of capital and labour inputs.

Regulatory reform having wider impact (labour-market changes, reforms to the tax base, etc)

- increased readiness of labour (and capital) to move to better-rewarded production opportunities, as signalled by market prices.

The consequences at micro level of macroeconomic policy shifts

(These are superimposed on the consequences of the microeconomic policy changes under the first two policy headings.)

- deflationary consequences of fiscal and monetary policies aimed at restoring economic stability, leading to slow growth or falls in output for many industries producing for the domestic market
- consequences of the disinflationary monetary policies applied since 1984:
 - high interest rates, affecting equity returns to more capital-intensive industries, and/or where debt/equity ratios are high

- a strengthening of the New Zealand dollar until 1988, putting downward pressure on prices and profitability in the tradeable goods industries, both for exporters and for import-competing industries.

It can be seen that these microeconomic consequences of the macroeconomic policies will have a general confounding effect, making it more difficult to identify the specific outcomes of microeconomic restructuring policies.

A further general point is that the responses to restructuring can take the form of both quantity and price adjustments, for reasons outlined in Chapter Two. The intention of the policy changes is that responses should be flexible. Price adjustments which bring supply and demand back into balance in a changed environment are one aspect of flexibility. A readiness to make output changes, in the sense of abandoning lines of production no longer providing a sufficient return, and transferring resources to more profitable lines, is another form of flexibility. In this sense both quantity and price adjustments are rational responses to restructuring and both are evidence of adaptability. A lack of flexibility is shown where resources are retained in, or perhaps cannot readily be shifted from, production areas whose projected return is poor. Consistency and credibility of government policies make it easier to assess future prospects for profitability.

Expected Data Outcomes

The following are the changes to be expected in actual data outcomes at individual industry level.

Relative price changes and consequences for profitability

- relative price decreases for industries particularly subject to regulatory reform
- upward price shifts for non-tradeables industries as a consequence of the strengthening of the New Zealand dollar exchange rate 1984 to 1988
- increased variability in commodity prices about the average inflation rate.

Similar influences are to be expected for profit margins, but with output and productivity changes and changes in input costs, particularly labour cost per unit output, also affecting profit levels.

Output changes

- increased variability of industry growth rates
- continued or increasing output growth where prices (output and input) are responsive to restructuring changes, but otherwise a slowing in growth or a fall.

Changes in labour and capital inputs

- increased variability in input growth rates in response to higher output growth variability
- changes in the rate of new investment in response to differing industry profitability experience.

Productivity changes

- a general increase in the productivity of utilised labour and capital inputs in response to increased competition

- possibly a greater variability in productivity growth between industries, but not necessarily, for example, those industries whose growth has slowed because of restructuring may have reduced labour and capital inputs more than proportionately, so increasing productivity.

Changes in external trading performance

- increased imports as a result of reductions in border protection, and the New Zealand dollar strengthening
- decreased export volumes or a decrease in export profitability because of the elimination of export-oriented subsidies, and the strengthening of the New Zealand dollar.

(There will be offsets to these effects from domestic recession, from reductions in input price inflation as a result of restructuring, and from productivity gains.)

Changes in asset prices

- changes in asset prices paralleling those changes in profitability caused by restructuring for those assets specific to given end-uses, and for which a well-functioning market exists, land in particular. (Asset prices have changed for other reasons also, including speculative pressure and tax changes.)

The correspondence of these expected data outcomes to reality is discussed in Chapters Four to Seven.

CHAPTER FOUR

Outcomes in Domestic Product Markets

Introduction

The most important outcomes of economic restructuring will occur at the microeconomic level -- in the performance of individual enterprises. The essence of the reform is to shift away from assisting or protecting whole sectors and industries, towards creating a climate in which enterprises that are well structured, adaptable and well managed can succeed, and those which are not will face increased pressure to improve or to shift out of the industry. That should produce an overall economic structure which sustains better performance in meeting social objectives.

Outcomes at the microeconomic level are particularly difficult to detect and assess over the short term for a number of reasons. Because these outcomes are so important this chapter will attempt to discern technical evidence of change while acknowledging the difficulty of drawing reliable conclusions.

The difficulties include problems of aggregation, variety in the timing of reforms and the response to them, and the wide range of factors, quite separate from the reforms, which will affect outcomes in the shorter term.

Reliable data and trends emerge slowly, and at the sector or industry level averages may conceal a wide range of outcomes for different firms. Within an industry, half the firms may have great difficulty coping with the more direct exposure to market signals -- and provide much anecdotal evidence of failure -- while the other half may respond very effectively, producing an average result for the whole industry which shows little evidence of any change.

Many reforms have been introduced over the last decade with different effects on enterprises in different industries over that time. Agricultural enterprises, for example, may have received some benefits early on from regulatory reform of land transport, some immediate adverse effects from reductions in direct assistance, and some longer-term benefits from increased competition among suppliers of their manufactured inputs.

At the same time different enterprises within agriculture have been affected differently by movements in world market prices for their products, some of which reflect international commodity price trends, some reflect their industry's own performance in positioning their products in relation to world market trends, and some reflect particular exchange rate changes.

In that context, assessing the impact of specific reforms is fraught with uncertainty. The material in this chapter concentrates on a narrow range of technical but relatively simple quantitative indicators of change:

- shifts in prices of products (both goods and services)
- changes in quantity of products

- changes in productivity
- shifts in profitability.

With the wide diversity of businesses operating in New Zealand it is convenient to aggregate enterprises into groups or sectors. A common aggregation is that of primary, manufacturing, and service sectors. This classification also corresponds quite closely to the distinction between tradeable and non-tradeable products, with tradeables broadly covering goods from primary and manufacturing industries, and non-tradeables the products from the service sector. However, services are becoming more contestable internationally, including some research, marketing, financial, educational, and transport services.

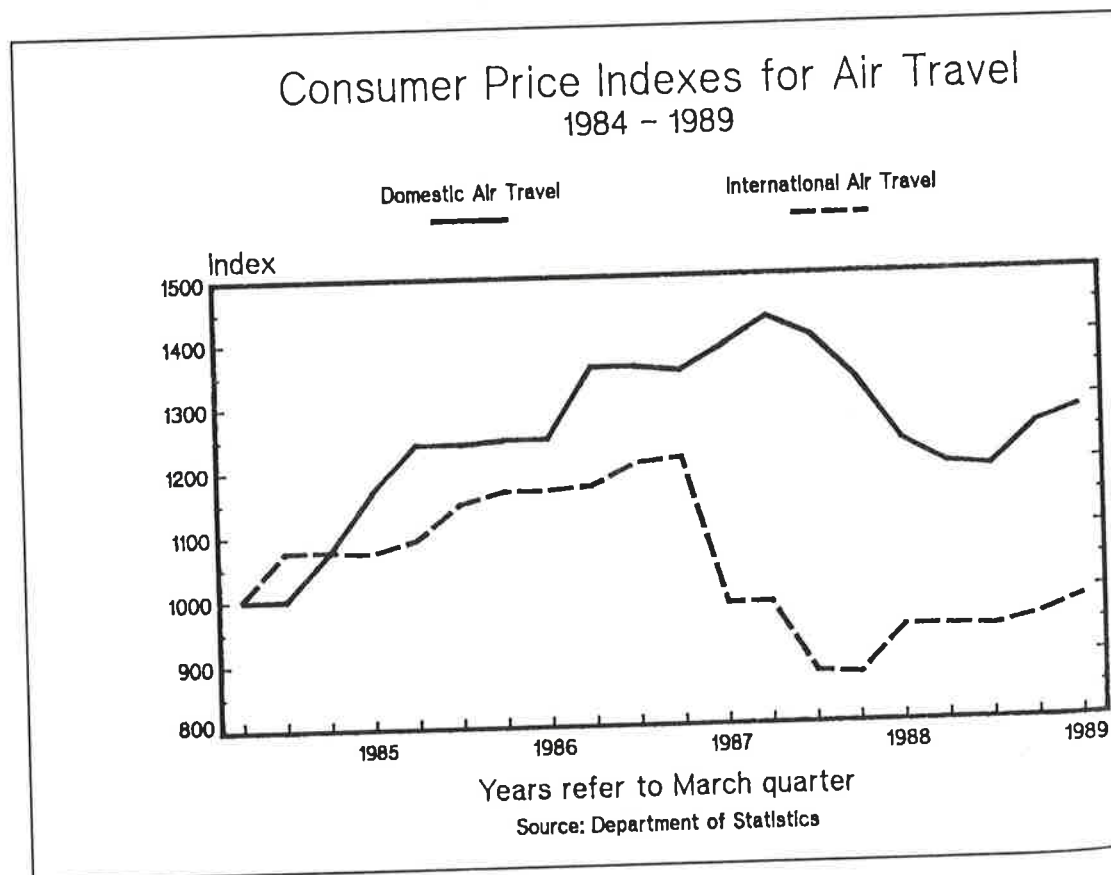
Price Changes — for the Consumer and the Producer

One expected outcome of restructuring is that greater competition should produce more variety in prices of products available to consumers and producers, and more constraint on price increases.

Consumer Benefits

Useful illustrations of consumer benefits can be obtained from the transport industry data used in compiling the Consumer Price Index. The price of international air travel fell from the end of 1986, as shown in Infogram 4.1. Exchange rate shifts and changes in world prices of aviation fuels influence international fares, although the specific cause of the sharp fall in prices at the end of 1986 appears to have been increased competition on international routes from United States' airline companies.

Infogram 4.1



The price of domestic air travel continued to rise until the June quarter of 1987, but then this also fell significantly. Ansett New Zealand commenced operations in July 1987, introducing competition on routes formerly operated only by government-owned Air New Zealand. The reduction in domestic fares is the result of the introduction of competition.

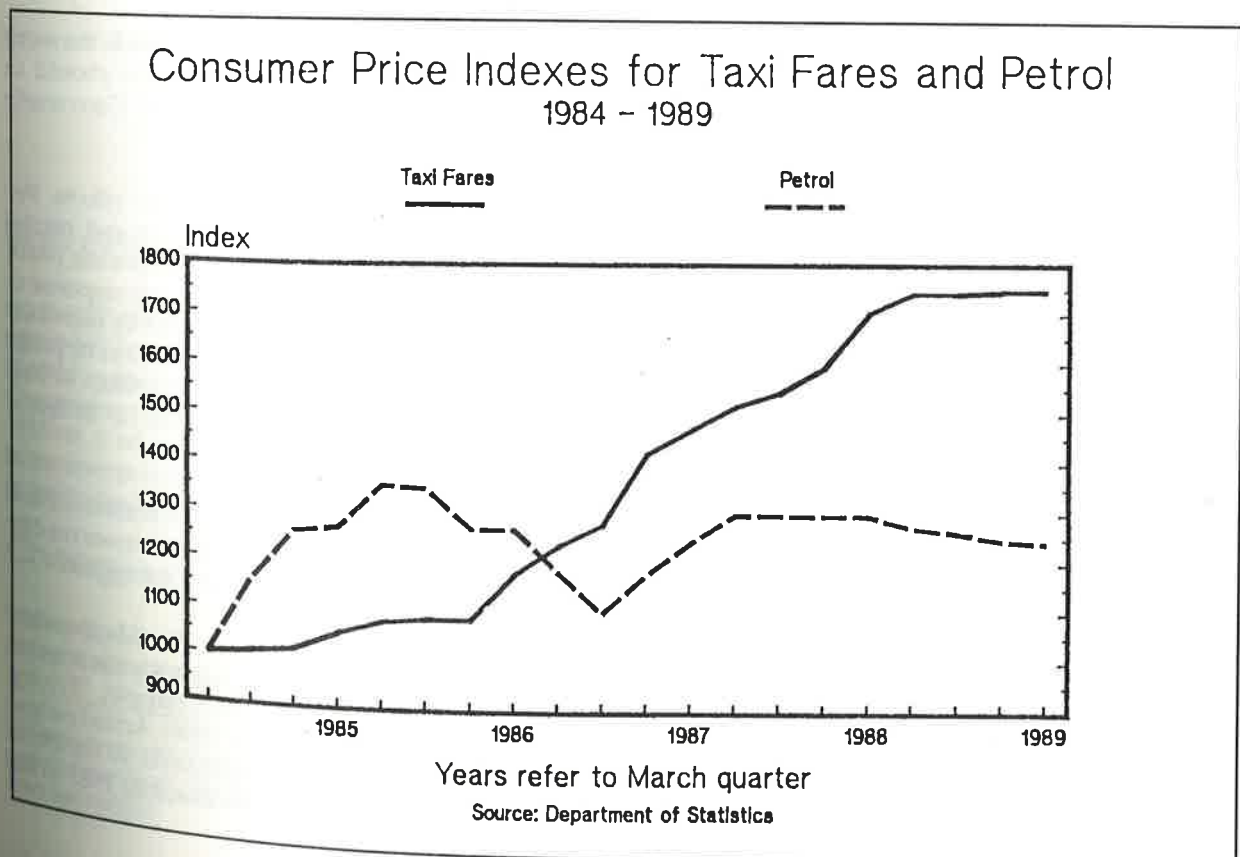
Petrol prices, charted with taxi fares in Infogram 4.2, are subject to a number of influences including world price levels and taxes. However, the removal of price control from the industry during 1988 is associated with the downward trend in prices seen in that year. The taxi industry remains heavily regulated and the fares it charges have risen steadily since 1985.

In clothing, footwear and electronics, a wider range of products at different prices is available, giving consumers a wider choice and some benefits in price restraint from increased import competition.

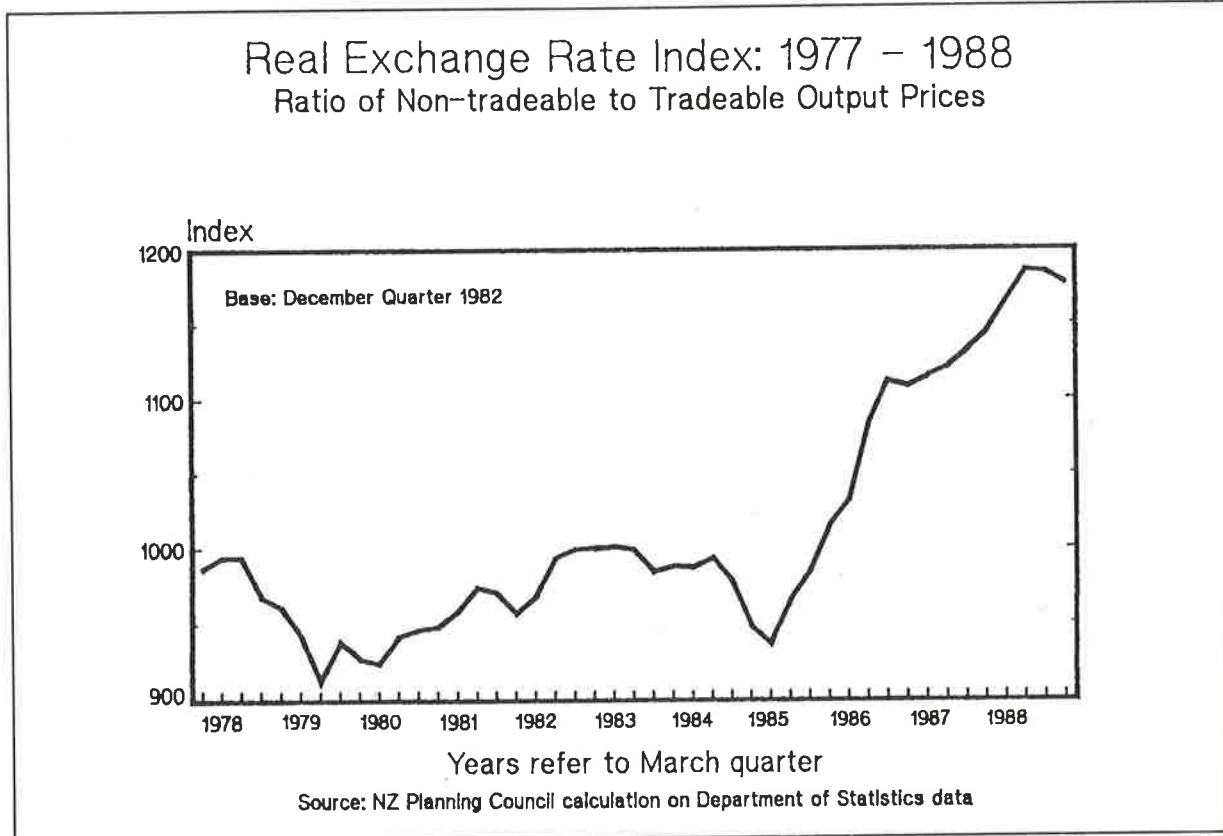
Output Price Changes for Producers

Increased competition on its own in an economy should lead to a reduction in the margin between input costs and the selling price, but other factors can override this. In particular, the targeting of monetary policy at disinflation has contributed to an increase in the interest rate and strengthening of the nominal exchange rate. This in turn has led to an appreciation of the Real Exchange Rate, which is the ratio of non-tradeables output prices to tradeables output prices. Infogram 4.3 shows its path from 1977 to 1988, and also shows the reversal in the trend from early 1988. (See Chapter Five for further discussion of trends in international competitiveness.)

Infogram 4.2



Infogram 4.3



The outcomes of this major upward shift in the Real Exchange Rate are clearly likely to dominate the more specific industry effects of restructuring policies. Profitability of non-tradeables production should generally increase, more especially if inputs include a significant proportion of tradeables. Conversely, the profitability of tradeables industries would be expected to fall.

However, these general conclusions will still be modified to a degree by industry-specific effects. For example, in non-tradeables industries where competitive pressures are strong and labour and capital resources are readily drawn into the industry for output expansion in response to increased profits, profit margins would erode and relative output prices increase less. For tradeables industries whose response to changes in demand takes the form of output changes rather than price changes, the effect of increased competition from imports would be to reduce domestic output as well as, or rather than, prices or profit margins. The degree of substitutability between the domestic good and the imported product is also relevant, as are also the differing degrees to which import protection has been reduced for different industries.

Such differences will be shown by differences in the paths of industry real exchange rates. For instance, those industries whose output for the domestic market is less readily substituted for by imports will more readily be able to maintain their output prices and so have less of an appreciation in their real exchange rate.

That at least some tradeable goods industries have been able to maintain selling prices at a level higher than might be expected from the adverse exchange rate shift, receives support from research reported in a recent Reserve Bank study on manufacturing pricing behaviour up to the end of 1986 (S. Chapple, "Pricing Behaviour in New Zealand Manufacturing", *Reserve Bank Bulletin*, Vol. 51, June quarter 1988). Actual output prices were compared with prices predicted on a normal cost plus fixed mark-up hypothesis. In the event, actual output prices exceeded predicted prices by a substantial margin, for the period from mid 1985 to

end of 1986, for the manufacturing sector as a whole. At production-group level the excess of actual over predicted selling prices was most marked for chemicals, non-metallic mineral products, and fabricated metals. These are all industries where it might be expected that domestic output would be less easily substituted for by imports than in some other manufacturing industries. The observed outcome will also reflect changes in the output composition of these industries, for example, the shedding of less profitable lines of production.

Shifts at industry level

Similar real exchange rates can be constructed for each tradeable industry, taking the ratio of non-tradeable output prices in general to each tradeable industry's prices. (The details of these calculations are not given here.)

- Agriculture and mining have experienced an even stronger appreciation of the Real Exchange Rate than tradeables in general.
- Both fishing and forestry on the other hand, have experienced a weakening of their real exchange rates over this period -- that is favourable demand and price trends have been sufficient for these two industries to outweigh nominal exchange rate shifts.
- Correspondingly, while real exchange rates have strengthened for the wood products, and paper and printing industries, the shift has not been as great as for tradeables in general.
- In the manufacturing sector there have been particularly strong upwards shifts for the food processing, and chemicals groups. The latter outcome may be taken as the result of an outside factor, the fall in oil prices on world markets in recent years. (If transport is regarded as a tradeables industry, the substantial increase in its real exchange rate is at least partly attributable to the same cause.)
- Fabricated metals -- a large and important production group -- has undergone a real exchange rate appreciation, but substantially less so than manufacturing in general. It is possible that a significant part of the output of this industry is little subject to competition from imports, while considerable industry plan protection continues for the motor vehicle industry, even though it is affected by the rapid build-up in used car imports.

Variation of Producer Prices

An examination of data at industry level confirms this expectation although the detail of the results is not presented here. Briefly the overall rate of inflation (of producer output prices) at a given point of time was plotted against a measure of the dispersion of rates of inflation for the output prices of individual industries. Comparing observations in two periods, up to and including the March quarter of 1985, and from March 1985 on, it was readily apparent that there has been a shift upwards in price variability between industries in the later period. That is, at a given overall level of inflation there is now a wider range -- about that average in individual price movements.

Changes in Outputs

The measures of output used in this section are, in general, those calculated by the Department of Statistics in the National Accounts.¹

¹ These are nominally measures of 'net' output, that is of value added. In practice, however, the Department of Statistics extrapolates base-year figures using indicators of output change which for most industries are of gross output rather than net output.

Infogram 4.4 shows growth in the primary, manufacturing, and services market sectors, and Infogram 4.5 contains the same information for individual production groups, both market and non-market, as well as for GDP in total.

Infogram 4.4

OUTPUT GROWTH BY MAIN SECTOR ¹			
	Market Sectors ² (% per annum)		
	Year Ending March		
	1977/78 to 1982/83	1982/83 to 1987/88	Whole ten years
Primary	3.8	4.3	4.0
Manufacturing	2.4	1.2	1.8
Services	1.0	3.4	2.2
Total GDP	1.8	2.2	2.0

Source: Department of Statistics

Notes: 1. The figures used for 1987/88 are provisional estimates only
2. Excluding ownership of owner-occupied dwellings

Growth in total GDP accelerated marginally in the latter five-year period. Growth was strongest in the primary sector throughout, with fishing and hunting, and forestry recording strong output growth as well as agriculture. Their slower growth in the latest period probably reflects biological constraints on both fisheries and plantation forest resource.

Note that there are some statistical anomalies affecting the primary sector. Growth in real net output in the agricultural sector has been high, but in recent years at least this has been partly due to cutbacks in expenditures on inputs, such as fertilisers. In effect pastoral farming has been drawing on its fertility 'bank' build-up from past fertiliser application. For the mining production group, growth estimates are affected by the classification of exploration expenditure as an intermediate input. Hence an increase in hydrocarbon and gold exploration will reduce the value-added contribution of the sector.

Overall, manufacturing growth slowed in the latest five-year period whilst services-sector growth accelerated sharply. Virtually all the manufacturing groups show low growth, with a significant deterioration in the latest five years, including the important machinery and metal products group. This output response of both export- and import-competing manufacturers is due mainly to the strengthening of the New Zealand dollar, combined with for exporters the removal of export subsidies, and for import competitors the progressive reduction in protection levels. One exception however, is paper and publishing.

Among the non-tradeables, the electricity, communications, and finance production groups all show high rates of growth with a noticeable acceleration for the last two sectors in recent years. It is likely that this is a consequence of recent regulatory reforms particularly for the finance and business services sector. It is also likely that faster growth in the transport sector is due to the reduction in regulatory burden which began in the late 1970s. The poorest growth performance is in the trade, restaurants and hotels sector.

The various production groups are brought together in Infogram 4.6, in terms of a cross-classification of growth performance over the past ten years, against whether their output growth is tending to accelerate or otherwise.

Factors other than recent economic restructuring explain the generally high growth in the primary sector. It is likely in fact that the changes associated with restructuring will lead in the near future to a reduction in growth in some parts of the agriculture sector.

Infogram 4.5

AVERAGE GROWTH RATES OF REAL GDP BY PRODUCTION GROUP¹ five-year average growth rates (% per annum)

Year Ending March

	1977/78 to 1982/83	1982/83 to 1987/88	Whole ten years
Agriculture	4.4	4.4	4.4
Fishing & hunting	8.7	3.6	6.1
Forestry	5.5	1.9	3.7
Mining	-1.6	6.2	2.3
Food, beverages & tobacco	3.4	0.4	1.9
Textiles & apparel	2.1	0.7	1.4
Wood	2.0	0.8	1.4
Paper & publishing	1.2	6.4	3.8
Chemicals	1.1	2.4	1.8
Non-metallic minerals	3.5	0.6	2.1
Basic metals	2.1	-0.1	1.0
Machinery products miscellaneous	2.5	-0.2	1.1
Electricity, gas, water	4.4	3.0	3.7
Construction	-1.9	5.8	1.9
Trade, restaurants, hotels	0.1	-0.2	0.0
Transport & storage	0.5	4.1	2.3
Communications	4.7	6.8	5.8
Finance & business services	2.5	7.2	4.8
Ownership of owner-occupied dwellings	1.9	2.1	2.0
General government	1.5	0.0	0.8
Community services etc	2.0	2.6	2.3
GDP	1.8	2.2	2.0

Note: 1. The figures used for 1987/88 are provisional estimates only

In manufacturing most industry groups have experienced only moderate growth in the past, and growth has recently slowed. One exception is the chemicals group, because of the think-big projects commissioned in the mid 1980s. Slower long-term growth in manufacturing output than for the economy as a whole is a feature common to many developed economies, as manufacturing declines relative to the services sector. However the slowdown in growth in recent years is more attributable to the effects of restructuring. Manufacturing profitability in total fell less than might have been expected in the initial phase of post-1984 restructuring, but that this was achieved by cutting back on less profitable lines of production is confirmed by the reduction in output growth.

Services sector industries, with the exception of government, and trade, restaurants and hotels, are all either high growth or showing accelerating growth -- and are dominant in that group of industries whose growth is increasing. As already discussed this faster growth can in part be attributed to restructuring, and it is here

that the restructuring process has in its first stage provided the most positive outcomes in terms of output and employment.

Structural Change

One outcome to be expected from restructuring is that the range of outcomes experienced by individual industries and firms should widen, as some contract while others expand more rapidly. Infogram 4.1 contains, as a measure of this, the standard deviation of industry growth rates over the first and second five years of the 1977/78 to 1987/88 period. On this basis there appears to be a speeding-up in structural change for manufacturing industries in the latter period. There is also a widening in the dispersion of growth rates for the traded market production groups in general, although this is less marked than for manufacturing

Changes in Productivity

Infogram 1.2 compared New Zealand's productivity performance with OECD countries -- it is only since about 1980 that New Zealand's productivity performance has been reasonably comparable with the OECD average. Productivity performance can be measured in terms of the ratio of output trends to labour input trends, or to capital input trends, or to the two combined.

Infogram 4.6

OUTPUT GROWTH CLASSIFICATION OF PRODUCTION GROUPS over the last ten years			
	Growth Decelerating	Growth Stable	Growth Accelerating
High growth (above 3 percent annum)	Fishing Forestry Electricity, gas, etc	Agriculture	Paper and publishing Communications Finance and business services
Moderate growth (1 to 3 percent per annum)	Food Textiles Wood Non-metallic minerals Metal products & machinery	Ownership of dwellings	Chemicals Construction Transport Mining
Low or negative growth (below 1 percent per annum)	Basic metals General government Trade		

Infogram 4.7

CHANGE OVER TIME IN DISPERSION OF OUTPUT GROWTH RATES

	Standard Deviations of Growth Rates (%)		
	1977/78 to 1982/83	1982/83 to 1987/88	Whole ten years
Eight manufacturing production groups ¹	0.8	2.0	0.8
Nineteen trading groups ²	2.3	2.5	1.9

Notes: 1. Other manufacturing combined with metal products, machinery, etc

2. Including the eight manufacturing production groups; ownership of owner-occupied dwellings is excluded

Labour Input

Labour-force changes are examined in Chapter Seven. The broad trends observed are that employment has fallen in the primary and manufacturing sectors, and more rapidly in the most recent period, but has grown in the services sector, more especially in trade, financial services, and personal and community services.

Noteworthy features include the extent of the 'shedding' of labour in the tradeable goods industries, accentuated by the effects of the corporatisation of state-owned enterprises, in particular coal mining, forestry, and electricity. However, some of the decline in employment in agriculture and manufacturing is a continuation of long-term trends, not specifically associated with restructuring.

Capital Input

Estimates of capital stock are obtainable from the work of the Project on Economic Planning (PEP), Victoria University, and these can be used as a measure of capital input. It is important to note, however, that measures of capital input based on a 'perpetual inventory' approach, such as the PEP estimates, have defects in a period of rapid structural change. Essentially the approach is to add each year new investment by the industry to its capital stock, at the same time writing off a proportion of the existing stock at some assumed constant rate of economic depreciation. When rapid structural change is under way, however, some of the investment decisions of the past will be found inappropriate to the new environment, and in effect the capital stock depreciates more rapidly than assumed in perpetual inventory calculations. It should be borne in mind that particularly for industries with falling output, capital input is also likely to be falling more than the figures show, and a negative bias imparted to productivity trends (see the following discussion).

Productivity

Infograms 4.8 and 4.9 give estimates of productivity growth for primary, manufacturing and services, and then for individual production groups. The three different measures of productivity are labour productivity -- output/labour input; capital productivity -- output/capital input and Total Factor Productivity (TFP) -- output/combined inputs.

Infogram 4.8

PRODUCTIVITY GROWTH BY MAIN SECTORS (%)			
	1977/78 to 1982/83	1982/83 to 1987/88	1977/78 to 1987/88
Labour Productivity			
Primary	4.0	6.6	5.3
Manufacturing	2.5	3.1	2.8
Services ¹	0.7	1.2	1.0
Total market ¹	1.5	2.1	1.8
Capital Productivity			
Primary	2.8	4.3	3.6
Manufacturing	0.6	-4.0	-1.7
Services ¹	-0.9	1.3	0.2
Total market ¹	0.2	1.0	0.6
Total Factor Productivity			
Primary	3.1	4.8	4.0
Manufacturing	1.9	0.5	1.2
Services ¹	-0.0	1.2	0.6
Total market ¹	0.9	1.6	1.3

Note: 1. Excluding ownership of owner-occupied dwellings

In these tables TFP is calculated as a weighted average of labour productivity and capital productivity growth. The weights are the respective contributions of labour and capital to GDP for each individual production group, over each five-year period analysed.

