



**NEW ZEALAND INSTITUTE FOR THE STUDY
OF COMPETITION AND REGULATION INC.**

Reporting the Economy *Background to Sustainability*

Journalists' Training Organisation Course

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and

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CORPORATE MEMBERS

Contact Energy Ltd

Fonterra Co-operative
Dairy Group Limited

Meridian Energy

Powerco

Telecom Corporation
of New Zealand Ltd

Transpower New Zealand Ltd

Vector Ltd

Victoria University of Wellington

Westpac Institutional Bank



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Overview

- Quick stocktake: the New Zealand economy
- Implications for policies for sustainability



NZ Is Isolated

- Gravity model (2002) scale that reflects nearness to relevant markets (GDP)
 - New Zealand at 2.45 lowest of all OECD
 - Australia 2.5, Finland 9.6, Sweden 11.92, Norway 12.05, Ireland 14.22, Netherlands 26.57; and
 - The UK 26.87.
- Distance does seem to matter (*Australian Treasury Study*) distance explains 50% of the Aus. income gap with the US

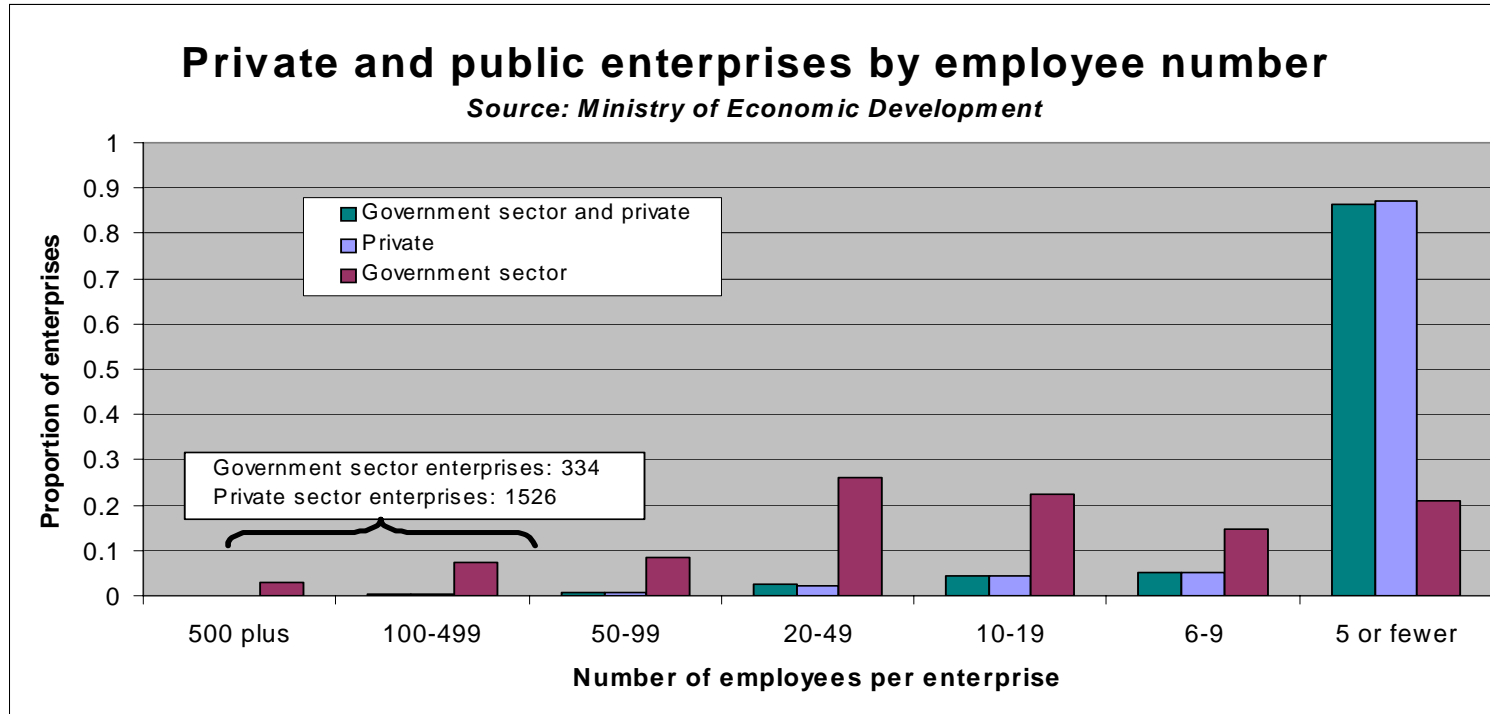


Some Implications of Isolation

- Market size
 - limits domestic scale economies
 - Limits specialisation
 - Limitations for traded goods relaxed by openness
[exports+imports 68% size of GDP]
- Size (and resource endowments) limit the liquidity of markets
- Relatively large share of activity in state ownership or cooperative form limited competition in the ownership market



Private Enterprises Are Very Small (2005)



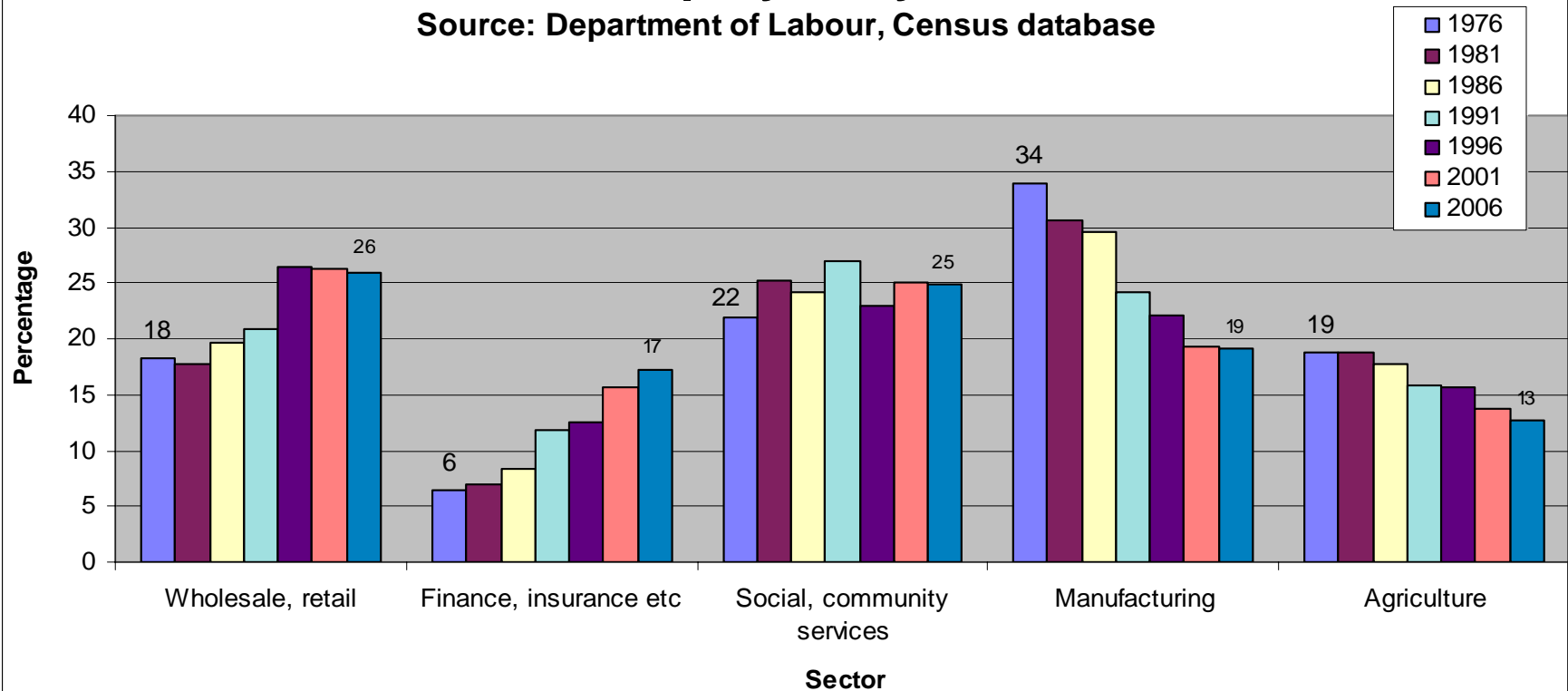
- The average number of employees per New Zealand enterprise was 5.2 as at February 2005
- Government enterprises are relatively large



