REVIEW OF THE NEW ZEALAND MACROECONOMY by PAUL DALZIEL and RALPH LATTIMORE

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To go through five editions of a book in New Zealand indicates the authors must be doing something right. What they seem to be doing right is producing a book that is short, clearly and concisely written and consequently very accessible to a considerable target audience – those doing an economics course in the last years of high school and the first years of university.

For those of the authors' generation (and here I include myself), the reforms of the 1984–1991 period were a watershed. This watershed is reflected in the motivation for writing the first edition of this book and is fundamental to its organisation even into the fifth edition. Chapter 2 is on "New Zealand's economic performance 1960–1984" and Chapter 9 is on "New Zealand's economic performance 1884–2003". In between come chapters on the economic reforms and their legacy, international trade, monetary policy, fiscal policy, industry policy and labour policy, and a final tack-on chapter deals with macroeconomic forecasting. This edition is subtitled "striving for sustainable growth with equity", indicating that the intended central concerns of the work have changed in response to the economic agenda pursued by the current Labour Government. In fact, much of the book seeks to evaluate the success of the 1984 reforms in the context of this "growth with equity" worldview.

The purpose of this review is not to simply congratulate the authors on a fifth edition well done, but to suggest some areas of potential improvement for a likely sixth edition. My belief is that there is room for improvement and my argument is set out below.

New Zealand's macroeconomic history in the book very much begins in the 1960s, with a decisive break in 1984, or thereabouts, which is the reform watershed mentioned above. Yet others who have taken a longer view, like historian James Belich, have questioned 1984 as a decisive break point. It would have been interesting for Dalziel and Lattimore to have tackled this sort of view head on and assessed its pros and cons.

My personal view is that a much longer-term perspective on New Zealand's macroeconomy should be presented for the intended audience, regardless of whether a pre/post-1984 periodisation is emphasised. This is essential for a complete understanding of today's macroeconomy in terms of the goals – growth with equity – on which Dalziel and Lattimore focus.

There is quite a lot of good data for a study to take a longer view. For example, there is data on national aggregates, created by Keith Rankin and others, going back to the Vogel years and before, consumer price information created by various Victoria University economic historians going back to the 1870s, terms-of-trade data, created by Brian Easton and others, again going back to the 19th century, as well as gross fixed capital formation data going back to the 1920s, created by Bryan Philpott and others. Equally, there is a long history going back to at least the 1890s of considerating New Zealand's aggregate income with that of other countries in the work of Mulhall and others. All of this data could be used to create a richer, longer perspective, placing "1984 and all that" in deeper macroeconomic context.

Now turning to the 1984 reforms themselves, it seems to me that a macroeconomic evaluation of the success of the reforms at its crudest involves a two-step process. The first is setting out appropriate measures of what would constitute success and failure. The second involves defining a counterfactual path whereby actual measures can be compared to counterfactual measures that would have occurred in the absence of reforms, individually or as a package. The book could have usefully discussed the practical difficulties that may arise in defining counterfactuals or problems that may arise when one takes a multi-dimensional approach to evaluation of macroeconomic policy. These problems include the issue of how to interpret a situation where one indicator improves relative to a counterfactual while another deteriorates, and how one deals with the fact that different people will chose different indicators as their success measure. It could also have usefully discussed choice of start points, break points and end points in time series to set up potentially misleading counterfactual pathways, a practice that is indulged in by numerous commentators on economic reforms to produce the result desired by their ideological priors.

Much of the evaluation of economic reform has centred on whether New Zealand's GDP per head – the amount of marketed goods and services produced within the national boundary – has been catching up to other OECD economies. Dalziel and Lattimore follow in this tradition. The focus on international comparisons of GDP per capita through time has always struck me as inappropriate. GNP per head – the amount of marketed goods and services available to national residents following servicing payments on net external debt – appears to be a self-evidently superior measure of national welfare. Given that different OECD economies are accumulating net external assets at different rates, differing wedges may well be opening up between per capita GDP and per capita GNP over time. Exploration of this issue is highly relevant and could be appropriately explored in the context of a volume like this one.

Equally, there is a growing literature on the macroeconomics of happiness, which suggests alternatives to market-income-per-head measures of welfare, using a weighted index of consumer price inflation and unemployment that differs from the standard “misery index” – the sum of the inflation and unemployment rate – in placing a larger weighting on the unemployment rate. Again, these alternatives may be worthy of exploration.