The important figures are those for Total Factor Productivity, as both labour and capital productivity are affected by changes in the contribution to overall growth of the other factor. Thus for instance, growth in labour productivity is generally higher than TFP growth, because of the increases in capital to labour ratio over the period. (Where there are doubts concerning the adequacy of capital stock estimates, as referred to, measures of labour productivity may provide better guidance.)

Recent Productivity Trends in Manufacturing

The past year has been one of slow recovery beginning from the 1987/88 recession. Total GDP is estimated to have risen by between half and one percent during 1988/89, after falling about 2.5 percent in 1987/88.

It is during this upturn that long-term productivity gains from economic restructuring should become apparent. Comprehensive up-to-date productivity measures are not available. However, estimates can be made of trends in labour productivity in the manufacturing sector. Infogram 4.10 shows long-term trends up to the end of 1988 in real value added per hour worked in the manufacturing sector. The value added data are obtained by constructing constant price output and input series, and differencing the

Infogram 4.9

PRODUCTIVITY GROWTH BY INDUSTRY GROUP¹
(%)

	1977/78 to 1982/83	1982/83 to 1987/88	1977/78 to 1987/88
LABOUR PRODUCTIVITY			
Agriculture	4.8	6.1	5.4
Fishing & hunting	4.2	2.8	3.5
Forestry	5.1	15.4	10.2
Mining	-1.1	12.2	5.4
Food, beverages, tobacco	3.8	0.6	2.2
Textiles & apparel	3.5	3.5	3.5
Wood	0.9	1.5	1.2
Paper & publishing	0.1	7.7	3.8
Chemicals	0.4	3.7	2.0
Non-metallic minerals	4.8	5.1	5.0
Basic metals, machinery and metal products etc	2.6	2.8	2.7
Electricity, gas, water	2.1	0.0	1.0
Construction	1.1	6.4	3.7
Trade, restaurants, hotels	-1.1	-2.1	1.6
Transport & storage	2.6	0.9	1.7
Communications	4.6	8.7	6.6
Finance & business services	0.2	1.2	0.7
Community services etc	1.3	0.7	1.0
CAPITAL PRODUCTIVITY			
Agriculture	4.0	4.7	4.4
Fishing & hunting	0.1	-4.4	-2.2
Forestry	3.0	2.6	2.8
Mining	-8.1	-3.6	-2.4
Food, beverages, tobacco	-0.2	-1.5	-0.8
Textiles & apparel	2.5	-0.5	1.0
Wood	2.1	-2.3	-0.1
Paper & publishing	2.3	4.8	3.5
Chemicals	-5.9	-13.6	-9.8
Non-metallic minerals	4.2	0.9	2.6
Basic metals	-1.9	-16.2	-9.3
Machinery, metal products etc	2.4	-1.4	0.5
Electricity, gas, water	2.2	2.2	2.2
Construction	-1.9	5.7	1.8
Trade, restaurants, hotels	-1.5	-3.3	-2.4
Transport & storage	-1.2	3.2	1.0
Communications	5.3	0.4	2.8
Finance & business services	-1.3	1.8	0.3
Ownership of owner- occupied dwellings	0.9	0.6	0.8
Community services etc	-3.0	-1.3	-2.1

Infogram 4.9

PRODUCTIVITY GROWTH BY INDUSTRY GROUP
(%)

	1977/78 to 1982/83	1982/83 to 1987/88	1977/78 to 1987/88
TOTAL FACTOR PRODUCTIVITY			4.6
Agriculture	4.2	5.0	0.2
Fishing & hunting	1.6	-1.3	4.8
Forestry	3.9	5.8	-0.3
Mining	-6.1	5.8	1.3
Food, beverages, tobacco	2.8	-0.1	2.7
Textiles & apparel	3.2	2.2	0.7
Wood	1.2	0.3	3.8
Paper & publishing	0.9	6.7	-3.1
Chemicals	-1.8	-4.3	3.6
Non-metallic minerals	4.5	2.7	
Basic metals, machinery, metal products etc	1.7	-1.9	-0.1
Electricity, gas, water	2.2	1.6	1.9
Construction	0.0	6.1	3.0
Trade, restaurants, hotels	-1.3	-2.6	-1.9
Transport & storage	1.3	1.7	1.5
Communications	4.8	4.9	4.9
Finance & business services	-0.6	1.6	0.5
Ownership of owner- occupied dwellings	0.9	0.6	0.8
Community services etc	-0.7	-0.3	-0.5

¹ Source: Department of Statistics, Project on Economic Planning, NZPC calculations
Note: The figures are estimates only, subject to ongoing revision (see Orr NZIER 1989); estimates for the smaller sized group
as fishing and hunting are particularly subject to error

These figures will differ from official Department of Statistics' estimates of manufacturing output, which are based on trends in gross output. The chemicals and basic metals production groups are excluded from the manufacturing total, in order to preserve comparability through the period of installation of the projects in those industries in the mid 1980s. In fact, however, their inclusion has little effect on the trends.

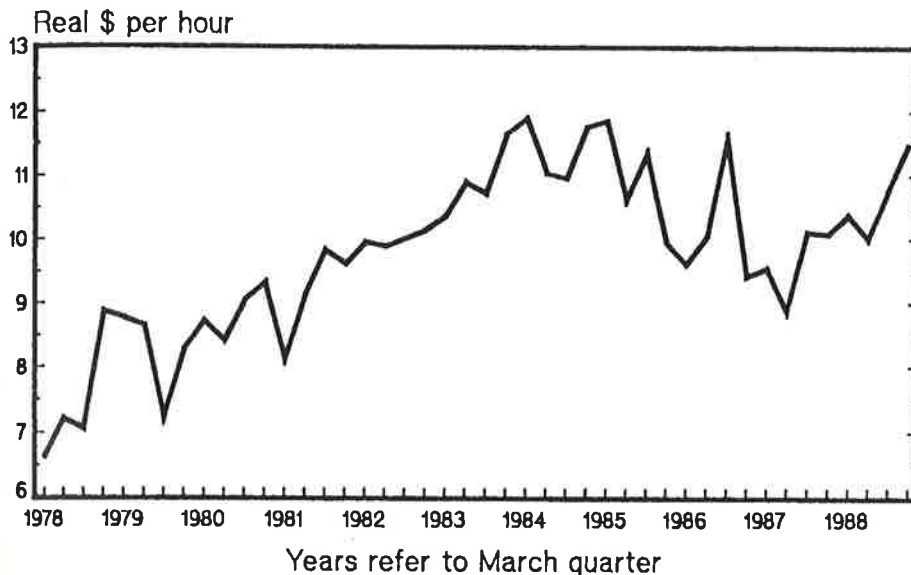
The charted measure of real hourly output can be seen to have peaked in 1984/85, and then to have declined to early 1987, apart from a short-lived upturn in 1986. From mid 1987, however, there has been a marked increase in labour productivity in the manufacturing sector.

This recovery has taken place during a period of recession. It has been achieved largely through a reduction in labour input, although the decline in real output appears to have 'bottomed' and an upturn has occurred. In other words manufacturing industry, at least, has become considerably 'leaner' and more efficient in its operation as a result of restructuring. At more detailed production-group level, corresponding increases in labour productivity are evident in the textiles, wood products, chemicals, and fabricated metals production groups. The textiles and apparel, and fabricated metals industries are the two industries most protected against competition from imports (see Chapter Five).

Infogram 4.10

Manufacturing – Net Real Hourly Output: 1978 – 1988

(excluding the basic metals and chemicals, etc production groups)



Comments

From Infogram 4.8 it can be seen that TFP growth, at 1.3 percent per annum for the last ten years, has been satisfactory by OECD standards (0.6 percent per annum for 1979 to 1986). Also, TFP growth accelerated in the latest five years. This overall picture is the aggregate of:

- continuing high TFP growth in the primary sector
- a fall in manufacturing TFP growth
- offset by an improvement in services TFP.

At production-group level, TFP growth has slowed for most manufacturing groups, except paper and publishing, and has fallen especially strongly for the think-big project affected groups (chemicals and basic metals), because of the very sizeable additions to capital stock in those industries (whose 'book value' has subsequently had to be 'written down' very substantially). However, more recent though partial data, shown in Infogram 4.10, points to a significant improvement in manufacturing productivity over the past year and a half.

Of the services groups, electricity, construction, transport, and communications have all recorded strong, high or reasonable TFP growth. However, productivity performance of the trade group has been poor -- this is one for which there are significant difficulties in measuring both output and labour input.

The finance and business services group has also shown low productivity growth over the past decade. However, there has been a significant improvement more recently, related to the reforms of recent years.

Changes in Industry Profitability

Changes in output prices, quantity of output, and costs of inputs (partly through productivity changes) ultimately effect the profitability of industries and individual businesses. Changed levels of profitability in turn lead business to expand, contract, or possibly even shut down operations. Change in profitability, on an aggregate basis can be measured by indexes of relative added value.

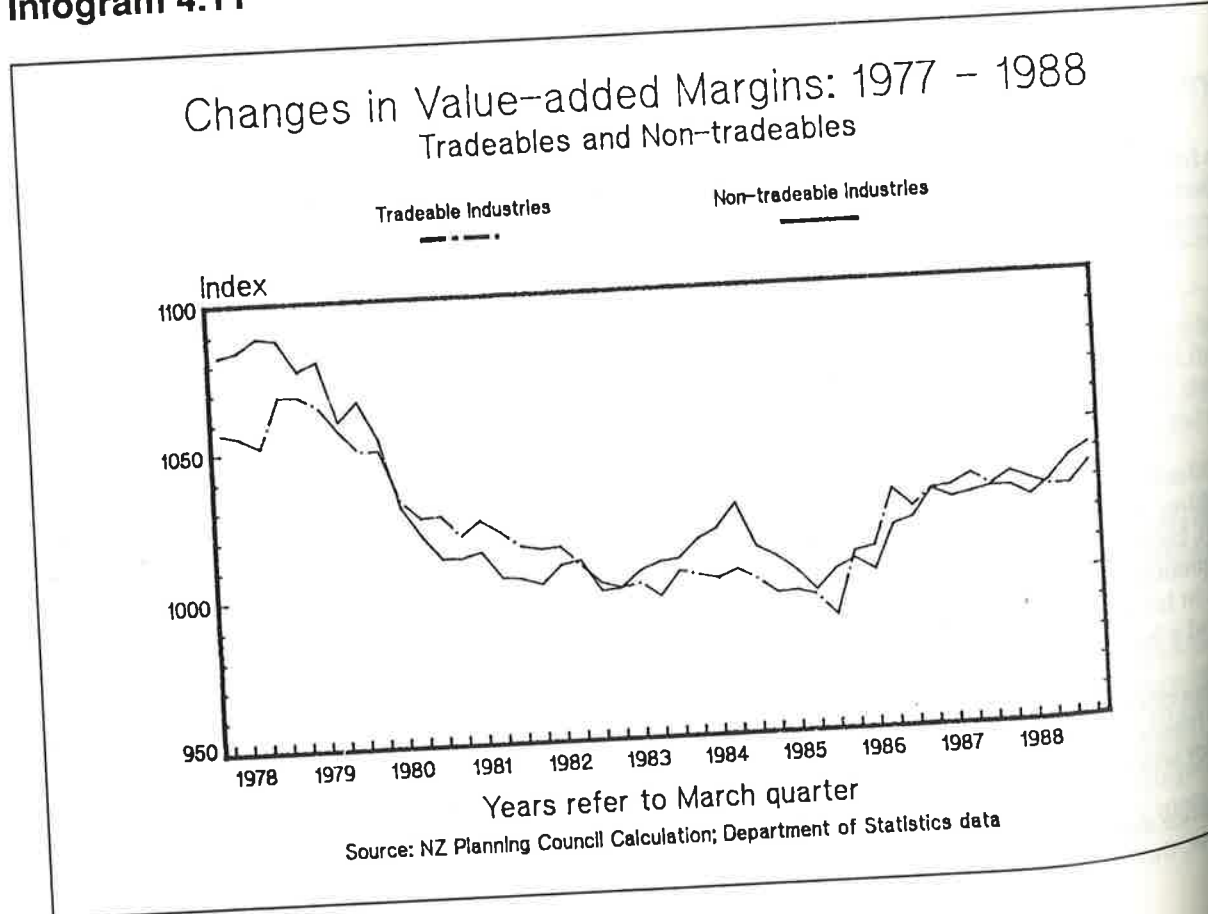
For much of the economy, aggregate and up-to-date statistics on profits and profitability are not readily available. A first approximation is given, however, by a measure of value added margins.

Indexes of Relative 'Value-added' Margins for Industry Groups

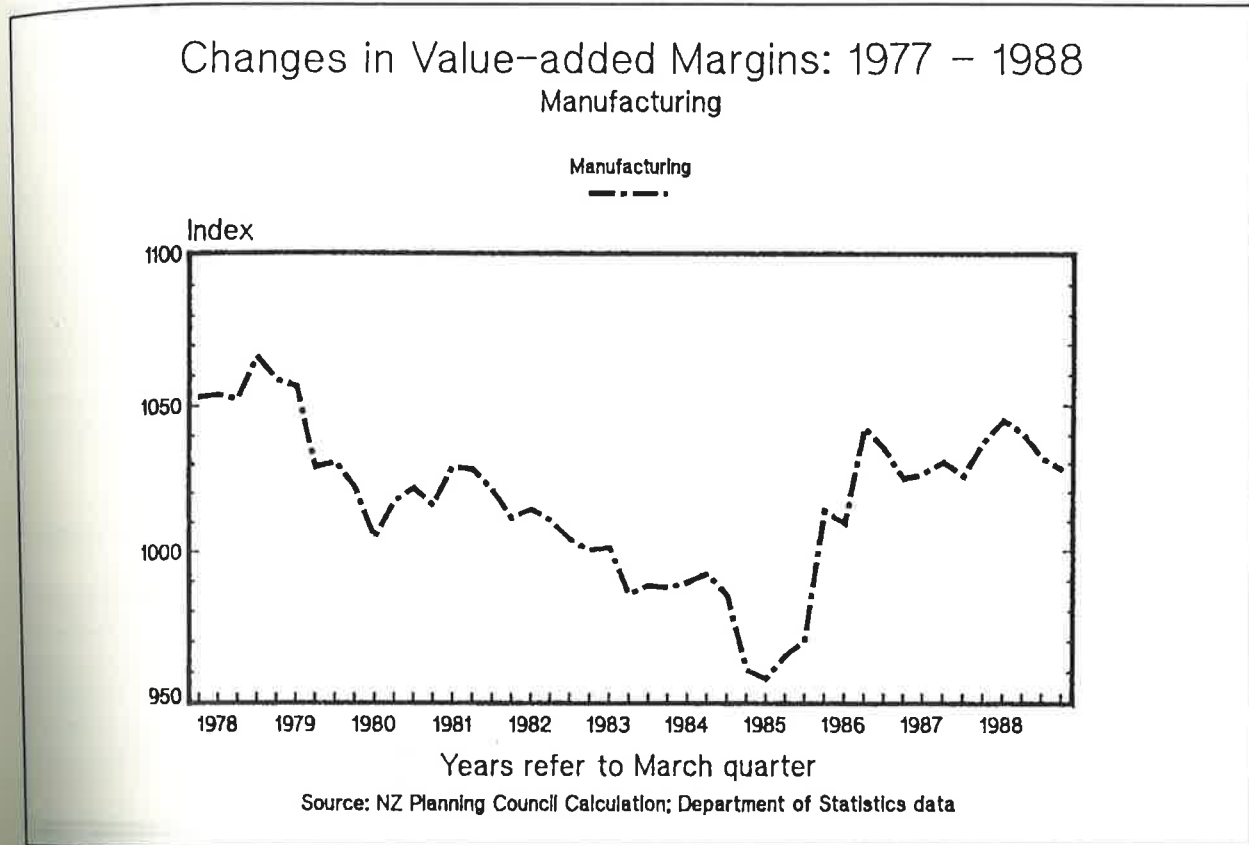
Trends in the ratio of the output prices index to the input price indexes for a given industry, are a measure of changes in value added. The indexes used are the producer price indexes. The inputs index does not include labour inputs or finance costs. Hence the ratio is a measure of trends in value added, rather than profitability in its more usual meaning. However, when cost indexes are constructed which combine labour costs with commodity input costs, very similar trends are observed.

This measure has been calculated for the ten-year period from 1978/79 to 1987/88. Infogram 4.11 shows the ratio for the non-tradeables and tradeables sectors separately, and Infogram 4.12 for manufacturing as a whole.

Infogram 4.11



Infogram 4.12



The striking feature of the results is that, in Infogram 4.11, the ratios for tradeables and non-tradeables, move so closely together for the whole period from 1978 to 1988. Likewise in Infogram 4.12, the feature is the apparent recovery in manufacturing value added margins from 1985 onwards, when a quite different result might have been expected as a consequence of exchange rate shifts, and the reduction in border protection and industry assistance.

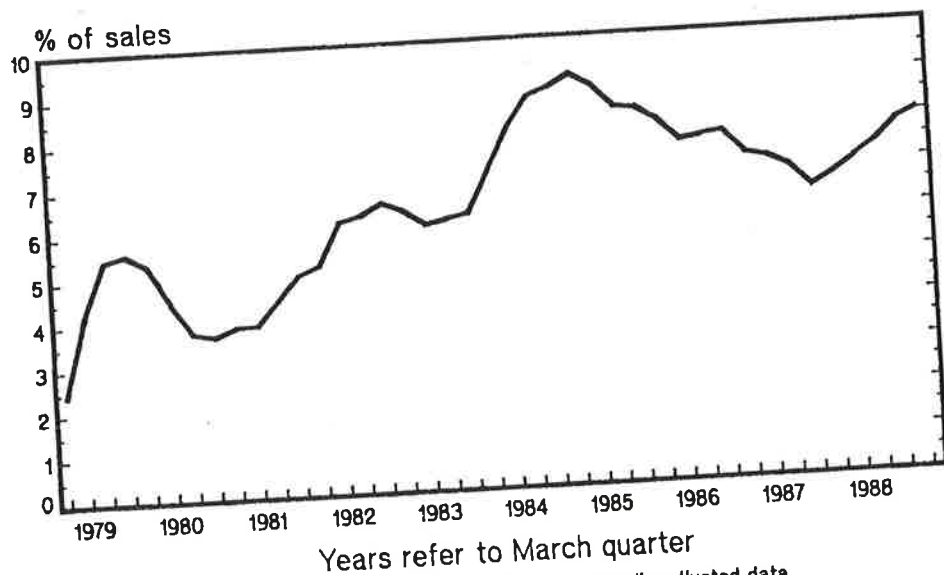
These outcomes are best explained by the manufacturing sector being predominantly output-responsive, rather than price-responsive, to competitive pressures in the market environment. In the face of increased competition, output of now unprofitable lines is reduced, in preference to cutting prices. Output is switched to other more profitable lines, or reduced in total. For the primary sector, a relevant factor is that input price indexes for pastoral agriculture include livestock values, which have declined in parallel to falling returns for pastoral produce.

For manufacturing industries, actual profits data are available from the quarterly manufacturing survey. Measuring profitability as the profits to sales ratio provides the information charted in Infogram 4.13. Three production groups have, however, been omitted from the total -- primary foods, chemicals and base metals. The last two groups contain the major-growth projects (think-big) coming on stream in recent years. These are very substantial operations, much more capital intensive than the average of New Zealand industry, and their inclusion destroys the comparability of the data over time. (The exclusion of primary foods has less effect, and is basically because its fortunes are more linked to those of the farming sector and to commodity terms of trade.)

Infogram 4.13 shows some interesting trends. Profitability rose from the early 1980s to a peak in mid 1984. The economic recovery of that period, in combination with labour costs being reduced by the 1982 to 1984 wage-price freeze, contributed to this. Profit margins then fell, through to mid 1987, as labour costs bounced back and the exchange rate strengthened. Finally, since mid 1987, profitability has again improved. It is this

Infogram 4.13

Manufacturing Profitability: 1978 - 1988
(excluding basic metals, chemicals and primary foods)



Source: Department of Statistics - seasonally adjusted data

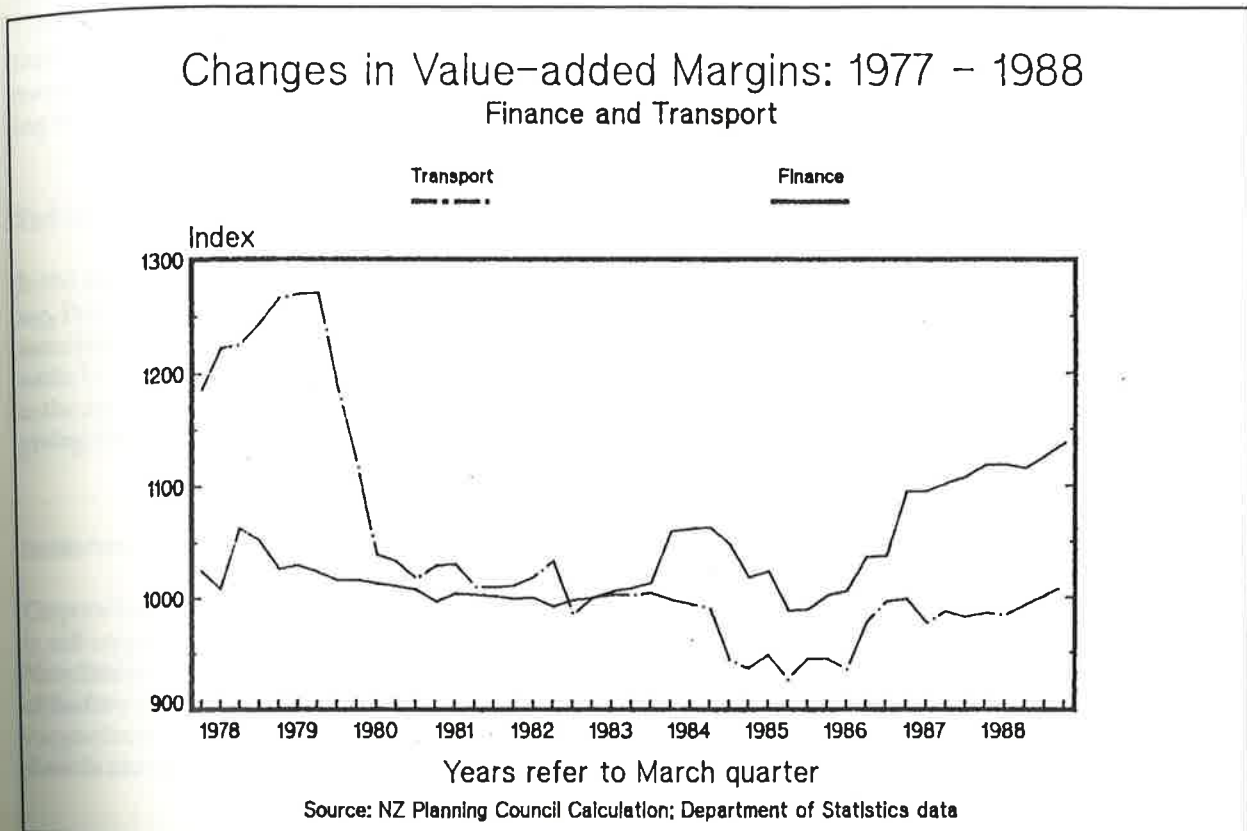
latest trend which is of particular interest. It is certainly tempting to see it as evidence of adjustment in the new environment, in using resources more efficiently, quitting less profitable lines of production most recently, enjoying the benefits of the improvement in New Zealand's external competitiveness over last year.

Turning now to specific instances of deregulation, two industries are of special interest; transport finance and business services. The relative value-added indexes for those two are shown in Infogram 4.14. (The effect of recent transport-sector reforms on consumer prices is discussed earlier in this chapter.)

The transport index does show a decline for the period as a whole, although with some recovery recently. However, the picture is confused by shifts in the price of a major input over the period, namely petroleum. The rapid decline in the index in 1979/80 is most obviously explained by the rise in world oil prices at that time. Given the general weakening in the price of oil since then, however, the fact that the index does not appear to have increased substantially can be seen as a consequence of deregulation of parts of the transport industry exerting a downward pressure on output prices.

Deregulation of the finance sector occurred in particular in 1984. Apart from the initial 1984/85 period, the ratio of output to input prices for the industry has tended to increase subsequently, including through 1988. The sizeable shift upwards in the ratio in the fourth quarter of 1986 is a consequence of the introduction of GST in that quarter -- GST being non-deductible for financial institutions, although the general trend has been affected. Recent results from the Bank of New Zealand and New Zealand Insurance suggest this ratio has changed since 1988.

Infogram 4.14



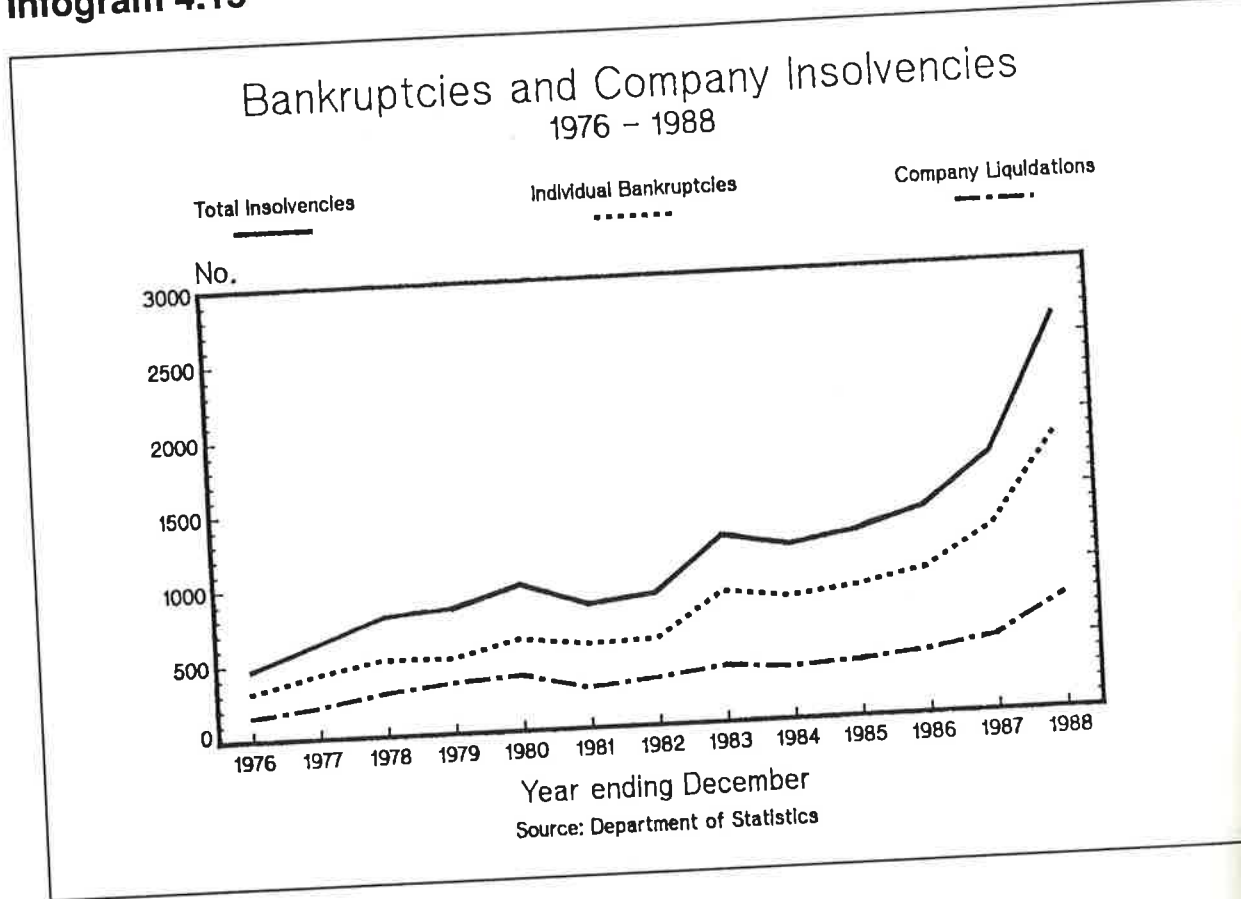
Restructuring Changes at Firm Level

The ideal position from which to observe response to the changed economic environment, is at the level of the individual firm, but there is little readily available information.

A measure of the casualties of change is provided by the available statistics on business and personal financial failure. Infogram 4.15 charts individual bankruptcies and company insolvencies over recent years. A large rise in total failures is evident in 1987 and 1988 although the number are only a tiny proportion of the total number of registered companies and other businesses.

Of more interest would be data on the 'births' and 'deaths' of businesses and changes within existing businesses. After 1984, but before October 1987, there appeared to be a dramatic change of attitude towards the setting-up of new business enterprises, with a raft of seemingly innovative ideas, including non-traditional livestock farming of goats, deer, rabbits, bloodstock and llamas, waste recycling, water exports, firewood growing, plus the usual property development, tourism ventures, and financial operations. State-owned enterprises were also developing a new business enterprise culture, and were beginning to test the marketplace with new ventures. The private sector development was primarily assisted by a strongly advancing sharemarket, which brought quick monetary rewards to those setting up the businesses in terms of capital gains, well before any real income was forthcoming. New manufacturing ventures were notably absent. This growth in new businesses is reflected in census data with a strong increase in self-employment between 1981 and 1986, after a long-term decline since the 1920s (see Infogram 4.16).

