

# Asymmetric information

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A newsletter to promote the exchange of information, news and ideas among members of the New Zealand Association of Economists (Inc).

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**New Zealand Association of Economists Inc.**

**JOHN CREEDY** Editor *email:* [john.creedy@vuw.ac.nz](mailto:john.creedy@vuw.ac.nz) or

[John.creedy@treasury.govt.nz](mailto:John.creedy@treasury.govt.nz). <http://www.nzae.org.nz>

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# EDITORIAL

John Creedy ([john.creedy@vuw.ac.nz](mailto:john.creedy@vuw.ac.nz); [John.creedy@treasury.govt.nz](mailto:John.creedy@treasury.govt.nz))

This issue of AI begins with the fourth in our series of interviews with eminent New Zealand economists: Peter Bushnell interviews Graham Scott. At the NZAE Conference, Alan Bollard was made a Life Member: the citation is included here. Regular contributions follow from Grant Scobie ('2B Red'), Stuart Birks ('Frames'), Paul Walker ('Blogwatch'), Mark Holmes (NZEP). Jeff Pope reports on

Regional GDP statistics. In this issue, 'Fine Lines' is contributed by Dorian Owen. The subject of the 'Five Minute Interview' is Adolf Stroombergen. News of the Government Economics Network (GEN) and the VUW Chair in Public Finance is included, and the economics department at The University of Otago provides this issue's report of Research in Progress.

## INTERVIEW WITH G. SCOTT BY PETER BUSHNELL

### **Q: To begin at the beginning: what led you to taking economics and accounting at Canterbury University?**

A: When I left school I had a choice of going into various professions and started off as an accountant, but to be honest I found it a bit dull. You did your classes in the morning before you went to work and then you did more classes at night before you went home. I studied economics and really loved it. So I decided to give up studying accounting part time and went back to university full time studying arts but kept a commerce degree going because I knew I had to make a living one day.

The economics department at Canterbury at that time was really a very interesting place. We had Alan Danks who taught us a lot about industrial relations, industrial economics and so on. But the person who stood out particularly for me was Frank Tay who had come from Singapore. He was an astonishing academic who could give a complete class without any notes, remember all the footnotes from the journals he was quoting, and really turned a group of us onto development economics, which we hadn't thought about much before. So he was hugely influential in my becoming an economist.

Also Wolfgang Rosenberg, although he was severely Keynesian in his outlook and really didn't introduce us to a lot of alternative ways of thinking about macroeconomics, was a good teacher and had a strong interest in economic philosophy. He taught us about Karl Popper and the methodology of economics, which I also found fascinating. And so, it was really a group of them there who turned me onto the idea of being a professional economist and I am glad they did.

### **Q: Were any of these particularly influential?**

A: At the time Bert Brownlie had come down from Auckland as a very bright young quantitative economist and had replaced Alan Danks who had gone off to head the Vice-Chancellors' committee. Bert was telling us that economics was changing completely away from the more verbal tradition we had been taught at Canterbury, that the future of economics was about mathematics and econometrics and economics would become a bit like a branch of engineering. Bert was very influential on me at that time so I went off to do the drills and those things which we hadn't done before at Canterbury. Of course at the end of the day I haven't followed that direction as I ended up with other interests in economics but he was influential nevertheless.

More widely, the economists that influenced my generation of economists globally were Samuelson and Friedman with the

extraordinary debate between them about everything from deep economic methodology, positivism, and so on, into public policy. The two of them would debate at every level from high theory to articles in Newsweek magazine. These debates between them were really very important to all economists around the world at that time.

One of the interesting things about Canterbury though was the strong emphasis in the graduate classes on the history of economic thought. We were drilled in Smith, Ricardo, Mill, Marshall and Marx. It was a terrific grounding in the kind of economics that had preceded the marginal revolution and the introduction of mathematics and econometrics.

Economists I was very influenced by later were the American Institutional Economists. When I arrived at Duke University, North Carolina I remember reading an article by Douglass North, who I had never heard of before, but who I came to follow a lot for the rest of my career. He had written an article on the economics of slavery, which seemed very politically incorrect given that I was living in the south of the United States. But it showed that the economic method in the United States tradition would be pushed into all corners of life and society as Gary Becker, another economist of that ilk, also did, with his studies of economics of family formation and so on. There were really some terrific practicing American economists at the time who were very clear eyed and would try anything.

And then there were Institutionalists to whom I had been introduced by Frank Tay. These were the founders of development economics: W.A. Lewis, Singer, Prebisch, and Myrdal. In relation to developed economies, Herbert Simon was questioning the standard Marshallian microeconomic model, and Ronald Coase of course, who we never heard about until long after his seminal article in 1930s had been written, (which has dominated the development of institutional economics subsequently). And then of course, Oliver Williamson and his astonishing book on the institutions of capitalism, tracing back to its antecedents historically and again pushing simple ideas deeply to throw light into the nature of the capitalist economy.

So there was no single economist really that stood out from all of that, but there were a large number of economists going back to Smith and right up to modern Institutionalists who have been very influential on the way I thought about things.

### **Q: Part of your shift to Duke in North Carolina exposed you to all this wider thinking. But you also went there in the late 1960s at a time of great political and social change. What was that like for you? And how did it influence your approach to issues?**

A: It was overwhelming really. This was the Vietnam War era when some of my graduate class mates were going off to Vietnam. Some had changed so much when they came back I couldn't recognise them. It was the tail end of the civil rights movement and I remember becoming quite active politically at that time. There were marches in the streets of the town that I was in. There were curfews on the city and the National Guard driving around in jeeps with machine guns.

At the time I was there the great assassinations took place and the student body was deeply disturbed by all of this. I became quite absorbed in it, and somewhat radicalised in my politics really; a liberal in the US sense of that word. And it kind of changed a lot of things for me. I'd grown up in this relatively benign society where social conflict hadn't been that great since the waterfront strike in the 1950s.

To be in a society that was so deeply riven was a very formative experience. The other thing that really struck me about it, and made me admire the strength of the United States' democracy, was the speed with which the formal structures of discrimination were got rid of. I mean that happened while I was there. Duke University allowed the first African-American student on the campus about 1962; I arrived there in 1966. By the time I left a couple of years later, they had African-American studies courses and all of that. When the United States decides to change, it can change very rapidly. And so the America I left was quite different from the one I arrived in, and that had a big impact on me, really. I always had an interest in politics and that experience aroused my interest in just what could be done through concerted political actions in the face of things that really needed to be changed.

**Q: Has this led you to a view that once the society has decided on policy change, that it should get on and act without undue delay?**

A: Yes, I do think that. I think that, subject to constitutional restraints, intellectuals and policy advisers do have a role in a robust democracy, that they should give their advice and if it's taken it's taken and if it is not, it is not, and that's the end of it. But I have always believed that people need to stand up for their views, and in the United States, they do. Their debates are hard. Eye-ball to eye-ball, they are rough on each other, and they don't always look for a non-existent compromise. If there isn't full agreement there, well, they don't hold back from implementing things that they have decided to do. Perhaps it's not so true today of the United States, with a deadlock in its political system, which is horrifying, really. But it has had a long history of getting on and doing stuff when it decides it needs to be done.

**Q: Having seen your involvement in policy over the years, a surprise to me was that you have City and Regional Planning as a minor, in your PhD program. Tell us a little bit about that.**

A: Yes, it came out of living in North Carolina. I can't imagine I would have been interested in it otherwise. I was at this very privileged wealthy University on the 'Piedmont', with the massive Duke Family fortunes paying for my education. But only a couple of hours drive away, up near the Appalachian hills, there were very poor, rural communities. These were the same kinds of people who had come to New Zealand and done well. Those people who went to the United States, 100 or 150 years earlier, had been left behind. I got very interested in why in such a small area as North Carolina you had such extremes of wealth and poverty.

I went to the University of North Carolina for my minor field, and had the opportunity to study with Maynard Hufschmidt. He had come from the Harvard group that had developed a lot of new thinking about regional planning and regional economics and really turned me onto thinking about these issues. So I did some work on the Tennessee Valley Authority and its impact on rural poverty in Appalachia. At that time in the United States there was a lot of emphasis on trying to clean up the urban slums, and I visited places like Harlem and similar slums in Chicago. As a New Zealander, I was shocked by it, and got very interested in what created those pockets of poverty, a kind of the third world inside the first world. This was an extension of my interest in development economics, but within a large and wealthy economy.

**Q: And the conclusion?**

A: The conclusion? Well firstly, I guess a great deal of disappointment about 1960s attempts at slum clearance, and a lot more modesty that people have learned to have today about the assumption that just dealing with the physical side of a slum is going to do much about it permanently. Saul Alinsky and other community development leaders in the United States were showing new ways of thinking about these things. In a way, they rather foreshadowed the work, a long time later, of de Soto in South America about recognising what kind of infrastructure there can be in very poor areas and working much more modestly with that rather than having big plans for clearing slums and housing developments. So, the lesson out of it is one of modesty, and one of recognising that you've got to work with the social infrastructure that is there. As de Soto pointed out, what might look to you like a slum can in fact be a very vibrant community, and the way to lift its living standards, isn't to empty it out.

**Q: Turning to your time at Treasury; there's been a lot talked about the nature of Treasury advice in 1984 and its origin. What's less widely known is why the Treasury bundled up all of its economic advice in a coherent post-election briefing, released, under the title of Economic Management. What was behind that radical change in practice?**

The people who wrote it had been thinking about these issues for a number of years. If you look at what was written in the briefing in 1984 there were clear portents that it was coming back in briefings that had been written in 1981 and even back in 1978 I think there were some indications then. This had to do with Noel Lough who was a public servant for whom I had great admiration, and to whom I really owe my entry into the Treasury. He had spent most of his career concerned about the nature of economic policy in New Zealand and under the Muldoon administration he grew more and more concerned about a misalignment of policy instruments. He had asked me to head Economics II with a mandate to rethink the Treasury advice on economic policy.

By the time 1984 came along a considerable investment that had been made. Unbeknown to most of the public, pretty much all of it had been exposed to the outgoing National Party. In the years before the 1984 election, when Bill Birch was the minister of development and we were his advisers, we provided him with all these papers on monetary policy, fiscal policy, exchange rate policy, and protection policy. So it really wasn't the hidden kind of document that Treasury enemies have attempted subsequently to make it.

As far as it being a document, I had been influenced by a man called T.K. (Ken) Whitaker who had been the Secretary of the Department of Finance in Ireland at a time when the Irish economy was dead in the water. He had the bottle to oversee the writing of a document on economic development<sup>1</sup>. I had a copy of it once. Ken went on to be the head of the central bank in Ireland, and was even at one stage mooted as a candidate for presidency. But he'd had guts to stand up and write this document in what must have been very difficult times.

That's where I got the idea, really, that instead of just delivering a set of little papers into a government on one thing or another, why don't we put this thinking together, in a single document. And of course at the time, we gave it to in-coming government we never imagined that it was going to get published. We gave it the title of Economic Management because we thought the way which the economy was being managed was wrong; and the central idea was that the instruments of economics were being targeting on the wrong variables. That is what the chapter I

<sup>1</sup> This was a White Paper called First Programme for Economic Expansion, published under Whitaker's name in 1958. He became Governor of the Irish Central Bank in 1969.

personally wrote in that document, along with editing the whole thing, actually said.

We were aware that New Zealand had an economic crisis that was deeply troubling. The problem was slow adjustment. NZ had delayed adjustment and was one of the slowest countries in the OECD, possibly the slowest, to adjust to the oil crises. We had barely got underway with dealing with the first one, when the second one hit. This was for reasons of politics more than economics. Muldoon was a very intelligent man, and understood economic policy well enough, but politically he could not see himself doing what we were talking about. So he came up with this completely different approach of locking the economy up in regulations, and hoping to sustain it for the future by massive investments in energy related infrastructure investments. All of these relied on a rapidly escalating oil price, which didn't happen.

So, we did feel that it was a time when Treasury had to stand up. If you are the government's chief economic adviser and the economy is at a crisis, then stand up or move over so someone else does the job. It wasn't a time for doffing our caps and asking the ministers what they'd like. We needed to give advice and see what they said.

**Q: There was a lot of debate publicly about the sequencing of the 1984-87 reforms. Some have recommended that the slowest reacting markets, particularly the labour market, should have been opened up to competition before financial markets were. With hindsight what's your take on that issue?**

A: That as a theoretical proposition, in an abstract model, the point has merit. But in the real world, not only the Labour party when it came in, but also the National party before it, had spent huge political energy trying to get movement in the labour market regulations, and could not get anywhere politically.

The ink was scarcely dry on Muldoon's freeze in 1981 before he started talking to us about 'how do I get out of this', because he knew as well as we did, that all he was doing was holding back the tide and we had an incipient inflation rate that was well into double figures. He was appropriately worried that that was exactly what would re-emerge, once his controls had been removed. He was also aware of the distortions.

