

MACROECONOMIC POLICY FORUM, 23 and 24 June 2011

Closing Comments

Geoff Bascand, Government Statistician

TRANSCRIPT

Panel Chair (Struan Little): We've run out of time and I think there's a lot more discussion in fact I think we're just starting to really wind up so I think there's going to be a lot more conversations, even amongst the panellists. But I think it's important we do keep to time so I'd like us all to thank the panellists.

And just to close the forum I'd like to invite Geoff Bascand, the Government Statistician to give us a few closing remarks. Geoff.

Geoff Bascand: Thanks Struan, I think I should say thank you, I'm not sure. I have this suspicion that the reason you asked me is that I'm Exhibit A for Sebastian Edward's equation the Model of Increased Government spending on Non-tradeables activity. That's an input of some uncertain coefficient but let me assure you, high contribution to New Zealand's growth prospects.

Let me remind you right at the outset of Gab's opening remarks and his expectations for this conference. He said to us that he hoped it would help us to better understand the macro challenges and policy levers and that we'd have an open and wide ranging debate. I think we've certainly had that. It's been a stimulating two days with many provocative ideas and analyses. Whether we've got a clear way forward I'm less sure, which I know was the Minister of Finance's hope. But certainly we've got some avenues to pursue and I'll touch on some of those.

I think one of the themes that has run through the conference has been in a sense set up first by Sebastian's opening remarks reminding us of policy targeting principles. We've actually had quite a lot of discussion about different

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imbalances. Part of the challenge in the discussion is we've had different targets and different instruments floating around a little bit and I was just remembering - I hope accurately, as I couldn't find it when I was looking for it quickly today, a paper by Charles Shultz who was Chair of the Council of Economic Advisors back in the early 80s I think, who once famously said that there were two kinds of economists, those who believe that if you looked after the long run the short run would look after itself, and those who believed that if you looked after the short run the long run would be fine. And I think in a sense we've been having some of that discussion. There's been this debate about what are long run issues and what are short run issues and we haven't always taken perhaps quite enough care to segment those and think about what's appropriate to what.

But we certainly can satisfy ourselves that we haven't been pre-occupied with only one of them, and I think that's been important. Sebastian stressed to us competitiveness right from the outset; the long run growth property, the importance of that in the real exchange rate sense, and so forth. But then we've also had a lot of the discussions about the temporary imbalances brought about through overheating and crowding out of traded goods. Then there was some discussion as to whether that also has long run consequences,, and Philip reminded us that it does have some long run consequences if you believe the 'learning by doing' models and various other things that can harm your export sector in a dynamic sense, and not just in a short-term competition for resources sense.

So to some of the provocative ideas and challenges - well Michael Reddell probably takes the cake doesn't he? It is great to see thinking in different ways, namely that our problem is too many people and a policy shock from a more open immigration policy. The migration housing shock certainly caused some real disruption and Arthur has reminded us of that with his highlighting the required transfer of resources from one part of the economy to another. But whether that's a long run situation is less certain, given the supply side benefits of the extra labour, as well, or maybe that the adjustment processes are a lot longer than we often allow? And I think again we've heard quite a lot about that

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through the course of the conference, do we know enough about adjustment periods? What we thought were permanent moves in growth rates were actually very, very long cycles.

Sebastian told us that he thought a sudden “stop” to the economy wasn’t very likely, but Philip Lane told us that he was pretty nervous about the possibility. Prasanna Gai told us that the world was a much riskier place than we’d formerly believed, and Craig Burnside said it was already priced-in and we already knew how risky it was, and that we should comfort ourselves with the fact that we and Australia were both equally risky, it’s just the fact they grew a lot faster! I don’t know how that left me feeling.

But there were some points of agreement as well as those points of difference if you like.

On the points of agreement, I think there was agreement that imbalances matter. However, we have to be clear about how we’re defining those. But in terms of risk exposure, of large external debt positions, excessive credit booms, which everyone can identify, there was that sense that the world has taught us that there is a severe amount of risk there and the consequences of not having some ways to absorb it and/or manage it, or deal with it, and even prevent it if one can, are quite severe. And we need to build that risk perception a bit more strongly into the way we’ve thought about things perhaps, and the appropriate policy regime. That was the heart of the discussion. I think there was a sense in which people would say that, there is a pay-off to prudence that we’ve all got to take account of. We think that being a little more Scottish is a good thing.