Infogram 4.15



Infogram 4.16

SELF-EMPLOYED AS A PROPORTION OF THE LABOUR FORCE¹ (%)

	1926	1936	1945	1956	1966	1971	1976	1981	1986
Self-employed with employees	9.5	9.1	9.4	7.5	7.2	6.1	6.6	5.9	7.3
Self-employed without employees	12.8	11.4	9.6	9.8	6.8	6.5	7.2	7.0	9.3
All self-employed	22.3	20.5	17.9	18.7	14.0	12.5	13.8	12.9	16.6

Note: 1. Total full-time labour force includes unemployed, and for all time periods represents those working 20 or more hours per week

This increase in self-employment appears to be spread across virtually all industry types, with perhaps the most surprising trend being a net increase in manufacturing jobs within small businesses between 1987 and 1988. It is difficult to isolate the effects of attitude and structural change in this altered trend. Up until the mid 1970s, much of the decline in the proportion of self-employed can be linked to the decline of employment in the primary sector where there is a high proportion of self-employed, and the rise of manufacturing where self-employment is relatively low. Some of the more recent changes reflect a range of other factors.

Technological change

In the last few decades there has been considerable focus on economies of scale, particularly in manufacturing, but also in areas such as banking, transport, communications, forestry and fishing. This has also been associated with the growth of multi-national firms, where the economies of scale can be on a world-wide basis. In certain areas this trend towards large enterprises is likely to continue. New technology, particularly in the area of micro-electronics, is also enhancing the competitiveness of small-scale customised production, giving rise to new opportunities for self-employment.

Institutional change

Corporatisation, devolution and freeing-up entry barriers for new firms all potentially contribute to growth in self-employment. Two examples of where there have been major changes are the corporatisation of the New Zealand Forest Service and the Post Office, particularly telecommunications. In the forestry area some of the former wage and salary earners are now contractors, while in communications there have been a wide range of new companies set up to install and sell telephones, put in wiring, lease PABX etc. With devolution there is also more potential for sub-contractors at a local level.

Labour-market changes

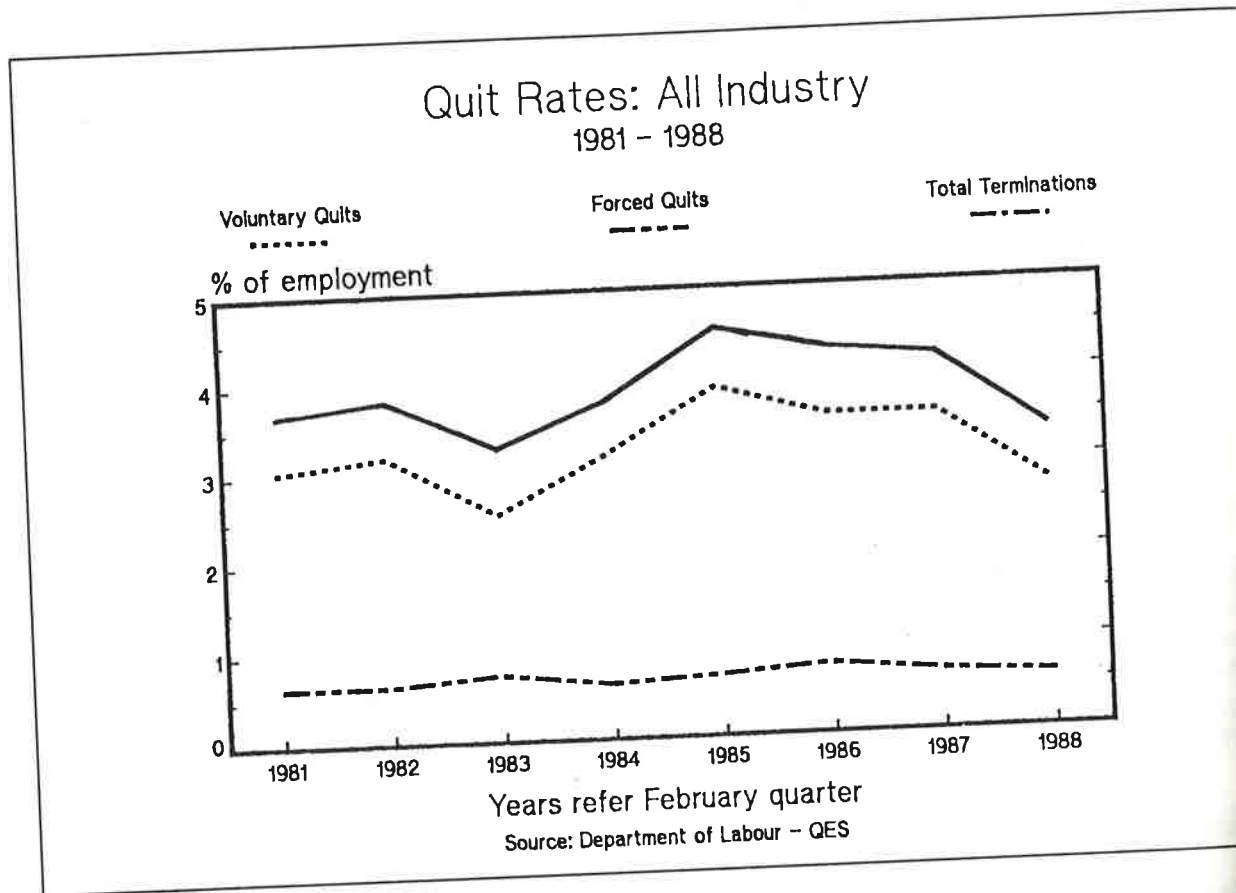
Employers or employees wishing to have more flexibility of employment arrangements may move from wage or salary agreement to contract arrangements. This may lead to a change in the classification of employment status.

Following the October 1987 sharemarket crash, a significant proportion of the more high-profile new businesses have failed, due to a mixture of business naivety in some enterprises, and a lack of substance in others.

Despite these failures there still appears to be growth in self-employment. The Department of Statistics' Business Patterns Survey indicates that the percentage of those gainfully employed in the category 'individual ownership' rose from 7.0 percent in 1987 to 7.2 percent in 1988, while those in partnerships rose from 8.6 percent to 8.8 percent. If a significant proportion of these new businesses can thrive and grow, a wider employment base could be expanded.

The restructuring period has seen large-scale layoffs in bigger industries despite the trend in self-employment and growth in small businesses. Large-scale redundancies and layoffs as a result of business closure attract considerable attention, and are naturally seen as prima facie evidence of change in response to restructuring. Surprisingly, the available data show very little fluctuation in the level of 'forced terminations' of employment over the past decade. (See Infogram 4.17, data from Quarterly Employment Survey.) The figures should be interpreted with some caution, however -- the infogram figures refer only to the February survey, and are for private sector, non-seasonal employment only, in still-operating businesses. But in general, voluntary 'quits' are far more numerous than forced 'quits', and vary with the business cycle. Labour turnover increases during an economic expansion, but decreases during a downturn. The total rate of quits has fallen since February 1985.

Infogram 4.17



Special studies provide an alternative to the official statistical sources. Pages 53 and 54 summarise the results of two such studies. The first is a report commissioned by the Economic Monitoring Group on the computer software industry in Christchurch. The second is a Department of Scientific and Industrial Research (DSIR) report on the electronics industry.

The computer software industry is a 'high-tech' industry which has been expanding rapidly for some years. Restructuring policies have not been a key factor in this expansion but are seen by industry participants as creating a favourable environment for continuing growth.

The electronics industry has not fared well in recent years, as shown by the infogram (p.54). Both output and employment have fallen substantially and increased competition from imports is certainly a factor in this. Interestingly this is not because protection against imports has been much diminished, but rather due to the production of traditional consumer electronic goods -- for example, radio and television -- has not been sufficient to hold markets against the competition of more technologically-advanced overseas products -- such as compact discs and video recorders. This is a good illustration of how high protection will not necessarily guarantee an industry long-term survival. However the DSIR study has identified a number of firms which have responded quite differently to the industry as a whole. If the growth of those firms continues, the consequence will be an upturn in output for the industry as a whole.

In summary, there are changes going on at the individual-firm level in response to regulatory reform and other restructuring policies. It is hard to obtain detailed evidence for these changes, but such glimpses as have been obtained suggest that they are in the desired direction.

THE CHRISTCHURCH COMPUTER SOFTWARE INDUSTRY (summarised from a case study commissioned by the EMG)

The computer software industry is a rapidly developing 'high tech' industry. It is dependent on advanced technical knowledge, a skilled workforce and good communications providing links to overseas markets.

Regulatory reform has not been a key factor in the development of the industry in Christchurch. However, it is seen by the industry as creating a more favourable environment and should induce further fast growth.

Software exporters in Christchurch account for about 11 percent of exporters nationwide and for about 24 percent of the total value of software exports. Export growth of 40 percent is expected for 1989.

SEVEN CHRISTCHURCH FIRMS: EMPLOYMENT AND GROSS OUTPUT (approximate figures)

	1984	1988
Employment	45	200
Gross output (\$million)	2.2	20.0

There are several beneficial effects of restructuring cited by the software firms. Business activity has been made far simpler and less time consuming. The zero-based inflation objective is helping firms remain competitive in international markets although the high New Zealand dollar is an inhibiting factor. Lower company tax rates, in an industry strongly reliant on profits for funding new projects, are seen as a strong plus factor for the future. Smaller firms stress the need for R & D incentives.

ELECTRONICS MANUFACTURING (summarised from a DSIR report, 1988)

In 1980 the electronics manufacturing industry was highly protected against competition from imports and today still retains a considerable degree of protection.

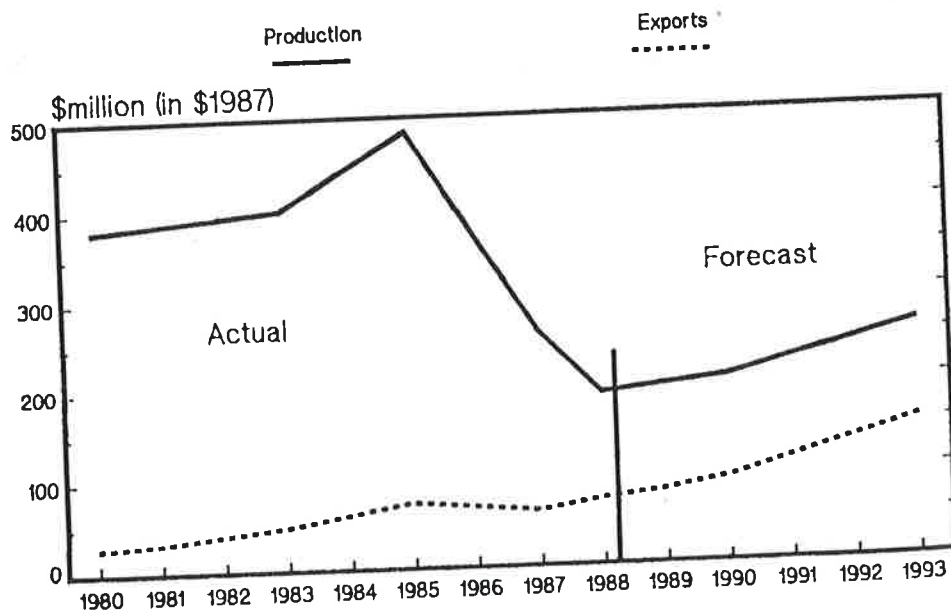
Output growth continued until 1985 and exports increased to 12 percent of total production in that year. Output then dropped rapidly to a level in 1988 of only 56 percent of 1980 production and employment of nearly 5000 in 1980 was halved.

The DSIR study was of selected 'growth' firms. These accounted for 70 percent of industry output in 1988, compared with 25 percent in 1980. On average they exported 50 percent of production. Employment of professionals trained in electronics doubled between 1980 and 1988 for the industry as a whole.

The infogram shows the projected growth of the industry if expansion of growth firms relative to non-growth should continue at 1985 to 1987 rates. Both industry output and exports would grow in real terms, and the industry would become predominantly export-oriented.

It is clear some firms are adapting to and prospering in the new more outward-looking environment, and this could lead to renewed growth for the industry as a whole. Growth is linked to a more skilled workforce than in the past. The declining part of the industry appears to consist of firms assembling consumer electronic goods from imported designs, whereas the 'growth' firms appear to be those aiming at the business market, and finding 'niches' for products from their own research.

Electronics Manufacturing: Projected Growth 1980 - 1993



Source: DSIR Report

Summary

At industry level, it is not easy to disentangle the effects of industry-specific restructuring policies from such general influences as the business cycle, and real exchange rate changes. Also there are long-term 'natural' restructuring changes going on, whose consequences are easily confused with the outcomes from policy-caused restructuring. Examples include diversification in land use, the trend of declining employment in manufacturing, and increasing employment in service industries.

It can be concluded, however, that rapid change by previous New Zealand standards is occurring. Adjustments to the new environment are reflected in both price changes and output changes, with the latter seeming the more general response (Output price responsiveness can of course be constrained by rigidities in input prices.) The actual response will differ from industry to industry depending on the changed environment for each industry, and their different production structures. For instance, the response of a 'price-taking' industry such as agriculture to the difficult conditions faced in the early stage of restructuring has been the traditional one -- of maintaining and increasing output but reducing inputs. For manufacturing industries, the choice is more to constrain output. However, labour inputs have been reduced more rapidly (an acceleration in previous trends) so that a reasonable growth in labour productivity has been maintained. (It is difficult to assess overall productivity performance for manufacturing, because of the significant changes in the sector's capital stock.) There is more variability in outcomes between the different services industries, but for the services sector as a whole, there has been an impressive improvement which seems to be at least partly caused by restructuring reforms, in terms of faster output growth, a significant speed-up in productivity growth, and the maintenance of employment growth. The latter has not been sufficiently large to outbalance the labour-force shake-out in primary and manufacturing industries.

These changes are at aggregate industry level -- it is more difficult to assemble evidence on outcomes at the level of individual businesses. Such evidence as is available suggests that at least a proportion of firms are adapting to the new environment in ways which will improve their individual growth performance, and that of the economy as a whole.

CHAPTER FIVE

External Trade Outcomes

This chapter focuses on two areas -- first, the effect of reductions in protection and in assistance to industry in general and, secondly, changes in external competitiveness, particularly as they affect exports. The reduction in industry assistance and protection is a major component of the restructuring reforms of this decade. Changes in competitiveness are an outcome of economic restructuring. For each of these areas data are provided on the changes in assistance levels and in competitiveness. An attempt is made to assess the outcomes of these changes, in terms of changes in imports and exports.

Background

From the late 1930s, restrictions on imports and foreign exchange transactions to deal with balance of payment difficulties were put in place. These temporarily suppressed the problems of external imbalance, but did not offer a permanent cure. Instead, such measures raised a protective barrier around New Zealand manufacturing by isolating producers from competitive pressures and raising domestic costs.

From the early 1960s, a policy of active encouragement of exports was adopted, in addition to import protection. Initially a major aim of this policy was export diversification into 'non-traditional' products, motivated in particular by the United Kingdom's attempts to enter the European Economic Community. Subsequently, as the costs of import protection to the rest of the economy were realised, 'compensation' for the 'excess' domestic costs of protection became an important part of the justification for export encouragement. Eventually very substantial assistance was also extended to 'traditional' exporters -- in particular Supplementary Minimum Price (SMP) subsidies to pastoral agriculture -- in addition to the rapidly expanding assistance being paid to 'non-traditional' exporters.

By about 1980, as a result of this haphazard accumulation of protection and assistance policies over the decades, a structure of industry assistance had taken shape. This was:

- highly protective on average
- very variable in its incidence
- non-transparent
- distorting in its effects on the allocation of resources
- costly in the fiscal sense
- costly to the consumer.

These problems had long been known and discussed. In 1969 apparent agreement was reached on the need to replace import licensing by tariffs as a first step towards greater rationality and transparency. The first tentative steps were taken from 1979 onwards by putting up an increasing proportion of import licenses for tender in order to establish tariff equivalents. Programmes were established to phase out the import licensing system. At the same time negotiations with the Australian Government led to the Closer Economic Relations trade agreement (ANZCERTA) commonly known as CER, replacing the previous free trade agreement. Signed in 1983, CER provided for trans-Tasman free trade by the mid 1990s. (Progress towards this is currently ahead of schedule.)

The pace of change accelerated considerably from 1984 -- most export incentives and subsidies have now been eliminated. The phasing-out of import licensing was completed by July 1988 (apart from some residual controls for more vulnerable industries such as textiles and apparel, and auto assembly).

The focus has now switched to tariff reform, with the general objective being a phased reduction in all tariff levels, but with greater reductions in the higher tariffs (Tariff Review Committee report 1987).

Technical Concepts

Assistance to industry includes:

- output subsidies -- for example, SMPs for agriculture, and export incentives for manufactured goods. In this category there is also the 'subsidy' which border protection (tariffs and import licenses) confers on producers for the domestic market by pushing up the prices they can charge
- input subsidies -- for example, fertiliser subsidies for agriculture
- subsidies to value added -- for example, government-financed research and advisory services, subsidised labour, concessional interest rates in some sectors.

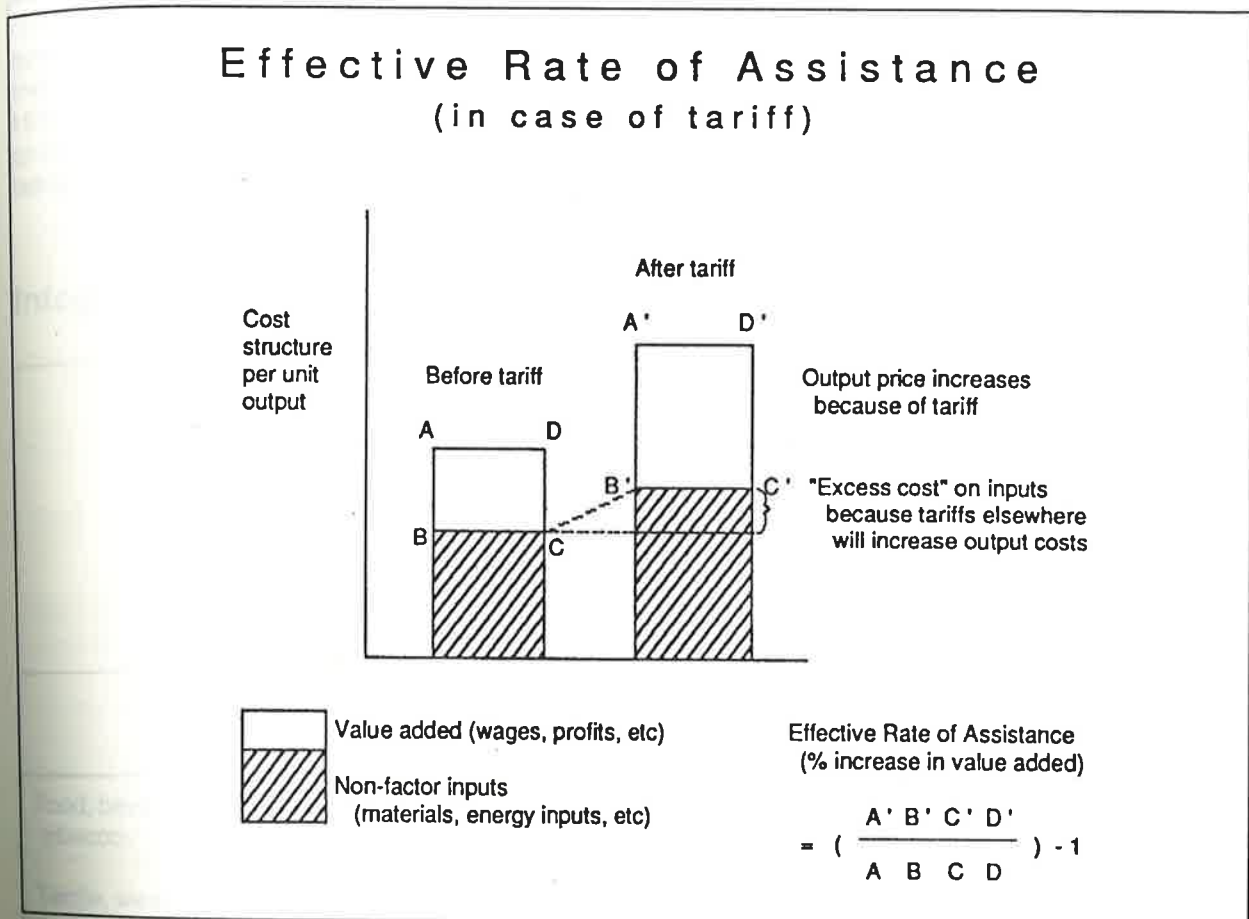
Border protection is one of the major means of providing assistance to domestic import-competing industries but it is only a part of total assistance to industry (including assistance to exporters and to producers of non-tradable goods and services).

A widely-used measure for comparing the level of assistance between different industries, which indicates the magnitude of resource-allocation effects, is the Effective Rate of Assistance (ERA). This measures the proportionate amount by which the value added per unit output of a given commodity is increased by government's assistance measures above what it would have been without government intervention. It allows for the fact that tariffs and import licenses, while allowing domestic producers to increase their selling price, can also increase the cost of inputs purchased by the producers -- that is, causes an excess cost. The ERA measures the net outcome of these two effects.

Infogram 5.1 illustrates the calculation of the ERA for a good whose output prices and input prices are increased by tariffs (or other border protection). Note that the ERA can be negative, for example, if the excess costs imposed on inputs by tariffs and import licenses should exceed positive assistance elsewhere. It is generally argued that exporters, particularly those of traditional pastoral produce, have been in a weak position. Recent work, however, puts these excess costs for agriculture at rather lower levels than previously believed.

It should be noted that ERAs thus measured are so-called partial equilibrium measures -- that is, they measure the direct impact on a specified industry or commodity. They do not take into account the indirect consequences ramifying through the economy in the form of changes in employment, pay rates, Real Exchange Rate, etc. To take account of such effects an economy-wide general equilibrium measure is needed. An ERA measures assistance per unit output. The Net Subsidy Equivalent (NSE) is the aggregate notional subsidy -- that is, an industry's pre-assistance aggregate value-added multiplied by the Effective Rate of Assistance.

Infogram 5.1



Estimates of Changes in the Level of Assistance

Trends in the level of industry assistance in recent years are provided by a recent government-commissioned report, *Industry Assistance Reform in New Zealand* (Syntec Economic Services 1988). The report covers agriculture and manufacturing, but excludes assistance provided through export subsidies, mainly to manufacturing. The substantial forthcoming tariff reductions announced in December 1987 are not taken into account.

Infograms 5.2 and 5.3 compare the decline in aggregate assistance to the agriculture and manufacturing sectors. Net assistance to pastoral agriculture fell by more than 50 percent between 1985/86 and 1987/88; that to manufacturing fell by about one-third. This bears out the common assertion that agriculture has been forced to adjust much more rapidly than manufacturing towards an 'intervention-free' situation. The data for both sectors are in current prices, not adjusted for inflation, so in real terms the fall is substantially larger.

Infogram 5.2

AGGREGATE ASSISTANCE TO MANUFACTURING

	March Years		
	1981/82	1985/86	1987/88
	(\$million)		
Gross subsidy equivalent - on outputs	3,008	2,887	2,195
Gross tax equivalent - on inputs	825	776	731
Net subsidy equivalent - on value added	2,183	2,111	1,463

Source: Syntec 1988, Table 2.1 (p.33)

Infogram 5.3

AGGREGATE ASSISTANCE TO AGRICULTURE

	March Years				
	1981/82	1983/84	1984/85	1985/86	1986/87
Gross Assistance (\$million)					
On output (e.g. SMPs)		422	296	152	86
On inputs (e.g. fertiliser)		80	68	29	20
To value-adding factors (e.g. Rural Bank loans at concessional interest) ¹		1,131	482	713	1,611
Total		1,633	846	894	1,717
Net Subsidy Equivalent²	600			536	343

Source: Syntec 1988, Tables 2.2 (p.35) and 2.7 (p.43)

Notes: 1. Also discounting of Rural Bank debt in 1987/88, and substantial stabilisation account debt write-offs in 1983/84 and 1987/88.
2. The gross figure is for all agriculture, and the NSE for pastoral agriculture only, but the effects of this difference in coverage should be small

Infogram 5.4 shows the ERAs for manufacturing by industry and also the Net Subsidy Equivalent. For manufacturing as a whole the ERA fell by one-third, from 39 to 26 percent between 1981/82 and 1987/88, most of this from 1985/86. At industry-group level, assistance fell for all groups, but substantially more in general for those with higher initial levels of protection, so that the overall variability of assistance between industries was reduced. A more detailed analysis shows a general reduction in variability within industries. However, effective assistance levels are still high for textiles and apparel, and the fabricated metal products group. Net Subsidy Equivalent assistance to these two groups amounted to over half the net assistance still being provided to manufacturing in 1987/88. Infogram 5.5 illustrates the changes at industry level.

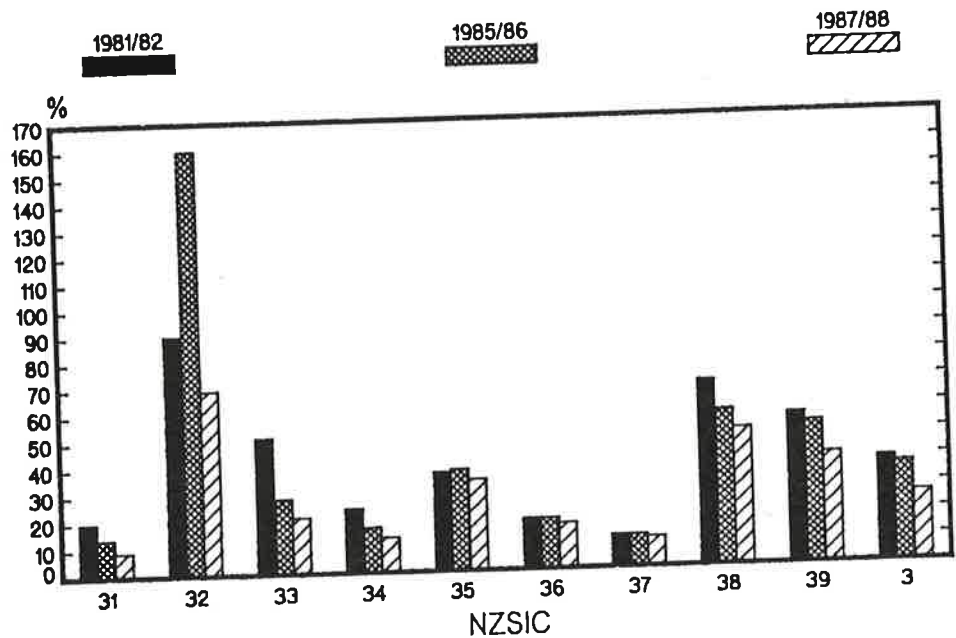
Infogram 5.4

	Average (%)			Net Subsidy Equivalent (\$million)
	by industry			
	1981/82	1985/86	1987/88	
Food, beverages & tobacco	20	14	9	148
Textile, wearing apparel, leather industries	90	160	69	286
Wood & wood products, including furniture	51	28	21	78
Paper and paper products, printing & publishing	24	17	13	108
Chemical & petrol, coal, rubber & plastic products	37	38	34	217
Non-metal mineral products excluding petrol & coal products	19	19	17	49
Basic metal industries	12	12	11	29
Fabricated metal products, machinery & equipment	69	58	51	528
Other manufacturing industries	56	53	41	21
All manufacturing	39	37	26	1,463

Source: Syntec 1988, Tables 2.5 and 2.6 (pp.41-42)

Infogram 5.5

Manufacturing: Average Effective Rates of Assistance
1981/82 - 1987/88



Source: Syntec 1988, Figure 3.2, (p.55)

For Infogram 5.5 (above) the New Zealand Standard Industry Codes (NZSIC) are as follows: 31 food, beverages and tobacco; 32 textiles, wearing apparel, leather industries; 33 wood and wood products, including furniture; 34 paper and paper products, printing and publishing; 35 chemical and petrol, coal, rubber and plastic products; 36 other non-metallic mineral products; 37 basic metal industries; 38 fabricated metal products, machinery and equipment; 39 other manufacturing industries; 3 manufacturing in total.

A breakdown for pastoral agriculture is shown in Infogram 5.6. The high ERAs in 1981/82 and 1986/87 were primarily due to SMP subsidies and stabilisation debt write-offs respectively. The assistance rate of 15 percent in 1987/88 was dominated by the contribution of concessional Rural Bank loans and discounting of Rural Bank debt. This can be expected to diminish as Rural Bank rates converge towards market rates. (Debt write-offs are not an easy concept to handle as they are often, in effect, a capitalisation of subsidies relating to earlier years.)

In general the assistance provided for agriculture has been different in nature from that for manufacturing. Agricultural assistance was predominantly devised to carry farmers through years of temporary difficulty whereas assistance to manufacturing has been much more of a stable long-term nature. It is therefore to be expected that agricultural output will respond to the same extent to reductions in assistance as will manufacturing.