Increasingly Services Dominate

Distribution of employed by industrial sector

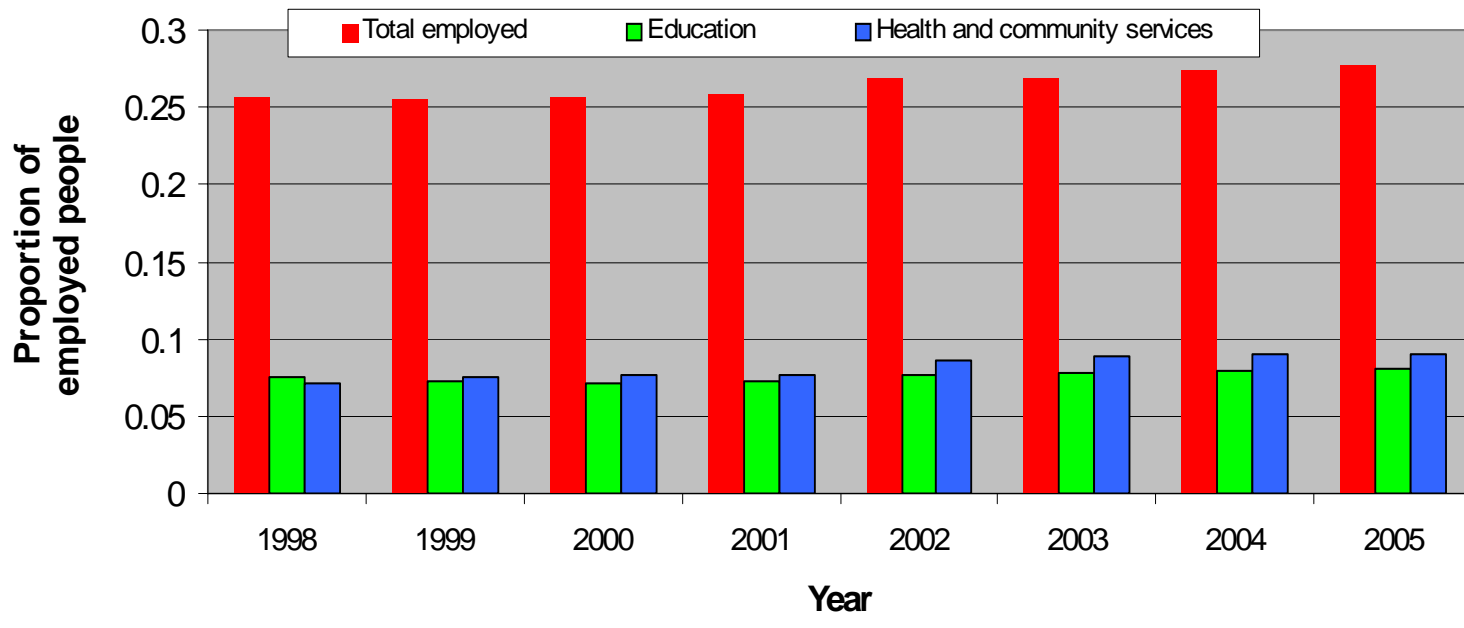
Source: Department of Labour, Census database



Share of Government Services in the Economy 28% of 68% (services)

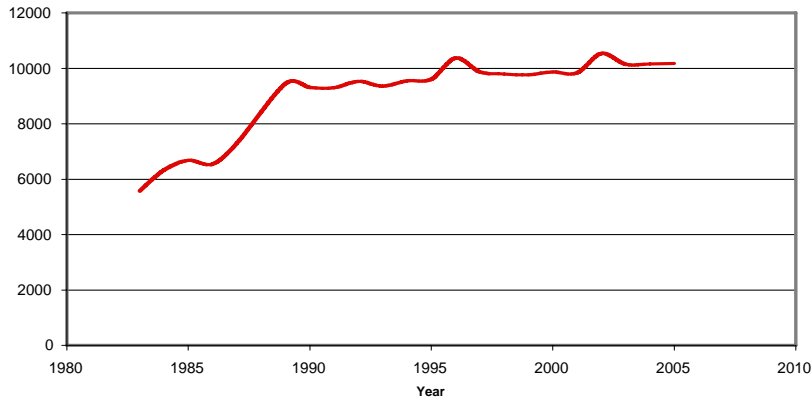
Percentage of people employed by the Government administration and defence, education, health and community, cultural and recreational services, and personal and other services