We also agreed that the financial stability risks, and their links to macro stability, are crucial. And we need to continue to assess those inter-linkages. I thought we under-did the inter-linkages. My question yesterday to Prasanna was how much these risks fluctuate and are dynamically associated with macro conditions, as opposed to a static set of ever present financial stability risks? The dynamics we haven’t fully understood yet and we need to look at that.

So the central message there is that if there's an upward rating of the risk assessment of the world, then we've got to look at policy responses and keep on progressing that stream of thinking and quite hard.

Another key point of agreement - notwithstanding Arthur's last provocative thought regarding the cost of exchange rate flexibility – was acknowledgement of the merits of our fundamental policy frameworks and some strengths that we do have, both in exchange rate flexibility and the monetary policy framework, (the latter at least which Arthur was endorsing); flexible labour markets on an international scale; and a fiscal framework that's got a clear sustainability dimension. So these are strong things in our favour.

There was agreement that fiscal policy is not everything but it definitely is something (in terms of potential leverage on imbalances). There seemed to be some recognition that the primary roles (or focus) remain sustainability and structural, in terms of the typology of fiscal objectives that Anne-Marie Brook set out. There was some discussion, though I don't know how much agreement, that some asymmetric bias, if one could construct it without undue welfare losses, might be helpful. But interestingly there was also a measure of agreement that the efficacy of fiscal policy in a stabilisation sense remains questionable. Anne-Marie's own paper almost says it would be a good idea if we knew precisely enough where on the economic and fiscal cycles we are, but we're not sure we do know. Structural/cyclical analysis perhaps is an area to further explore.

On the sustainability issue, I was really glad that the demographics came out because I think in the long term sustainability sense, it's questionable. It's certainly alright for 20 years but on a 50 year basis one would say it's not there. And the world's going to have an enormous amount of adjustment all over the place dealing with those demographic and long term fiscal issues.

Coming back to the targeting and instruments point, I'm not sure we've fully integrated the risks, the cycles, the stabilisation debates. There was a sense in

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which sometimes we were talking about temporary economic stabilisation and sometimes we seemed to be talking about a long run imbalance issue. They are different. And I'm not satisfied that we've quite conquered that yet. Why the long run real exchange rate doesn't adjust (via prices or the nominal exchange rate) after 30 or 40 years is an interesting question. But certainly one can understand ten years of demand pressure (perhaps from extraordinary migration and other things) but what's the long run story?

So another point of agreement was there was a need for that remaining enduring focus on efficiency in the productivity of the economy, particularly in the non-tradeable sector. New Zealand is special in the sense it's small. You don't get much contestability in the non-tradeables by definition. You don't get a lot of scale effects when you're small. It's hard. So you need really, really good policy settings to get the best out of that. But thankfully we've got the Productivity Commission and hopefully they'll solve that for us in a couple of years' time!

There was a strong measure of agreement that the political economy is crucial. A lot of that discussion saw it as a constraint. It's a reality. It's something that is also I think, not stable. It can have a dynamic and it can be positive and I think that was the Minister of Finance's statement yesterday, we do believe that institutions can make a difference; we do believe transparency of debate can make a difference. You would certainly expect to hear that from the Government Statistician - an informed society does help. It's incumbent upon us, and this conference itself is part of that, to shift the public debate and the discourse in favour of better policy setting

Let me say one other thing which I think we haven't quite touched on as much as we might have, which is as follows: It is hard to identify whether you can use discretionary fiscal policy in an active sense if you are having difficulty understanding what's structural and what's cyclical. Contributing to this uncertainty was a belief that we had a permanent shift in our income growth through the early 90s. David Plank reminded us of some of the previous confidence that we had come from consistently under-forecasting and using that

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to justify an uplift in our permanent growth prospects. We seem to have done that a couple of times at least in the last 20 years. And maybe that actually encouraged some of the capital inflows as well. Maybe the markets had exactly the same perceptions about New Zealand as a place to shift money to, that wasn't all entirely driven by fiscal stimulus and crowding in but there was some real-growth stuff going on, even bringing forward some consumption in anticipation of higher permanent income.