Infogram 5.6

ASSISTANCE TO PASTORAL AGRICULTURE

	Years ended March			
	1981/82	1985/86	1986/87	1987/88
Effective Rate of Assistance (%)				
Sheepmeat	184	huge	huge	25
Wool	121	2	10	11
Beef	91	33	19	19
Manufacturing milk	30	19	23	21
Town milk	88	104	128	33
Total	82	46	94	18
Net Subsidy Equivalent (\$million)				
Sheepmeat	149	245	114	41
Wool	217	98	45	47
Beef	117	81	68	55
Manufacturing milk	98	88	89	80
Town milk	19	24	27	11
Total	600	536	343	234

Source: Syntec 1988, Table 2.7 (p.43)

International Competitiveness

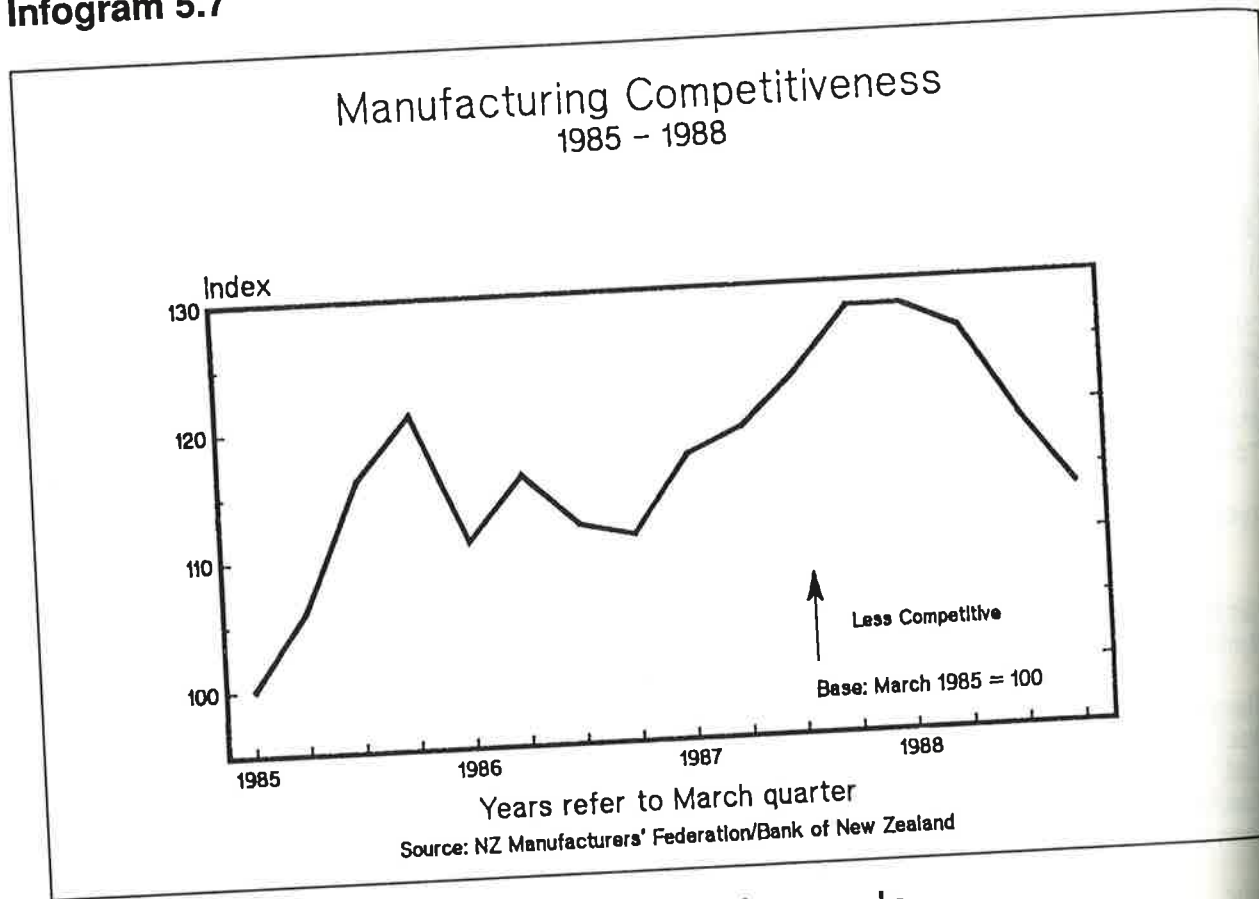
The competitiveness of New Zealand-produced goods and services on export markets, or within New Zealand in competition with imported commodities, is affected by:

- changes in the nominal exchange rate
- changes in the relative output prices of New Zealand-produced and competing foreign-produced goods.

A Real Effective Exchange Rate index (REER) (see Appendix Two) measures the combined effect of these two influences on competitiveness. If expressed as the ratio of prices of New Zealand goods to prices of foreign-produced goods, adjusted for exchange-rate changes, then a rise in the index shows a loss of competitiveness, and a fall shows a gain in external competitiveness. The index used here is the Manufacturers' Federation/Bank of New Zealand index which compares producers' prices.

Infogram 5.7 shows the Manfed/BNZ index for manufacturing-sector competitiveness from 1985 onwards. After the 1985 float, there was an initial weakening in competitiveness (rise in the index) followed by an improvement in 1986. There was a further pronounced deterioration in competitiveness up until the end of 1987. Since June 1988, with the fall in the nominal exchange rate, and in inflation, competitiveness has improved significantly although not back to the level in March 1985.

Infogram 5.7



Outcomes for Manufactured Imports

The level of imports, and of domestic output, is influenced by changes in international competitiveness and in levels of border protection.

Some of the sharpest falls in previously high effective rates of assistance have occurred in:

- leather and leather products (from 54 percent in 1985/86 to 25 percent in 1987/88)
- footwear (from 102 percent in 1981/82, to 586 percent in 1985/86 and 73 percent in 1987/88)
- furniture and fixtures (233 percent in 1981/82, 123 percent in 1985/86, 75 percent in 1987/88)

Infogram 5.8 shows imports for selected years since 1979/80, in the above categories. Imports in all the categories have increased relative to total imports. The growth in furniture imports is particularly noteworthy.

Data complexities hinder a more complete analysis. Nevertheless the figures do suggest that there have been significant impacts on import levels and composition resulting from reductions in border protection. In addition to more general changes resulting from loss of international competitiveness during 1985 to 1988, a wider range of goods is available to New Zealand consumers, and New Zealand industry is facing greater competition. The textiles and apparel group receives assistance from protection higher on average than any other production group, but has also undergone a significant reduction in its effective rate of assistance. An EMG-commissioned case study on the textiles and apparel group is summarised on page 65.

¹ Rates of the order of several hundred percent are a result of problems with data accuracy when the value added is small.

THE TEXTILES AND APPAREL INDUSTRY

The industry is largely producing import-competing goods (apparel, footwear, textiles) but also has a significant export component of processed primary products (wool scouring, hides, furs) and manufactured goods (carpets, carpet yarn, leather goods). It is predominantly labour-intensive, with many small firms widely dispersed. The proportion of women in the workforce is much higher than for the rest of manufacturing.

The industry's competitiveness has been affected by the removal of export subsidies, by the reduction in protective barriers against imports (although protection is still in general high) and by the rise in the exchange rate.

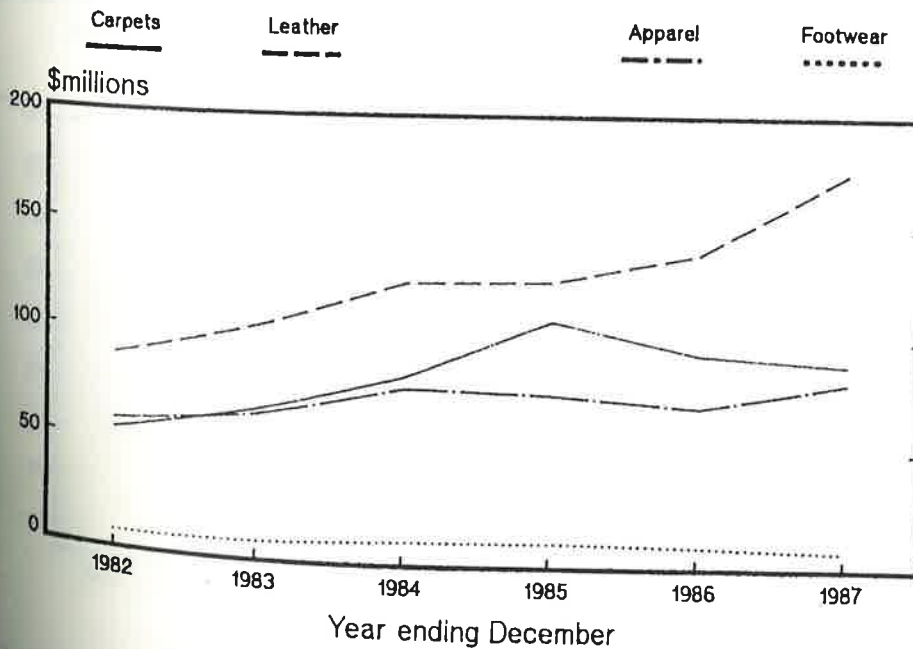
As a result of these changes imports have increased from 7 percent of the domestic market in 1983/84 to 22 percent in 1988/89 and are projected to reach 37 percent by 1992/93.

From 1982 to 1987 export growth has slowed, although leather and leather products have increased. This could be a result of fashion demand, but could also reflect resources being reallocated to those sectors of the industry with a better competitive advantage.

Between 1981 and 1986 wages increased less for this sector than for the workforce as a whole. The long-term trend since the mid 1970s has been for declining employment in the industry, with labour productivity rising. Restructuring has accentuated these trends. Output and employment have fallen recently, employment more rapidly, while labour productivity has increased further.

Some of the more efficient producers are adapting to the change and expanding production.

Textile Exports 1982 - 1987



Source: Department of Statistics

There have been some useful reforms in the company tax field in recent years which have reduced distortionary effects on business decisions, including those effects compounded by inflation. They include the 'imputation' of tax on dividends, the removal of selective investment incentives, the reforms to primary sector taxation, and the reduction in company tax rates. The introduction of a capital gains tax is under consideration.

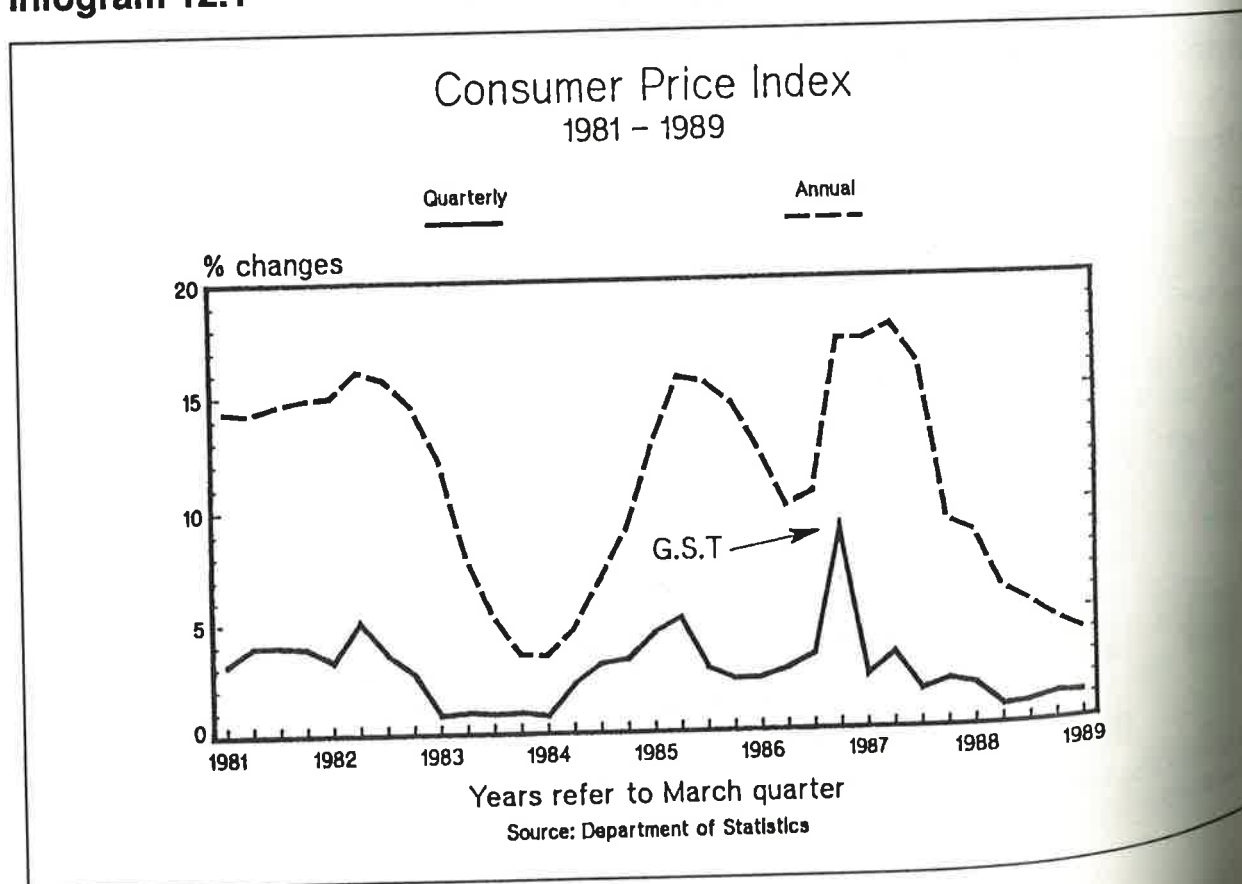
These changes have not, however, eliminated all the problems caused by the interaction of the tax structure and persistent inflation. Changes to the tax system and accounting practices can provide only a second-best solution to the problems caused by inflation. The best solution is to reduce the rate of inflation to a low level.

Movements in the Consumer Price Index (see Infogram 12.1) indicate that the path to low inflation has by no means been rapid or steady.

The impetus to inflation observed in 1984 at the end of the wage-price freeze is clearly evident. This has already been argued to be the inevitable consequence of a totally inadequate price and incomes approach. However, despite this catch-up effect, monetary policies had succeeded quite rapidly by early 1985 in halting these rates of price growth and in starting to pull inflation back toward single figures. The introduction of GST in October 1986 clearly interrupted this process, though price increases recommenced their downward trend in mid 1987. These trends suggest that with present disinflationary policies, an inflation rate less than 4 percent in 1989/90 is possible.

The only lower rates of inflation seen in recent years were for the two quarters at the end of 1983 and the beginning of 1984 when year-on-year consumer price inflation fell to 3.5 percent. However, this was a consequence of the wage-price freeze from June 1982, and it was evident at the time that the success in controlling inflation was likely to be transitory as the Consumers Price Index increasing 2.2 percent for the quarter, and the increase from a year earlier rising to 4.7 percent.

Infogram 12.1



The present reduction has been achieved not by controls on prices and wages but by disinflationary monetary and fiscal policies, aided by microeconomic regulatory reform. Its success will be longer-lasting than in 1983/84. The current policy disputes are not over the success of post-1984 policies in achieving the disinflation objective, but as to whether the success achieved is sufficiently established to allow a relaxation in those policies. Put another way, have inflationary expectations in the community, well-founded on past experience, been sufficiently quelled by experience since 1985 to prevent a resurgence of cost-inflation on any appearance of easing of policy? Or, as the Reserve Bank argues, is there still general scepticism about the long-term resolve of government in reducing inflation, and hence a necessity to prove that resolve by persisting with firm monetary policies for some time yet?

There is considerable support for the Reserve Bank view in the history of the last two decades, with an apparent cycle in inflation -- the rate rising every few years to in excess of 15 percent on the upswing, before being brought down again to single-digit levels by disinflationary economic policies. What is more in question than a continuing need for disinflationary policies is the current mix of those policies, with its strong reliance on monetary control and the consequent costs, via the exchange rate, for the export-oriented sectors.

Two other comments are relevant. First, an economy with 'fully-clearing' markets would not suffer the output and employment costs currently being experienced during the process of eliminating inflation. Real-life economies do not approach the 'market-clearing' model very closely. However, making markets more competitive, both domestically and against overseas competition, does help prevent a rapid resurgence of inflationary pressures as economic growth picks up. This is a major justification for the microeconomic policy reforms of recent years, and for their continuance into the future.

Secondly, a social 'compact', as currently being considered, could also have a role in containing any resurgence in inflationary expectations. This, in whatever form such a compact would take, does likely involve constraints on labour-market competitiveness, but at the aggregate level could play a part in relating general nominal wage increases more closely to overall productivity growth.

Fiscal balance

Chronic substantial fiscal deficits are harmful to the economic prospects of a country, both because of the added borrowing that they entail, and because of the growth of government debt that they lead to. The former tends to increase interest rates and hence the real exchange rate as well as indirectly depressing private investment. The growth of debt increases debt-servicing costs and so crowds out other items of government expenditure, and can generate pressures to 'monetise' the deficit so that inflation re-emerges, as a means of reducing the real debt burden. The achievement of fiscal balance is therefore important.

At its simplest, fiscal balance means government balancing its revenue and expenditure so that there is, on average, a zero deficit or surplus. However, as discussed in Chapter Ten, there are several measures of the fiscal deficit for use in varying policy contexts. Also, if debt or debt-servicing costs are judged to be too high, the fiscal target needs to move more towards surplus, at least initially, until debt is reduced to a more appropriate level.

Whatever the measure used, there has been very considerable progress towards achieving the objective of fiscal balance. Infogram 10.1 (p.121) illustrates this, with most measures of the deficit reaching their peak in 1984/85. Since then, there has been a very considerable reduction in the deficit. Corresponding to this has been a reduction in the ratio of public debt to GDP, as shown in Infogram 10.2 (p.123).

What should be the appropriate target level for the deficit or surplus? The EMG's previous report, *Tracking Down the Deficit*, argued for a deficit target (cyclically-adjusted net financial balance) on a sustainable basis of "well below" 2 percent of GDP (p.65). Over the longer term, the recommendation was that "a balanced budget should remain the goal".

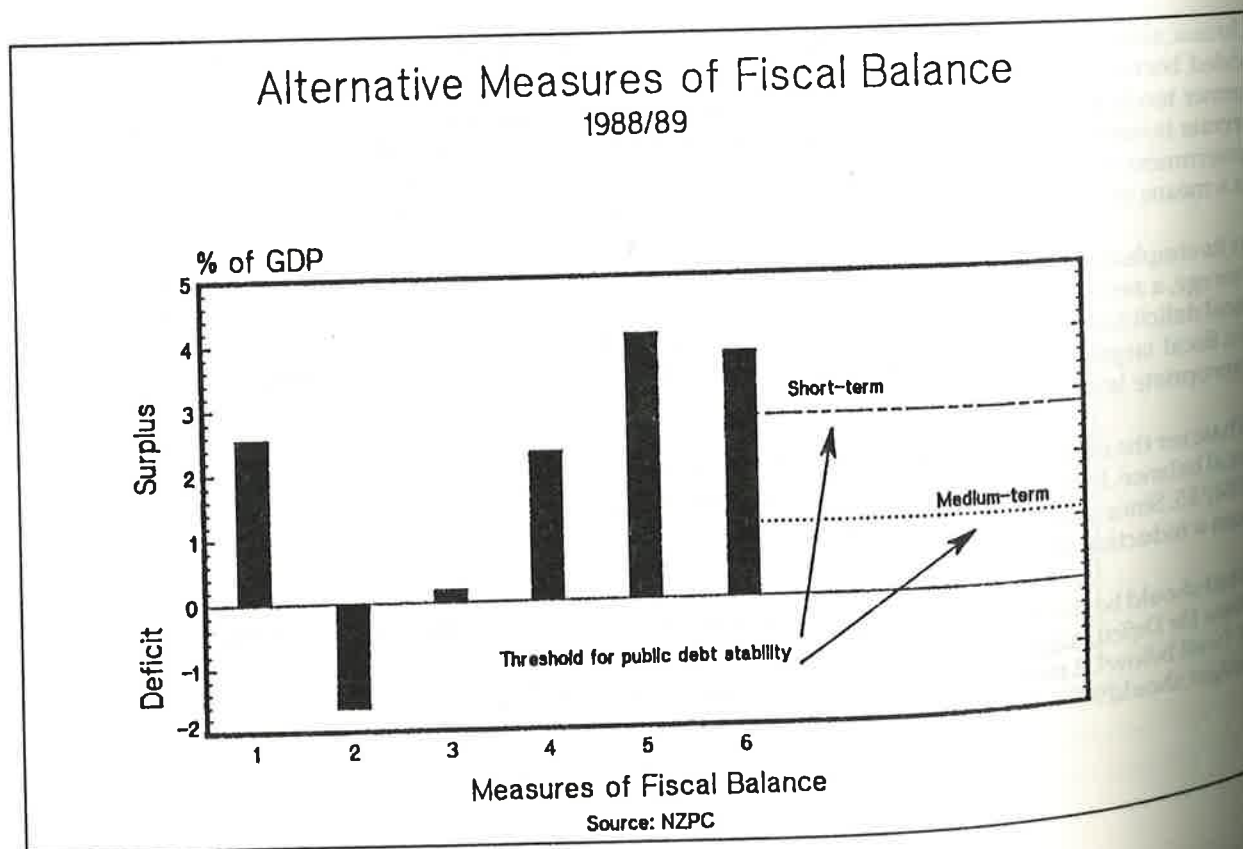
Infogram 12.2 shows, for the various measures of fiscal balance discussed in Chapter Ten, the estimated outcomes for the latest fiscal year to March 31 1989. Some special features of the tax changes applying in that year (for instance, the bringing forward of provisional tax payment dates) mean that without other policy changes the fiscal balance could be expected to deteriorate during the current fiscal year, 1989/90. However, tax and expenditure changes announced in the Minister of Finance's Economic Statement of 21 March 1989 are projected to reduce the 1989/90 deficit by around \$1.5 billion.

From the 1988/89 outcomes in Infogram 12.2, the deficit target earlier proposed by the EMG has been comfortably achieved. However, it has to be added that there are some differences in the calculation of the cyclical adjustment (and also of the inflation adjustment). The cyclical adjustment for 1988/89 calculated on the same basis as in earlier EMG reports amounts to some \$1200 million. However, governmental calculations give much smaller estimates of the adjustment, resulting in a substantially larger cyclically-adjusted deficit.

Given the technical difficulties leading to these differences in estimates, and also an underlying conceptual difficulty (see Chapter Ten), the EMG now considers that the cyclically-adjusted balance is not the appropriate fiscal target.

Of the measures listed in Infogram 12.2, the unadjusted Net Financial Balance has the advantage of being unambiguously measured. The inflation-adjusted NFB measures changes in real public financial worth, while the non-interest budget balance, relative to the 'threshold', shows whether or not public debt is growing relative to GDP. The last two are closely related, but their calculation is again affected by assumptions made about the 'real' interest rate. The EMG considers, however, that its approach, using an estimated stable long-term real interest rate in preference to actual real rates varying year to year, is the better. The key for Infogram 12.2 (below) is as follows: 1. Budget Table No. 2 balance; 2. Net Financial Balance (NFB); 3. NFB cyclically adjusted (structural balance); 4. NFB inflation adjusted; 5. NFB cyclically and inflation adjusted; 6. Non-interest budget balance.

Infogram 12.2



The EMG considers that a primary objective of fiscal policy should be a continued reduction in debt ratios, and that this is best achieved for now in terms of a non-interest budget balance target. The surplus on this measure should certainly continue to be higher than the 'medium term' 1.1 percent threshold in Infogram 12.2, and should be of the order of 3 percent or higher at current interest rates. This is more or less consistent with a deficit on the Net Financial Balance of not more than 2 percent of GDP.

To sum up, the fiscal balance objectives of restructuring, like the disinflation objectives, are well on their way to being met. The doubt about holding the fiscal balance objective is different from the doubts about holding the disinflation objective expressed earlier. Holding the latter depends on the eradication of inflationary expectations in the general populace, while the former depends on the elimination of the electoral cycle of fiscal deficits that have characterised so much of New Zealand's post-war economic history. It is to be hoped that the unhappy experience with substantial deficit financing over the 1974 to 1985 period will make such cycles less appealing to political parties and to the electorate in the future.

External balance and overseas debt

As with internal fiscal deficits, chronic and substantial external deficits are harmful to economic prospects. They lead to a build-up in overseas debt. The servicing of that debt, other than that incurred for reasons of productive investment, is a cost borne by New Zealanders in the future to pay for today's consumption.

Above a certain level of debt, New Zealand's credit rating is affected and interest rates on borrowing are increased. With further increases in external debt, the economy becomes increasingly vulnerable to sudden changes in the external environment which could make the debt-servicing burden insupportable, and require radical and hurtful changes in economic policy. New Zealand is not in that position, but is much nearer to it than would have been thinkable two decades ago.

The external balance objective is to reach an external surplus or deficit position which is sustainable on average over the years, and compatible with satisfactory long-term growth for the economy as a whole. One interpretation of this objective is in terms of external debt and its ratio to GDP. Namely, any continuing external deficit on current account should be at a level on average such that the net external debt/GDP ratio should not increase.

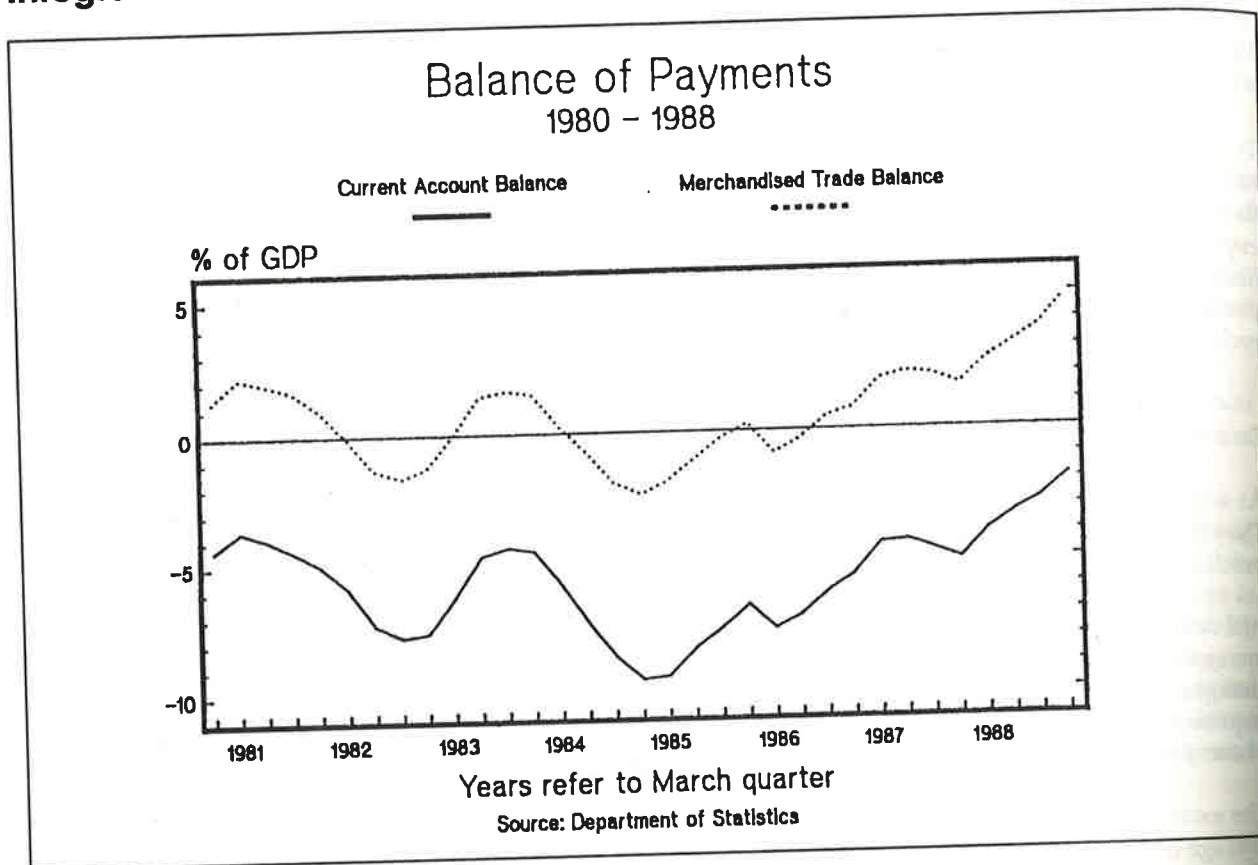
With net external debt having climbed to the level it had by 1985, any further increase in the external debt ratio was clearly dangerous in terms of New Zealand's creditworthiness (see *Overseas Debt – An Assessment*, D. Webber 1988). And rather than following a policy of holding debt at existing levels, the more imperative need had become to reduce the debt/GDP ratio. While asset sales, or a shift to a faster growth path etc, can contribute to this, the fundamental adjustment mechanism must be the running of a sufficiently large surplus on trade in goods and services, larger in amount than the contribution of debt-servicing costs to the overall current account deficit.

As shown in *Overseas Debt – An Assessment*, and in *Prospects: Economic and Sectoral Trends to 1997* (New Zealand Planning Council 1988), a surplus on the goods and services balance of the order of 1.5 percent or more does reduce external debt levels to a less precarious position by the mid to late 1990s. This is in terms of the debt to GDP ratio.

Substantial progress towards external balance has been made since 1985 (see Infogram 12.3). A surplus on the trade balance of the order of 5 percent of GDP was achieved in the calendar year 1988. Although much of this improvement has been offset in dollar terms by a continuing large deficit on invisibles trade, the overall current account balance, as a proportion of GDP, has shown quite steady improvement. Most recently, this improving trend has picked up pace and, with the reduction in the growth rate of interest payments arising from a stabilised stock of external debt, it is reasonable to expect that the current account deficit will reduce further, and possibly more quickly over a subsequent period.

This trend has been somewhat surprising in view of the decline in competitiveness arising from the exchange rate and relative inflation rate movements described in Chapter Nine.