Source: Statistics New Zealand



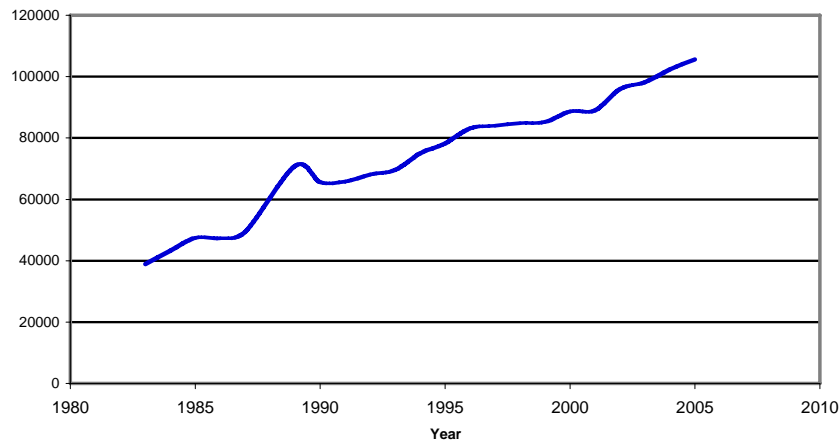
What has happened to Variety?

Goods



Number of goods

Total Variety



Variety/sources

Variety/good grew 49% 83-05
Faster than all but “developing”
countries



Variety

- Improves economic performance for firms and consumers
- Entails more fixed cost
 - in a closed economy: entry “may” be excessive but important in the competitive process
- NZ has an open economy: so fixed cost not such an issue
- NZ variety per good from 1983,
 - appears to have been increasing at a more rapid rate than other developed economies, and
 - is on a lower base



The Information Economy

Information:

- Has characteristics of public goods/ measurability issues
- Is central to (co)operation in (among) firms
- Acquisition, analysis and use is fundamental to the operation of all activity

- Associated technology has:
 - Reduced transaction costs
 - Sped up change
 - Arguably enhanced (virtual) networks
 - Affected relative costs associated with economic activity
 - Generally augmented competition



But for New Zealand Isolation may Remain

Distance: *the reports of my death are greatly exaggerated: Mark Twain*

Is face-to-face communication a **complement** or **substitute** with communication technology?

Glaeser (and others 1998 onwards) argue and provide evidence that it is a complement, and that

- the relative cost of distance has not fallen although, transactions costs have fallen over time
- centers have grown in relative advantage/economic and social importance

Centers appear: they are not planned



The Information Economy and NZ

(McCann 2007) NZ's performance on various economic yardsticks has been variable

Includes weak performance in real income per head:

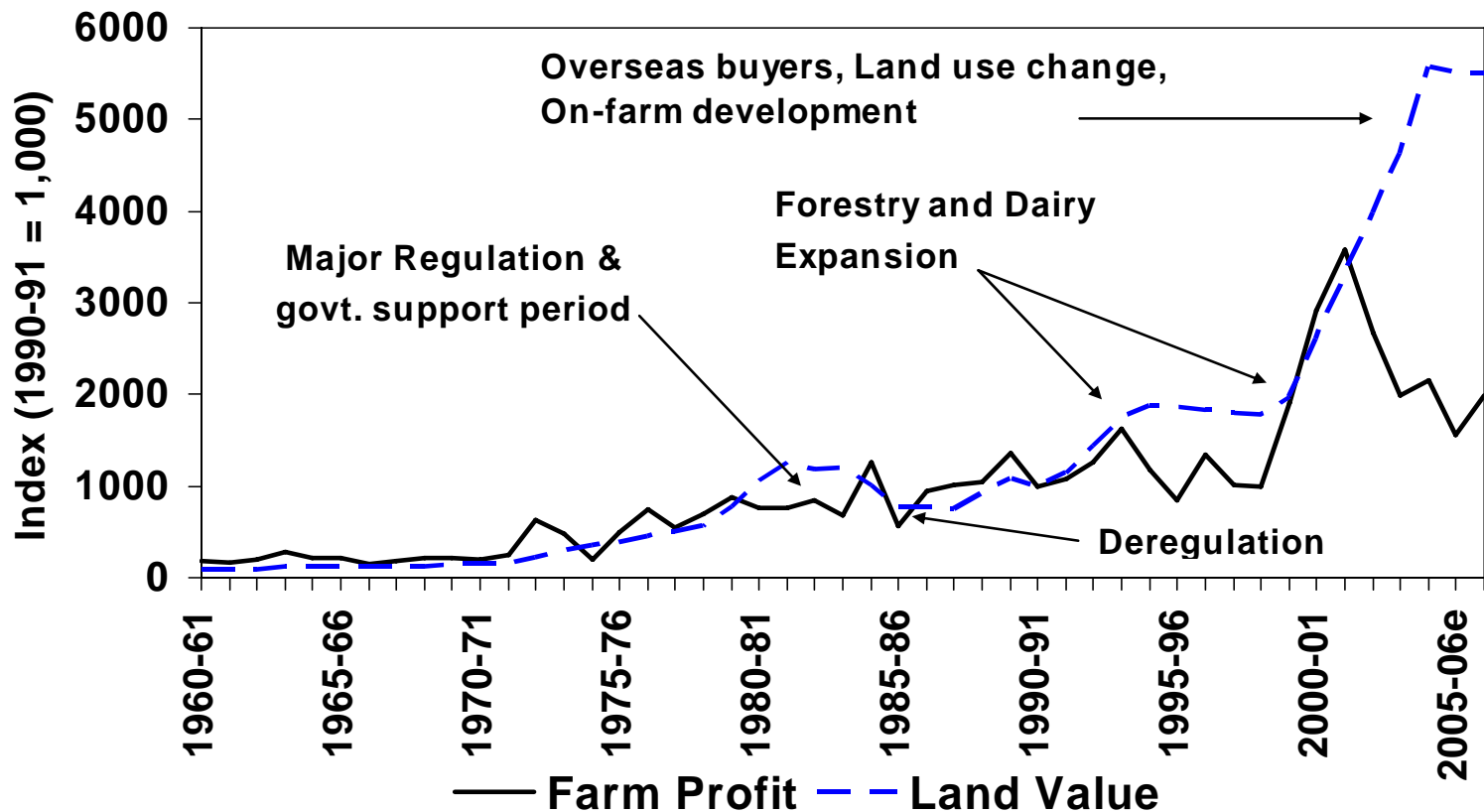
- transaction cost reduction has not favoured relatively distant trade
- since the 1990s there has been burgeoning trade between all (closer) countries such that
 - NZ is no longer “open” relative to many other nations
 - NZ variety has not caught up to that of many other (developed) nations
- NZ may be relatively disadvantaged

Implication:

NZ will struggle to grow income/head in a competitive world



Is NZ in the Midst of Significant Structural Change?

