

Lessons for NZ from Recent Developments in World Economics

Will Inequality Shift Voters Left ?

Evidence suggests that people are becoming better rewarded for skills & education in Western Nations.

Little indication that inequality driven by higher returns to skills shifts the politic of a nation left. But if wealth stems from corruption (i.e., is not “deserved”) then people vote for redistributive taxes & regulation.

NZ has lowest level of corruption in the world. Not *one* bank was bailed during GFC in which bankers took “undeserved” bonuses → unlikely inequality will shift voters left.

“Good” Policies for NZ in the Face of Inequality Caused by Higher Returns to Skills & Education

- *Better Education for lower income groups*

Teacher Quality: *“Policies that make the teaching profession more attractive & allow schools to weed out poor performing teachers could lead to higher incomes ... Many experts believe the current role of teachers’ unions prevents such reforms”*

Martin Feldstein, AEA President

Privately Provided, State Funded *“.. Evidence suggests urban charter schools generate impressive achievement gains, especially for minority students living in high-poverty areas”*

Josh Angrist, MIT

- *Earned Income Tax Credits*

Earned Income Tax Credits are a pro-business, pro-worker policy that **dominates** increasing the minimum wage

“Bad” Policies for NZ in the Face of Inequality Caused by Higher Returns to Skills & Education

- *The Politics of Envy* (Redistributive Taxation)

- *Creating propaganda about cronyism*

1. Sky City

2. Avatar

People may perceive these kinds of interventions are about favouring “big business” due to conflicting political arguments filled with dogma & guesswork over whether they are “good” or “bad” for the country.

How does one avoid these kinds of accusations ?

The Stunning Triumph of Cost-Benefit Analysis in the US

“Republicans & Democrats have come to agree on one issue: the essential need for Cost-Benefit Analysis [which] has become part of the informal constitution of the U.S. regulatory state. This is an extraordinary development”

CBA endorsed for more than than 3 decades by 5 U.S. Presidents .. begun by Reagan

Obama made an unprecedented commitment to quantification of both costs & benefits by [ordering] executive agencies to review all significant rules ... largely with the goal of eliminating or streamlining excessive requirements.

“1st, we’ve approached regulatory problems not with dogma or guesswork ...

2nd, we’ve used cost-benefit analysis in a highly disciplined way ...

3rd, we’ve promoted transparency & open government in unprecedented ways”.

Cass Sunstein; 13 September, 2013

The Stunning Indifference to Cost-Benefit Analysis in NZ

The NZ Treasury Cost-Benefit Primer: *“This Primer is targeted at public sector policy and financial analysts with little economic or financial knowledge”.*

Sky City Convention Centre fails Cost-Benefit Analysis ?

In a briefing paper to cabinet ministers, economic development ministry officials note that Treasury was “not convinced by the cost benefit analysis“ for the centre .. [and] expressed concerns about the social harm of increased gambling.

Fairfax NZ News, 17 July, 2013

Avatar Subsidy fails Cost-Benefit Analysis ?

“Cabinet papers show Treasury opposed the Government's decision announced on Monday to increase .. the rebate for screen productions, arguing the scheme had delivered only small economic benefits”.

Hive News, 17 December, 2013

Post-GFC Policy Challenges for the Central Bank & for Fiscal Policy

**Should the RBNZ have reacted to “bubble” concerns by
implementing Loan-to-Value-Restrictions ?**

‘Limited power is the price of political independence.

*Once the Fed manipulates credit flows throughout the financial system, it will be
whipsawed by interest groups ..*

*How will home builders react if the Fed decides their investments are bubbly &
restricts their credit? Will not all of these people call their lobbyists &
administration contacts & demand change? ...*

*Willy-nilly financial dirigisme will inevitably lead to politicization, cronyism, a
sclerotic, uncompetitive financial system & political oversight.’*

John Cochrane, University of Chicago

Has NZ Fiscal Policy post-GFC been an Historic Missed Opportunity ?

In the aftermath of the GFC, the US Fed, satisfied there were no inflationary pressures, cut short-term interest rates to 0 to help employment, consistent with its “dual mandate” (to achieve maximum employment & stable prices).

Faced with an inability to cut rates below 0, US *monetary policy* lost potency leading to a raging debate over whether a more radical *fiscal policy* could help revitalize the sluggish post-GFC economy.

The “stimulus vs austerity” debate has largely bypassed NZ.

Post 2008: The Austerity versus Stimulus World Debate

Summers argued the U.S. government should take advantage of low interest rates to invest in infrastructure.

Larry Summers, Ex-US Treasury Secretary, Davos , 2014.

“The size of the 5 year infrastructure program would have to exceed \$1 trillion to achieve the needed rise in the economic growth rate. But the short run fiscal stimulus [must be] combined with policies to reduce future gov’t spending ...”

Martin Feldstein, AEA President, 2013

“[In 2009] the Administration should have designed long-term investment programs for large-scale highway upgrading, large-scale skill & job training ..”

Jeffrey Sachs, Columbia University, 2012

The New Zealand Context

Since Budget 2009, the Gov't has been charting a course to tighten spending, return to surplus, cap the increase in public debt as a share of GDP & bring this debt down to more prudent levels

NZ Treasury 2012

The short-term aim of the fiscal strategy is straightforward – to return to surplus as quickly as is practical

NZ Treasury Budget Fiscal Strategy Report; 2010

... this in the NZ context of ...

- A low Public Debt to GDP ratio (~ 35% compared to ~ 80-90% in US, UK)
- No “Too-Big-To-Fail” Problems arising from the GFC
- Government able to Borrow at Historic Low Interest Rates Post-2008
- Spare Capacity Post-2008; Unemployment ~ 7%
- World's Lowest Corruption so small “leakage” on public investment

Conclusions

Lessons for NZ from Recent Developments in World Economics

1. Inequality and the “politics of envy” are unlikely to gain much traction in NZ
.... since wealth is largely “deserved” (NZ is least corrupt nation in the world)

However the degree to which cost-benefit-analysis is not being taken seriously opens the government up to all sorts of allegations about favouring “big business” since regulatory interventions lack objectivity & discipline.

2. A powerful set of opinion from many eminent economists suggests there was an historic opportunity to embark on a radically different fiscal policy to that adopted by NZ post-2008 that may have helped transform the economy.