Infogram 12.3



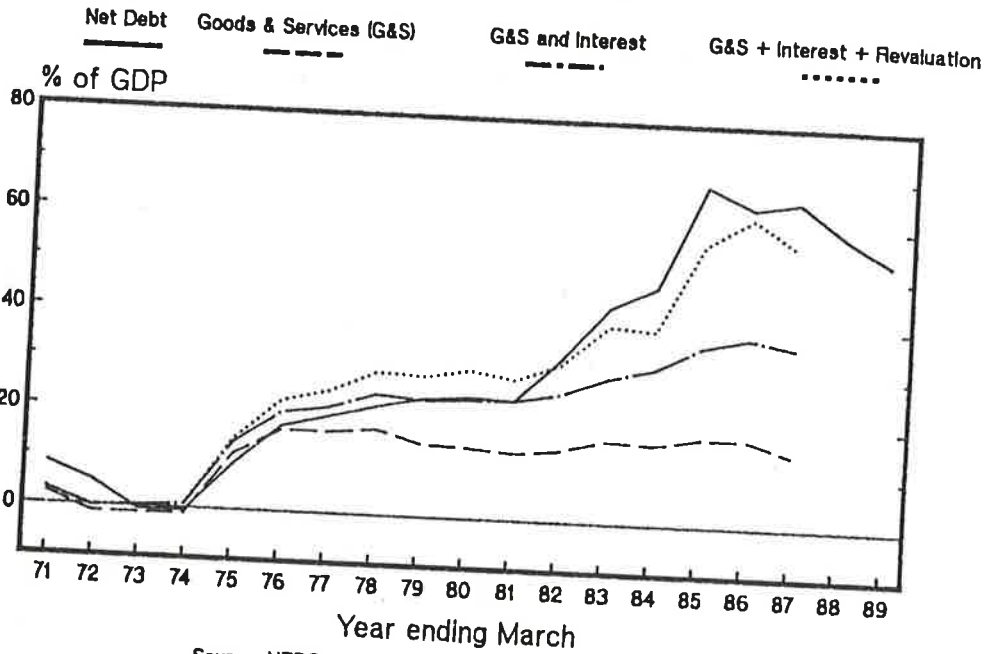
Of course, improvements in the trade balance and current account may be attributable to factors quite independent of trends in competitiveness. The impact of world economic factors on New Zealand's terms of trade has been a major factor in the improved receipts. At the same time, serious recession in the New Zealand economy has acted to suppress the demand for imports. Import volumes will increase with economic recovery (it is possible that the reduction in import volume signals a permanent upward shift in domestic savings).

The causes and rate of growth of New Zealand's external debt are examined in detail in *Overseas Debt - An Assessment*. Infograms 12.4 and 12.5 are updated from that report. Infogram 12.4 shows the build-up of net external debt since 1974 and the contributing factors. Infogram 12.5 shows the author's forecasts of future indebtedness trends on two scenarios labelled 'status quo' and 'base case'. The path of the actual debt ratio can be seen to have fallen much more rapidly, since March 1987, than projected on either scenario. This confirms that the growth of external debt is indeed under control and that present policies, if sustained, should ensure a continuing reduction. This clearly depends, however, on a continuation of trade surpluses.

The fundamental cause of the levelling-off of net overseas debt since 1985 has been the improvement in national savings -- both government and private -- relative to income. The reduction in the fiscal deficit and the government's firm monetary policies have been major factors in this.

Infogram 12.4

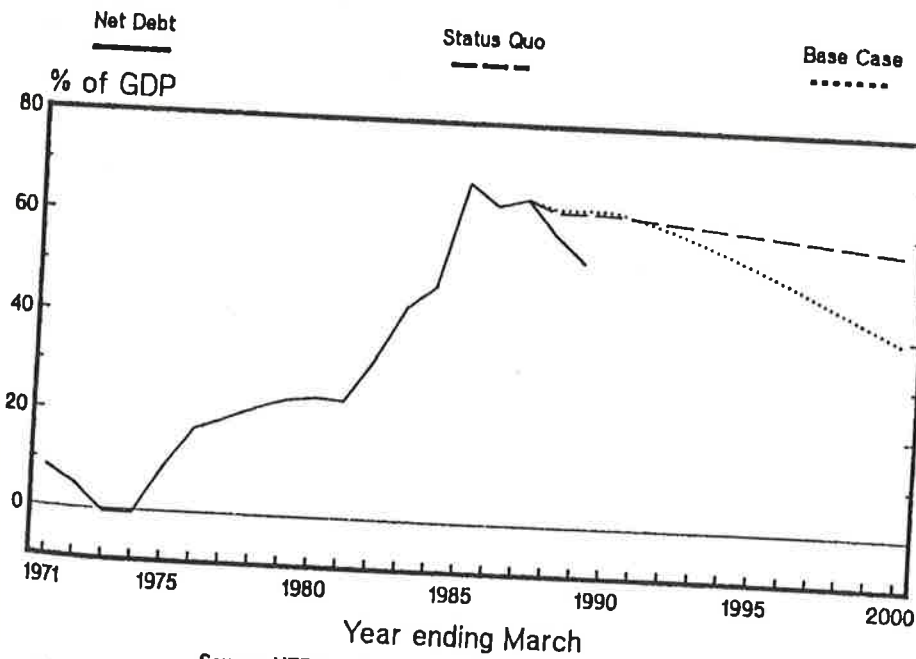
New Zealand's Overseas Debt
Composition of Net Debt 1971 - 1987



Source: NZPC - Overseas Debt - An Assessment, 1988

Infogram 12.5

New Zealand's Overseas Debt/GDP Ratio
Possible Trends 1987 - 2000



Source: NZPC - Overseas Debt - An Assessment, 1988

The fall in the government's own net overseas debt has been implemented through the decisions of government not to undertake overseas borrowing other than to roll over existing liabilities, and to sell assets and retire a portion of outstanding official debt. At the same time, official *internal* debt has tended to increase as a result of the government's continuing financial deficits. In the longer term, sustained viability in the nation's external accounts can only be achieved by actions and policies which maintain higher net savings by individuals, the business sector and government, thus cementing in the improving external balance trends. Until this problem is addressed, as much by the private sector and individuals as by the government, asset sales or other causes of reductions in the debt figures can only represent a shifting of obligations from one balance sheet to another or, at best, a temporary respite from the current high costs of debt servicing.

Long-term Objectives

Restructuring of the New Zealand economy has made good progress towards satisfying what were described at the start of this chapter as the facilitating conditions which help achieve the ultimate objective of satisfying long-term economic and social objectives. It is now time to examine the progress made towards satisfying the objectives themselves. These objectives are output and productivity growth, and employment and real income growth.

The reasons why these objectives are seen as desirable can be briefly stated. Output growth contributes to material wellbeing -- an important component of overall social wellbeing. Productivity improvements mean that fewer resources are needed for given output. The resources saved can be either 'conserved' (for example, leisure, natural resources, the environment) or put to other productive uses. Furthermore, productivity improvements help maintain competitiveness with overseas producers.

Employment growth provides jobs for a labour force which is projected to continue expanding for at least the next ten years, even on 'low' growth demographic assumptions. (The increases projected by the Department of Statistics for the twelve years from 1989 to 2001 range from 153,000 to 246,000, or from 9 to 15 percent of the present labour force of approximately 1,680,000.) Further, employment growth enables a steady reduction in the present level of unemployment. The importance of employment as a major factor in both material and social wellbeing needs no stressing.

Real income growth gives the average citizen more purchasing power over everyday goods and services. It also enables resource provision for support in old age, for the maintenance of health, for improved public services in general, and for investment in education and improvements and additions to the physical capital stock. It can also, if the threatened changes in the global natural environment emerge, provide the resources for amelioration of and accommodation to the changes.

Growth in real per capita income also maintains the living standards of New Zealanders relative to those of other countries. The ranking of countries in terms of GDP per capita can be seen as putting too much stress on the material aspects of wellbeing. But growth in real income can also be seen as a measure of the adaptability of a country's citizens, of their ability to create and innovate. Furthermore, a static economy is liable to lose many of its more talented citizens to more dynamic and invigorating economies.

Output and Productivity Growth

The output and productivity performance of different industries and sectors are examined in detail in Chapter Four on goods markets, comparing growth in the five-year period to 1987/88, with that in the preceding five years. To summarise:

- Real GDP grew on average about 2 percent per annum over the decade to 1987/88. However, the market sectors of the economy grew slightly faster, with growth appearing to accelerate significantly in recent years.

- At broad sectoral level, growth has been high in the primary sector -- partly through a rundown of the capital stock (for example, not maintaining fertilizer application levels); accelerated markedly in the services sector, broadly defined; fallen significantly in manufacturing with growth almost halving in the 1982/83 to 1987/88 period compared with the previous five years.
- At the more detailed industry level, growth has been particularly strong in paper and publishing; transport and storage; communications; finance and business services.

Growth has been poor in general in manufacturing industries, and in the large trade, restaurants and hotel industry grouping.

- Of the high-growth industries it is probable that the performance of three at least — transport, communications and finance — can be attributed to the effects of regulatory reform and general economic restructuring.
- In general it is difficult to separate the effects of restructuring from those of the normal business cycle. However, the macroeconomic policies associated with restructuring, in particular the strong exchange rate and high interest rates, have played a major role in the slow growth of the manufacturing sector.

Turning now to productivity growth:

- Total Factor Productivity (TFP) growth has been respectable by OECD standards over the past decade (in contrast to the preceding years) and has accelerated in more recent years. (See Infogram 1.2.)
- Improved productivity in the services sector has contributed most to this improvement in overall productivity. Total Factor Productivity growth has fallen sharply for manufacturing.
- Those industries experiencing high output growth have generally also experienced high productivity growth. The exception is finance and business services, where productivity growth is still low though better than previously. Productivity in trade has deteriorated.

In all, the evidence suggests that restructuring has been favourable to some service industries -- notably transport, finance and communications. For manufacturing, while the experience of individual firms and industries has been varied, the outcome as a whole has been unfavourable up to 1987/88.

Employment and Real Income Growth

Strong employment growth combined with real income growth, leading eventually to a full-employment economy with high real incomes, is the ultimate goal of restructuring.

Improved productivity is the necessary prior condition for a long-term improvement in real income. Initial improvements in productivity can, however, result from reduced use of labour, capital and other inputs for a given output. This is clearly what has been happening for much of industry thus far in the restructuring process.

Employment has fallen significantly in the primary industries (high productivity growth) and in the manufacturing sector (slowing output and productivity growth).

Employment growth has been concentrated in the services sector, and particularly in the trade, finance and business services, and community and personal services industries. The productivity performance of all these industries has been poor, although that of the finance industry shows some improvement.

The consequence of slow employment growth and a naturally increasing labour force has been the 1987/88 upsurge in unemployment. The extent of recent growth in numbers of unemployed is discussed in Chapter Seven. Recent forecasts by both official and private sector agencies suggest that unemployment will remain high for the immediate future.

To sum up briefly, the improvements in productivity from restructuring have so far mostly been provided by a labour-force shake-out. The combination of employment growth and real income growth will only be achieved when real output growth recommences.

Summary and Impediments to Further Progress

The restructuring policies of the last five years have had, with a few qualifications, substantial success in achieving those preliminary objectives seen as facilitating the achievement of long-term social and economic goals. Included in these are the macroeconomic goals of low inflation, and better fiscal and external balance. The only qualifications about this success are:

- that the improvement in the external balance is at least partly a result of improvements in the external environment, and of domestic recession
- that low inflation and fiscal balance are achievements which need a continuing high priority amongst government objectives if they are not to be lost.

The Economic Monitoring Group believes also that the restructuring process has had beneficial attitudinal effects. There is less inclination to look for government intervention and support, and more inclination to apply resources and effort to genuinely productive purposes. There is some, though not yet conclusive, evidence of more flexible response to ongoing economic change.

This success with the intermediate objectives has not yet been matched by success in achieving the longer-term objectives, of growth in output, productivity, employment and real incomes.

The policy challenge is that of moving onto a growth path based on an improving productivity performance, with output growth sufficiently high to increase employment and reduce unemployment. The recent report of the Planning Council's National Sectoral Programme, *Prospects: Economic and Sectoral Trends to 1997*, shows a possible path which the economy might follow which would achieve this. GDP growth is projected at 3.5 percent from 1992 to 1997 (p.57). On the assumptions in that report, this leads to unemployment falling to 4.6 percent in 1997, after peaking at 6.5 percent in 1992. This is achieved without significant pressure on the balance of payments.

The present over-riding policy question is whether such a growth path will henceforward develop of its own accord, now that a stable macroeconomic framework is well on the way to being restored and markets generally made more competitive, gradually drawing back into productive use those resources now unemployed, especially labour? Or whether the policy phase of restructuring is as yet incomplete, and further changes required?

The difficulties at the moment are, firstly, that unemployment is concentrated amongst the more unskilled and/or inexperienced members of the labour force. This is a potential constraint on growth of those industries requiring skilled labour. General growth, together with further freeing-up of the labour market would lead to some absorption of less skilled labour through the expansion of consumer service industries, and also through the projected expansion of forestry-based and tourism industries. Such opportunities for unskilled employment can be particularly important as a stepping-stone into the labour force for young people. However, it is probable there will continue to be a relative decline in the proportion of jobs suitable for unskilled persons, and even in those industries requiring less skilled labour, there is a need for some training, leading to a more adaptable workforce.

A crucial question is how far should government intervene to improve the skill-levels of the workforce, on the assumption that unskilled persons are myopic about future job opportunities, and given the difficulties in forecasting labour-force requirements.

The second difficulty is that the present exchange rate level, and high nominal and real interest rates are a deterrent to output expansion and investment for many producers, particularly in the tradeables sector. (Although the recent terms of trade improvement has benefitted some of these industries and external competitiveness has improved significantly since mid 1988.)

Thirdly, overall, there has been a strong deflationary shift in the macroeconomic policy settings. It is not possible to easily visualise how this general policy orientation could have been avoided, given the need to halt, and reverse the past build-up in debt, both internal and external. The deflationary policies have stopped output growth, increased unemployment, and are a deterrent at present to new investment until the prospect of sustained growth is more certain.

In this situation the achievements in restoring macroeconomic stability are easy to overlook. They are, as just discussed, very substantial, although there is a need to ensure that they are maintained.

Given this, and the sweeping reduction of microeconomic barriers to growth, and the more positive attitude to new investment opportunities these should engender, the EMG is confident of an eventual return to a long-term sustainable growth path. Some impediments to this occurring have just been discussed; the policy implications are discussed in Chapter Fourteen.

CHAPTER 13

Social Objectives and Outcomes

Economic gains are pursued for social purposes. The inter-relationship of economic restructuring and longer-term social objectives and the 'social' outcomes of restructuring so far are discussed in this chapter.

First, long-term social objectives are set out with their links to economic objectives, and some general discussion of the progress made towards them. This is followed by a more detailed analysis of social outcomes, couched in terms of the gains and losses so far experienced from economic restructuring, and the differential impact on different groups in society.

The Inter-relationship of Social and Economic Objectives

The economic objectives of restructuring are to improve the efficiency of society, through the full employment of resources in the most productive and sustainable way, so as to maximise real income over time. Economic objectives or goals should not be seen as an end in themselves, but as the means of achieving a good society.

Social objectives are often thought of in terms of the fairness (or equity) of economic outcomes, and also the justice of the processes by which these outcomes are reached, the overall social objective being to increase social wellbeing. This is closely related to the economic objective of increasing real income per head, and creating full employment.

Clearly, social and economic objectives cannot be separated. Single-minded pursuit of social objectives of 'fairness' at the expense of economic efficiency can impair economic performance sufficiently for the social objectives not to be realised. The converse is also true. Pursuit of income maximisation without regard to distributional consequences for example, can destroy the social cohesion and cooperation necessary for good economic performance.

Principal Social Objectives

There are a wide range of possible social objectives. *Social Policy Options* (J. Davey, New Zealand Planning Council 1987, pp.1-5) listed 13 distinct objectives of social policy. The discussion here is based around the concepts of participation and choice, and fairness. Participation and choice encompass the opportunity for all New Zealanders to work in an area suitable for their capabilities, ensuring Maori have adequate scope to develop and providing for all New Zealanders to participate in decisions affecting their lives. Fairness is defined as establishing a distribution of income to meet the community's standard of fairness.

Access to Worthwhile Employment

Full employment is an economic objective. It is also a social objective. The benefits from work-force participation, through widened social contacts, enhanced self-respect, etc, need little demonstration. But perhaps most important is the role of full employment in ensuring a fairer distribution of income and wealth. To quote from the Planning Council's recent publication *For Richer or Poorer*

"Access to paid work is one of the most important determinants of the income level of individuals, and through the accumulation of savings and creditworthiness is also a major determinant of people's wealth".

The social objective of full employment is wider in scope than the economic. It extends to ensuring equal access to employment opportunity, that for example, there should not be discrimination in employment on grounds of race or gender. The social objective also encompasses policies intended to remove impediments to some groups entering the labour force, such as the provision of child-care facilities so as to allow women more choice in employment.

As progress towards the goal of full employment is likely to be slow in the immediate future social policies aimed at ameliorating the harmful social effects of long-duration unemployment, particularly for first-time labour-force entrants, must continue to receive considerable priority over the next few years.

Equal Opportunity and Resources for Maori Development

For historical reasons, well-documented in Planning Council reports, in the work of the Royal Commission on Social Policy, and many other sources, Maori lag behind non-Maori in economic terms. Taking the longer perspective, there has been good progress over the past 50 years in reducing economic differences between Maori and non-Maori, as well as the gaps on other social indicators, such as health. However, the gaps are still substantial and the effect of the country's poor economic performance in the last 20 years has been to slow down, or even reverse, the earlier progress. Restructuring to a better-performing economy is the best long-term guarantee of Maori obtaining those resources which will lead to further progress towards racial equality.

Participation

The opportunity to participate in decision-making is an important aspect of social wellbeing. In a sense of course a 'market economy' does devolve much decision-making to the individual. But for those many decisions for which the market-place is not the most suitable mechanism an important social objective is that decisions should be informed, and taken, as much as possible by the individuals affected or by persons accessible to them.

This is the argument for devolution of decision-making authority, a process now gaining momentum in areas such as local government, health and education. Although less advanced, the devolution of resources to iwi authorities is also being developed.

A Fair Distribution of Income and Wealth

Trends in average incomes are discussed in Chapter Seven. A detailed analysis of apparent shifts in the distribution of income, between individuals and between households, follows later. Briefly that material, using Household Expenditure and Income Survey data, indicates some shift in the direction of greater income inequality over the last few years. This is in terms of pre-tax incomes, and is presumably caused largely by the increase in unemployment over the period. The question of the 'fairness' of shifts towards greater inequality, or equality, is also touched on in the subsequent discussion.

Gains and Losses

The gains and losses from the very large number of changes in recent years are widespread. It is impracticable to catalogue the effects of each change and quantify the total impact at any point. Gains and losses by categories of people, that is, by region, age or gender, are somewhat easier to assess and are discussed in later sections. Generally losses are more obvious than gains at this stage. In part that is inevitable. Structural changes are not completed quickly and do not produce immediate benefits. The gains are generally widespread, small for each individual and not obviously related to a policy change. The losses are usually more immediate, large for the individual affected and directly attributable to the change.

Regulatory reform in the transport sector illustrates these points. The direct and indirect gains in increased efficiency, better service, and lower prices are spread widely through the community and probably substantial for the economy as a whole. For the individual consumer, however, the gains will be small and not identifiable as the outcome of reforms. The losses -- in terms of companies going out of business and drivers losing their jobs -- are large and obviously the result of the policy change. Four areas of change are examined briefly and these are employment shifts, shifts in relative prices, changes in the provision of government services, and shifts in relative real incomes.

Employment Shifts

The number of unemployed, and the risk of unemployment for those currently employed, has increased. For others, with the appropriate skills and attitudes, restructuring has given access to new job and business opportunities.

Shifts in Relative Prices

The prices of non-tradable commodities, mainly services, have increased, on average, relative to those of tradeable goods and services. Other price changes include the relative shift upwards in interest rates, and in average pre-tax wages.

Government tax changes, such as the introduction of Goods and Services Tax (GST) in October 1986 partly offset by reductions in other indirect taxes, and the increased emphasis on user-pays charges for government-provided services, have also had significant effects on relative prices.

In the last few years a whole range of policies, probably more than in any earlier period, have had an impact on prices. The net impact on any specific population group is extremely difficult to measure. A technical, and policy difficulty is that the Consumers Price Index (CPI) is generally used to measure changes in the purchasing power of income, but is based on the expenditure pattern of the 'average' household. It may not estimate accurately changes in the purchasing power of those households whose expenditure pattern differs significantly from the average especially in a period of rapid change such as the past few years. It should be remembered that some of the shifts, in particular the increase in interest rates and in the real exchange rate are expected to be a transitional phenomenon during the interim stage of restructuring. Later in this chapter the effects of these changes on different population sub groups, particularly on home-mortgagors and renters, is examined.

Changes in Provision of Government Services

Related to relative price changes are changes in the provision of a number of government services. An example is the closure of many post offices, particularly affecting rural areas. The gain is a service cheaper in financial terms than it would otherwise be. The loss is reduced accessibility.

Shifts in Relative Real Incomes

These include shifts in income between those employed in different sectors of industry, and between those in employment and unemployment. Changes in the tax structure in recent years, the most significant of which were in October 1982, October 1986, and during the 1988/89 tax year have produced shifts in after-tax income, between those at different points in the income scale, and with different income sources. Shifts in relative incomes may or may not be offset by shifts in relative prices, and in service-provision, etc. Relative shifts in real income are the net outcome from all these effects.

Differential Impact on Regions

The economic impact of restructuring has varied greatly from region to region. Regional economic impacts can be investigated in considerable detail. For present purposes a broad categorisation is sufficient. The regions are examined in two broad categories, major urban — the Auckland, Wellington, and Christchurch urban areas, and non-urban — urban areas with populations up to 150,000 (Hamilton, Dunedin) and the rural areas.

The economies of these two categories are of course interlinked. However resources such as labour and capital in the short term have a degree of geographical immobility, and land permanently so. Thus policies impacting more on one set of regions than the other will cause different trends in employment and income, and also cause inter-regional migration. The non-urban regions have both benefitted and lost from the process of restructuring so far.

Benefits include the more rational pricing structure being put into place, gradually bringing prices more into line with world prices for tradeable goods. To the extent that non-urban areas are oriented to export markets, this will encourage the growth of profitable export industries, and reduce the costs passed on to those industries by protected domestic producers.

The more efficient transport industry which has emerged from restructuring over the past decade is also of benefit to those in the non-urban regions. However, the consequences of a more efficient transport sector in terms of the location of secondary and service industries, and of employment, are ambiguous. In some cases greater production is encouraged in the non-urban areas, for both the domestic and export markets. In other cases, more efficient transport can lead to industry concentrating in the larger urban areas.

Costs are linked in particular to the pressures that the primary and primary-processing industries, particularly agriculture and forestry-based, have been under. These are the rapid elimination of primary sector subsidies, the strengthening of the exchange rate, and the lay-offs from the new state-owned enterprises particularly the Forestry Corporation. (See case study on Forestry Corporation labour changes, p.?) Other pressures have included the elimination, or potential elimination, of cross-subsidies favouring rural areas, for example in postal services and electricity distribution. Finally, cut-backs in some services, or their elimination, such as postal and postal-banking services, have borne more heavily on rural areas. Extra costs in some regions, in the interests of financial efficiency, lead to gains for other regions.

Two principal statistical sources are used to examine the different experiences of the regions. These are unemployment data, and expenditure data, as shown by retail sales.

Regional Unemployment

Judging from the Household Labour Force Survey figures (see Infogram 13.1), unemployment rates were fairly similar throughout New Zealand in early 1986, although Wellington's unemployment rate was somewhat lower. Through the remainder of 1986 until late 1987 a gap opened between the major urban areas on one hand, and the rest of New Zealand. This was due essentially to a fall in unemployment in the major

CORPORATISATION OF THE FOREST SERVICE — THE IMPACT ON EMPLOYMENT

In April 1987 the New Zealand Forestry Corporation was established, taking over all the commercial operations of the New Zealand Forest Service (NZFS), a government department which had sought to combine policy advisory, commercial and employment-creation roles. The corporation owns over half of the national exotic forest estate, by area. (It has since been decided that the corporation's forests should be sold to the private sector, subject to resolving Maori land-ownership issues.)

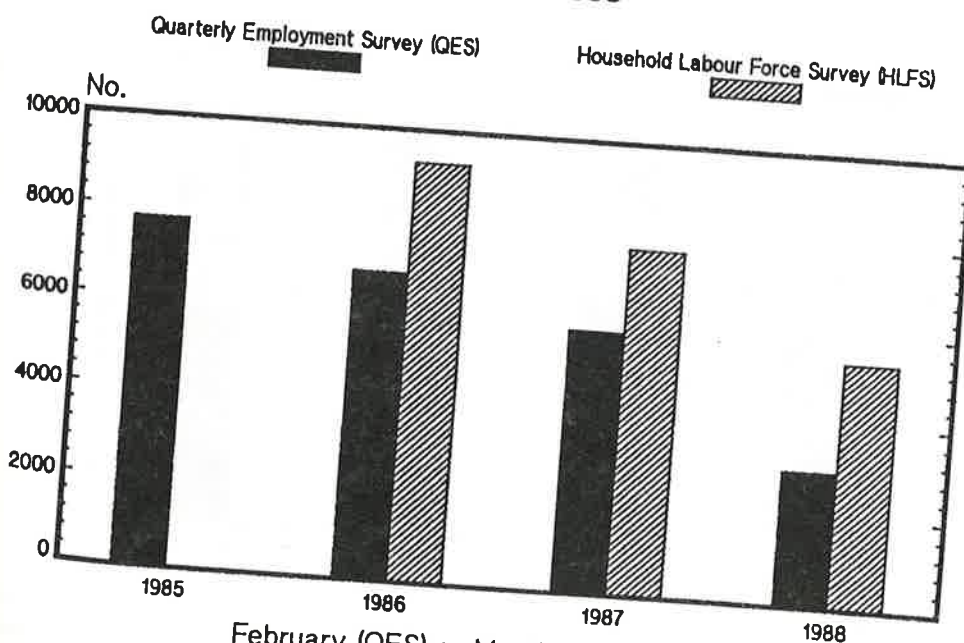
There was an immediate rationalisation of the corporation's operations in order to achieve its newly defined commercial objectives. Just over 3,900 of former NZFS staff took either voluntary severance or early retirement. The corporation cut back on providing employment in some regions and new planting and pruning.

The changes have had a significant impact in terms of lost employment opportunities. These have been felt most in regions such as the central North Island and Bay of Plenty, and also particularly by Maori, given the substantial Maori workforce in the sector.

For the Forestry Corporation this labour-shedding resulted in a substantial increase in labour productivity, and a dramatic cash-flow turn-round, from a deficit of \$64 million on production forestry in 1986/87 to a cash surplus of \$54 million in 1987/88.

The impact on employment in the industry as a whole was substantial. There had been an ongoing labour-force reduction in the sector before April 1987, with rationalisation in the private as well as in the government sector. The QES data shown overstates the decline, because it excludes small contractors, including many former NZFS employees. The HLFS figures are more comprehensive and show a fall in the sector's labour force between 1987 and 1988 of around 2,300, or 30 percent.

Employment in the Forestry and Logging Industry 1985 - 1988



February (QES) or March quarter (HLFS)

Source: Department of Labour, Department of Statistics

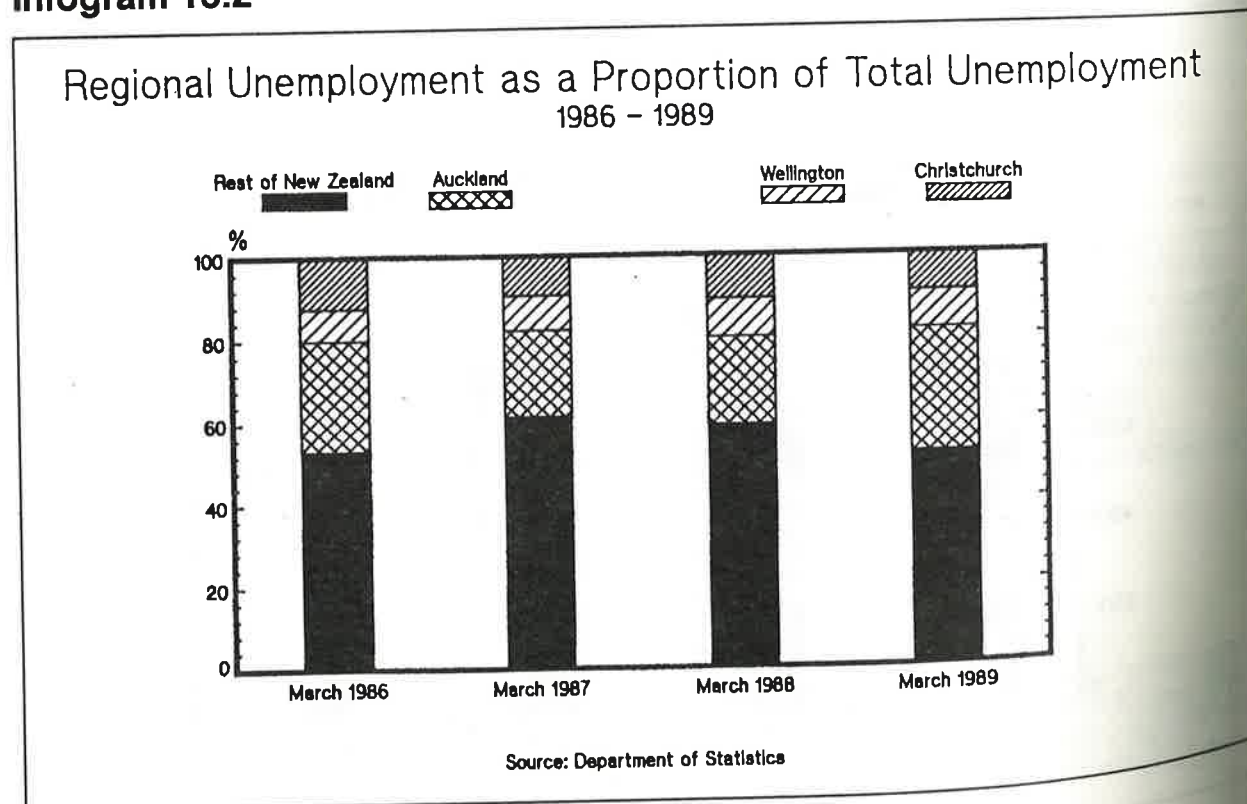
urban areas, more especially Auckland, and an increase in the 'rest of New Zealand'. From late 1987 onwards, there has been a general increase in all regions. Infogram 13.2 shows, however, that the 'rest of New Zealand' share of total unemployment has fallen since 1987. Unemployment in Auckland, and its share of the total, has increased significantly over the past year.