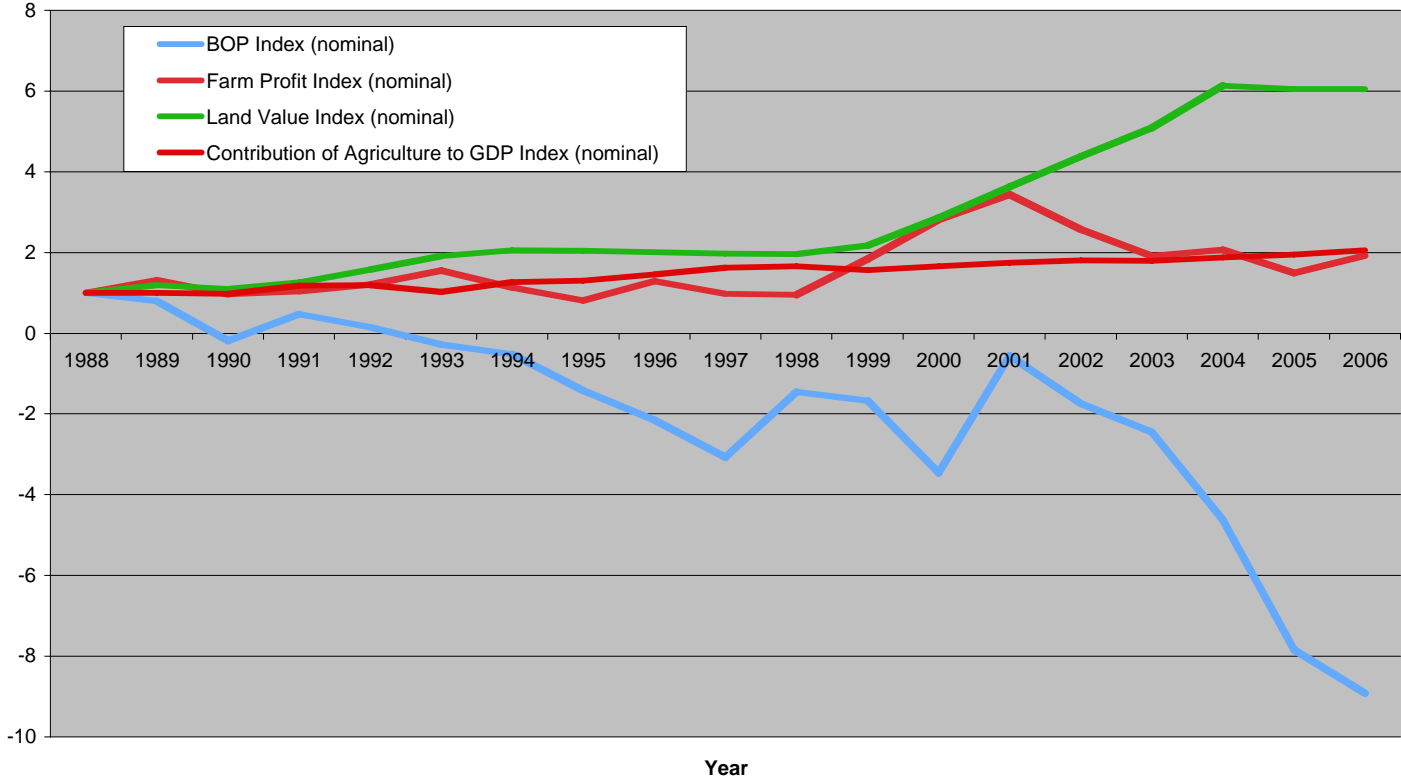


Source: Meat & Wool New Zealand Economic Service,
All Classes Sheep and Beef Farm Survey



Whither to Now?

Source: Meat and Wool New Zealand, Statistics New Zealand



Stock Take: NZ Economy 2007

The economy

- has not grown income per head as rapidly as might have been expected
- is isolated and arguably continuing to be so
- has concentrated (small firm) industries relative to larger countries
- has economies of scale/specialisation opportunity issues, particularly for non-exporters
- has a large share of services many for which scale is important
- has domestic infrastructure issues
- may be undergoing significant structural change,