So, he started off talking to the trade unions, at the time, in particular spent a lot of time talking to Jim Knox. He also was rather attracted to dealing with Ken Douglas, who in spite of the fact that he was a communist, was very intelligent. At one point Muldoon even asked if Douglas would come and join the Prime Minister's department to help with communication or even provide some leverage to help negotiate a wage restraint with the trade unions in exchange for other economic policies.

People need to remember that tax-based incomes policies, or TIPs, were fashionable at the time including in the United States with the Carter administration. The only reason we got the wage-price freeze with Muldoon was that he had tried a tax-wage trade-off with the trade unions, and they rejected it. So Muldoon said 'alright, if you won't take it as a negotiated proposition, I will impose it on you by law' even though he knew that he was going to have awful troubles getting back out of it.

Then when the Labour government came in, they went to the trade unions with exactly the same kind of proposition. I know less about the details of this, because I was not as directly involved as I had been with the Muldoon administration when I was his adviser on this stuff. But I do know that there was a crucial meeting, when the senior ministers got together with the heads of the trade union movement, and talked to them about how they could find a way of getting out of this control regime, without risking a rapid escalation in unemployment. Roger Douglas who was at the meeting told me, and I confirmed this later with Geoffrey Palmer, something was said along the lines

that if the unions aren't willing to reach an agreement with us about this, we're going to have to go ahead with the programme and the unemployment will be on your head.

Second point to add is that, in a way it may seem unlikely to Treasury's critics, I went to see Roger Douglas with a note Howard Fancy and I had prepared, in which we'd said to them 'if you introduce these policies of monetary and fiscal consolidation, without moderating the expectations of the labour unions and of the businesses about setting prices, then you face a very heavy risk of raising unemployment. You ought to think about keeping the controls in place for longer, as a way of trying to manage this risk'. Roger Douglas told me later that he thought a lot about that advice, but finally decided that they were just not going to get a deal with the unions. The costs that the unions would have been looking for, essentially, was to have stopped the government from implementing policies that it thought were necessary to get out of the crisis.

So, the practicalities of it were that people were very conscious of the sequencing problem. A huge amount of political energy was put into trying to deal with it. But at the end of the day, the trade union movement couldn't find an accommodation with the government. I don't know exactly what was offered so I don't want to make it seem it was all their fault. I do know that a lot of thought was put into this before what finally happened took place.

**Q: Your tenure in Treasury covered a period of really significant change in policies, and also a change in a way that Treasury was run. As you look back at this set of changes, which are the ones you are most proud of and why?**

A: Most policies are transitory, all policies have unintended side-effects and triumphalism is a very risky thing. Having said that, what is clear is that the institutionalist approach that we took to monetary and fiscal policy and also to the state sector itself, have created institutions which have lasted a very long time, longer probably than any of us involved in designing them might have expected. Each of them has done about what could have been expected from them.

The new monetary institution, which was entirely built on a model of institutional economics, although it was always going to get called monetarist by its opponents, was all about 'where should monetary decisions be taken, given the nature of the monetary transmission mechanisms'. The idea was to maintain political control of the institution, but to take politicians hands off the direct levers given that we had a long history of rapid monetary expansions before an election, followed by monetary contraction after an election, which was destabilizing the economy.

In the case of fiscal policy, we began with a deficit to GDP ratio of 10 per cent, and over a period from 1984 through to about 1994 when the surpluses appeared, there was a steady use of what I still think today are the proper approaches to fiscal consolidation. This is not just about squeezing, which usually just means you are postponing expenditures, rather than reducing them, but rethinking the drivers behind expenditures, and the institutions around those drivers, and reorganising them.

I think the policy change, which was one of the biggest triumphs, was the State-Owned Enterprise policy, because these organisations were absorbing huge subsidies, paying no tax, and providing standards of service, at prices, which were quite out of kilter with what was possible. The turnaround by creating these 8 or 9 state enterprises out of the government departments they used to be in, led to them needing no more subsidies, paying taxes, paying dividends, and in most cases, dropping their prices while improving their quality. Now how often in the course of an advisor's career do you come up with an idea like that? It's been stunningly successful. It came about through an extraordinary interchange between advisors and



politicians. It was done quickly and administered quickly.

Of course the reduction in labour that went along with it was a cost to the people who lost their jobs. At the same time, however, there were very generous redundancy arrangements for people who lost their jobs. A lot of the people, who were released from these institutions, were people with the human capital that enabled them to go into the market and get a job somewhere else. The social impact of it though, was in the rural railway communities where things were pretty tough for people. But overall, I think that that policy has to be regarded as having been a success.

As far as the public sector management is concerned, again it's an application of the state sector reform principles. This is the area where New Zealand moved out of the pack internationally, with some pretty unusual and innovative things. The State enterprise policy was only one of them. The State Sector Act and the Public Finance Act were noticed all around the world. They were peculiarly New Zealand and large numbers of people came to New Zealand to study them. The afterglow of those changes can still be detected in the background radiation. Judgements of whether they succeeded or failed are for others to make.

But I think the judgment is that they did enable the government to control and cap the growth of administrative expenditures in government, and to do so in a way that didn't just lead to arbitrary caps and service cuts. This happened at a time when the Government really needed to get fiscal control. Managers were trusted to behave like adults and think of more efficient ways to do the things they were mandated to do. The changes greatly increased the accountability and the transparency of the public sector. Like all policies they had some negative side-effects, which ones you choose to dwell on depends on your point of view. But again I think that, overall, it is something that New Zealand was innovative about, and one would have liked to have seen that innovation continued rather more robustly than in fact it did.

You could say that the problem that we've had since those reforms has been that our political and advisory class has spent far too much time debating whether we should have done them or not, rather than addressing the next set of problems. Those are problems about how you co-ordinate across state sector institutions including with the private and third sectors, how you maintain the capability to provide strategic policy advice, and how you find more effective and efficient ways of delivering public services that exploit modern technologies and tailor them to citizens. I think we somehow rather basked in self-satisfaction there, and for a while also lost our confidence given the criticism from the centre-left about those reforms, instead of getting on with a new round of innovations.

**Q: What lessons would you draw from your recent review of policy advice about the nature of the institutional arrangement you really need to have in place to prevent performance degradation?**

A: That's a sensitive question, but when I did the review in 2010, it was pretty clear (and pretty surprising) that there were centres of policy advice around the government that I thought should be providing robust and strategic advice to the ministers, but weren't. What I saw in the 'engine' room of government validated what the Minister of Finance had said, at an earlier stage, when he asked me to give him advice about the so called 'purchase agreements' with the Finance Ministry, but went out beyond that discussion. This government was plainly unhappy with the capability for giving policy advice that they found when they came to office. This was widely said to be a reflection of the fact that the previous government hadn't wanted officials' advice. That may be the case but the ancestors have also had governments that did not want their advice. They did not take several years to get around to responding to a clear demand

from a new government that wanted advice and was intending to rely significantly on it.

In wondering about why the capability was as weak as we found in that review, I think some of it had to do with the nature of the modern public sector manager. A lot of people in high places have got there because they are safe hands. They are articulate, they have learned a lot about modern management, but if they ever were a policy advisor, they have probably gone pretty rusty. Also we didn't see much by way of inspired, high level, even if somewhat eccentric, policy advisors in high places around the government. There were one or two, and some of them were stunningly good. It is probably not fair to mention individuals, but you could see that in places where some ministries had said that a 'core' responsibility for us is giving top quality advice, they had arranged to put really expert people in high places to do that and those people controlled the relationships with the ministers about their advice.

But that was the exception to the rule. I also think that you cannot engineer a top quality advisory organisation. You can create the environment in which one may flourish, but that's all you can do. In my experience getting a policy organisation to really go from being ordinary to being stunningly good is a somewhat mysterious process. It is about a group of people with a common purpose and a lot of respect for each other, drawing on each other, making each other better. This is team work.

It is like a rugby team. You'll have a good run for a while and then you'll go off. But when you get it going it's magic that you can find new ways of thinking about things. Then those insights set an agenda that gives a stream of productive work following its implications to all sorts of corners before inspiration runs dry and you need new insights to move forward again.

I had the great privilege of leading a team of people for the Treasury for whom that happened. You can see from the careers that they had subsequently, that however ordinary or extraordinary they may have been when they arrived, that the experience in the Treasury lifted all our games in a way that was really very rewarding. It is hard to duplicate, but it can happen again and it has happened again. However you don't just get there by numbers using the management drills. There is some other magic that has to happen.

**Q: The changes that you brought about in Treasury came off the base of an organisation that was in fairly dire management straits. You did that with very little management experience behind you. What were the things that most influenced the approach that you took and in hindsight what would you most like to have done differently?**

A: I did it out of necessity. That was the problem that I had. Both I and the minister I was working for started with the assumption that I was going to be sitting in the Minister's office giving him policy advice, hour after hour. But in reality what happened was that I inherited an organisation that was rapidly bleeding its key staff. We had a staff ceiling of something like 132 policy analysts and by Christmas 1985, we were down to, I think it was 70. What's more, I was told that if I didn't deal with the problems another 20 wouldn't have come back after the summer holidays. So I did this out of necessity.

I had always been a bit inspired by my father who was a natural manager, and I had grown up in a family where my father taught me, not in any formal way, but I was watching a man who was very good at this, through my childhood, and I got a lot of insights from him. Also I had been at the Harvard Business School advanced management program, where I was surrounded by people my age, who were all sitting about level 3 and 2 in global companies, being finished off on the way to higher places in industries around the world. I learned a whole lot from them about how to think about management. But as you said, I had never had a management job before, and so had to kind of teach myself and rely on colleagues as I went. I got a lot of help from IBM, who saw it as a civic duty, to provide me with a lot of advice and help as to how to run an organisation.

I had a team of people who were just as keen as I was to lift the performance. I never did try to manage the flow as if I was a general in the American army. I was motivated more by views of modern management and leadership that were very collaborative and focussed on building teams, which was a bit new at the time. It's old hat now. I had a team around me, and all of us decided we were going to make this place better managed than it had been. To the extent we got there I was in charge of it but an awful lot of other people helped with the heavy lifting.

I don't really have much by way of regrets. Some things I would have done differently at a later stage in my career, and been a much more skilful manager than I was when I first ran around the block. But there is not much point in my wishing I had had the experience at the beginning that I had accumulated at the end. That's how life is.

If you are managing you have always some regrets about people who you disappoint and you feel terrible if you are clumsy in dealing with people and hurt them. But that's a day in a life of every manager, really, so I don't have a lot of regrets.

**Q: How much of that initial exposure to development economics, under Frank Tay, was responsible for you deciding to focus on consulting work with developing countries when you left Treasury?**

A: Almost entirely. For family reasons I didn't leave New Zealand at that stage, and for other reasons perhaps I would have been better to. But the family didn't want to go, and so instead of my taking a job in the World Bank or other opportunities I had I became a consultant. For me it was entirely about going back to economic development.

My work in New Zealand's reform program was what opened the doors to high places around the world such as an invitation to go and visit the Vice-President Gore who was thinking about reforming the United States government. I got those invitations because of what had gone on in New Zealand. But for me that was a back door into development economics. I got to see most of the third world and in particular I had the fascinating experience of showing up in the ruins of the Soviet Union, as the various republics tried to lift themselves up to independent modern economies, in very different circumstances from third world developing countries. I had the great fortune to be out there doing this at the time of astonishing change in the world and so I continued to have a most exciting and interesting career. Seeing the world, having fun and doing good work wherever I could, with some successes and no doubt some failures.

**Q: Thinking about your consulting work across all these countries, what are the main lessons you take for public management?**

A: They are political economy lessons really. The institutional interests that I have had have always refused to recognise a boundary between economics and politics in any simple way. What you can get done in any country is conditioned by the political economy around what you are trying to do as an economist. It is just that it is so much more obvious when you are working in a third world country than it is when you are working in a developed world where politics is a less vicious business. New Zealand, thank goodness, is less hurt by patronage and corruption than almost any other country in the world. So this is a very benign environment for an advisor to work in, whereas I have worked in other countries where the impact of politics on economic policy is straight in your face.

For example, I was an advisor to the head of the tax administration in the Philippines whose life was in danger from him trying to reform and undo some of the appalling corruption. I have worked in dictatorships. I have worked in communist countries. I have worked in a Buddhist theocracy and worked in countries of all kinds of political systems. The great blessing that that has given me is an opportunity to reflect on the inter-relationship of politics and advice and the role of intellectuals in governments run from from many

different perspectives around the world.

**Q: Given the interaction of politics and economic change, does it make sense to ask for examples of leading practices in public management or is it too contextual to do so? If there are such things which country would you look to?**

A: I think there are examples of good public management which travel well. But they are only high level principles. I have been the enemy of "best" practice and have argued all over the world with people who somehow expect that I can bolt the New Zealand model onto the way they run their government and I have never done that.