Infogram 13.1

		UNEMPLOYMENT BY REGION			
		Auckland	Wellington	Christchurch	Rest of New Zealand
March 1986	% (000s)	4.0	2.9	4.4	4.6
March 1987	% (000s)	2.9 (14.0)	3.1 (5.6)	3.5 (6.3)	5.2 (41.1)
March 1988	% (000s)	3.5 (17.0)	4.2 (7.5)	4.6 (8.5)	6.2 (47.6)
March 1989	% (000s)	7.5 (34.8)	6.0 (10.7)	5.9 (10.6)	7.9 (60.2)

Source: Household Labour Force Survey, Department of Statistics

Infogram 13.2



The trends described appear consistent with unemployment levels in the regions being largely determined by a combination of 'business cycle' effects for the economy as a whole, and output changes in industries of greater importance to non-urban New Zealand – agriculture, forestry, and related manufacturing and service industries.

Using data from the unemployment register, it is possible to investigate regional trends in more detail. Infograms 13.3 and 13.4 draw on this source for Gisborne whose unemployment rate is amongst the highest of all employment districts. Infogram 13.3 shows a more than tenfold increase in registered unemployment through the 1980s, with the increase accelerating from 1986. Expressed as a proportion of the national total in Infogram 13.4, the Gisborne figures show again a rising trend, peaking in the period from late 1986 to early 1988. The ratio has fallen, however, over the year to March 1989, suggesting some improvement in regions such as Gisborne relative to the rest of the nation.

Retail Expenditure

Retail sales are a measure of relative trends in aggregate regional income. Infogram 13.5 shows the proportion of total sales in each of five regions (Auckland, Wellington, Remainder North Island, Christchurch, Remainder South Island). Infogram 13.6 aggregates these into an urban/non-urban split.

It is evident that from about mid 1985, the retail turnover proportion in non-urban areas began falling. The decline ceased however about the second quarter of 1987 and since then has reversed.

Of the individual regions, the decline over the last year in Auckland and Wellington is apparent. Christchurch appears, however, to be still showing an upward trend. Recovery over the past year is more marked in the remainder North Island region than in the remainder South Island.

The picture is broadly consistent with that shown by trends in unemployment. It is consistent also with the claim that the 'pain' of restructuring has been borne in the first instance by primary and primary-processing industry, most of which are in the smaller centres.

Over the past year it appears that either the brunt of readjustment has shifted to the major urban areas, or that the effects of the cyclical downturn are being felt more there, while primary-based industry has seen a recovery in export markets. Perhaps also the productivity gains in primary and processing industries are bearing fruit, although this is difficult to establish as yet.

Differential Impact by Age

Youth unemployment is high, notably for those in the 15 to 19 age group, but also for those in the 20 to 24 age group. Infogram 13.7 shows the age-unemployment profile from recent Household Labour Force surveys.

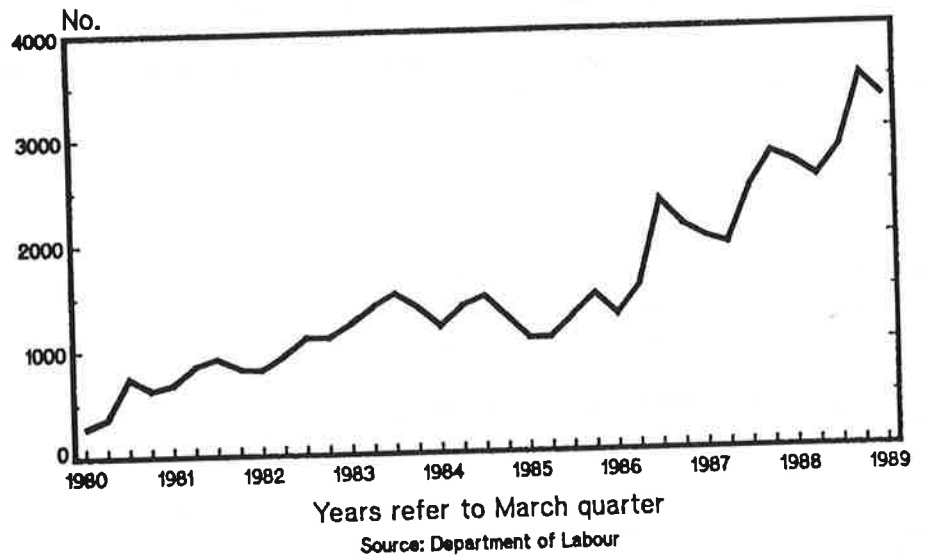
This is not a totally new phenomenon. While at the 1986 Census the number of 15 to 19-year-olds who described themselves as unemployed had risen to 20 percent (see *From Birth to Death II* 1989, p.52), this was from the already high level of 14 percent at the time of the 1981 Census. Even in 1976 the rate of unemployment for this group was 6 percent.

There are of course obvious reasons why there should be more unemployment amongst young people. These include the transition period from full-time attendance at educational institutions into the workforce, and a shaking-down period as young workers seek the type of work best suited to their talents.

That said, it remains true that youth unemployment is far too high, and that prolonged periods of unemployment for a sizeable proportion of young people can disadvantage those affected for the remainder of their lifetimes, and risks making some permanently 'unemployable'.

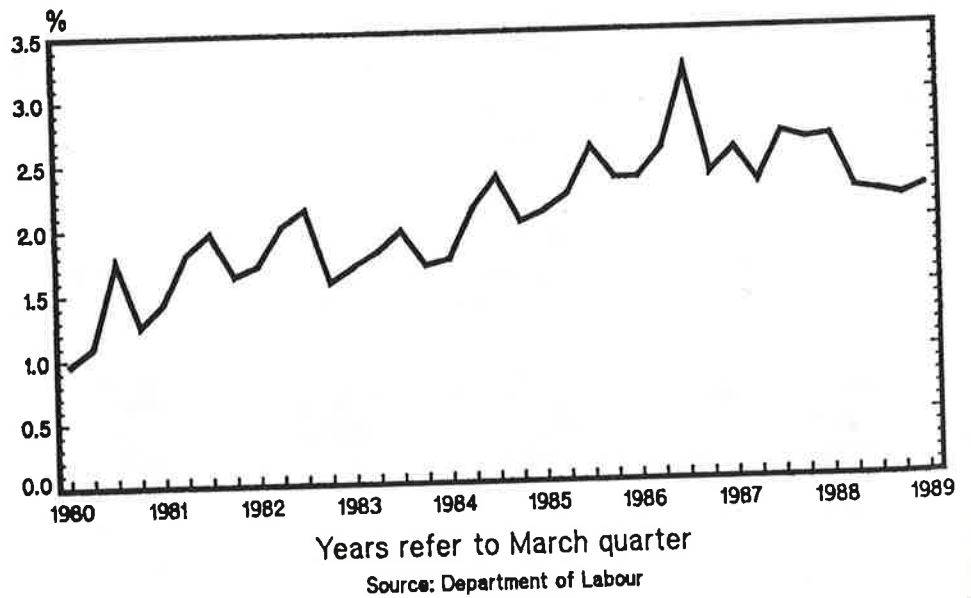
Infogram 13.3

Registered Unemployment in the Gisborne Employment District
1980 - 1989

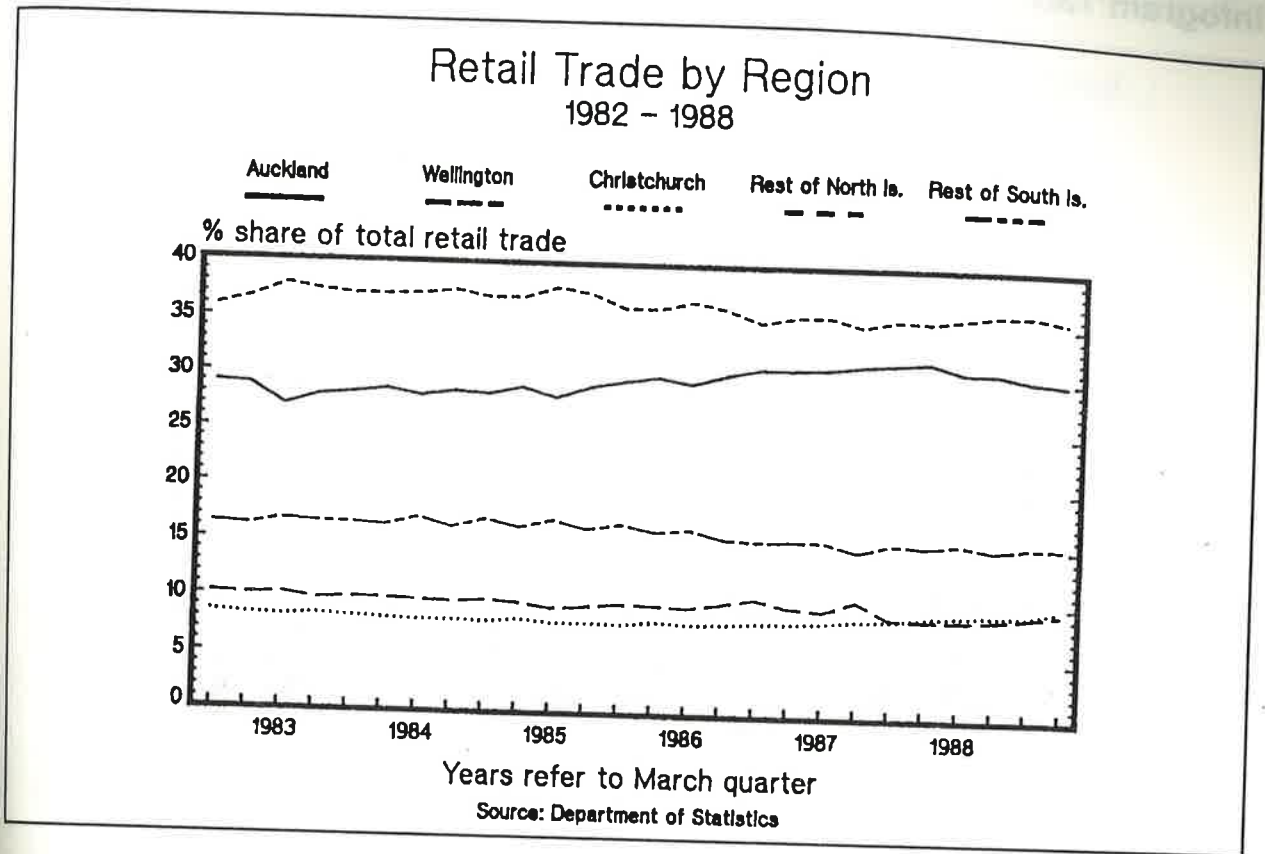


Infogram 13.4

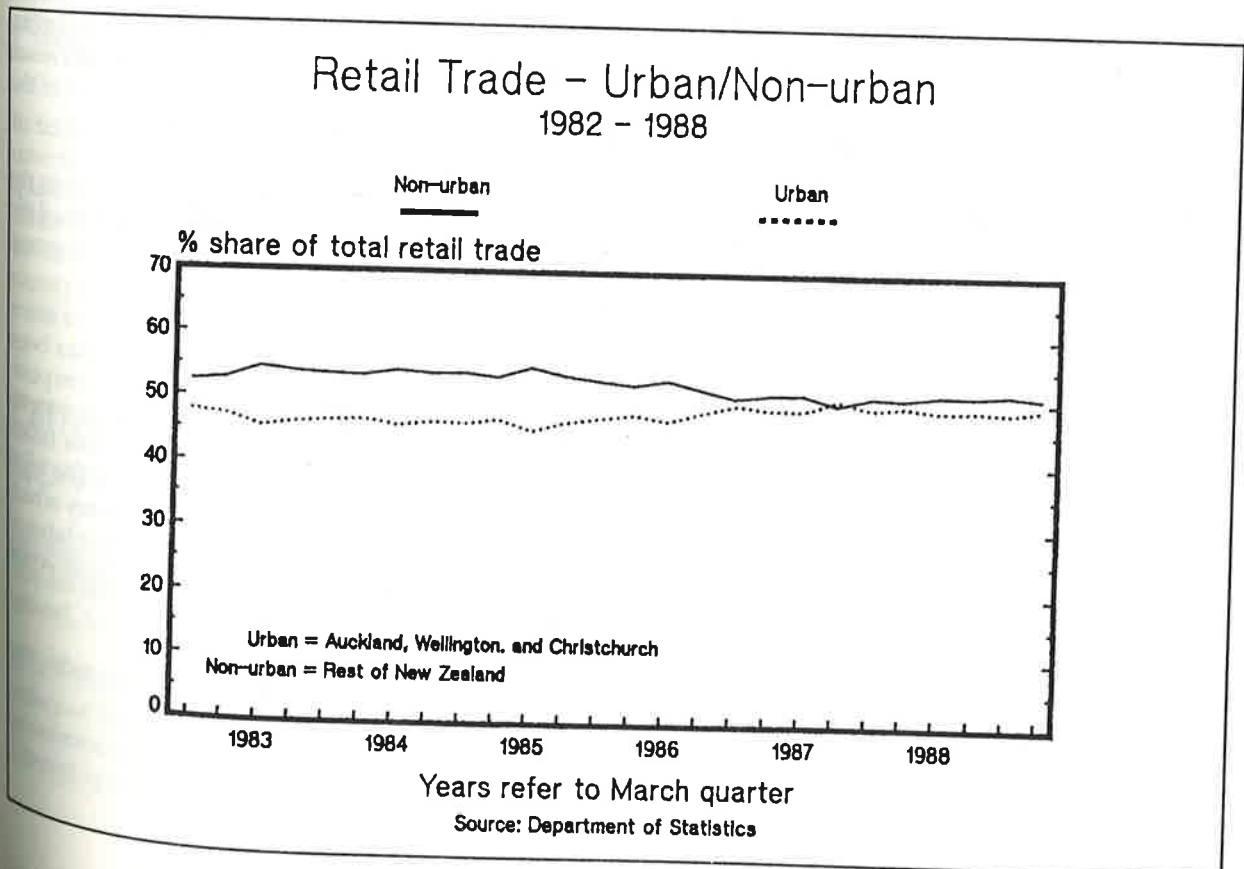
Gisborne Unemployment as a Proportion of the NZ Total
1980 - 1989



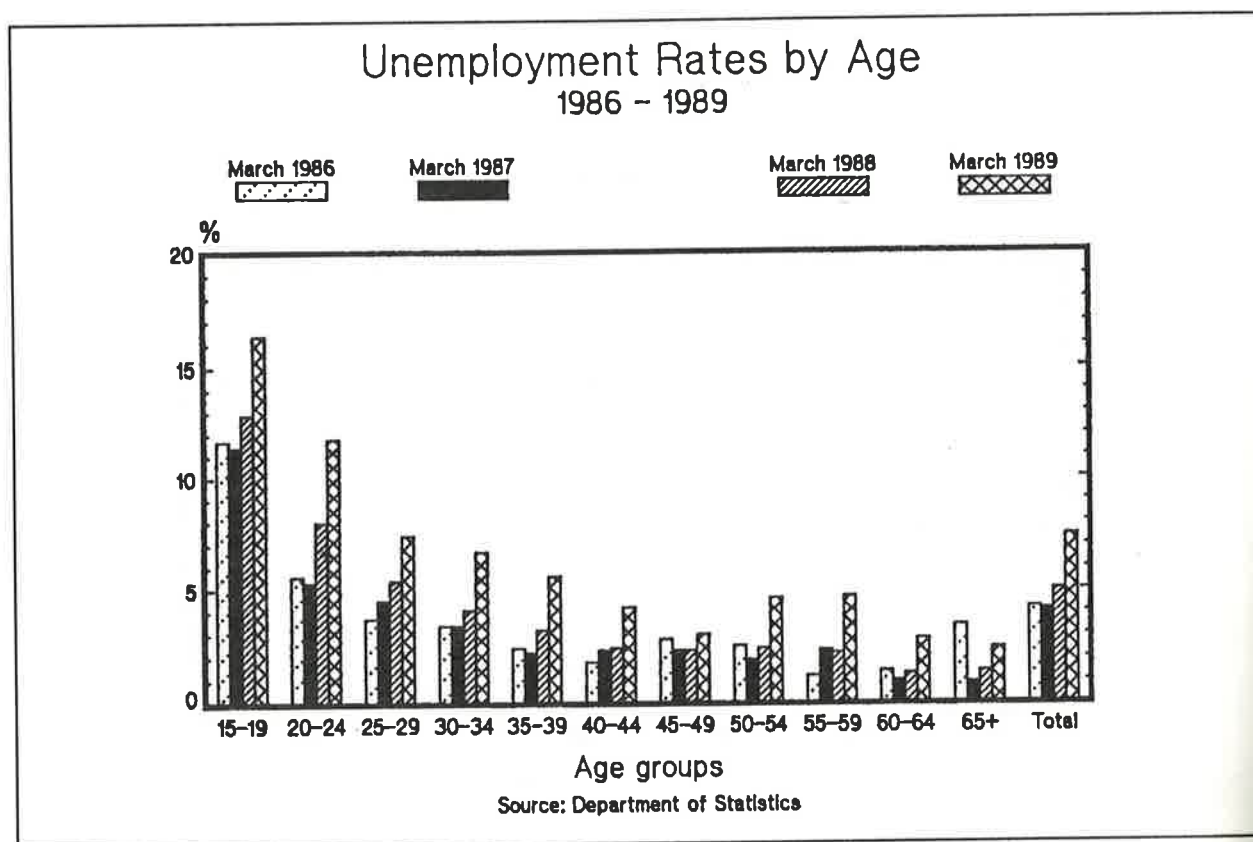
Infogram 13.5



Infogram 13.6



Infogram 13.7



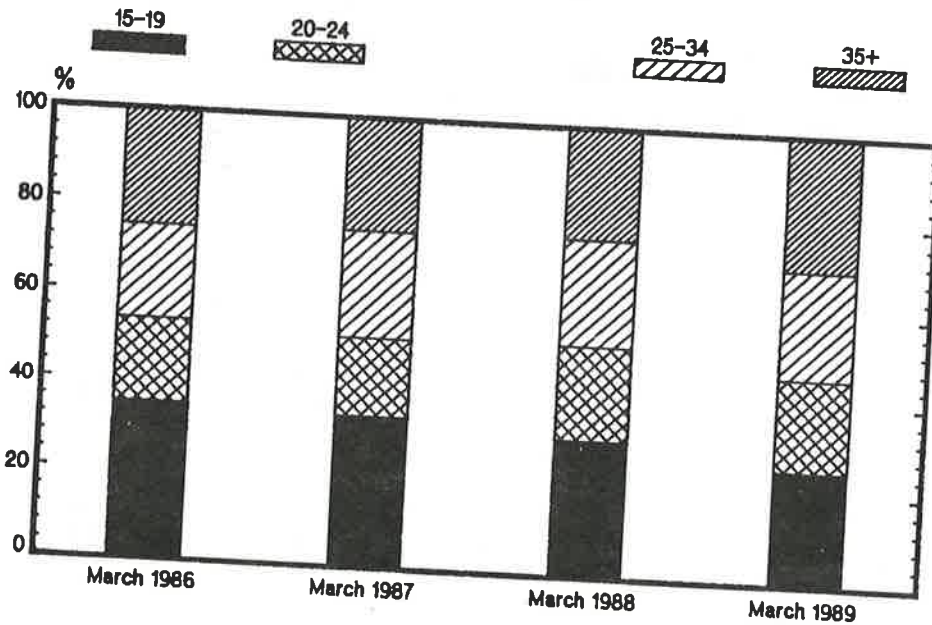
Infogram 13.8 presents unemployment data for selected age groups from 1986 to the present. Salient features from the infogram include the high unemployment rates, now exceeding 15 percent for teenagers, the still-high rates in the twenties age group, and up to and including the thirties age group, the lesser recent increases in teenage unemployment compared with those in the next age groups up -- from 35 percent of the total in March 1986, teenage unemployment dropped to just over 25 percent in March 1989.

The infogram also shows the substantial increase in unemployment in almost all older age groups over the past year. Unemployment amongst those aged 35 and over, from being a relatively stable 25 percent of the total, increased to almost 30 percent in March 1989. In absolute terms, unemployment for this older group rose from 19,800 in March 1988 to 34,400 in March 1989.

The data show the undesirably high level of youth unemployment. But it is also clear that this has been present for some years, since at least the mid 1970s. Although industry and other restructuring policies post-1984, have increased youth unemployment, this age group was already bearing the brunt of unemployment. It is interesting to note that teenage unemployment as a proportion of total unemployment has fallen between 1986 and 1989. (This is in part accounted for by higher retention in formal education.) The high unemployment among young people can for the most part be attributed to imbalances in the economy which developed through the 1970s and early 1980s, specifically, economic growth too slow to absorb new labour-force entrants (those born in the baby-boom years), inappropriate skills for the jobs available and youth wage-levels insufficiently responsive to the developing surplus of inexperienced labour.

The recent increase in unemployment for the older group is accounted for predominantly by the reduction in the labour force in the manufacturing sector.

Infogram 13.8

Shifts in the Age Composition of the Unemployed
1986 - 1989

Source: Department of Statistics

Differential Impact by Educational Attainment

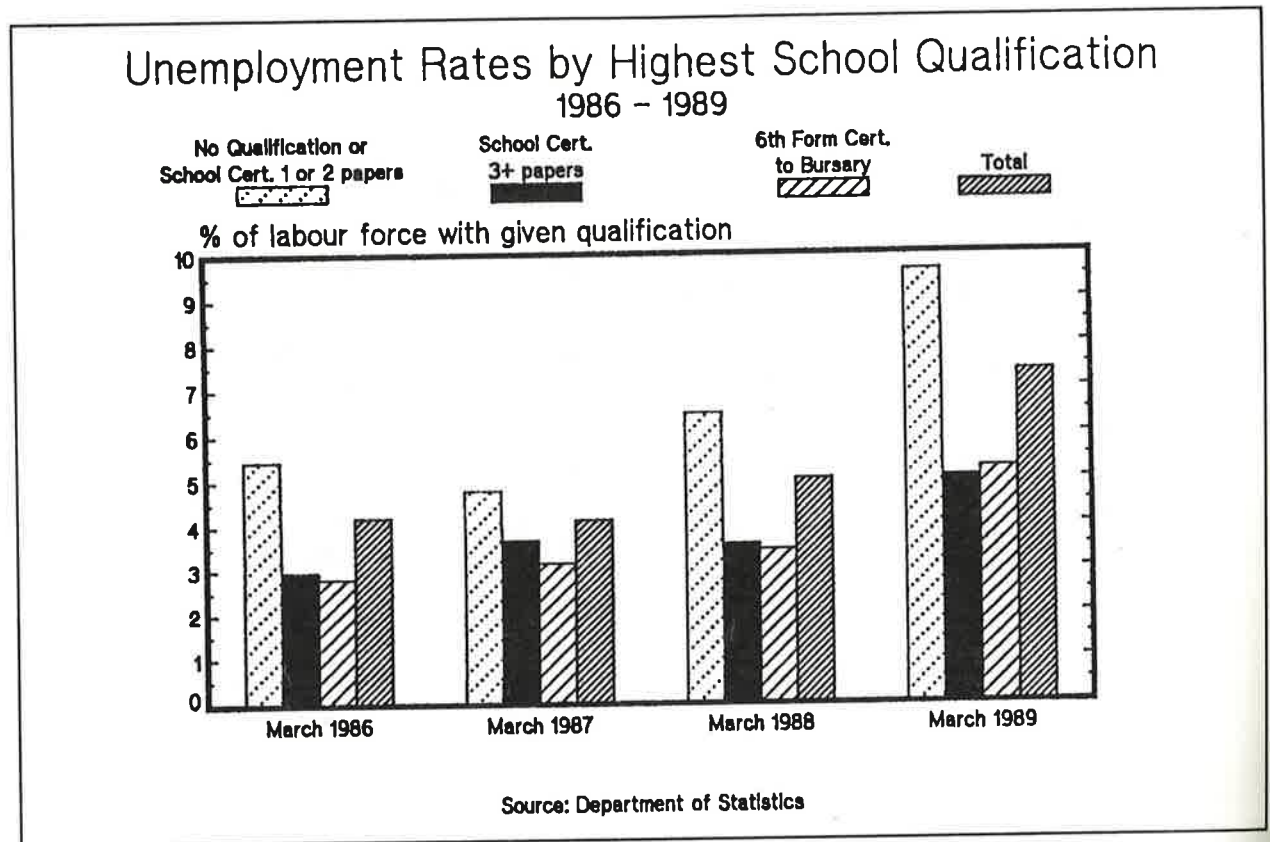
In terms of labour-market outcomes by level of formal educational qualification, Infogram 13.9 shows that unemployment rates are significantly higher for those in the labour force with no qualifications, or minimal qualifications than for those with higher qualifications. In fact the great majority of those unemployed have no formal educational qualification. Two-thirds of the unemployed in the September 1988 quarter either had no formal school qualification, or had passed School Certificate in only one or two subjects. The unemployment rate in these categories has increased substantially over the three years to December 1988. Clearly, most of those unemployed because of restructuring, are lacking in formal educational qualifications.

Differential Impact on Lenders and Borrowers and by Home-ownership Status

For many years lenders in general received negative real rates of return on loaned funds, in that the inflation rate exceeded the interest return. This was even more true when measured post-tax. Conversely borrowers gained, in that outstanding debt was being eroded by inflation.

In late 1984 most controls on financial institutions and on interest rates were scrapped. Together with the policy of 'fully funding' the government deficit, introduced at the same time, and its necessary corollary that government stock rates should not be hindered from finding their market level, this led to a rapid rise in interest rates.

Infogram 13.9



This new policy setting has major advantages for the economy as a whole. At the macroeconomic level it should encourage savings and lead to a better internal and external balance, between expenditure and production as a whole. At the level of the individual business, or household, those projects which promise high returns but also high risk, need no longer be squeezed out by the credit-rationing practices formerly prevalent.

For the business, individual or farmer, already carrying substantial debt however, the new policies have seemed less attractive. Here we will focus on the home purchasers.

Infograms 13.10 and 13.11 show the shift upwards in mortgage interest rates from 1984 to 1987, and the increase in the home ownership and rental sub-group Consumer Price Indexes, both increasing much more rapidly than the 'all groups' CPI from about the same period. (Rent controls were phased out in 1984/85, and the increase in interest costs is reflected also in upwards pressure on rents.)

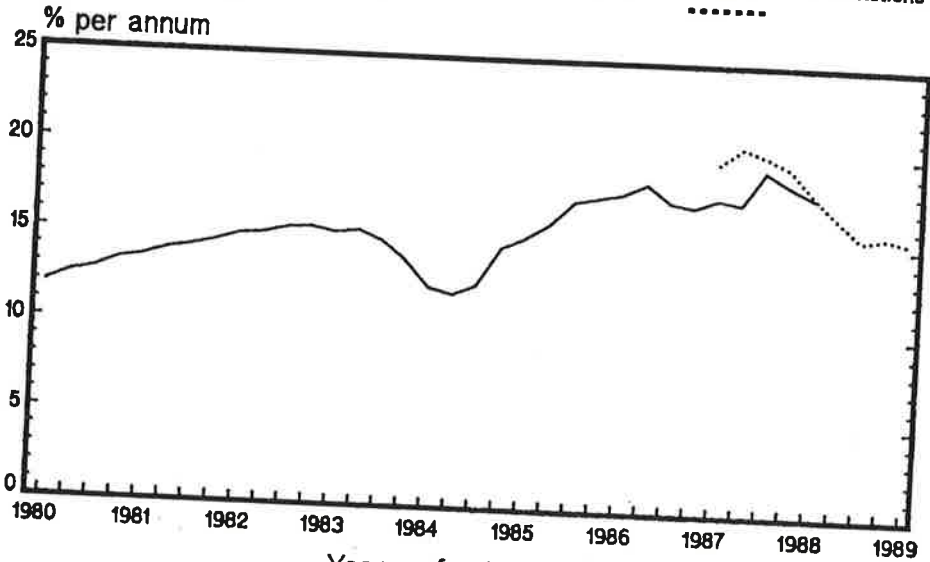
Infogram 13.12 shows housing expenditure in recent years, by types of housing tenure. The two categories of most interest are those renting, and those owning a house with a mortgage.

The upward surge in both rentals and interest rates has had a significant effect on expenditure patterns for those affected. Between 1983/84 and 1987/88, the proportion of total expenditure required to meet housing costs shifted upwards almost 4 percent for tenants, and over 4 percent for mortgagors. In real terms this represents an increase in housing costs of around 20 percent for both these tenure categories. For comparison, housing expenditure by those owning a house mortgage-free, mainly on rates and maintenance, fell from 17 to around 15 percent. If the expenditure of those renting and those with mortgages is compared to those mortgage-free, we find that whereas in 1983/84 renters were the same as mortgage-free and mortgagors double that of mortgage-free, by 1987/88 renters expenditure was 40 percent higher and mortgagors more than three times higher than mortgage-free households.