NZ needs to make every post a winning post

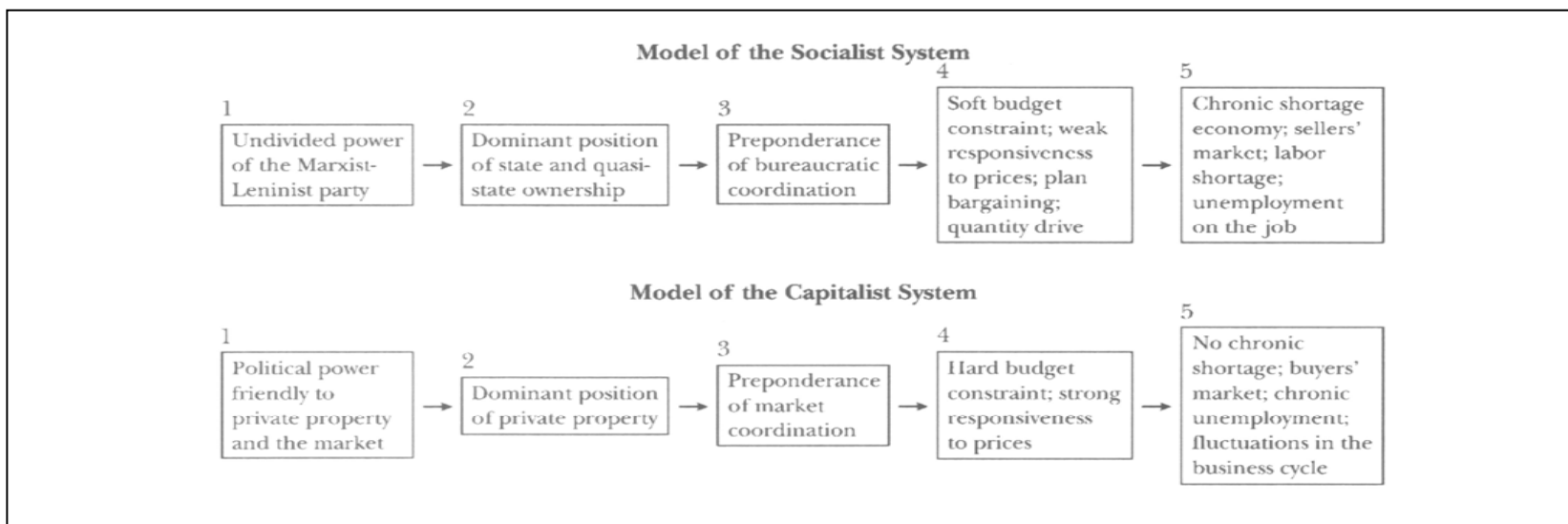


Implications for Policy Settings

- Glaeser (1996, p.6) : Cities that minimise tax and regulatory burdens, invest in physical and educational infrastructure will be the successful cities in the information age economy of the 21st century
- Government governance that facilitates de-centralised decision making by individuals as, consumers, workers, owners and citizens.
- Government set the framework: including institutional arrangements to mitigate externalities, but in such a way that innovative and various solutions are assessable
- Important externalities relate to
 - The environment
 - Increasingly scarce natural resources
- Heavily centralised systems are not flexible, do not encourage adaptation or innovation or accountability



Centralised vs Decentralised



Centralised systems have not been kind to the environment

Kornai, J., 2000, "What the Change of System From Socialism to Capitalism Does and Does Not Mean", Journal of Economic Perspectives, Vol. 14, No. 1



Policy Design

- Economic systems require all critical elements to be actually in place for reasonable performance: piecemeal does not do it
- De-centralised systems require
 - having the overall organising objective of economic efficiency (criterion of cost-benefit analysis)
 - minimal but effective governance systems: minimise interference with private activity:
 - governance arrangements that are stable over time but which accommodate change that arises for good reason; must be at some distance from politician
 - governance that assigns rights that convey incentive, responsibility, and accountability in use [it need not be ownership but must be secure]
 - externalities to be priced in the direction of the problem
 - “*bads*” treated as “*bads*”, “*goods*” encouraged,
 - implemented by taxes or quantitative restrictions that can be priced (cap and trade)



Policy Design and Implementation

has some way to go across the board

These policy issues of policy and governance design are important for effective, sustainable economic activity and are applicable across

- Electricity
- Water
- Fish
- Forestry
- Nutrient
- Infrastructure
- etc etc

sectors in a generic form



The Issue is Really Important

Having it not right is very costly

The Kyoto chainsaw massacre By ANDREW JAMES - The Dominion Post |

Saturday, 3 March 2007

Increasing New Zealand's forestry plantation is one of the Government's key climate change levers. Carbon-absorbing forests are vital in offsetting pollution from agricultural, transport and industrial emissions. They also help reduce the bill, now estimated at \$563 million, that the Government will have to pay for emissions during the first Kyoto protocol commitment period from 2008-12. But, ironically, large-scale conversions of forestry to farming are taking place in the central North Island and on the Canterbury plains.



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