Of the things that do travel well, in the developed world it seems to me that the State of Victoria in Australia, New Zealand when it is at its best, some US States, the Office of Management and Budget in the United States when it comes to evaluating programs for their effectiveness. Some things in Canada and some number of the blizzard of initiatives that get launched in the United Kingdom are path-breaking and travel well, although many of their initiatives fade pretty quickly. So that's sort of the top drawer in public management.

If I look around the rest of the world where the underlying conditions that are in Victoria and New Zealand don't apply, I have seen some people I admire very deeply working in impossible conditions in developing countries, committing themselves to change against almost impossible odds. I admire these people. They may not get far, but they are the future. You know these are the people who are training the young ones to look at their role in their societies differently for the future. One of the great joys I have had, even with some of the least effective consultancies I have had, is to look back with a degree of pleasure at some young people who wanted to live in a country that was doing better than they found it and were making the commitment to do that. I can see that all over the world. So I am quite optimistic that the slummy public management that you see over so much of the world will slowly pass.

**Q: Your time at health funding where you chaired the Central RHA and later the Health Funding Authority, was a shift into a much more operational agency. What led you to make the change and what are the insights that you take from that?**

A: There are two areas of policy the Treasury had been engaged during my time, where I really thought we hadn't got the job done, and we were only kind of a bit player, in some of them anyway. They were other's people responsibility, but I still sort of felt I had been Secretary to the Treasury, and there were bits that really came off the rail. Health policy was one of them. It wasn't designed in the Treasury, but I, and I think the senior Treasury officers in the area, felt that the health reforms in the early 1990s had been far too complicated. Far too many things had to fall the right way for them to succeed, and that the political economy hadn't been thought through sufficiently.

The whole idea had been to have an internal market, to summarise it briefly. A crucial element of that was that people could opt out of the regional health authorities, which were their government insurance companies, essentially. But the opt-out was removed, and so you ended up with a pancake layer of bureaucratic interventions that was expensive and still hadn't fundamentally changed the underlying behaviour of the system.

When I was asked to chair the Central Regional Health Authority, and later the National Health Funding authority, I could not resist the opportunity to see if I could make a contribution to doing it better.

However we got the political economy wrong. The first thing the Labour government did that was elected in 1999 was to announce that it was abolishing the whole idea and I was the first person that they got rid of. But I think it was a bit of a tragedy really. I take no pleasure out of the fact that over the ensuing three years, the amount

of public money spent on the health system rose by over 50 per cent, while the volume of work done by the hospitals went down. It was a collapse in productivity in the public hospital system.

It would have been so much better if the reforms and the various modifications to them through the 90s had built in a degree of political sustainability to avoid both real and imagined problems of the late 1990s system and to avoid what happened subsequently with the abolition of the authority.

The other area of policy that I had always felt we had not done properly was the electricity industry and so I grabbed the opportunity when it was offered to me to chair the company which started the wholesale electricity market, and it worked really well. It is still there today. It has become regulated though we built it as unregulated organisation. It achieved what was intended to do in signalling the market's view of scarcity of the water in the lakes and what price could enable the wholesale players to react to market perceptions of the demand and supply for electricity. So that was quite successful. That was why I got involved in those two public institutions.

**Q: Regulatory approaches in New Zealand, often seem to have shifts in policy more driven by ideology and casual empiricism than by really solid analysis. For instance current prescriptive regulations in financial markets, don't seem to acknowledge or draw very heavily on past analyses of the underlying problems. How much of a risk you think we run over repeating past mistakes in regulations?**

A: Very high risk. That's why I think it is so important to create a kind of intellectual policy foundation; a collective knowledge and experience, with a very careful and adult debate around that. I never believed that advice can be completely lacking in ideology. The whole idea of advice is itself kind of ideological through a post-modern lens. People do have their preferences and advisers do have to make calls that go beyond the analysis - they should not apologise for that; that is their job. But it is a real worry when the underlying body of research, analysis and historical knowledge isn't rich enough to ground the discussion about what should happen. So that the politicians fill the gap and you get seemingly popular ideas that haven't been thought through properly or a refusal to recognise and engage with the observation that 'we tried this three times before and it didn't work then, why do you think it's going to work now?'

I don't want to be too critical of New Zealand because we are a very advanced democracy and one of the oldest ones in the world. We've got a lot to be thankful for and proud of, but I do think we are far too casual in the way in which we kind of flip from one thing to another. I recognise that some people might say 'well didn't that happen in the 1980s', and my answer to that I have already given is 'no'. There were years of research sitting behind those policy changes and they were set squarely in the OECD consensus of adjustment policies.

But I think that being a liberal, which is how I think of my preferences, is ultimately about a commitment to debate, to ideas, and to knowledge. While that is ideological in the sense that I mentioned earlier, it is not about whether you are a 'wide-eye market liberal', or 'post-marxist', or something. I think we can do way better than that.

The body of stuff we can agree on can be richer than it is, although, finally you don't get politics out of political decision making, and ideology counts and advisers have preferences. That's why the quality, the openness, and the transparency of the conversation and the analysis of the public policy matter so much.

**Q: In 2008, in a presentation, you said you believed there had been a diminution of the place of economics in the development of public policy. Now a few years on from that, do you think that diminution was temporary or a**

**permanent change?**

A: Going back to the point I made earlier, the grounding for answering this question is that I am an enlightenment guy and rationalism has its place. In the Popperian sense, knowledge can be generated that is valuable and is not just the expression of personal opinion.

So to look at that particular question you might argue that a government was elected in 1999, that was politically committed to a position that rejected its own history and positioned itself against the policies of the 1980s when it had last been in office and that meant that it positioned itself against the Treasury which was in its view strongly associated with those policies. It is quite OK for it to seek advice from somewhere else, from people who weren't trained Treasury economists. That is not a failure in the democracy, but I think it happened. That is what that speech I gave was about and I gave examples of public policies which plainly were developed without the benefit of mainstream economic advice, and the consequences, I thought, were apparent.

What is a bit surprising is that the present government couldn't have signalled more loudly than it has, and the Minister of Finance, in particular, how much he would value high quality advice. He even said to the GEN network (the Government Economics Network) that he was looking for advice that would frighten the government. He wanted to know the truth, as advisers saw it, and he told the official advisers, 'if we don't get it from you, we'll get it from somewhere else'. Indeed that's what the various groups they put together around taxation and welfare have done. They have gone to alternative sources of advice. I think the public service advisors should see this as a challenge. Their monopoly is gone and in fact, it probably went a long time ago. But they do have the privilege of access. They have the privilege of information. They have a trusted relationship with their political masters. They are the first responders when things go wrong so they have the opportunity to be first in the room to present new opportunities.

I am perplexed as to why we've got a government with a Minister of Finance, who happens to be a former Treasury official, who seems to have been, at least for a while when they first got elected, somewhat dissatisfied with whatever advice on the big issues was coming up.

My impression is that they are probably more satisfied now, but I really don't know. You need to be on the inside to be able to judge that. I think it's as my 2010 report with Patricia Faulkner and Pat Duignan said, that the heads of the civil service do need to give more attention to what does policy capability mean, how do they put it together, preserve it, stimulate and create the environment, in which this kind of buzz can happen between policy advisers, and in which breakthroughs can be made in tough areas of policy. They've still got a way to go, I think, to solve the problems that we reported.

**Q: Pursuing the political economy into which policy advice has to play. Policies such as privatisation have been pursued around the world by governments of every stripe. Yet we've seen these same policies being opposed vehemently in New Zealand. Why do you think New Zealand is such an outlier?**

A: It's a mystery but I'll try to answer the question though I really don't feel confident that I know. But I'd go back to what I said earlier about the need to base public policy on a strong foundation of knowledge, and debate with hard argument. We used to talk in the Treasury about 'being hard on the ideas and easy on the people'. Too much of our debate has become characterised by rudeness between people, and we've left a gap.

I think that the policy advisory group around public policy has made it too easy for politicians to respond to populist causes. I don't want to be critical of politicians here, I tried to be one once and didn't succeed. But I mean they've got a job to do, like the rest of us. They are trying to find ways to get elected, win votes and have power to deliver stuff to the people who voted for them, and



hopefully to people who did not vote for them too. In the search for votes, if they find that the public really doesn't like privatisation, then you'll get a policy that says 'we don't like privatisation'. I don't think that's leadership, that's a kind of responsiveness that might happen in any political system. However we do see Sweden and left-of-centre countries with a long tradition of social democracy that don't have these ideological hot buttons around privatisation, and other elements.

I think what we are seeing here is a bit surprising. Policy changes cast a very long shadow, and it may be that the shadow of the 1980s still hangs over policy making in New Zealand. That seems ridiculous, but I wonder if it does hold, and certainly for a very long time our policy debate seems to be between people who have been in favour of what had happened and people who didn't. But they were not concentrating on what needed to be done next.

It's an inadequate answer but I think the response to it is to have a deep and adult policy community that will pressure the political system over time to be more rational, and more concerned about the quality of discussion and debate, with less 'name calling' than has been going on.

**Q: Universities have a role in terms of helping to expose ideas in society. How well do you think they are helping to pull out all the sides of arguments of key arguments we face, so that people have a strong basis for judgement about the strength of different effects?**

A: To be honest it has been a bit disappointing. To be fair to the academics though they will say their reward and incentive structure is based around publishing articles in international journals and not by spending your energy thinking about New Zealand policy. I think there is a truth in that. I also think there has been a bit of a tendency for those academics who do take an interest in policy to have pretty strong ideological views which come through in their policy advice. That's OK, as long as you've got a contrast of different views. I am not saying you can be ideologically neutral, you can't. But overall it has been a fairly disappointing contribution from academia to the quality of public policy debate and that's unfortunate.

**Q: Transparency agencies are another institution to increase knowledge. The Australian Productivity Commission has often been credited with a major role in lifting Australian understanding of the benefits of economic reforms and helping to sustain continued change. How much can we expect from the NZ Productivity Commission and what's needed for it to have a significant impact?**

A: I am not a spokesman for the Commission, the Chairman is, but my personal view is that you should expect a lot from the Productivity Commission. To do that it will need a bit of time to build its networks and capabilities and to establish itself in the eyes of stakeholders as a worthwhile organisation. Even though people will be annoyed by some of its reports there will be others that they are very happy with.

In my personal view we've got off a pretty good start with the housing report, which attracted a lot of attention, and exposed problems that the government needed to attend to. It also built connections with people who are essential to solving these issues in third sector and Maori house provision.. I think the transport report was influential in the government's approach to the permission for carrels in the international shipping industry. I think the local government report has touched on sensitive issues about managing the system of relationships between central and local governments around regulatory interventions that are administered by local governments and I think the local government has responded well to that. They were probably hard messages for someone in central government.

But that's just our start up. We need to build the capability and aspire to be as influential in a constitutionally appropriate way, as is the Australian Productivity Commission which we were modelled on. We need to develop global networks so that people

welcome our engagement with them and see some of our papers as being interesting from an international stand point. Finally, we need to build and sustain our presence in the policy discussion in New Zealand.

But time will tell. There have been a number of attempts over many years to create sustainable organisations like this. I think it's essential and I am very pleased to have accepted an appointment and then a reappointment to it. But the organisation will, I am sure, develop a position in NZ policy-making that's far above and beyond the reputations of particular individuals.

**Q: In 2005 you stood for parliament; a pretty unprecedented step for a former Secretary to the Treasury in NZ, although not for Australia where John Stone was elected as a senator and served for some time. What led you to the step and what you get from it?**

A: Well, the time I did it, was around the time when I was becoming very concerned that economists were finding it difficult to get their messages absorbed in public policy in important areas. I had been active in politics in Christchurch in the 1960s, in the National party. Then as my political views had changed a bit when I lived in the Unites States, although I never joined the Labour party I had friends in it from the Princes St branch of party who ended up in high places. So I was sort of a non-participant supporter of Labour through the 1970s. Of course, when I joined the public service I obviously stopped any of those connections.

But there were two people that had a big influence on me when I was a public servant. One of them was Derek Quigley, who was the one minister with the bottle to stand up to Prime Minister Muldoon in the early 1980s. I crossed his career as a politician, but I admired him for doing that and he had done some very good things, as a Minister of Housing. I was sad to see him lose his career for criticising Think Big. Then there was Roger Douglas who I had met briefly in Auckland, long before. When I was working with him, I found he was an extraordinary politician whose ability inside the government to develop a case and carry his colleagues with him, and then to explain what he was doing to the public was second to none. He was a man who was deeply committed, as part of the Labour aristocracy, to looking after people whose opportunities in society were wrecked. His particular vision about how to do that had changed from seeking a raft of interventions, to making sure that the economy and the society was open to people like his constituents from Otara in South Auckland. The credibility of the man representing one of the poorest electorates in the country, was considerable.