Infogram 13.10

Mortgage Interest Rates 1980 - 1989

Average of All Registered New Mortgage (NZDOS) New First Mortgages - Major Finance Institutions (RBNZ)

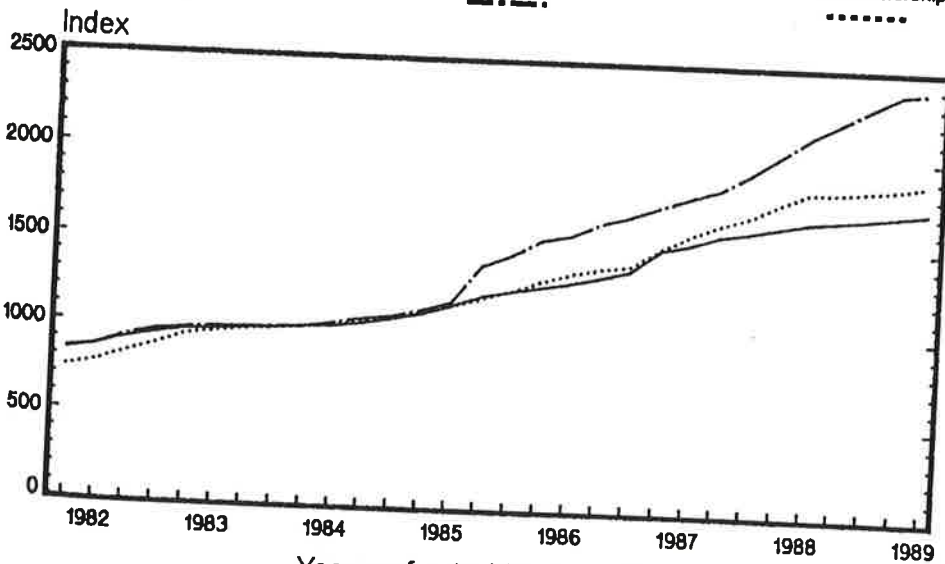


Source: Department of Statistics, Reserve Bank

Infogram 13.11

Consumer Price Indexes for Housing 1981 - 1989

All Groups Rentals Home Ownership



Source: Department of Statistics

Infogram 13.12

HOUSING EXPENDITURE BY TENURE					
	Rent Paid	Rental Free	Owned with Mortgage	Owned without Mortgage	All Tenures
1983/84					
Percent of households surveyed (%)	24.7	5.0	37.3	33.0	100.0
Rent \$	42.74				
Mortgage payments ¹			50.22		
Total housing expenditure \$	48.65	18.11	104.02	49.35	68.03
Total net expenditure \$	287.96	271.26	434.09	289.76	342.29
Housing as % of total	16.9	6.7	24.0	17.0	19.9
1985/86					
Percent of households surveyed (%)	23.4	5.7	36.0	34.9	100.0
Rent \$	64.27				
Mortgage payments ¹ \$			70.34		
Total housing expenditure \$	64.82	1.14	139.84	55.48	84.93
Total net expenditure \$	353.35	311.49	532.67	354.11	415.74
Housing as % of total	18.3	0.4	26.3	15.7	20.4
1987/88					
Percent of of households surveyed (%)	23	3	37	37	100
Rent \$	83.20				
Mortgage payments ¹			104.10		
Total housing expenditure \$	91.48 ²	15.40	195.11	64.48	108.65
Total net expenditure \$	444.88 ²	338.48	685.47	432.15	517.28
Housing as % of total	20.6	4.5	28.5	14.9	

Source: Household Expenditure and Income Survey, Department of Statistics
Notes: 1. Including repayment of principal
2. Survey averages adjusted upwards by \$39.55 to remove effect on rent-paying household averages of a 'freak' surveyed household which had a very large capital inflow

Overall, restructuring policies have borne hard on those renting and those with substantial mortgages, in relation to income. On the other hand, and perhaps more so than elsewhere, the policy objective of reducing inflation is being met, promising future relief in terms of falling interest rates.

Impact on Maori

As noted in the discussion of objectives earlier in the chapter, Maori have borne a disproportionate share of the costs of New Zealand's poor economic performance over the past two to three decades. There are indications that, unless there is a change in the base and direction of Maori development, those adverse effects could continue in the future.¹

This section examines the impacts of restructuring on Maori through employment and housing.

Employment Impacts

Classifying employment by industry into three broad sectors, Maori have approximately equal representation in the primary sector as the total population, but are over-represented in manufacturing, and under-represented in the largest sector, services.

Infogram 13.13

MAORI EMPLOYMENT 1986 TO 1989
(000s)

	March 1986	March 1987	March 1988	March 1989	Percent Growth 1986 to 1989
Males					
Maori Total	59.3 909.2	57.1 909.3	46.7 881.2	42.6 843.2	-28.2 -7.3
Females					
Maori Total	39.6 635.8	40.4 648.8	36.9 647.3	31.4 622.2	-20.7 -2.1
Total					
Maori Total	98.9 1545.0	97.6 1558.1	83.6 1528.5	74.0 1465.5	-25.2 -5.2

Source: Household Labour Force Survey, Department of Statistics

¹ A Planning Council discussion paper *Economic and Social Trends to 1997: Implications for Maori development*, National Sectoral Programme 1989, contains an examination of these forward trends.

In general the Maori workforce is concentrated in those industries with less-than-average employment growth in recent years, in particular in industries such as forestry, food, etc, which have been strongly affected by restructuring. In terms of occupations also, the Maori workforce is more strongly represented in those broad occupational groupings which have been growing more slowly.

Over the past three years while the total number of New Zealanders in employment has fallen by 5.2 percent, Maori employment has fallen a staggering 25 percent, or by almost 25,000 (see Infogram 13.13). Most of this decline in Maori employment has not shown up in unemployment. The number of Maori reported as unemployed by the Household Labour Force Survey (see Infogram 13.14) has increased but only by 4,700.² The bulk of the decline must be explained by a combination of other factors including migration to Australia and elsewhere, increased participation in education, and 'discouraged' workers permanently leaving the labour force.

1986 Census data confirms that the Maori unemployment rate is more than twice the rate for all New Zealanders. Even in 1986, almost one-fifth of Maori females in the labour force were unemployed and seeking work, either full-time or part-time.

There is, on present projections, potentially a serious problem of worsening Maori unemployment, on top of already excessively high unemployment, as the economy shifts further towards an employment structure different from that of the Maori workforce. If Maori unemployment is to be contained, and made to converge towards non-Maori unemployment rates, a high degree of industry and occupational mobility will be required of Maori, more so than for non-Maori.

Infogram 13.14

MAORI AND EUROPEAN UNEMPLOYMENT (rate and number)		
	Maori	European
March 1986 % (000s)	12.3 (13,900)	3.4 (45,300)
March 1987 % (000s)	11.1 (12,200)	3.4 (45,500)
March 1988 % (000s)	12.9 (12,400)	4.0 (54,100)
March 1989 % (000s)	20.1 (18,600)	5.9 (78,100)

Source: Household Labour Force Survey, Department of Statistics

² The Household Labour Force Survey asks respondents to identify their ethnic origin and reports the results in six categories: European, Maori, Maori-European, Pacific Island Polynesian, other and not-specified. A broader analysis of the impacts of unemployment by ethnic origin would be useful but the size of the HLFS sample and the reporting system do not allow reliable interpretation for the smaller categories. Two points are however worth noting. The unemployed are predominantly 'European' (78,000 or about two-thirds of the total in the March 1989 survey). There has been a sharp rise in unemployment among Pacific Island Polynesians in the last two years, from 2,600 in March 1987 to 7,500 or 17.2 percent of their labour force in March 1989.

Impact of Increased Housing Costs

A greater proportion of Maori-headed households fall in the categories of home-owners with a mortgage or renting, some 80 percent as compared with about 65 percent for all households. As discussed earlier these are the households most affected by higher mortgage rates and rentals.

A household headed by a Maori has about one person more on average, across all tenure categories, than the average for the whole population. For both Maori and non-Maori, the highest average number of occupants is found in dwellings owned with a mortgage. Approximately 82 percent of those living in Maori-headed households live in a dwelling which is either mortgaged or rented. The corresponding figure for the whole population is 72 percent.

In terms then, of either the proportion of households, or proportion of individuals living in those households, a larger proportion of Maori live in those two forms of tenure in which costs have risen particularly rapidly in recent years. This relative shift in real purchasing power is an undoubted consequence of the post-1984 monetary policy changes.

Summary

The impact of restructuring has been relatively more unfavourable for Maori than non-Maori in two important areas, that of unemployment, and in the effect on housing costs.

It is clear that the greater difficulties of Maori in the labour market are due to a combination of factors. These include the greater youth of Maori, on average, and a pattern of skills and occupations which do not match developing job opportunities.

The rural to urban migration of Maori after World War II enabled Maori to reduce somewhat the gap between them and non-Maori in economic wellbeing. That migration was accomplished with little assistance from the rest of the community, although helped by the full-employment economy of the time.

Maori are now faced, more than are non-Maori, by the need for a second 'migration', in rather more difficult economic circumstances, now taking the form not of geographical mobility, but of mobility to new industries and occupations.

Different Effects on Men and Women

Women are less likely to have paid jobs than men and more likely to work fewer hours. On average they earn around 80 percent of men's hourly earnings and, due to their shorter working hours, around 70 to 72 percent of men's total weekly earnings.

Over the last thirty years women's labour-force participation has increased steadily. Women's incomes improved relative to men in the 1970s but there has been little change in the last ten years. These are long-term trends and it is difficult to ascertain what impact the restructuring process has had. In terms of labour-force participation, that of women has dropped less than male participation, so the increasing 'feminisation' of the workforce has continued through the period of restructuring.

The greater concentration of women in the service industries such as trade, community and personal, and business services has meant that women have been less vulnerable to the employment losses which have occurred mainly in the primary and manufacturing industries. Also the decline in full-time jobs and the continued increase in part-time jobs has probably been more favourable to women than to men.

The unemployment statistics lend some support to this view. Since the mid 1980s unemployment rates have risen more strongly for men. The male unemployment rate, as defined in the Household Labour Force Survey, is higher than the female rate (7.5 percent against 7.1 percent in the March 1989 quarter).

In the deregulated economic environment workers need to be more adaptable and responsive to change. They may need to be more geographically mobile, to learn new skills and to be more entrepreneurial and prepared to go into business on their own account.

Women seeking to combine home and child-care responsibilities with paid-work commitments may have more difficulty in meeting some of these requirements. Years out of the workforce may mean that substantial retraining is needed. Women are probably less geographically mobile than men on average and have more difficulty in raising the capital and putting in the long hours which establishing a business usually requires.

Overall there is little available evidence to suggest that the restructuring process has had more negative consequences for women than for men. If anything the reverse appears to be true.

Impact of Restructuring on the Distribution of Income

It is generally possible, given adequate data, to say whether the distribution of income, or wealth, within an economy has become more or less unequal, (though there are difficulties when there is greater equality over one part of an income distribution, and less over another part).

It is not possible, however, within the assumptions of economics, to say whether a given income distribution is equitable or not, and therefore whether a change in an income distribution is a change in the direction of greater fairness, or the reverse. Such a statement requires a value judgement, made by the individual, or obtained in some manner for society as a whole.

In this section the available empirical data on shifts in recent years in the distribution of income are examined. The principal data sources are the Household Expenditure and Income Survey (HEIS), and the quarterly indexes of Real Disposable Income (RDI), both from the Department of Statistics. The RDI indexes are in fact based on HEIS information, but the principal indexes are for full-time wage and salary earners only, that is excluding the unemployed, part-timers, and the self-employed.

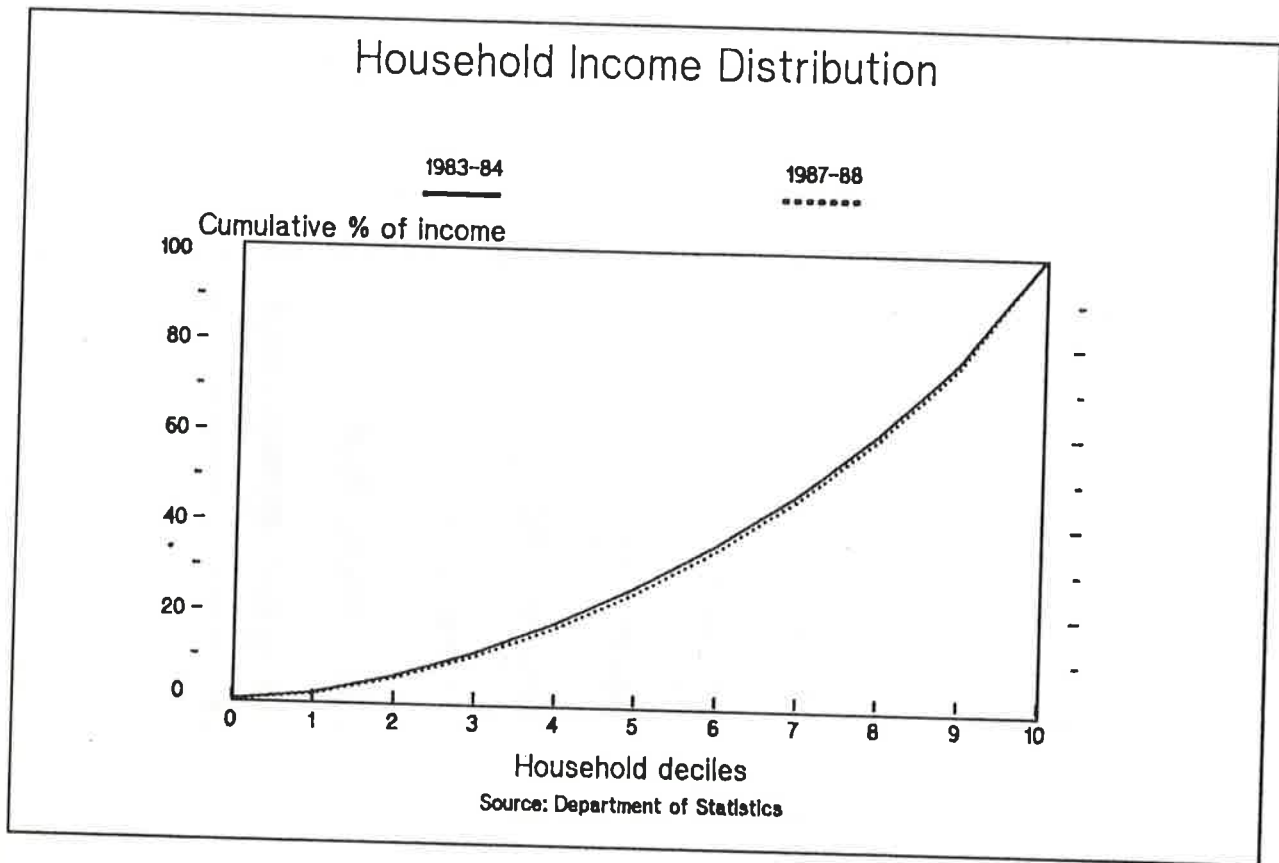
A more detailed discussion of trends in income distribution is contained in the Planning Council's 1988 publication *For Richer or Poorer*, and also in various reports from the SEBIRD project, concerned with the redistributive impact of government revenue-collecting and expenditure activities.

Pre-tax Distribution of Income

The Department of Statistics has published for some years from HEIS data estimates of the income levels which split the surveyed population into ten equal groups (deciles) in order of increasing income. The measures are in terms of 'regular' income, which includes, in addition to normal income from earnings, rents, interest, dividends, etc, income from benefits such as national superannuation, the domestic purposes benefit, unemployment benefit, etc. This is done for each of heads of household, all persons aged over 15 years and households in total.

A Lorenz curve for household income, from this source, is displayed in Infogram 13.15. The curve shows the cumulative proportion of total income accounted for by all deciles up to a given point. It can be seen that if the curve is not far below the 45° diagonal it shows a relatively equal distribution of income, whereas if it is curved more downwards and to the right the income distribution is less equal.

Infogram 13.15



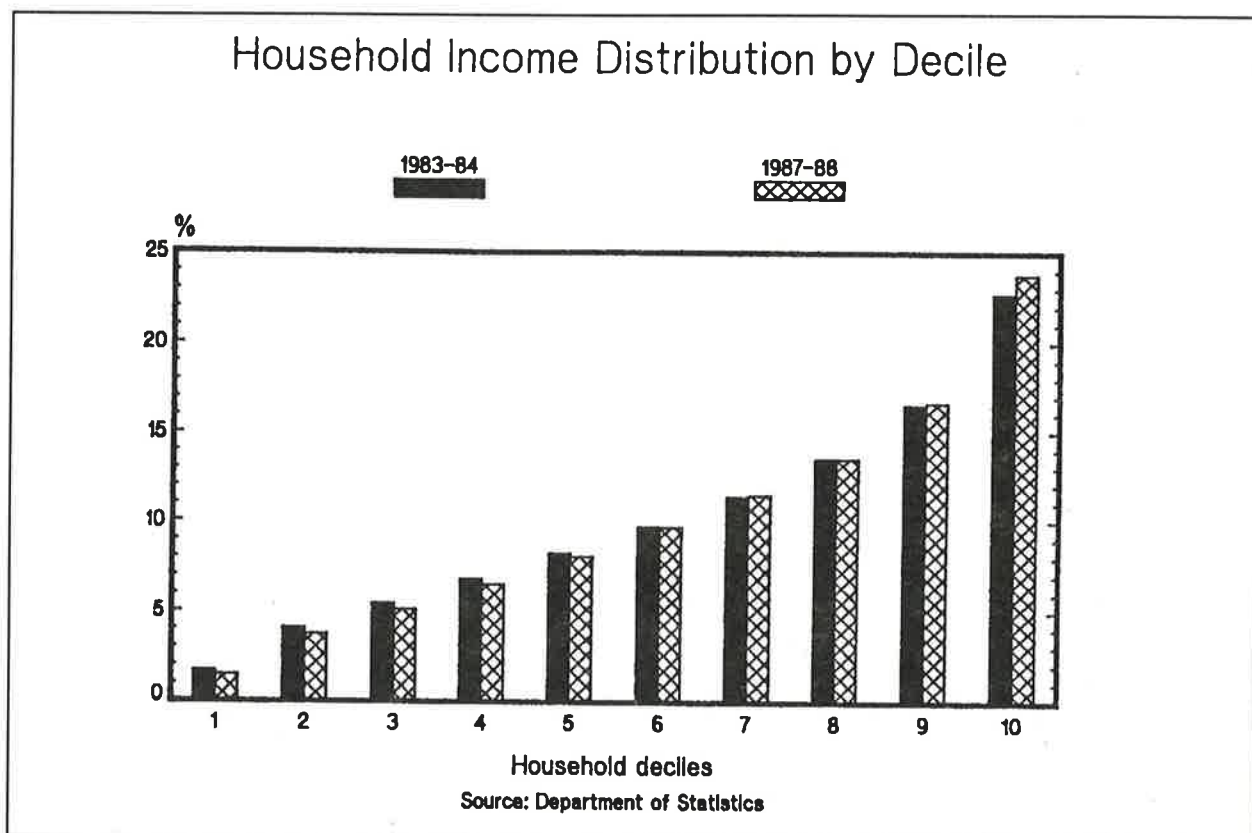
Some caution is appropriate in using these HEIS data. In particular, the decile estimates are subject to sampling error. Also, approximations are used in estimating average incomes within each decile, which are most subject to error in the top and bottom deciles.

The curves compare household 'regular income' distributions between 1983/84 and 1987/88. As can be seen there has been a tendency towards an increase in (pre-tax) income inequality over this four-year period, although the shift does not appear large visually. (A similar shift is apparent for the incomes of heads of household, not shown here, but not for all individuals over age 15).

Infogram 13.16 presents the material in a different manner. It compares proportions of total income accounted for by each decile, in the two years. This shows a fall in relative incomes for all deciles up to the fifth, and an increase in the top deciles.

There are undoubtedly a number of factors behind these estimated shifts, with for example, changes in benefit levels, including national superannuation, relative to other income possibly being significant. It is probable, however, that restructuring has played some part in the shift towards greater income inequality, through increased unemployment and also through relative income reduction for those employed, or self-employed, in some sectors such as farming and manufacturing. The increase in income share of the top decile might, on the other hand, be accounted for by many in this decile being employed in prospering sectors such as financial services.

Infogram 13.16



Post-tax Distribution of Income for Full-time Wage and Salary Earners

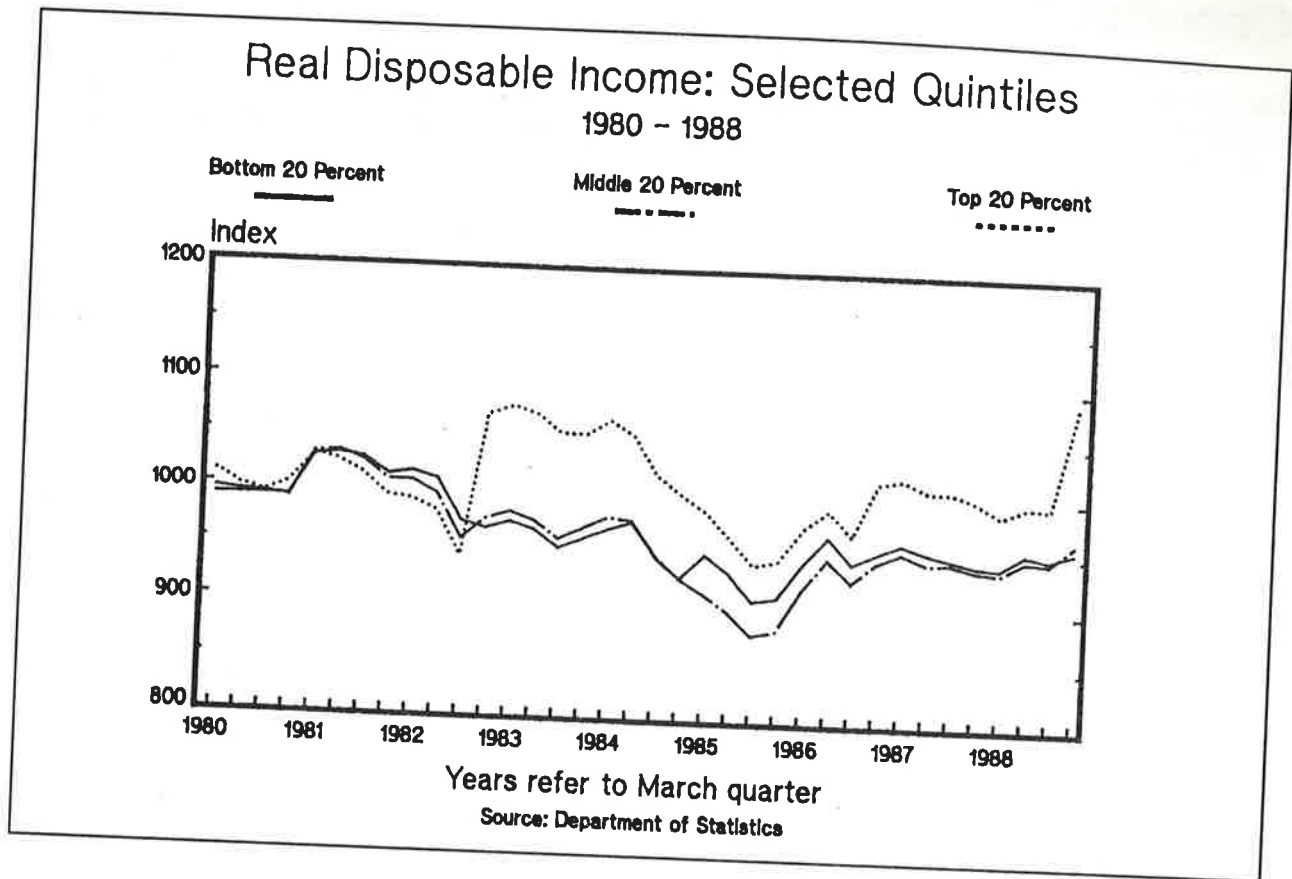
In addition to the shifts in pre-tax income, including benefits, there are shifts in real after-tax income resulting from changes in direct and indirect taxes and their differential impact. The principal data on these are provided by the Real Disposable Income (RDI) indexes. These are indexes of movements in after-tax income for five income quintiles, deflated by movements in the CPI to give measures of real purchasing power.

The indexes, it should be noted, exclude the self-employed, the unemployed, and the part-time employed and assume the expenditure pattern is the same across all income ranges.

Infogram 13.17 shows the path since 1980 of the top, middle, and bottom quintiles. The individual quintile indexes, after peaking in early 1981, fell fairly steadily through the period of the 1982/84 wage-price freeze and continued to fall to mid 1985, as inflation accelerated from the beginning of 1984. There was then a strong recovery to 1986 following which the indexes have been fairly stable, at a level about 8 percent below the 1981 peak. (This is for after-tax incomes. Movements in the pre-tax real product wage are discussed elsewhere.)

The exception to this general trend is the top income quintile, which registered nearly a 15 percent gain in after-tax income when personal income tax scales were restructured in October 1982. The gap has narrowed since, but has not been eliminated. Other significant influences, though less so, were the gains for the bottom quintile from the tax and benefit changes at the beginning of 1985, and the gains for the top quintile at the time of the introduction of GST in October 1986. The latest tax changes, from October 1988, show a further relative increase in the index for the top quintile.

Infogram 13.17



The movements between the quintiles should, however, be interpreted with some caution. First, the fact that the indexes happen to commence in the first quarter of 1980 does not imply any special sanctity about their ratio at that date. Second, it is clear that changes in the personal tax-scale are responsible for occasional major shifts in relative after-tax incomes, notably in October 1982, but also in 1985, 1986 and 1988. In between these shifts, however, there tends to be a gradual erosion of the relative income advantage of the upper income groups. This is almost certainly due to the phenomenon of 'fiscal drag', or 'bracket creep', where inflation combined with fixed tax scales causes a gradual increase in average tax rates, more particularly for those higher up the tax scale. In this context, tax reductions favouring higher income groups can be seen as correcting for the distributional impact of inflation. Again, the indexes are for wage and salary earners only, and while higher-bracket tax rates have also fallen for other income earners, the various steps to widen the tax base and make tax avoidance more difficult are likely to have had a more significant effect on non-employee income.

However, a final point is that all income groups are implicitly assumed to have the same expenditure patterns, and hence to be affected equally by price inflation. It is certainly not the case that expenditure patterns are constant across the income range, and it could well be that the purchasing power of persons on lower incomes has worsened relatively, for instance because of the more rapid escalation in housing costs than in other prices, and possibly the greater incidence of user-pays policies on the lower paid.

Overall the picture shown by the RDI indexes is consistent with most of the changes in relative after-tax incomes being a result of occasional major tax-scale (and benefit) changes, with fiscal drag taking effect in the intervening periods. The most significant change in relativity was in 1982, that is before the restructuring period. Concentrating on the post-1984 period, the gap in post-tax real incomes initially narrowed, and then, in late 1986 and again in late 1988, widened.

Conclusions

The emphasis in the preceding discussion has tended to be on the 'losses' rather than the 'gains' from economic restructuring. At this stage of the restructuring process, the losses are particularly noticeable in terms of increased unemployment which bears particularly harshly on certain identifiable groups such as the young, the less-skilled, and Maori.

It is worth stressing therefore that there have been gains as well as losses in the outcomes so far from restructuring. For instance cheaper goods and services are available as a consequence of deregulation of industries such as transport, and the reduction of border protection and the removal of export subsidies. In general these gains are very wide-spread, but are small and difficult to identify for each individual gaining. Losses, on the other hand, are more unequally distributed, and often very noticeable.

The population groups discussed in this chapter as containing a relatively larger proportion of 'net losers' have been particularly vulnerable to three impacts of restructuring:

- the initial impact of restructuring on export- and import-competing industries, leading to employment losses in these industries, and concentrated at least initially in the non-urban parts of New Zealand -- reductions in border protection, the removal of export subsidies, and a strong exchange rate resulting from firm monetary policies, have all contributed to this
- the increase in financing costs, including those of home mortgagors, as a result of the firm monetary stance
- the general increase in unemployment, concentrated amongst the less experienced and/or less skilled, following from the 'deflationary shift' in monetary and fiscal policy over the last five years.

As noted earlier, Maori are disproportionately represented in each of these categories.

The first and second of these impacts can be seen as interim consequences of the restructuring process, which have now largely worked through. For the primary sector, exporters in general, and mortgagors, there are indicators that the gains from restructuring are beginning to, or will shortly, become more evident.

That is not the case for the third impact, that part of the increase in unemployment attributable to restructuring. Again the expectation is that a more efficient and more flexible economy will generate faster sustainable growth and increased employment. Two difficulties, however, are that:

- the low skill levels of many of the unemployed is itself a barrier to growth and to the creation of new job opportunities
- there is a possibility that even on a higher growth path, there will continue to be a relative contraction in job opportunities open to unskilled workers, and hence either continuing 'structural' unemployment, or else jobs available for the unskilled at pay rates so low compared with the rest of the community as to conflict with social objectives of 'fairness'.

This raises an ethical question. Restructuring is intended to benefit the whole community -- and should do so by improving the efficiency of the community's economic base. But some groups, including the unskilled, the young and Maori, are bearing an unfair, disproportionate share of the costs. Unless it is argued that these groups were disproportionately responsible for the need for restructuring, does the community not owe them compensation for the costs they are bearing?

In general it is not possible to compensate directly the losers from each economic change. To do so would in many cases defeat the purpose of the change -- by removing the incentive to shift resources or alter behaviour. But it is possible to provide indirect compensation by assisting the most vulnerable to adjust

more readily and to position themselves to take advantage of new opportunities. In some cases that is being done, but there is more scope for programmes to encourage positive adjustment rather than compensating for the negative impacts of past change. A priority for such programmes should be the provision of opportunities and incentives for those entering the labour force to enhance their skills and qualifications. But the compensation promised by these programmes depends on achievement of the goals of restructuring - more efficient and adaptable economic structure capable of sustaining faster growth in incomes and employment.

CHAPTER FOURTEEN

Conclusions and Policy Implications

Progress So Far

The intermediate macroeconomic objectives of lowered inflation, internal fiscal balance, and external balance have largely been achieved. In the field of microeconomic policy there has been a very considerable 'freeing-up' of the economy, through a wholesale elimination or reduction of impediments to market forces. In some areas, such as tariff protection and the labour market, the rate of change has been slower, but still significant. Attitudinal changes take time to bear fruit, but there is some indication that the opportunities provided by a less regulated market-place are being taken.

Progress towards the longer-term objective of a faster-growing, full-employment economy is less apparent. Productivity has increased in some industries. But to date the 'deflationary shift' in macroeconomic policy settings, pursued in order to restore macroeconomic balance, has outweighed the positive effects of restructuring. In consequence unemployment is higher than it would otherwise have been, and new investment in fixed assets is depressed. Investment is the key to the shift to a high-growth, full-employment economy. At present it is being held back by depressed domestic demand and the financing difficulties caused by the high debt to equity ratios of many businesses. This is further compounded by continuing high interest rates. Also, there is some continuing uncertainty about government's policy intentions, particularly in the area of taxation. More positively, even with the existing capital stock, profitability is improving, certainly in manufacturing, and there has been a positive shift in attitudes to export prospects, aided by the recent improvement in New Zealand's international competitiveness.