So I suppose the reason for bringing that back is to say that there's a long run set of issues that we've got to pay significant attention to as well as the short run stabilisation issues, and I just want to distinguish those in some sense. This leads me into where do we go from here; i.e. some research avenues.

Some of the key avenues to pursue that struck me through this conference are as follows. Clearly, one is the dynamic risks to the financial sector, and the interplay between the financial sector and the macro - the real economy. Also the savings debate continues. Obviously I think the current account numbers are "perfect", but that inability to reconcile the micro economic story of savings from the Scobie et al work and the macro savings story continues to be a challenge for us to work through further. Are people really making bad decisions? Why does the macro picture not seem like an aggregation of a whole set of optimal individual decisions? The non-traded sector productivity performance we've talked about, and the fiscal rules - can we create a set of fiscal rules that creates some greater insurance against these downside risks without creating undue efficiency and welfare costs?

And I suppose if I had a message on my part, this is it - we must analyse all of these things in a welfare sense with a very strong policy analysis framework. It's easy just to see a particular response function. It's much harder to see the costs of those response functions. Do we really know what the distortions and the micro economic consequences of these policy responses are? So it's going to take a lot of care to work that through.

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Just finally, finishing on the research avenue with a little bit of a plug for some of the things that we're offering you. Some of the information and data that can help with some of these avenues of enquiry: a new unit labour cost series came out on an experimental basis yesterday, which can help understanding of competitiveness. We are working on productivity levels measurement and improving the services sector output as a productivity measure.

And then on the vulnerability side, along with the Reserve Bank in particular, we are looking at how we can enhance the information on household and business balance sheet information. And hopefully in some fashion, to do this not just as aggregate macro figures but we'll also enable some distributional analyses of those which seem crucial. We really want to assess the risks, and flow of funds data would help. So those are on the agenda. They're not going to be immediate but they are coming.

In conclusion, what I've tried to do is say there are some important places of agreement, some areas of debate that we're still clearly having, and some research directions that we need to pursue, but also some responsibility on all of your part to continue that public discourse.

And that's a good segue into how I wanted to finish which was to say - what happens from here? The presentations I'm told will be available on the web next week. The papers I think are continuing to be edited or finalised in light of reviews and comments but will be published as part of a special issue of New Zealand Economic Papers later this year. Treasury will endeavour, as they should, to draw key conclusions out and advise the Minister of Finance next week, who I'm sure is looking for more concrete ways forward than I've managed to produce, but he has a particular appetite for such things. So the papers and the discourse will follow.

The last remarks are really thanks on behalf of the sponsors: Victoria University, the Reserve Bank, and the Treasury. In particular I'd like to thank all the speakers, especially the invited speakers, those who've come from afar and

closer. So Phillip Lane, Sebastian Edwards, Craig Burnside, Prasanna Gai, Anne-Marie Brook, and Peter Jarrett, thank you so much for contributing to New Zealand's really important public policy debate.

Thank you too to everybody else for participating and contributing. To the steering committee who put the seminar together. Some of the same people that I've mentioned but let me mention them by name rather than by sponsorship: Viv Hall, Tim Hampton, Mike Reddell, John McDermott, and Christie Smith, Jess Wayte and Gary Blick who have been doing all the practical side of making things work, so thank you to all of you folk.

And can I just say just on my personal part, thank you to the Treasury. Gabs' third objective that he had at the start of the conference was that this conference would help with Treasury's long run reputation for constructive policy debate. I'm not sure he said it exactly like that, but I think that was implied by what he said. And I've got to say that I think that has been met. It takes courage to conduct a debate like this, even in this sort of forum but in general to open up their own policy effectiveness, along with their collaborators, to this sort of scrutiny and exposure and to legitimise the debate about fiscal policy in particular, as well as wider macroeconomic and microeconomic policy upon which they advise the Government. So well done to them for doing this, I think it's tremendous and thank you very much for the opportunity to participate. Let's all give a hand to the organisers in particular.