After I had left the Treasury, I was approached by them to stand for a political party that had been started by two politicians, in whose liberalism I believed personally, and for whom I had personally worked. They kept asking me and I kept saying no. Finally in 2005 they came around one more time. A lot of things came together. There were my concerns about the lack of mainstream economic advice affecting policy choices. I had been out of the public service then for 12 years, so I wasn't in any way causing damage to the public service by becoming political 12 years after I left it. And remember also my daughter had drowned in the Southern Alps, so I wanted to cut down on travelling and spend more time with my family in NZ, who were being pretty hurt by that.

It was a quixotic thing to do, in a way, but not as quixotic as it might appear from the outside. Don Brash was leader of the National Party. I knew him well and had had worked with him for a long time, and Nationals were rising in the polls. ACT was in a certain amount of difficulty, but I was assured that if I went in there I would have a considerable influence on its policies. Also since the National party had lost a lot of its cabinet material in the previous elections there was a significant chance that I might have ended up as an associate minister of Revenues or Expenditures or Public Sector management or some important but minor role like that. So I rolled the dice, but didn't get a six, though I didn't miss by that much. I mean in hindsight it would have been better for me to go to the National Party, and I probably could have got on their list at



the time I suppose, but there was something about the liberalism that I liked in the best of the ACT people. As a small party I had a lot of influence on its policy in the short time I was involved with it.

My liberalism is to the left of the classical liberals, and more in line with European parties like the Free Democrats in Germany. It could have all worked out, but it just didn't and I don't have regrets about that.

**Q: Finally what advice would you give to young economists, just out of university who wanted to make a difference in NZ?**

A: If you are willing to be imaginative and work hard, you can have an astonishingly interesting career. I have never been bored in a career as an economist from the day I started being one, which is a very long time ago, from the early 1960s, to being a commissioner on a productivity commission, and continuing to do global consulting work with all sorts of interesting people, on interesting things. I have had a wonderful career and don't regret a minute of it. So I do talk to young economists about how they might pursue their careers.

If you want to make a difference, I suppose you can do that by being one of the great academics. That's hard to do, and you probably need to go overseas and get a PhD and get recognised overseas rather than carving out a career only in NZ universities. Within the public sector these days the walls have come down, and I hope they'll never go up again. It's possible for people as a

result of the reforms we did in the 1980s, to move in and out of the public sector. I think that Treasury will always continue to be what it has been in the past, a kind of university inside the government, a finishing school for economists, which is what Geoffrey Palmer once described it as. The Reserve Bank has always been a stunningly good place to craft your skills as an economist, as is the Treasury, you now have got MBIE, which I think is lifting its game and thinking about economic development rather than just being a commerce ministry. The Justice Ministry is a congenial location for a law and economics graduates. Public sector economists these days really do need to understand that conjuncture between law and economics to do their jobs well.

The GEN network I think is a wonderful innovation and I hope it matures into something which really consolidates and creates a team and a profession of public sector economists, to encourage you to build your career and enable you to join together with other public sector economists. Hopefully in the course of your career, from time to time, you'll have the buzz that I've had, of finding yourself surrounded with a collection of economic minds who become personal friends and who you get excited working with, and that you find yourself in a place where your advice has been taken. You can make changes that will always be a mixture of things that went right and a few things that went wrong, but you can build a career in which you feel satisfied later on about the impact that you've had in raising the living standards of your people.

## ALAN BOLLARD ELECTED NZAE LIFE MEMBER

It is with great pleasure that the Association honours Alan Bollard with the award of Life Membership of the New Zealand Association of Economists.

Alan graduated with Bachelors, Masters and PhD degrees in economics from the University of Auckland in the 1970s. After working in London, he returned to New Zealand to join the New Zealand Institute of Economic Research in 1984. He held the role of NZIER Director from 1987 to 1994, working to restore its financial position while continuing to ensure that the Institute conducted high quality economic research relevant to New Zealand.

Alan then took on three successive high profile public sector positions: Commerce Commission Chairman (1994-1998), Treasury Secretary (1998-2002) and Reserve Bank of New Zealand Governor (2002-2012). Few, if any, New Zealanders have served in such a range of high profile public sector economic leadership roles.

In each of these roles, Alan was a champion for the application of economics in general, and for the activities of the New Zealand Association of Economists in particular. He served as an NZAE Council member for three years from 1995, including serving as NZAE President in 1997. He has also been an active supporter of Association events in many other ways. While at the Treasury and the Reserve Bank, he encouraged economists at those institutions to present papers and to attend the Association's annual conferences, and ensured provision of financial support to assist the attendance of high quality keynote speakers for the conferences. Particularly noteworthy was his role in Chairing the International Advisory Board for the the 2008 NZAE/ESAM Conference in honour of AW Phillips; his speech on the life of AW Phillips was a conference highlight for many.

While at the NZIER, Alan was instrumental in having one of Bill Phillips' MONIAC machines repatriated to New Zealand and restored to working order. He has promoted economics education in a number of ways, including through the Young Enterprise Trust and through the establishment of the Reserve Bank museum, which currently hosts the MONIAC. These education initiatives continue to bear fruit within New Zealand now that Alan has moved offshore to take the position of Executive Director of the APEC Secretariat in Singapore.

Alan's contributions to New Zealand public policy have been recognised through honorary doctorates from the University of Auckland and from Massey University, and through being named a Companion of the New Zealand Order of Merit in 2013.

The Association honours Alan for his contribution to the Association and to New Zealand economic policy, economic research and the economics profession, and has pleasure in awarding him life membership of the Association.



# FROM THE 2B RED FILE

by Grant M. Scobie

([grant.scobie@treasury.govt.nz](mailto:grant.scobie@treasury.govt.nz))

This year's NZAE conference ended with a keynote address by that Australian iconoclast, John Quiggin. The Association seems to specialise in having at least one book-promoting key noter among its distinguished imports. Recall Tim Harford's recounting the saga of Thomas Thwaite's attempt to build a toaster, which (the saga not the toaster) was designed to have you dashing to the desk in the foyer to layout \$39.99 (the conference special price) for the latest Harford epistle (Adapt: Why success always starts with failure).

This time it was Quiggin's turn to use his NZAE platform to promote **John Quiggin (2012) *Zombie Economics: How Dead Ideas Still Walk Among Us* (Princeton, NJ: Princeton University Press)**. Building a career by writing a best seller damning your colleagues is not a new approach - recall the JK Galbraith trilogy starting with *The Affluent Society* (1958) - although one is reminded of the Yiddish proverb: "spitting in the well from which he drinks."

The central thesis is that much of economics since Keynes (and quite a bit before) is misguided, ill founded, ignores reality, fails to predict anything significant - in short, basically useless. And with a couple of exceptions (Minsky, and fellow Australian Steve Keen - *Debunking Economics* (2011)) the rest of us were just a herd of followers - an unquestioning, gullible crowd scene who actually subscribed to Real Business Cycles, Rational Expectations, Monetarism, Ricardian Equivalence, Efficient Market Hypothesis, and Dynamic, Stochastic General Equilibrium. And worse - blind adherence to this shonky stuff contributed in no small part to the Global Financial Crisis.

Professor Quiggin apparently believed that all that unmitigated, irrelevant economic waffle had been confined to the scrap heap of ideas after the GFC. He is clearly distraught that, like the Zombies, "they continue to lumber around the intellectual landscape." However, if you are looking for a concise, pithy synoptic overview of the history of thought since the 1930s, you could do a lot worse. But if you are asking what Professor Quiggin would have us turn to instead, you might just find his prescriptions for the new twenty first century economic paradigm a tad on the light side:

*"Economics should focus:*

- *More on realism, less on rigour*
- *More on equity, less on efficiency*
- *More on humility, less on hubris."*

"Prediction is always difficult - especially when it's about the future" is an old line, trotted out at every forecasting meeting ever held. My next pick for this issue of 2BRED is **Nate Silver (2012) *The Signal and the Noise: Why So Many Predictions Fail—but Some Don't*** (London: The Penguin Group). The author is a statistician and political forecaster at the *New York Times*. This is a substantial book (524 pages) which explores the highways and byways of prediction. This is no text but a rattling good ramble through countless failures (and a few successes) in the world of forecasting. Silver tackles dynamic systems (the weather, movement of the tectonic plates and earthquakes and the economy) and documents a pretty mediocre success rate.

The author then introduces Bayes Theorem in one of the most readable discussions I have seen - he makes it come alive. "Suppose you are living with a partner and come home from a business trip to discover a strange pair of underwear in your dresser drawer" (p.243) does strike one as a more titillating way to motivate the concept of prior and posterior probabilities than dreary pages of equations in a text book on decision theory.

He draws an interesting analogy between Bayes and Adam Smith's work - (contemporaries educated in Scotland and influenced by David Hume). Smith's invisible hand is analogous to a Bayesian process whereby an initial price is subject to changes in supply and demand and eventually converges to an equilibrium. A Bayesian process is like the invisible hand as ideas and beliefs are updated with new information. The book concludes with chapters on sports betting, chess, poker, global warming and terrorism all cast in a Bayesian framework. Whether you will enjoy this book I can't predict, but my prior probability is 0.8.

We koo-woys constantly beat ourselves up about being a poor offshore island from Australia. The main consequence is that vast numbers of us migrate to the sunnier, richer climes of Oz. A new book on the lucky country draws on decades of teaching and research to offer a most readable account of Australia's economic history. **Ian W. McLean (2013) *Why Australia Prospered: The Shifting Sources of Economic Growth* (Princeton Economic History of the Western World)**. It is a masterful account weaving history, culture, world markets, migration and the role of institutions into an accessible, non-technical story. Can we draw implications for improving our miserable lot? Perhaps we should have been less hasty in leaving the Constitutional Conventions of the 1890s and foregoing statehood. On the other hand ... perhaps if we ask nicely, it might not be too late?

"I had the good fortune to grow up in a wonderful area of Jerusalem, surrounded by a diverse range of people: Rabbi Meizel, the communist Sala Marcel, my widowed Aunt Hannah, and the intellectual Yaacovson. ...As far as I'm concerned, the opinion of such people is just as authoritative for making social and economic decisions as the opinion of an expert using a model." This quote is from **Ariel Rubinstein (2012) *Economic Fables* (Cambridge: Open Book Publishers CIC Ltd.)**. (location 536 in my Kindle edition).

Rubinstein is a widely published economist from Tel Aviv University. The book was originally published in Hebrew in 2009. He offers a wonderfully engaging blend of economic theory and autobiography drawing on his childhood, family and career in Israel. Hotelling's theorem, game theory, rationality and equilibria are all explained and illustrated with stories (fables) told in a seemingly folksy way - although the underlying arguments and logic are not always for the faint hearted. As bedtime reading, this one might best be restricted to my more nerdy readers.

The closing chapter entitled (*Sort of*) Economic Policy brings the fables together to look at the economics of everyday life. With due humility, Rubinstein recognises that economic logic does not necessarily explain everything. "The existence of a national home for the Jewish people in the land of Israel has about as much economic logic as building a convalescent home on a traffic island" (location 3277). Forget the Zionist project and send the many talented Jews to populate Manhattan and Silicon Valley - "a much more economically efficient outcome." Israel's defence budget and the investments in West Bank settlements would provide each outgoing migrant with a handsome annuity.

In short, this is a book of wonderful fables woven from the economic, political and cultural fabric of modern Israeli society by an outstanding theoretical economist and story teller. Our profession is the richer for such members.

# THE FIVE-MINUTE INTERVIEW WITH... ADOLF STROOMBERGEN

## 1. When did you decide that you wanted a career in economics?

After studying it in my first year at university, although my interest was initially aroused at a careers evening at college.

## 2. Did any particular event or experience influence your decision to study economics?

My father and uncles were forever arguing about politics and economics, usually with more heat than light. I thought that I could change that by studying those subjects at university. That was naive – nothing changed.

## 3. Are there particular books which stimulated your early interest in economics?

Dorfman, Samuelson and Solow: Linear Programming and Economic Analysis, which provided a blend of economics and mathematics that appealed to me.

## 4. Did any teachers, lecturers or supervisors play a significant role in your early education?

Professor Bryan Philpott. He employed me during university holidays to do data analysis for the Research Project on Economic Planning. He led me into linear programming and general equilibrium theory, and subsequently became my PhD supervisor.

## 5. Do you have any favourite economists whose works you always read?

Not really as I find most aspects of economics interesting. However, I'm especially keen on good econometric research so articles by James Heckman et al are always high on the list.

## 6. Do you have a favourite among your own papers or books?

Being a private sector consulting economist I don't get much opportunity to write academic papers, let alone books. At one stage I had the opportunity to do some consulting work in the Faroe Islands, which included building a general equilibrium model of the Faroese economy. That would probably be my favourite piece of work.