However, the endeavour to put the economy onto a long-term, higher growth, full-employment path has so far been at the cost of an increase in current unemployment levels.

That cost is largely being borne by three sectors in the labour force -- Maori, the young and the unskilled, or those with skills less in demand. Changes in policy which could reduce some of the economic and social costs of restructuring are discussed later. The EMG considers, however, that the 'restructuring' policies of recent years have been in general appropriate, and indeed essential, to reverse the steady long-term deterioration in New Zealand's economic performance. Policy changes should be changes in emphasis, not changes in direction.

General Considerations

The benefits from change are often widespread, and while sizeable for the economy in total are small for each individual recipient, for example, reductions in the cost of consumer goods and producers' materials as a result of lower tariffs. The costs of change, however, can be more concentrated, as for example, unemployment amongst the less skilled.

The costs of restructuring should not be evaluated in terms of the total cost of the malfunctioning of an economy at a given point in time, for example, by taking the total present level of unemployment as an indication of the cost of restructuring. Rather it is the incremental cost associated with the changed policies, the increase in unemployment compared with what would otherwise have occurred (that is, compared with the counterfactual situation) which is the true measure of the cost of the policies. It is difficult to assess what in fact the counterfactual situation would have been. It is clear, however, that the long-term trend in unemployment had been upwards. Also, that certain policy changes were inevitable by 1984. In particular, there was strong pressure on New Zealand to phase out direct assistance to exporters in the form of export subsidies and farm subsidies. Also it is improbable that the fiscal deficit would, or could, have been allowed to continue at the level prevailing in the years up to 1985, or that overseas debt could have been allowed to continue increasing at the same rate as seen in those years. In other words, some of the macroeconomic policy changes associated with restructuring would in any case have occurred.

The time element is important. The costs which do accompany restructuring are justified on the grounds that they are outweighed by ongoing benefits in the future. The expectation is that this will be true for most people. But there are some, those for example suffering long-duration unemployment or bankruptcy because of restructuring, for whom the present costs outweigh potential future benefits.

This is not a sufficient argument for halting the restructuring process. Expected gains for the community as a whole if substantial enough, will justify proceeding with a policy, even though costs are unequally shared. Also, a good proportion of the costs of restructuring have already been borne. It is an argument of course for trying to reduce the size and duration of those costs. The scope for this is discussed under policy requirements and options.

Policy Requirements

To many New Zealanders this generally positive assessment of restructuring will be surprising given the immediate evidence of costs. But the whole purpose of restructuring is to shift away from short-term tinkering towards tackling the longer-term structural decline in the New Zealand economy. Some general consideration should be noted.

Within existing policies, the broad macroeconomic objectives of low inflation, and external and internal balance, are important for achieving a better economic performance than in the past. They should continue to be major policy objectives. In the longer term greater year-to-year flexibility may be tolerable on the objectives of fiscal and external balance, but in the immediate future the room for manoeuvre is constrained by the debt built up from past deficits.

In the area of microeconomic policy, the EMG supports the continuation of present policies, with border protection being further phased-down, and likewise in the domestic economy positions of privilege being opened to competitive pressures.

Policy Options for the Future

For the future the overall objective is to move as rapidly as possible onto a growth path higher than in the past, with output growth sufficiently high to bring about a return to a full-employment economy. Some current impediments to the spontaneous development of such a growth path are discussed in Chapter Twelve. The macroeconomic impediments are those affecting business confidence and investment intentions and hence are currently discouraging output and investment expansion. These include current macroeconomic policy settings as they impact on economic activity through, in particular, the exchange rate and interest rates. They also include some current uncertainties about government policies, in particular its fiscal objectives and taxation policies.

The microeconomic impediments include those likely to delay achievement of the longer-term objective of a full-employment, high-income economy, in particular labour-market inflexibility.

Macroeconomic Policy Options

Disinflationary monetary policies have led to much of the initial cost of restructuring falling on tradeables producers and persons employed in those industries. A strong exchange rate and high interest rates both contributed to this. Interest rates, in real terms, remain high. However the exchange rate has weakened significantly over the past year, and the competitiveness of New Zealand producers, aided by the fall in inflation, has been much enhanced. High interest rates are now probably seen by exporters and import-competing producers as more of an obstacle to economic expansion than is the exchange rate.

An easing of monetary policy in order to reduce interest rates has been widely advocated. The problems are, first, that such a policy, particularly if resulting in a further weakening of the exchange rate, could lead to a resurgence of inflation and, second, that the impact on the credibility of government's disinflationary policies might be such as to lead to an increase rather than reduction in long-term interest rates.

It is doubtful therefore whether an easing of monetary policy alone would be the right course to follow. Rather the preferable course is to further reduce the fiscal deficit, so easing the competition of the public sector with the private sector for funds, and thence interest rates. Firm monetary policies would need to be continued, however, to prevent any rapid resurgence in inflation stemming from an exchange rate fall.

Reducing the fiscal deficit is important, not only for assisting in the implementation of monetary policy as just mentioned, but for ensuring that we achieve equity between present and future generations. The deficit can be reduced either by reducing expenditure or by increasing taxation. Progress has been achieved since 1985, mainly by increasing taxation. Total expenditure has continued to increase, major factors in that being debt-servicing costs and unemployment benefits.

The EMG endorses the current thrust of policy that the best means of controlling government expenditure is by thorough scrutiny of its quality. The continuing reform of the public sector, with its emphasis on evaluating the services provided by government departments against their cost, and an equally careful evaluation of whether grants to individuals and agencies achieve sound social returns, is likely to be much more beneficial in the medium and long term than are arbitrary cuts. What social services should be provided, and whether they should be secured by transfers to individuals or agencies or provided directly, should be decided as aspects of the issue of securing the best possible outcome from New Zealand's resources. The absolute size of government is unimportant relative to securing an effective use of resources.

The medium-term fiscal objective, as discussed in Chapter Twelve, should be to reduce the ratio of government debt to GDP. This implies that for 1989/90, there should be a substantial surplus on the non-interest budget balance, and a deficit of not more than about 2 percent of GDP (or \$1400 million) on the Net Financial Balance. The information available to us now suggests that this will not necessitate any further increase in taxation immediately but will require continuing tight control on government expenditure.

The EMG believes that the policies which have been adopted will restrain debt-servicing costs, and it expects the total cost of unemployment benefits to fall before very long. There will then be greater scope for deciding whether resources should be used for public provision of social services or left for private decision-making through reduced taxation.

In the meantime, however, reduction of the debt to GDP ratio should remain a major objective of policy. There are difficult trade-offs required in making this judgement. Maintaining tax revenues at a level needed to reduce the debt ratio is itself a deterrent to new investment. Given that monetary policy should remain targeted at inflation, an even faster reduction of the deficit would give more relief from high interest rates. Whether the choice is to accept the present level of the fiscal deficit or reduce it further, it is the view of the EMG that policy credibility requires that government should determine expenditure levels by sound decision-making, avoiding both waste and arbitrary cuts.

In general, the government has gained considerable credibility for policy consistency and achievement over the last few years, notably in areas such as phasing-down border protection, and the reduction in the fiscal deficit.

Consistency has been less evident in the field of taxation. Announced changes in the tax system have been modified subsequently in several instances (and there is some concern that the sheer rate of change may prove a burden for some).

The prolonged uncertainty over the taxation of superannuation and pension funds has left institutions unsure of their direction, and has been a factor in the collapse of the commercial property market and slow recovery of the sharemarket.

It is important for investment decisions that uncertainties be resolved, and ideally a tax structure be established which is unlikely to undergo major change under successive administrations.

Microeconomic Policy Options

That labour-market flexibility has many dimensions is emphasised in several places in this report. (The topic is to be extensively explored in Planning Council reports and seminars over the coming year.) In the shorter term the relevant rigidities are restrictive work practices, tax and benefit structures which act as disincentives to seeking paid employment, and obstacles in the present institutional structure to 'industry' and 'firm' agreements aimed at improving productivity with benefits shared between workers and employer. The Industrial Relations Act 1987, appears to have led to some increase in labour-market flexibility. There should, however, be ongoing reviews of the operation of the Act to establish the changes needed for the future.

Longer-term rigidities, obstructing progress towards a full-employment, high real-wage economy, are caused by the low level of skill acquisition of much of the labour force. There is a significant imbalance for a proportion of the labour force, which includes large numbers of young people and Maori, between the skills they possess and the skills sought by prospective employers.

Even with greater wage flexibility such imbalances could take a long time to eliminate. Also, the outcome could be a full-employment economy, but one not providing the desired outcome of high real wages for the workforce in general. Skill upgrading is the alternative, or rather complementary, route to eliminating labour-market imbalances and restoring full employment as well as contributing to faster income growth. This will take time, however. Also unemployed and/or unskilled labour force members often lack the resources to take advantage of training opportunities, even where there are clear incentives to do so. For those already employed, 'upskilling' will largely depend on in-house training. So far as government intervention is required it should be aimed at eliminating obstacles and reinforcing the incentives to acquire appropriate skills.

New Zealand needs a more adaptable labour force in general. This involves the maintenance and probable further development of policies aimed at the unemployed as well as the employed, such as access to training opportunities, assistance with job-seeking and relocation, etc. Apart from the economic aspect, such policies are important in maintaining long-term expectations of a full role in society for those suffering long-duration unemployment.

Prospects for the Future

The many economic policy initiatives that have occurred over the past decade enable New Zealand to respond more quickly to the changing external environment. The aim of restructuring to promote adaptability and flexibility, as advocated by the EMG in *Strategy for Growth*, has thus largely been achieved. There are some policy issues where further improvement is desirable. While it is certainly important that these matters are addressed, they should not be seen as being of such importance that they are preventing the restructuring policies from working.

Indeed there is clear evidence that the policies are working. At the microeconomic level there has been a significant acceleration of change and at the macroeconomic level very substantial progress has been made towards the achievement of the intermediate objectives of low inflation, fiscal balance and external balance. At the same time, however, the aggregate level of economic activity has continued to stagnate and unemployment has grown to unacceptably high levels. A large part of the latter can be explained as an inevitable result of earlier policies and some of it should be seen as evidence of desirable change in the structure of the economy. However, the policy thrust of the past decade will clearly not have achieved its ultimate goals until sustained economic growth appears and unemployment is substantially reduced.

In considering when these goals are likely to be achieved, it must be realised that the restructuring policies are only enabling – they set the environment within which individuals act. Government of itself cannot cause sustained growth at full employment. This requires individuals and firms to increase their investment and savings and to look for new business ventures and new markets. All of these initiatives require confidence in the economy and in the stability of policy. As growth starts to reappear and the effects of the financial crash fade, so confidence should return. Provided the integrity of the policy framework is maintained, New Zealanders will be well placed to benefit from the changes that have taken place.

APPENDIX ONE

The Concept of Contestability

For industries whose costs per unit output fall with increasing scale or scope of operation, the potentially most efficient market structure in a relatively small economy, can consist of one or only a few firms. (Possible examples include electricity transmission, air and rail transport, and banking.) It can be difficult to enforce competitive pressures and prevent the exploitation of monopoly or oligopolistic power in such instances. However, recently developed theory suggests that in some circumstances it is sufficient for the market to be *contestable*. That is, the mere threat of entry by a potential competitor can restrain exploitation of market power.

The principal theoretical conditions for contestability to be effective are that the potential competitor has the same cost structure as the actual producer(s), and is able to enter and exit from the market costlessly. Even if these conditions are only approximately achieved, it is plausible that there should be some restraining effect.

This has been one of the factors motivating the reduction in barriers to merchandise imports and the opening-up of banking and air transport to overseas entrants. For some sectors it is not easy to apply contestability pressures, for example, cement (high transport costs for imports) and retail banking (requiring heavy capital investments). For others capital costs of entry are less significant, for example, non-retail banking, or at least are not substantial enough to prevent actual entry, as with the entry of Australian-owned Ansett Airlines to the domestic air-travel market in competition with Air New Zealand. That there is still dispute on the effectiveness of contestability is illustrated by the following quotation on the United States domestic airline industry.

"While the recent studies differ in their approaches, they all reach the same general conclusion that actual competition is a more powerful force for efficiency and low fares than is potential competition. It has been found, for example, that in many cases it took actual competition for a route to stimulate an established carrier to reduce fare levels and then, normally, only to the level of the new entrant. Moore's work found that while air fares fell between 1976 and 1983 this was only because of the introduction of actual competition on many routes and, further, this actual competition must involve several carriers. (A single competitor or even two is insufficient for an airline to be forced to price at minimum cost.) The findings of Morrison and Winston are very similar. They find that a single potential entrant has no significant effect on fares and that, indeed, an operator must be confronted by at least three potential competitors before pricing behaviour is affected. Furthermore, three potential entrants have the same effect on market behaviour as one actual competitor. While these developments cast something of a shadow over the extent of contestability of airline markets, they do not provide a case of rejecting it as a basis for reforming economic regulation. Firstly, while the studies we have cited indicate that potential competition exercises only a weak constraint over the actions of airlines, its existence does, however, seem to have produced benefits."

(Button, Kenneth J., and Morrison, Steven A., "The Effects of Reforming the Regulation of U.S. Domestic Civil Aviation", *The Royal Bank of Scotland Review*, Number 158, June 1988, pp.45-46.)

APPENDIX TWO

Exchange Rate Concepts

There are a number of 'exchange rate' measures in use for different purposes.

Real Exchange Rate (RER)

The RER is the ratio of an index of prices of non-tradeable commodities to an index of prices of tradeable commodities. *Tradeable* commodities are those goods and services which are either exported or imported, or are potentially exportable or importable given a change in supply or demand or market price. *Non-tradeables* are the remaining commodities – generally services.

The importance of the RER is that shifts in it over time indicate whether domestic resources are likely to be drawn to the production of non-tradeable or tradeable commodities. Suppose an objective of policy is to improve the balance on external transactions. A fall in the Real Exchange Rate -- a relative rise in the price of tradeable commodities -- will attract more resources into export- and import-competing production.

A fall in the nominal value of the New Zealand dollar (see below) will contribute to a RER fall, but the shift will be transitory if the fall results in increased domestic inflation.

Reserve Bank Trade-weighted Exchange Rate Index (TWI)

Exchange rates for the New Zealand dollar are quoted in terms of many foreign currencies. The TWI takes the exchange rates for the most important of these currencies, and weights them in proportion to their respective importance in New Zealand's transactions with the rest of the world. The TWI measures the 'nominal' exchange rate -- not adjusted for changes in relative inflation.

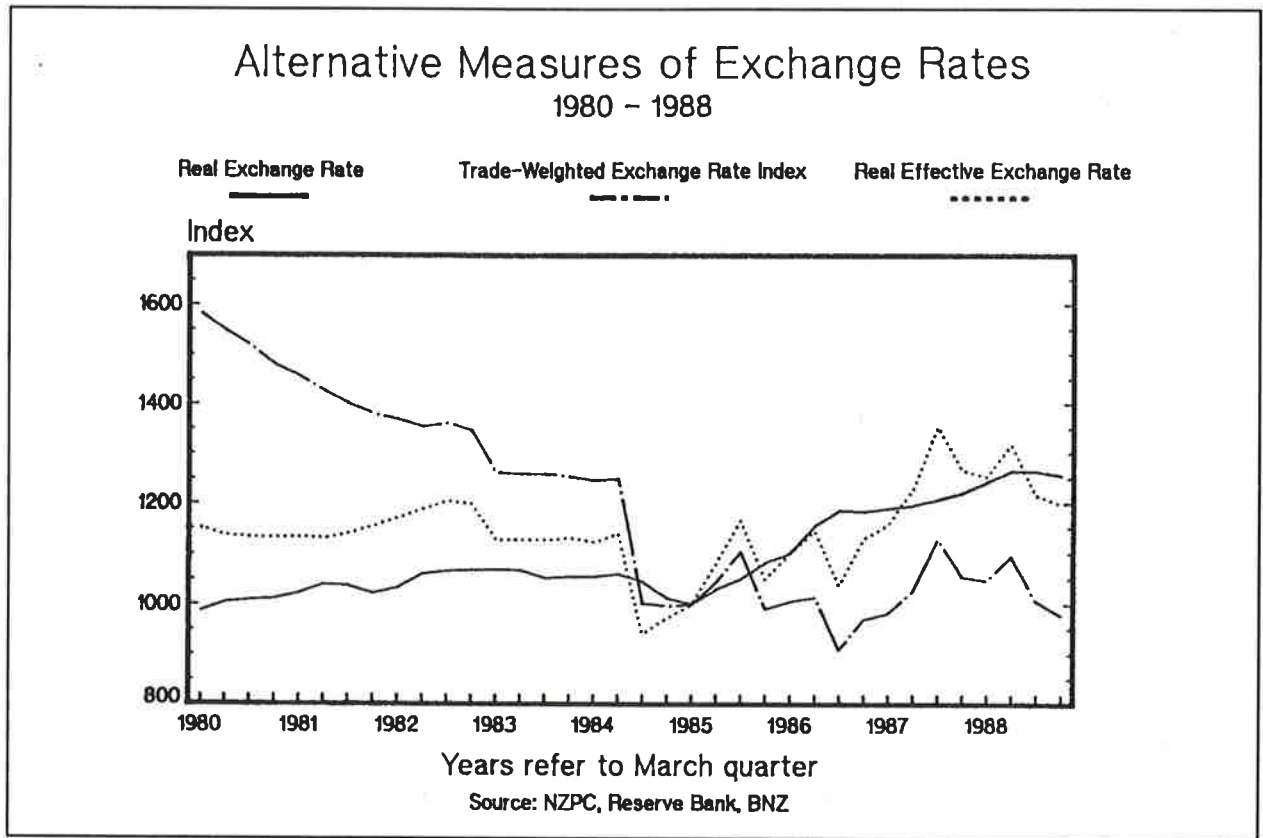
As the infogram shows, the TWI fell steadily through the early 1980s. Because this was offset by New Zealand's higher domestic inflation, the RER remained relatively stable.

Index of International Competitiveness or Real Effective Exchange Rate (REER)

This is an index designed specifically to measure changes in the relative competitiveness of domestic and overseas producers, on both the New Zealand market and on overseas markets. (Different versions of the index can be tailored to different commodities and markets).

The index shown here is that constructed by the Bank of New Zealand. It takes the ratio of New Zealand output prices to overseas producers' output prices, and then adjusts for shifts in the nominal exchange rate. A rise in the index shows a loss of competitiveness and a fall shows an improvement.

Infogram 1



APPENDIX THREE

Effects of Deregulating the Finance Sector

The material here is a summary of a more extensive Planning Council case study.

The policy changes affecting the sector were: the abolition of most direct regulatory controls on interest rates and credit extension in 1984; the abolition of most controls on foreign exchange transactions; and the opening of the banking industry to competition, including from overseas banks.

The finance sector has undergone accelerated change since the regulatory reforms.

The market structure of the sector changed rapidly -- from four registered banks before 1984 to 15 in November 1988, including many from overseas. New Zealand institutions expanded their representation and business overseas. Non-bank financial institutions expanded their range of financial services, although since the sharemarket crash and consequent liquidity difficulties for some, there has been a move back to 'mainstream' institutions. There have been a number of mergers and takeovers to form institutions more capable of competing with larger overseas banks. Overall there has been a blurring of the boundaries between various types of financial institutions.

Output has increased substantially, as has employment in the sector.

The range of services has expanded. This is as a result of increased demand for existing and new financial products in the new and volatile market environment, and also as a result of the increased links with overseas markets. Competitive pressures, and the labour-intensiveness of much banking activity have continued to impose pressures for further automation. This is reflected in an upsurge in investment in plant from \$52 million in 1977/78 to \$447 million in 1986/87.

Data for the 1970s suggest a higher earnings margin for New Zealand trading banks than for banks in other developed economies. Up until 1987/88 value-added and profit margins for the sector increased following deregulation. Possible reasons for this include the rapid expansion in demand which has outweighed the increase in competitive pressures; increased costs of servicing fixed investment; and possibly the absence of fully competitive markets in some parts of the sector.

The first surge of post-reform expansion is completed, and there is likely now to be more pressure on prices for services. Combined with continuing pressures to automate, it is probable this will lead to labour-force retrenchment, and a continuing tendency to larger institutions.

Chronology of Significant Microeconomic Policy Changes

The policy changes and other developments listed below are drawn from the Reserve Bank Bulletin, Bollard and Buckle (1987), Galt (1989), and OECD Economic Surveys of New Zealand. The list here is to highlight major developments. More detail is available in the sources quoted.

Separate chronologies are given under each of the major headings below.

Trade Policy and Liberalisation

Border Protection

- | | |
|-----------------|--|
| 1938 | Import licensing introduced to meet balance of payments crisis. |
| 1969 | National Development Conference recommends that import licensing be phased out and replaced by tariffs. |
| 1979 | Intention announced for a proportion of import licenses to be put out to tender, and for more flexible administration of the existing system. |
| 1981 | Import license tendering begins. The intention was for an increasing proportion of licenses to be put up for tender each year, and for tender premiums to provide benchmark measures of 'tariff equivalents' of import licenses. |
| 1984 | Agreement reached between government and manufacturers to phase out import licensing and replace it with tariff-based protection. |
| 1984 (December) | New motor vehicle industry plan allows greater access for imported vehicles and componentry. |
| 1985 | Acceleration of tariff and import license reductions. |
| 1986 | Import licensing to terminate by 1988, except for products within coverage of industry plans. |
| 1987 | Tariff structures reviewed. Programme for tariff phase-down and equalisation announced, involving substantial cuts over the four years from July 1988. |
| 1988 (July) | Import licensing ends for most goods. |

Trans-Tasman Trade

- 1966 New Zealand-Australia Free Trade Agreement (NAFTA) signed. This agreement liberalised trade in certain product areas, notably forestry. Extension to other product areas required mutual agreement.
- 1983 Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) signed. Much broader in scope than NAFTA, with only a small number of commodity groups specifically exempted from coverage. Otherwise license and tariff barriers to trans-Tasman trade are to be phased out by the 1990s.
- 1985 onwards The reduction of barriers to trans-Tasman trade accelerated beyond the original schedule under ANZCERTA, and commodities not originally covered are brought within its scope.

Other

- 1981 New Zealand accedes to GATT subsidies code -- this required the elimination of the existing system of export incentives.

Assistance to Industry and Consumers

Assistance to Export Industries

- 1962 and 1963 Export incentives introduced applying to 'non-traditional' markets and products -- gradually expanded over succeeding years. (To an estimated fiscal cost in excess of \$400 million in 1983/84.)
- 1976 Livestock Incentive Scheme -- to encourage increased livestock numbers.
- 1978 Supplementary Minimum Prices (SMPs) subsidy scheme.

This put a 'floor' under prices received by farmers for traditional pastoral produce exports. Their objective was to reduce risk and thereby encourage increased investment and production by the farm sector. In subsequent years, SMP payments became very substantial for some sectors of pastoral farming.
- 1981 New Zealand signs GATT code on Countervailing Duties. An undertaking was given the United States that export subsidies not qualifying under GATT rules would be phased out by 1984.
- 1984 (June) Abolition of SMP payments -- from end of 1983/84 season.
- 1984 (August) The Export Performance Tax Incentive (EPTI) to be phased out from April 1985 on a three-year timetable.
- 1984 (October) Abolition of fertiliser and fertiliser transport subsidies announced in Budget. Reserve Bank concessional interest rates to be increased to market rates.
- 1985 The Export Market Development Tax Incentive (EMDTI) to be phased out by 1990.

- 1986 Producer Board debt with the Reserve Bank is substantially written down.
- 1988 (March) Phase-out of EPTI completed.

Other

- 1975 (December) Subsidies on milk and bread reduced, and electricity, rail and postal charges increased, closer towards true cost of supply.
- 1976 Maximum retail price scheme revoked. Bread, flour, eggs and butter consumer subsidies abolished.
- 1984 (November) A sweeping elimination of various consumer and producer subsidies and incentives announced in the Budget, either taking place immediately, or being successively phased down.

Regulatory Structures and Reforms

Transport Industry

- 1977 The distance limit on transportation of goods by road in competition with rail increased to 150km.
- 1978 Road-user charges introduced -- a major step towards user pays for heavy road vehicles.
- 1983 Distance limit on goods transportation in competition with rail is removed, but with a fee for distances beyond 150km.
- 1984 A quality licensing system for road transport operators replaces previous quantity licensing system (under which areas, routes and prices were subject to control).
- 1984 The Air Services Licensing Act 1983 replaces quantity licensing by quality licensing for air services.
- 1986 The permit fee on road transportation of goods, where competing with rail beyond 150km, is abolished.
- 1987 Minimum price limit on petrol prices, in existence since the 1930s, abolished.
- 1987 Domestic air-routes opened to competition with Ansett New Zealand commencing operations.
- 1988 Remaining price controls on petrol pump prices abolished.

Financial and Foreign Exchange Regulation

- 1976 Limits on deposit interest rates relaxed.
- 1979 Controls on foreign investment in New Zealand eased.
- 1979 Forward exchange trading liberalised.
- 1981 Financial services regulations amended to limit increases in lending interest rates by financial institutions.
- 1982 (March) Suppliers of finance proposing to institute new specified financial services required to give the Reserve Bank notice in writing of the price they propose to charge.
- 1982 (June) A fixed exchange rate regime replaces the former 'crawling peg' regime.
- 1983 (April) Credit guidelines impose a limit of one percent growth per month in lending by a wide range of financial institutions.
- 1983 (April) New Zealand's international credit rating reduced from AAA to AA+ (Standard and Poors'). Reasons cited included the increasing government deficit.
- 1983 (September) Tendering system introduced for government stock.
- 1983 (November) Tight regulations imposed on interest rates, including an 11 percent ceiling on first mortgages.
- 1984 (Feb - May) Interest rate controls progressively extended and tightened, and regulations introduced penalising finance companies with lending growth in excess of guidelines.
- 1984 (July) The New Zealand dollar devalued 20 percent.
- 1984 (July & Aug) Controls on interest rates abolished and the credit growth guideline removed.
- 1984 (October) Credit rating (Moody's) for New Zealand reduced from AAA to AA.
- 1984 (Oct - Dec) Exchange control regulations and restrictions on overseas borrowing, and on the access of overseas companies to New Zealand capital markets progressively abolished.
- 1985 (February) The 'compulsory ratio system' for financial institutions abolished.
- 1985 (March) The New Zealand dollar floated.
- 1987 (April) Institutions of suitable status, including overseas organisations able to apply for banking licenses.
- 1987 (October) Sharemarket prices fall world-wide. New Zealand sharemarket suffers its biggest ever one-day fall.
- 1989 Reserve Bank of New Zealand Bill proposes greater autonomy for the Reserve Bank, and sets its primary objective as 'achieving and maintaining stability in the general level of prices'.

Changes in the Taxation System and the Composition of Government Expenditure

- 1982 (October) A rationalised income tax-scale introduced with far fewer steps, and tax cuts particularly in the top income bracket.
- 1984 (November) Budget announces removal of various subsidies and incentives.
- 1986 (July) The government assumes responsibility for major project and producer board debt worth \$7.2 billion.
- 1986 (October) Goods and Services Tax (GST) of 10 percent on almost all commodities introduced, accompanied by reductions in personal income taxes and benefit increases.
- 1987 (June) Budget announces plans for sale of government assets to pay off public debt.
- 1987 (December) Wide range of economic reforms announced, including plans for a single personal tax scale (later abandoned), an acceleration in public asset sales, reduced company tax rates, and the removal of tax exemption for long-term contractual savings.
- 1988 From 1989 the Government's balance date is to change from 31 March to 30 June.
- 1989 Increase in GST to 12.5 percent from July and a 'cap' in nominal dollar terms on government expenditure in almost all categories. The company tax rate is increased to equal the top personal income tax rate. The expected fiscal savings amount to \$1.5 billion. (Total savings of \$2 billion are the estimated requirement to reduce the fiscal deficit for 1989/90 to the Minister of Finance's target of one percent of GDP.)

Prices and Incomes Policies, and Labour Market Institutions

- 1982 (June) A twelve-month wage-price and rent freeze imposed, covering also interest rates and other fees and charges. (The freeze was later extended to 1984.)
- 1983 (December) Industrial Law Reform Act has the effects of making unions voluntary organisations (repealed in 1984).
- 1984 (July) Three months price freeze announced following general election and 20 percent dollar devaluation.
- 1984 (September) Economic Summit held, with representatives from various sectors.
- 1984 (October) New wage-fixing rules announced allowing greater flexibility in bargaining.
- 1987 (August) Labour Relations Act (1987) comes into effect.
- 1987 (December) State Sector bill introduced, concerning terms of employment and negotiation procedures for state employees. The act came into force from April 1988.
- 1988-89 Discussions are held between government and the unions on the development of a 'Social Compact'.

Agency Reforms and Other

- 1979 (September) Plans announced to proceed with a number of major growth projects (think-big) based on the utilisation of Maui natural gas.
- 1981 (September) Approval for synthetic petrol plant at Motunui.
- 1981 (October) Go-ahead given for New Zealand Steel expansion at Glenbrook.
- 1986 Commerce Act 1986 comes into effect.
- 1986 (May) Statement on Government Expenditure Reform outlines plans to change a number of departmental trading organisations to corporate structures.
- 1987 (April) Nine new state corporations (SOEs) come into existence.
- 1987 (June) Plans announced in Budget for sale of government assets to pay off public debt.
- 1987 (October) New Zealand Steel sold. Sales of other state-owned enterprises including Petrocorp, Air New Zealand, and Post Bank, have followed.
- 1988 Government Budget lists the principles and procedures for the sale of government businesses.
- 1989 Wide-ranging reforms are implemented for the education system.
- 1989 A new structure of local government comes into effect.

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