## 7. What do you regard as the most significant economic event in your lifetime?

Two really: the economic rise of China and the discarding of the gold standard. I've always been very interested in the idea of (the lack of) an invariant standard of value – Sraffa if I recall correctly.

## 8. What do you like to do when you are not doing economics?

Spending time with family, walking, offshore travel (particularly as I have three children living abroad), reading, and driving a V8 Jag,

## “FRAMES”

by Stuart Birks, [k.s.birks@massey.ac.nz](mailto:k.s.birks@massey.ac.nz)

### Social Dimensions to Exchange

As economists, our model-based view of the world falls far short of reality. Myrdal (1953, first published 1930) was concerned that economics takes too narrow a perspective. He was not alone, and more recent criticisms highlight the effect of research assessment processes as a strong incentive to conform to established conventions (Lee, Pham, & Gu, 2012).

It is worth considering some of the areas that a narrow framing may overlook. This column looks at one aspect, the social dimensions of exchange, identifying some areas where additional reserves, qualifications and adjustments (Keynes, 2007, pp. 297-298) may be useful.

It is said that money, as a medium of exchange, makes trade more efficient as compared to barter, which requires the double coincidence of wants. Far more options for exchange arise with the use of money. While this is true, it is not the full story.

This point was made on New Zealand Radio National on 20th of April 2013 (listen here). The item described a school having a bike library, where pupils could borrow bikes which were maintained in a shed run by fathers. It was stressed that the project was not based on financial transactions. “By leaving money out of the equation, we are coming back to people sharing skills, time with one another and building the community...” Titmuss (1970) identified the ‘gift relationship’ as being an important aspect for donating blood.

Payment would change the nature of the transaction. Introducing money could actually be problematic.

Lawson (2003) has criticised the atomistic representation of individuals in mainstream theory which results in adherents, “not seeing the distributional constraints, relationality, powers and forces about which those choices are defined and effected” (Rotheim, 2006, p. 614). Consider, for example, a group's choice of restaurant. This requires general compliance, not a set of autonomous decisions. Also, nearly a century ago Marshall wrote:

“What makes one course [of action] better than another, will not necessarily be a selfish gain, nor any material gain; and it will often have been argued that ‘though this or that plan saved a little trouble or a little money, yet it was not fair to others,’ and ‘it made one look mean,’ or ‘it made one feel mean.’” (Marshall, 1920, I.II.17)

That there is more to exchange than simply the transfer of goods and services in return for money is further illustrated if we consider the issue of dating. This requires the double coincidence of wants, as with barter. Would we consider it more efficient if dating were a financial transaction? Surely, using the standard market interpretation, this opens up far more options. However, we know that there is something more to dating than this. We can generalise from this. There are dimensions to transactions above and beyond

simple exchange between two parties.

This applies also to the operation of markets. While economists emphasise the benefits of competition, even in competitive markets, cooperation is required:

"Cooperative exchanges come in many forms. Cooperation can combine with competition, as when children cooperate in establishing the ground rules for a game in which they then compete against one another; in adult life this same **combination of cooperation and competition appears in economic markets**, in electoral politics and in diplomatic negotiations." (Sennett, 2012, p. 5, emphasis added).

There is cooperation in establishing the product, the market and the rules for exchange. Then there is competition within the market, influenced by the rules that have been established. Sennett's point was also made by our own John McMillan, albeit in terms of cooperation by complying with centralised decisions:

"The very fact that the internet is so decentralised is, ironically enough, the result of a decision made centrally... incompatibilities between networks could have arisen... Without a modicum of central management, the internet would not have grown into the flexible, easy-to-use tool we experience now." (McMillan, 2002, p. 158).

More generally, we might consider social interaction as part of, perhaps even an objective of, market exchange. The benefits may then depend on the nature of the transaction.

Such ideas can be incorporated in analyses through emphasis on process in addition to end results. However, process is overlooked in economic evaluations which focus on outcomes. The term 'consequentialism' has been used to refer to perspectives which consider solely the end result, suggesting, "the ends justify the means". Economics has been criticised for reliance on narrow concepts such as utility maximisation, and, "...the essence of purely economic progress, which is to achieve improvement at the price of social dislocation" (Polanyi, 1957, p. 34).

Consideration of process raises some interesting possibilities. It could be suggested that "retail therapy" is actually an attempt at social interaction. If so, the nature of shopping and monetised transactions may result in this being an unsatisfactory attempt to meet a need. However, process is a feature of procedural utility, which has been, "defined as the well-being people gain from living and acting under institutionalized processes as they contribute to a positive sense of self, addressing innate needs of autonomy, relatedness, and competence." (Frey, Benz, & Stutzer, 2004, p. 318)

In summary, there may be additional dimensions to transactions between individuals. Our approach to and use of market transactions and exchanges based on money may not consider all the needs that people are attempting to satisfy through these activities. However, this is commonly not perceived by economists.

It is sometimes suggested that western approaches to business rely on contracts whereas eastern cultures emphasise trust and long-term relationships. That may be an oversimplification, especially given the western concept of incomplete contracts (Hart, 1995). If we consider social motives for economic transactions, we should acknowledge that there may be many different ways to undertake such activity. Similarly, economics emphasises the use of incentives to change behaviour, but a meta analysis of studies on Intrinsic and extrinsic rewards concludes, "the evidence indicates clearly that strategies that focus primarily on the use of extrinsic

rewards... run a serious risk of diminishing rather than promoting intrinsic motivation" (Deci, Koestner, & Ryan, 1999, p. 659).

Seligman also describes the importance of process with an anecdote. Someone was given a lizard, but could not get it to eat until, by accident, he covered some food with a newspaper:

"The lizard took one look at this configuration, got up on its hind legs, stalked across the room, leapt up on the table, shredded the New York Times, and ate the ham sandwich. The moral is that lizards... have to hunt, kill, shred, and stalk. And while we're a lot more complex than lizards, we have to as well. There are no shortcuts..." (Seligman, 2004).

He is describing "hunting". Alison Armstrong sees hunting as a male, target-focused trait, whereas women have "gatherer" traits. In a short video she uses this perspective to describe shopping. We may not wish to accept anecdotes such as this as descriptors of real world activity, but there are numerous theories to be found in marketing books on consumer behaviour (Schiffman et al., 2008). This does suggest that there are dimensions which are not seen through the lens of mainstream economic theory. They may be important determinants of behaviour and aspects to consider when valuing alternatives.

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# FINE LINES: SOME REGRESSION LINES ARE FINER THAN OTHERS

By Dorian Owen

Although we make widespread use of regression analysis and its extensions, the results can often be deceiving. Data constructed by Anscombe (1973), which I first came across when teaching introductory econometrics at the University of Reading in the 1980s, provide a neat demonstration. The data, listed in Anscombe's paper, consist of four different sets of paired  $x$  and  $y$  values, each with 11 observations. A distinctive feature of the four datasets is that, apart from minor rounding differences, they all produce the same basic regression results:

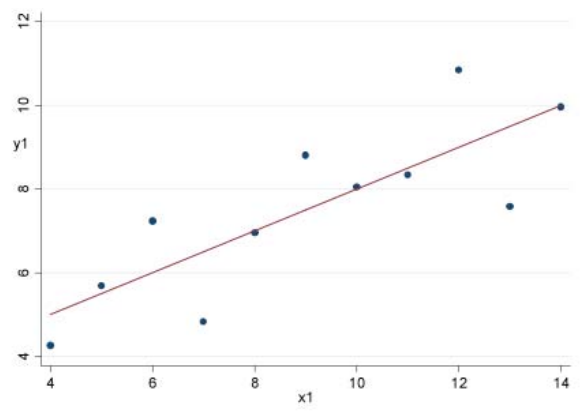
$$\hat{y} = 3 + 0.5x \quad R^2 = 0.67$$

(2.7) (4.2)

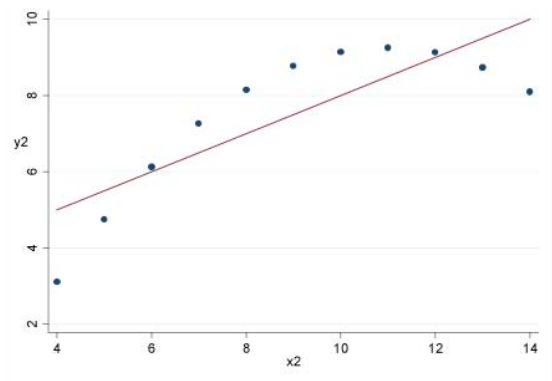
where  $\hat{y}$  is the fitted value of the dependent variable,  $t$ -statistics are reported in parentheses, and  $R^2$  is the coefficient of determination.

Regression analysis, like most econometric techniques, relies on assumptions about the nature of the data to deliver desirable statistical properties for parameter estimates and valid inference. Anscombe's motivation for designing his datasets was to make a case for routine use of graphical analysis to probe the validity of the underlying assumptions of regression models. His broader message, which is every bit as relevant today, is not to take regression results at face value too readily. This is vividly illustrated by his data because, even though the fitted regression lines for the four datasets are identical, their scatter plots are very different.

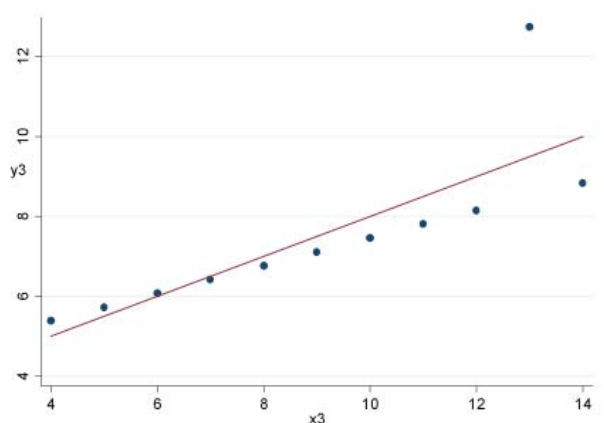
(a)



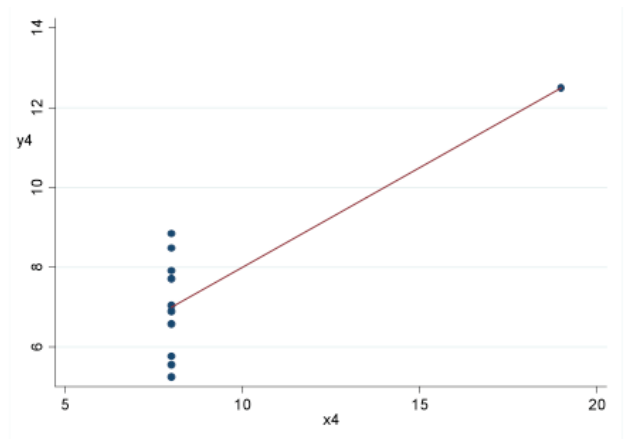
(b)



(c)



(d)



# THE CHAIR IN PUBLIC FINANCE, VICTORIA UNIVERSITY OF WELLINGTON

Plot (a) appears consistent with the usual underlying assumptions of a zero mean, homoskedastic, normally and independently distributed error term. Plot (b), by contrast, strongly suggests lack of independence of the errors stemming from the omission of a quadratic term in the regression model. Plot (c) contains a single marked outlier, without which the rest of the observations lie close to the line  $y = 4 + 0.35x$ , not the fitted regression line. Plot (d), although not obviously at odds with the usual underlying assumptions, features an extreme case of an influential observation; without the observation  $x = 19, y = 12.5$ , there would be no variation in  $x$  and the regression line could not be fitted. These features of the data sets would also be evident in plots of residuals against predicted values.

In Anscombe's artificial data, the peculiarities of the data, by design, show up clearly in the scatter plots<sup>1,2</sup>. With real data, graphical analysis would usefully be complemented by formal misspecification testing of the underlying assumptions and examination of diagnostics for other features, such as outliers and influential observations. In the same way that a graph will reveal nothing if it is not plotted, "a test that is never used has zero power" (McAleer 1994, p.334).

Testing of the probabilistic assumptions underlying statistical models probes for evidence of misspecification; "[i]f an estimated model is going to be used for any form of statistical inference, its statistical adequacy is what ensures the reliability of overall inference" (Spanos 2000, p.246). The danger with ignoring misspecification testing is that empirical studies may end up simply "illustrating" rather than rigorously testing theory models (Gilbert 1986).

Anscombe's dataset provides a nice illustration for introductory econometrics classes. But how seriously do we take the message about the need for graphical analysis and more formal misspecification testing to probe the statistical adequacy of our empirical models? Many published empirical studies seem to fit multiple variations of the same basic model, focusing on how different sets of controls affect the size and statistical significance of key parameters of interest and the overall goodness of fit. Very often there is little or no reported evidence of statistical adequacy based on misspecification testing or graphical analysis.

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<sup>1</sup> How Anscombe constructed his datasets is not known. However, Chatterjee and Firat (2007) outline a procedure, using a genetic algorithm, for constructing datasets characterized by identical summary statistics but different graphical representations.

<sup>2</sup> David Giles' blog, a wonderful resource full of useful information and explanations of all things econometric, includes a discussion of Anscombe's dataset, along with other interesting artificial datasets he constructed himself (Giles 2011).

The Chair in Public Finance (CPF) is a joint venture between the Victoria Business School at Victoria University, and four sponsoring institutions - PricewaterhouseCoopers, Inland Revenue, the Ministry of Social Development and The Treasury.

The Chair was established with two main aims in mind. First, to foster high quality academic research in the area of public finance broadly defined, including social welfare issues. Secondly to bring that research 'front and centre' within public policy debates to facilitate better evidence-based policy in New Zealand. The CPF therefore seeks to encourage debate and engagement with the public and private sectors on these research issues, especially as they relate to policy.

Norman Gemmill was appointed as the first incumbent of the Chair in November 2011, having previously been a professor of economics in the UK and Chief Economist at the New Zealand Treasury. Norman brings both economic and policy perspectives to the work of the CPF but he also collaborates with public finance specialists from other disciplines including Accounting and Law. For further information visit Norman's profile and publications at <http://www.victoria.ac.nz/cpf>



Last year, the CPF organised a number of events including four Public Finance debates in association with the Government Economics Network. Topics included: government spending caps, capital income tax rates, asset sales and the public sector discount rate. The Chair was also involved in Treasury's Long-Term Fiscal process - being part of the Long-Term Fiscal External Panel of experts that convened to present, discuss and critique the Treasury's assumptions and analyses. In December 2012, Treasury and the CPF hosted the Affording Our Future Conference, which invited the public to discuss the work leading up to the release of the Long-Term Fiscal Statement. The conference attracted a wide range of participants from various academic, business and policy organisations, including youth representation by university students. This process fed into Treasury's Long-Term Fiscal Statement, "Affording Our future", in July 2013.

The Chair has recently launched the New Zealand Public Finance website ([www.nzpublicfinance.com](http://www.nzpublicfinance.com)) - a research and policy 'hub' for all public finance related data, research and events. Among new initiatives, the NZPF website hosts the Long-Term Fiscal Calculator - an interactive fiscal web tool developed in partnership with Treasury. The LTF Calculator invites people to choose from various spending and tax options in order to manage the government's budget, at a sustainable level, over the next 40 years. Results can be submitted on-line to see how each user's choices compare with others.

Activities for the remainder of the year include additional papers for the *Working Papers in Public Finance* series, another round of Public Finance debates during October to December, and a first issue of the NZPF e-Newsletter planned from August/September.

If you have suggestions for events you'd like to see, or co-host, please contact us at [info@nzpublicfinance.com](mailto:info@nzpublicfinance.com). In addition, if you have public finance data, research and/or events you'd like to publicise on the NZ Public Finance website, we look forward to hearing from you.

# BLOGWATCH

by Paul Walker ([paul.walker@canterbury.ac.nz](mailto:paul.walker@canterbury.ac.nz))

This year's bad news for the economics profession continues with the announcement of the death of economic historian Robert W. Fogel. The Economist's blog 'Free Exchange' <http://www.economist.com/blogs/freeexchange/> covers the story here: <http://www.economist.com/blogs/freeexchange/2013/06/economic-history>, 'Real Times Economics' <http://blogs.wsj.com/economics/> here: <http://blogs.wsj.com/economics/2013/06/11/robert-fogel-nobel-laureate-dies/>, 'A Fine Theorem' <http://afinetheorem.wordpress.com/> here: [http://afinetheorem.wordpress.com/2013/06/11/without-consent-or-contract-r-w-fogel-1989/?utm\\_source=feedly](http://afinetheorem.wordpress.com/2013/06/11/without-consent-or-contract-r-w-fogel-1989/?utm_source=feedly) and 'Nicholas Wapshott' <http://blogs.reuters.com/nicholas-wapshott/> here: <http://blogs.reuters.com/nicholas-wapshott/2013/06/13/robert-fogel-and-the-economics-of-good-health/>.

In the international blogosphere there has been discussion and coverage of the Economist's debate on the pace and effects of technological progress <http://www.economist.com/debate/days/view/987>. The question the Economist asked was "Is technological progress accelerating?" Taking the "pro" position was Andrew McAfee of MIT while the "con" position was taken, unsurprisingly, by Robert Gordon. Gordon's recent work on technological stagnation has been widely discussed and controversial. A good point is made by Lynne Kiesling at the 'Knowledge Problem' blog <http://knowledgeproblem.com/> when she writes that "[...] in important ways the question is both pedantic and unanswerable. I think a better way of framing the question is to ask the comparative institutional question: what types of social institutions (culture, norms, law, statute, regulation) best facilitate thriving human creativity and the ability to turn innovation into new and different products and services, into transaction cost reductions that change organizational and industry structures, and lead to economic growth, even if it's in ways that don't show up in labor productivity statistics?" <http://knowledgeproblem.com/2013/06/14/economist-debate-on-technological-progress/>.

At the 'Becker-Posner' blog <http://www.becker-posner-blog.com/> consideration is given to the issue of the usefulness of a carbon tax. Posner argues that the evidence for global warming is serious enough to warrant action, and that a carbon tax is much more effective than regulation of carbon emissions <http://www.becker-posner-blog.com/2013/07/should-there-be-a-carbon-emissions-tax-posner.html>. Becker notes, however, that even if the case for a carbon tax is accepted, and there is powerful opposition to it in the United States, many issues remain about how carbon taxes should be implemented. It is some of these issues that he discusses <http://www.becker-posner-blog.com/2013/07/what-should-a-carbon-tax-look-like-becker.html>.

At the 'Why Nations Fail' blog <http://whynationsfail.com/> Daron Acemoglu and James Robinson have a series of posts on the "resource curse", or lack thereof. They argue that the empirical evidence suggests that there is a "conditional resource curse", whose existence depends on the institutions of a society. Countries with bad institutions will find that resource abundance lowers their rate of economic growth, while the opposite applies to countries with good institutions. For the discussion see here: <http://whynationsfail.com/blog/2013/5/16/is-there-a-curse-of-resources-the-case-of-the-cameroon.html>, here: <http://whynationsfail.com/blog/2013/5/23/the-economic-nature-of-the-resource-curse-mechanisms.html>, here: <http://whynationsfail.com/blog/2013/5/29/natural-resources-and-political-institutions-democracy.html>, here: <http://whynationsfail.com/blog/2013/6/4/more-on-natural-resources-and-democracy.html> and here: <http://whynationsfail.com/blog/2013/6/27/resource-curse-and-institutions-getting-more-specific.html>.

Peter Boettke over at the 'Coordination Problem' blog <http://www.coordinationproblem.org/> argues that we need more Econ 101. Robert Atkinson and Michael Lind have argued that "Econ 101 is killing America", the "myths" that economists expound are causing tragic

results for everyday Americans. [http://www.salon.com/2013/07/08/how\\_%E2%80%9Cecon\\_101%E2%80%9D\\_is\\_killing\\_america/](http://www.salon.com/2013/07/08/how_%E2%80%9Cecon_101%E2%80%9D_is_killing_america/). No says Boettke, Econ 101 isn't what is killing us, it is the denial of the practical implications of economics that is <http://www.coordinationproblem.org/2013/07/econ-101-is-what-is-needed-most.html>.

On the local blogging front, Matt Nolan at the 'TVHE' blog <http://www.tvhe.co.nz/> has been ranting against those who would ban the sale of houses to non-residents <http://www.tvhe.co.nz/2013/07/09/rant-time-house-sales-to-non-residents/>. Matt also speaks "In defence of Mankiw" since Greg Mankiw has come under attack because he is "Defending the One Percent" <http://gregmankiw.blogspot.co.nz/2013/06/defending-one-percent.html>. For Nolan, Mankiw is using standard economic welfare analysis, and applies well established principles of equity to try and articulate the impact of his assumed "cause" of changes in inequality – and the way that policy would respond given the fundamental equity-efficiency trade-off. This is basic "normative economics". Nolan sees the Mankiw paper as being written to clearly articulate economic concepts around redistribution to the lay reader <http://www.tvhe.co.nz/2013/06/19/in-defence-of-mankiw/>.

At the 'Fair Play and Forward Passes' blog <http://fairplayandforwardpasses.blogspot.co.nz/> Sam Richardson asks "Events capital = big returns, right?" Wrong suggests Richardson, there is not a whole lot in the way of compelling evidence that the economic impacts of sporting events are as substantive as commonly thought. Richardson notes that in academic circles, at least, there is agreement that the economic impact of sporting events is small. He has researched in this issue for the case of New Zealand and concludes that major sporting events are underwhelming in terms of what their realised impacts were on host cities <http://fairplayandforwardpasses.blogspot.co.nz/2013/05/events-capital-big-returns-right.html>.

Aaron Schiff <http://aaron Schiff.net/> does a service by pointing out that costs are not benefits. Schiff comments on a 2011 report for 2degrees Mobile entitled "Economic Study of the Benefits to the New Zealand Economy of New Competition in the New Zealand Mobile Market". In the report total estimated benefits from 2007 to 2021 are estimated to be 1) direct investment: \$5.3 billion, 2) indirect investment: \$3.4 billion and 3) competition dividend: \$1.4 billion. Schiff notes that items 1) and 2) correspond to expenditure by 2degrees and its suppliers on "capital and reinvested revenues". But as he says these are costs, not benefits. If 2degrees did not exist, these resources could have been used for something else <http://aaron Schiff.net/2013/05/costs-are-not-benefits-again/>.

At the 'Economics New Zealand' blog <http://economicsnz.blogspot.co.nz/> Donal Curtin writes on "The uphill struggle for free trade". He notes a comparison of the views of the American public with those of a panel of economists on the question "On average, citizens of the U.S. have been better off with the North American Free Trade Agreement than they would have been otherwise". Just 46.2% of the public agreed, another 15.4% weren't sure, and 38.4% thought NAFTA made things worse. Among the economists 94.6% thought NAFTA was a good idea, only 5.4% were unsure and not a single economist thought NAFTA was a bad plan <http://economicsnz.blogspot.co.nz/2013/07/the-uphill-struggle-for-free-trade.html>

Eric Crampton at the 'Offsetting Behaviour' blog <http://offsettingbehaviour.blogspot.co.nz/> points out that "The Rent is Really Rather High: Christchurch edition". He looks at the increases in house rents in Christchurch. He notes that since March the median house price is up by 8.2% and the 25th percentile is up by 13.3%. Part of the reason for this increase is that any homeowner with temporary accommodation coverage in his home insurance policy is pretty price inelastic in demand for the duration of repairs. Inelastic and increased demand meets fairly inelastic supply and results are pretty predictable <http://offsettingbehaviour.blogspot.co.nz/2013/07/the-rent-is-really-rather-high.html>.

<http://www.nzae.org.nz>

# REGIONAL GDP STATISTICS RELEASED

Statistics New Zealand recently released *Regional Gross Domestic Product statistics for the years ending March 2007–10*. This is the first of what may become a regular annual release, and is based on the methodologies developed in 2006 when a feasibility report was published. The release responds to a growing demand for regional economic statistics and complements the Regional Economic Activity Report, recently published by MBIE .

## Coverage of the Regional GDP statistics

The regional GDP series are compiled by calculating industry value-added at the regional level, i.e. they are production-based GDP measures. At this stage there are no plans to develop expenditure-based regional GDP measures as this would require, inter alia, information on inter-regional flows which are not currently available.

The table below shows the regions and industries covered in the regional GDP statistics.

REGIONAL GDP : DATA AVAILABILITY		
REGION	BY	INDUSTRY
Northland		Agriculture
Auckland		Forestry, fishing, mining, electricity, gas, water, and
Waikato		waste services
Bay of Plenty		Manufacturing
Gisborne		Construction
Hawkes Bay		Wholesale trade
Taranaki		Retail Trade
Manawatu-Wanganui		Accommodation and food services
Wellington		Transport, postal, and warehousing
Nelson / Tasman		Financial and insurance services
Marlborough		Rental, hiring, and real estate services
West Coast		Owner-occupied property operation
Canterbury		Professional, scientific, technical, administrative, and
Otago		Support services
Southland		Public administration, defence, and safety
		Education and training
		Health care and social assistance
		Arts, recreation, and other services; and information media and telecommunications (published as other services).

## General principles underlying the regional GDP statistics

The regional GDP statistics were compiled to be consistent with the published national accounts series, with the sum of the GDP of the regions equalling national-level GDP. However, there are conceptual and statistical issues that are particular to regional GDP estimation, and these are briefly discussed below:

### 1. The allocation of economic activity to the regions

Where an enterprise (e.g. a firm or a government agency) is based in one region but also operates in another region, then this raises a fundamental question in regional GDP compilation – what region or regions should the unit's activity be allocated to? The two major principles to choose from are the *residence* principle and the *territory* principle. The former allocates the activity to where the unit undertaking the activity is based, while the latter allocates to the territory where the activity takes place.

The principle of residence is chosen as the primary one for regional accounts. However, this is done with the understanding that enterprises can be made up of multiple geographic location units, and it is this geographic unit that is the statistical unit used when compiling the regional series. In most cases, the residency and territory principles coincide. However, there are two main situations where the principles of residence and territory differ:

- I. The lack of (actual) producer (geographic) units in the region in which the activity takes place, e.g. mobile labour (travelling salespersons), mobile capital (aeroplanes, rail), and capital assets located separately from their production units.
- II. Where activities themselves span many regions eg infrastructure assets such as electricity transmission. These situations pose issues which are difficult to resolve whichever concept is adopted.

Where no geographic unit is available but it is known that a significant level of activity is taking place in the region, then, provided some employment / capital data is available, a notional unit may be created and the enterprise's value added allocated in the normal way. However, for mobile capital (and air transport in particular), notional or actual units may not provide a good basis for measuring the activity taking place in each region. In practice, where notional or actual units are not being used for the estimates, the territory principle is being used.

### 2. Valuation

In the national accounts, industry value-added is measured at producer prices – it includes taxes and subsidies on products, but excludes unallocated GST on production and import duties. The latter are added in total to the sum of industry value added to obtain GDP at market prices. The same approach is adopted for regional GDP: industry value-added at the regional level is measured at producer prices and then a regional allocation of GST on production and import duties – based on the regional proportions of value added – is added to derive regional GDP at market prices.

The effect of this valuation treatment is that certain taxes are concentrated in the regions where the product that is being taxed is produced. Examples of this include excise duty on beer being allocated (mainly) to those regions where the main breweries are located, and gaming duty, much of which is allocated to Wellington, where administering agencies such as the TAB are located. While this is a correct treatment from a valuation perspective, it does influence per capita measures of regional GDP. Many analysts deriving per capita measures would more than likely prefer their regional GDP measures in basic prices, which would exclude the impact of these product taxes and better reflect the regional distribution of labour and capital inputs.

<sup>1</sup> Statistics New Zealand, Research Report on Regional Gross Domestic Product, 2006, available at [http://www.stats.govt.nz/browse\\_for\\_stats/economic\\_indicators/NationalAccounts/regional-gdp-feasibility-study.aspx](http://www.stats.govt.nz/browse_for_stats/economic_indicators/NationalAccounts/regional-gdp-feasibility-study.aspx)

<sup>2</sup> Available at <https://www.mbie.govt.nz/what-we-do/business-growth-agenda/feedback/regions>



### 3. Methodology: 'bottom-up' or 'top-down'?

The internationally preferred approach for regional GDP compilation is to directly measure the activity of local units (represented by geographic units in New Zealand), and build up regional accounts from this information. The geographic unit compilation approach is preferred as it directly measures value added in the region. This approach is also useful analytically since it is possible to directly link the activities of businesses within a region to the growth of that region. The New Zealand regional GDP estimates have used this approach for most industries.

The method of building up regional estimates from geographic unit data is known as the 'bottom-up' approach. The alternative, where regional indicators are used to allocate the national level GDP measure to regions, is the 'top-down' approach. For some industries the source data currently available is not sufficient to use the 'bottom-up' approach and a 'top-down' approach is used instead. Examples are the education, and non-residential property operation industries. This is usually due to a lack of unit level data, and typically top-down allocations are based on data from LEED or the Census of Population and Dwellings.

In practice, Regional GDP statistics are derived by industry (mainly using data from the annual enterprise survey (AES), Linked Employer-Employee Data (LEED), the Crown Financial Information System, the Local Authority Census and the Agriculture Production Census. Statistics NZ's business register information allows the geographic unit information from LEED to be linked to enterprise-level information from sources such as AES. LEED therefore allows modelling of the regional geographic unit values for those enterprises that operate across multiple regions. For these units, LEED total gross earnings is used as a proxy for value-added - the underlying assumption being that all components of GDP are allocated in proportion to gross earnings. While this is generally considered to be a reasonable assumption, there are exceptions, especially for those businesses with large capital assets in one region but employees located in another. For these industries, a 'capital intensive' adjustment is applied. Agriculture value-added has been allocated to regions based on the regional production of agriculture products.

More information on these principles and methodology can be found in the *Regional GDP Concepts, Sources and Methods* paper. While this describes the methods used to produce the 2006 feasibility study, the basic principles and methods still apply. The paper is available at [http://www.stats.govt.nz/browse\\_for\\_stats/economic\\_indicators/NationalAccounts/regional-gdp-feasibility-study.aspx](http://www.stats.govt.nz/browse_for_stats/economic_indicators/NationalAccounts/regional-gdp-feasibility-study.aspx)

#### Backdating and linking Regional GDP

While the statistics available in the *Regional Gross Domestic Product: Year ended March 2007-10* release adopt a similar methodology to those found in the 2006 feasibility study, they are not directly comparable. Back then, regional GDP by industry for 2000 to 2003 was provided, consistent with the national-level GDP statistics at the time. Since then, the national-level GDP statistics have changed due to incorporating new and updated data, conceptual changes such as incorporating financial intermediation services indirectly measured (FISIM) and the upgrade of the industry classification used in economic statistics, from ANZSIC96 to ANZSIC06.

These changes mean that linking the estimates for 2007 to 2010 back to those provided for 2000 to 2003 is not straight forward. Statistics NZ is currently investigating options to provide a full time series of annual regional GDP for 2000 to 2010.

#### Further Information

The report *Regional Gross Domestic Product statistics for the years ending March 2007-10* can be accessed at [http://www.stats.govt.nz/browse\\_for\\_stats/economic\\_indicators/NationalAccounts/RegionalGDP\\_HOTPYeMar0710.aspx](http://www.stats.govt.nz/browse_for_stats/economic_indicators/NationalAccounts/RegionalGDP_HOTPYeMar0710.aspx)

To ask for more information, please contact

Chase O'Brien  
(03) 964 8983 | Email: [chase.o'brien@stats.govt.nz](mailto:chase.o'brien@stats.govt.nz)

## EDITOR - NEW ZEALAND ECONOMIC PAPERS

Professor Mark Holmes concludes his term as Editor of [New Zealand Economic Papers](#) in December 2014. There are three issues per year, although there are plans to increase to four issues per year. NZEP is currently a B-ranked journal in the Australian Business Deans Council (ABDC) journal rankings. NZEP has been published since 1966 and a commemorative issue is planned for 2016.

The journal is published by Taylor and Francis, under the Routledge imprint, with online submission facilities.

The Association wishes to appoint a new Editor for a period of three years (2015 to 2018), who will maintain the high standard set by former editors. To this end the Council of the Association has established a Search Committee chaired by Anita King to recommend a new editor. The other members of the Search Committee are Mark Holmes, Stephen Knowles, and John Creedy. The Search Committee will report to Bill Kaye-Blake, the NZAE President. The Search Committee is happy to receive nominations or expressions of interest which include a statement of interest and a current CV. These should be emailed to Anita King ([anita.king@treasury.govt.nz](mailto:anita.king@treasury.govt.nz)) before 30 September 2013.

#### Position

- The job is to edit and produce an academic journal of three issues per year which is readable and relevant to economists generally and Australasian readers in particular. (The number of issues is to be reviewed by the NZAE council).
- The Editor is expected to maintain the established tradition of economic scholarship but is free to develop his or her own editorial policy. Any written policy must be approved by the NZAE Council.
- The Editor is expected to have a demonstrable commitment to the New Zealand Association of Economists that includes attendance at Council meetings and the Annual Conference.
- *New Zealand Economic Papers* is expected to include original research, surveys, and policy analyses.
- The Editor will maintain a fair, efficient and rigorous refereeing process.
- The Editor will report to the NZAE Council twice a year concerning the Editorial duties and key journal statistics.

#### Appointment

- The Editor will be appointed for 3 volumes (2015 to 2018) and will start receiving manuscripts before the end of 2014.
- The terms of appointment will be confirmed in writing by the President of the Association.
- The agreement can be broken by either party upon giving six months notice in writing to the other party.

#### Stipend

- The Editor will be paid a stipend of NZ\$4,500 per year.

## Government Economics Network GEN Website - [www.gen.org.nz](http://www.gen.org.nz)

by Andrea Fromm (GEN Committee), ([info@gen.org.nz](mailto:info@gen.org.nz))

### GEN ANNUAL CONFERENCE 2013

The Government Economics Network (GEN) has been holding two successful conferences in the previous years. Former speakers include Raj Chetty, Trevor Huddleston and Martin Weale. The aim of our conference is to showcase examples of innovative quality economic analysis solving real world policy problems. With innovative and future-focused speakers and panel discussions we intend to inform the whole of government and support networking across government departments.

This year's conference will be held at Te Papa on Tuesday, 3 December 2013. The conference will be concentrating on modern economic methods for policy analysis. The preliminary line-up of speakers and presenters includes John Fitzgerald, a Research Professor at the Economic and Social Research Institute (ESRI)

in Dublin, Ireland. John is also the President of the Association d'Instituts Européens de Conjuncture Économique and a former president of the Irish Economic Association. He is currently a member of the Commission of the Central Bank of Ireland. He will enlighten conference participants on evidence based research in Ireland that was successfully used to inform public policymakers in times of a continuing global financial and economic crisis. David McKenzie, a Lead Economist in the Development Research Group, Finance and Private Sector Development Unit of the World Bank, will also join us this year. He will be talking about the value of experiments for policymaking. Expect more innovative and future-focused speakers as well as a challenging panel discussion chaired by Kim Hill from Radio NZ.

Keep an eye on our website for updates and more or subscribe to our mailing list for regular updates on events ([info@gen.org.nz](mailto:info@gen.org.nz)).



# NZAE CONFE

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# CONFERENCE 2013

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# RESEARCH IN PROGRESS...

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

## Current Research in Progress by the Department of Economics, University of Otago

### Sarah Baird

Sarah is a development economist whose work largely focuses on analysing health and education issues in developing countries through careful program design and evaluation. She is currently working on several projects including: (1) analysing the impact of a randomly assigned Voluntary Counselling and Testing intervention among young females in Malawi (with Berk Özler (University of Otago), Erick Gong (Middlebury College) and Craig McIntosh (University of California, San Diego)); (2) examining the long-term effects of cash transfers on young women's empowerment and wellbeing in Malawi (with Berk Özler, Ephraim Chirwa (University of Malawi), and Craig McIntosh); (3) designing experiments to measure spillover and threshold effects (with Berk Özler, Aislinn Bohren at the University of Pennsylvania, and Craig McIntosh); (4) examining the targeting and impacts of Tanzania's flagship community driven development program (with Berk Özler and Craig McIntosh); and (5) working on the public finance implications of child health investments focusing on deworming in Kenya (with Joan Hamory Hicks (University of California, Berkeley), Michael Kremer (Harvard University), and Edward Miguel (University of California, Berkeley)).

### Nathan Berg

Nathan has research interests primarily in behavioural economics. His current research interests include information sharing and less-is-more effects on organizational performance; measuring the effects of welfare reforms on rates of welfare use; normative behavioural economics; counterintuitive benefits of using logically inconsistent decision algorithms modelled as lexicographic choice rules; models and empirics of institutions used to enhance self-control; the effects of physical activity on healthcare expenditures; simple heuristics in financial decision making and bank regulation; experimental evidence on the economics of stress; determinants of carbohydrate consumption; food choice; location choice by business owners; effects of public housing on residential real estate markets; models of pricing for Islamic Banking services; and behavioural models of private and public regulation.

### Andrew Coleman

Andrew divides his time between the Department of Economics at Otago and the New Zealand Treasury. His current research interests are in two main areas. The first examines intergenerational transfers and government policy; in this area he is reviewing the arguments for and against an expansion of New Zealand Superannuation on a pay-as-you-go rather

than a save-as-you-go basis, investigating the changing age distribution of the beneficiaries of government expenditure and government transfers in New Zealand over the last half century, and developing a theoretical model investigating how the optimal size of government debt depends on the extent a government's preferences can be represented by utilitarian rather than sustainability welfare metrics. His second current area of interest is modelling storage, transport costs, and localized postharvest price depression; this involves modelling the simultaneous occurrence of transport capacity constraints, borrowing constraints, and the absence of competitive storage markets, with reference to Bangladesh rice markets.

Dan Farhat works in computational economics with primary focus on agent-based modelling. He uses this approach to model consumption patterns, how human and social capital influence income and growth, how researchers produce science, and the determinants of demographic and economic change in economies with 'vampires'. Work in progress applies this approach to fisheries management (with Viktoria Kahui, University of Otago) and earnings differences between men and women. His other research interests include Artificial Neural Network modelling of consumption dynamics, the culturomic analysis of sexually transmitted disease, the culturomic analysis of confidence in healthcare (with Tarja Viitanen, University of Otago), and DSGE modelling of open economy business cycle transmission.

### David Fielding

David has research interests mainly in the areas of development macroeconomics and quantitative political economy. Current interests include structural modelling of social and economic development (with Sebastian Torres, Ministry of Industry, Uruguay, and Mark McGillivray, Deakin University), aid allocation and governance, financial recovery after civil war in Côte d'Ivoire (with Anna Shortland, King's College, London), excess liquidity in African banking (with Svetlana Adrianova, University of Leicester, Badi Baltagi, University of Syracuse, and Panicos Demetriades, University of Leicester), the macroeconomic impact of fiscal shocks in New Zealand, distributional consequences of monetary policy (with Kalvinder Shields, University of Melbourne), and price dispersion and inflation (with Chris Hajzler, University of Otago).

### Murat Genç

Murat has a wide research agenda in applied microeconometrics. His current research involves a number of projects. First, he is involved in a project that estimates price elasticities of 24 food items in order to determine the health outcomes of taxes and subsidies on health/unhealthy foods in New Zealand (with Cliona



Ni Mhurchu and Helen Eyles at the University of Auckland, and Tony Blakely at the University of Otago). Second, he is analysing immigration-induced changes in product diversity and trade patterns in the EU-Mediterranean-Eastern Europe zone (with Selim Çağatay at Akdeniz University in Turkey). Third, he is analysing the effects of living conditions on bilateral trade between the EU and Mediterranean countries (with Selim Çağatay). Fourth, he is studying the effects of ethnic diversity on the number of establishments and employment in the EU (with Selim Çağatay, Onur Koska at the University of Tübingen, and Perihan Ozge Saygin at the University of Mannheim).

#### **Chris Hajzler**

Chris works in International Macroeconomics and Trade. A primary focus of his research is international capital movements under risk of repudiation, such as expropriation of foreign direct investment, with emphasis on developing countries. He is also interested in the determinants of international and intra-national market disintegration and price dispersion and the effects of inflation on relative price dispersion. Joint projects include the sectoral composition of global trade (with Cristina Echevarria, University of Saskatchewan), retail price differences across US and Canadian cities during the Interwar period (with James MacGee, University of Western Ontario), relative price variability versus relative inflation variability (with David Fielding (University of Otago) and James MacGee), relative price variability and consumer search (with David Fielding) and the effects of market access to human germ-line enhancement (with Gillian Crozier, Laurentian University).

#### **Paul Hansen**

Paul works mainly in areas related to decision analysis, priority-setting and resource allocation, especially in the health sector. His main focus is on development and application of 1000Minds software ([www.1000minds.com](http://www.1000minds.com)), co-invented with Franz Ombler, for multi-criteria decision-making, allocating resources and conjoint analysis (discrete choice experiments). At least 250 research projects have been completed or are currently underway worldwide using 1000Minds (see [www.1000minds.com/researchers](http://www.1000minds.com/researchers)). One current project (with Nicole Kergozou (RBNZ), Stephen Knowles and Paul Thorsnes (University of Otago)) examines which recipient-country characteristics are the most important to people considering giving aid money to an NGO to spend in a developing country.

#### **Alfred Haug**

Alfred works in the broad area of empirical macroeconomics. His current focus is on modelling the relationship between oil prices, economic activity, exchange rates and stock markets in the global economy (with Syed Basher, Central Bank of Qatar, and Perry Sadorsky, York University), and Polish monetary and fiscal policy in a SVAR for a small open economy (with T. J drzejowicz and A. Sznajderska of the Polish Central Bank).

#### **Mohammad Jaforullah**

Mohammad is currently undertaking research in two main areas: energy economics and tourism economics. In the energy economics area, he is working on two projects; one is examining

the relationship between energy consumption and economic growth in New Zealand and the implications of the emission trading scheme, and the other is examining vulnerability of the New Zealand economy to world oil market shocks. In the tourism economics area, he is investigating the empirical relevance of the tourism-led growth hypothesis for New Zealand.

#### **Viktoria Kahui**

Viktoria has research interests in natural resource economics and fishery economics in particular. She combines theoretical bioeconomic models with real world issues in marine resource utilization to explain the observed behaviour of fishing agents. With colleagues at the University of Tromsø, she is examining the interactions between fisheries, their habitats, and their management, including Icelandic redfish fisheries and orange roughy in New Zealand. She is also agent-based modelling of fishing quota value (with Dan Farhat, University of Otago), efficient forestry management in New Zealand under the Emissions Trading Scheme (with Dan Farhat and Todd Hale), and common-property resource management by pre-settlement Maori (with A.C. Richards).

#### **Alan King**

Alan works mainly in the area of international macroeconomics. His current projects include using linear and nonlinear unit root tests to test income convergence (with Carlyn Dobson, University of Hull), examining how well the Taylor rule describes monetary policy in New Zealand since the mid-1990s (with Michael Beenstock, Hebrew University of Jerusalem), examining the behaviour of inflation expectations under New Zealand's inflation-targeting regime, and modelling exports of tourism for New Zealand.

#### **Stephen Knowles**

Stephen has research interests in economic growth and development and in experimental economics. In particular, he is currently investigating (with Maroš Servátka, University of Canterbury) the role of transactions costs and inertia in giving to charity, using a Dictator Game. He is also examining framing effects in expressive voting experiments (with Alvin Etang, World Bank, and David Fielding, University of Otago) and analysing the importance of different recipient-country characteristics to individual aid donors (with Paul Hansen, University of Otago, Nicole Kergozou, RBNZ, and Paul Thorsnes, University of Otago).

#### **Steffen Lippert**

Steffen undertakes research focusing on industrial economics, the economics of innovation, and the economics of social interaction and networks. Current projects include examining (with Simona Fabrizi, Massey University) whether governments should select poor agents into public office because it is easier to use their consumption patterns as indicators of their dishonesty. He is also exploring learning and collusion in new markets with uncertain entry costs (with Francis Bloch, École Polytechnique, Paris, and Simona Fabrizi), the modelling of patent-signalling by informed venture capitalists to incumbent acquirers of developed innovations (with Simona Fabrizi, Pehr-Johan Norback and Lars Persson, Research Institute of Industrial Economics, IFN, Stockholm), and vertical relationships between a manufacturer

and competing retailers when consumers have reference-dependent preferences (with Simona Fabrizi, Clemens Puppe (Karlsruhe Institute of Technology), and Stephanie Rosenkranz (Utrecht University)). Steffen is a co-founder of the Applied and Theoretical Economics Research Network ATE.

#### **Dorian Owen**

Dorian has research interests mainly in the areas of empirical modelling of economic growth and development, sports economics, and applied econometrics. Current projects include examining the statistical dimensions of instrument selection in the literature on the fundamental determinants of long-run economic growth and development, and analysing different aspects of the two-way aggregate relationship between improvements in health status and economic growth. In sports economics, he is examining the distributional properties of commonly used measures of competitive balance (with Nick King), developing balance measures that take into account key characteristics of competition design in sports leagues and testing different aspects of the uncertainty of outcome hypothesis.

#### **Arlene Ozanne**

Arlene has research interests mainly in the areas of economic education, labour economics, and economic development. She is currently examining the short-run macroeconomic determinants and impact on the Philippine economy of remittances (with Maria Varua, University of Western Sydney), the economic impact of natural disasters on migrant communities (with Ma. Ruth Carlos, Ryukoku University), factors contributing to the differences between students' grade expectations and the actual grades they receive (with Trudy Sullivan, University of Otago), and the migration path and settlement trends of Filipino and Indian nurses in New Zealand and their effects on health care provision.

#### **Berk Özler**

Berk is a development economist with a broad range of interests in poverty, inequality, education, and health. He is currently a co-principal investigator for several randomized controlled field experiments in Malawi and Tanzania. He is currently working on several projects: a. examining the long-term effects of cash transfers on young women's empowerment and wellbeing in Malawi (with Sarah Baird, University of Otago, Ephraim Chirwa, University of Malawi, and Craig McIntosh, University of California, San Diego); b. looking for evidence on the existence of poverty traps (or lack thereof) in Tanzania using a randomized intervention that provided grants, training, and cash to vulnerable individuals (with Sarah Baird, Craig McIntosh, and Martin Ravallion, Georgetown University); c. comparing the relative effectiveness of preschool-based interventions on early childhood development" (with Lia Fernald and Patricia Kariger, University of California, Berkeley, and Michelle Neuman, World Bank); d. designing experiments to measure spillover and threshold effects (with Sarah Baird, Aislinn Bohren, University of Pennsylvania, and Craig McIntosh); e. examining the relationship between inequality of opportunity and economic growth using cross-country data (with Francisco Ferreira, Christoph Lakner, and Maria Ana Lugo, World Bank). He is one of the four researchers who founded the World Bank's Development Impact blog and contributes to it regularly.

#### **Trent Smith**

Trent has research interests that lie primarily in the area of behavioural economics. Drawing on evidence from a wide array of behavioural sciences, including psychology, anthropology, behavioural ecology, neuroendocrinology, and molecular biology, he applies theoretical and empirical methods from economics to phenomena such as addiction, obesity, economic insecurity, and television advertisements. Current projects include: (a) the implications of endogenous dietary preferences for obesity prevention policy (with Corinna Hawke and Jo Jewell (World Cancer Research Fund), Ross Hammond (Brookings Institution) and Jane Wardle (University College, London); (b) costly search/multiple equilibria and the 'deep capture' phenomenon as it relates to the obesity debate (with Attila Tasnadi, Corvinus University of Budapest), and (c) an empirical study of the impact of economic insecurity on obesity in the U.S. (joint with Steve Stillman (University of Otago) and Stuart Craig (Yale University)).

#### **Steve Stillman**

Steve is broadly interested in research on migration, health, nutrition, education, household decision-making and inequality. His current research focuses on the impacts of migration of Pacific Islanders to New Zealand on the health and income of the immigrants themselves and their families in the Pacific Islands (with John Gibson and David McKenzie, supported by the Marsden Fund), gender wage gaps and firm-size wage premiums in New Zealand (with Richard Fabling and John Gibson, supported by the Marsden Fund), outcomes for immigrants and the impact of immigration on New Zealand (with Dave Maré, Jacques Poot, Mathias Sinning, and Malathi Velamuri), the impact of economic shocks and homeownership on wellbeing (with Dave Maré, Arthur Grimes, John Gibson, Stefan Boes and Bonggeun Kim), and the impact of primary health care reform in New Zealand (with Jackie Cumming and Stefan Boes).

#### **Trudy Sullivan**

Trudy has research interests primarily in health economics and multi-criteria decision analysis (MCDA). She is using a MCDA approach to develop a framework that can be used by decision-makers to prioritise publicly funded health care and is also using MCDA to develop prioritisation frameworks for other publicly funded services. In addition, in work with Arlene Ozanne (University of Otago), she is examining factors contributing to the differences between students' grade expectations and the actual grades they receive.

#### **Paul Thorsnes**

Paul has research interests primarily in urban economics, with a focus on issues in housing. His current research projects include investigating NZ household preferences for the characteristics of housing renovations that improve energy efficiency (with Rebecca Ford, Rob Lawson, Gerry Carrington, and Janet Stephenson, University of Otago, and Barry Barton, University of Waikato); the effects of environmental remediation on house prices and neighbourhood gentrification (with Daniel McMillen, University of Illinois), and the long-run impacts on urban development of low-income housing in built in high-amenity areas (with Robert Alexander, University of the Sunshine Coast and David Kidson, NZ Treasury).

## Tarja Viitanen

Tarja undertakes research relating to labour economics, economics of the family and socio-economics. Current projects examine the effects of parental divorce on later labour market outcomes (with Libertad Gonzalez, Universitat Pompeu Fabra) and the causal impact of education and terrorism on interpersonal trust (with Arnaud Chevalier, Royal Holloway University of London). She is also investigating topics relating to terrorism, death penalty, internet, tax evasion as well as government programmes on childcare and in-home help.

## ABOUT NZAE

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

## WEB-SITE

The NZAE web-site address is:

<http://nzae.org.nz/>

(list your job vacancies for economists here).

## MEMBERSHIP FEES

Full Member: \$130 (\$120 if paid by 31 March)

Graduate Student: \$60 (first year only)

If you would like more information about the NZAE, or would like to apply for membership, please contact:

Bruce McKeivitt - Secretary-Manager,  
New Zealand Association of Economists  
PO Box 568, 97 Cuba Mall.

WELLINGTON 6011

Phone: 04 801 7139 | fax: 04 801 7106

Email: [economists@nzae.org.nz](mailto:economists@nzae.org.nz)

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Is your profile on the NZAE website? If so, does it need updating? You may want to check...

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