The potential of the subtitle “growth with equity” is not convincingly realised by Dalziel and Lattimore. Equity as a concept is not defined in any detail by the authors, and as a consequence readers do not acquire any insight into its slippery nature, the required value judgements for selecting any measure of equity, and the wide variety of alternative measures of distributional outcomes that have a bearing on equity. It seems obvious to me evident that no government of any political stripe would desire growth without equity. The real issue is that different parts of the political spectrum define what they consider equitable in very different ways.

In terms of the empirical consideration of equity, readers are simply given a graph of after-tax real-dollar incomes at various deciles of cross-sectional distributions of New Zealand household equivalised income from the Household Economic Survey over a short period from 1984 to 1998, so the most recent data are six years out of date. The data are said to show the “rich got richer and the poor got poorer”, the absolute imiseration trope much loved on the left of the political spectrum and in this case, atypically, apparently supported by the evidence. However, the decline in real income of the bottom decile appears quite marginal and possibly within bounds of sampling error, although these issues are not raised for discussion. The big change however has not been absolute imiseration but change in the relative income distribution. It would have been good to explore what the potential and actual drivers of this change in relative inequality were – with some proximate candidates being tax and benefit policy, changes in household structures, industry and labour market deregulation, trade liberalisation, and labour market returns.

Finally, a consideration of more dynamic approaches to income distribution and issues of distribution over the life cycle would have been of considerable value to consider whether the rich have genuinely got richer and the poor poorer. The standard approach considering real income deciles derived from a sequence of cross-sectional surveys can only give very limited answers to the “rich getting richer and poor poorer” sort of question.

The other measure used to track equity is the unemployment rate, broken down by three ethnic groups – European, Māori and Pacific. Again, there is little discussion of a series of important issues related to this measure, including what dimension of equity a cross-sectional OECD-comparable measure of unemployment illuminates, what exactly ethnic differences in unemployment rates tell us, what is the best way to measure group labour market gaps, why macro-level group measures as opposed to personal or household-based measures of equity are important indicators, and why ethnic differences were considered primary measures of equity rather than differences by other possible aggregate group dimensions, like age, educational qualifications, sex or family type.

The chapter on labour policy focuses almost exclusively on regulation of the labour market and changes in the legislation in which the labour market has operated. There is little discussion and provision of information on key changes in union density of the workforce and on strike activity, which may indicate some of the proximate outcomes that changes in labour market regulation may have influenced. The section could very usefully have considered immigration policy, which arguably has had a more important impact on the New Zealand labour market than labour market regulation in the last 15 years. Additionally, consideration of fertility issues in the context of the labour market would have been of value.

The labour market chapter finishes with a graph on the real wage rate, which is said to indicate that the benefits of economic growth have not been widely shared, with little or no change in real wages in the last 20 years. In order to throw light on this issue, it would have been better to measure a consumption wage, using the consumer price index as a deflator, rather than deflating by the output price. More importantly, the nominal wage data used post-1992 by Dalziel and Lattimore is based on the labour cost index, which aims to measure wage increases for jobs adjusted for productivity gains. Thus real wage changes occurring as a consequence of economic growth are factored *out* of this measure and therefore it is no surprise that the data fail to indicate any growth! A much better approach to measuring nominal wages would to have been to use the *Quarterly Employment Survey* data on nominal wages or the national accounts wage and salary component multiplied through by a measure of labour productivity and the ratio of the GDP deflator to the consumer price index.

There are a number of time series graphs of labour force outcomes in the book. They sometimes incorporate *Household Labour Force Survey* backdates, and at other times do not, resulting in series breaks in 1985 (e.g. Graph 7.1 and 8.2). It would be good in future editions to ensure consistency in this regard by using the backdated data in all cases.

As far as I could see, the book appeared a bit light on a model-based organising framework for consideration of the macroeconomy. There are two basic macroeconomic workhorses available for consideration, both entirely conventional, both extremely useful to the audience for whom the book is intended – the Solow growth model for the long term and the IS-LM-BP expectations-augmented Philips curve model for the short term. These models, applied more rigorously, could readily provide a coherent but invisible skeleton around which to organise discussion of the New Zealand macroeconomy. An alternative, less theory-based approach – which may be at least as helpful – would be to employ a skeletal model that was based on the national accounting flow aggregates and their relationships to asset-accumulation identities, for example, focusing on gross fixed capital formation as the inflow to the capital stock, the fiscal deficit as the inflow to government debt, and the current account deficit as the inflow to net external debt. Such a consistent stock-flow accounting approach has been used with some success by Wynne Godley and others at Cambridge University in the late 1970s and early 1980s.

There is some discussion of the current government's growth strategy as a distinct break from previous governments of various stripes post-1984. The discussion could be a little bit more critically focused. Fundamental to an interventionist growth strategy at a sector level is the belief that either government officials have access to better information sets than the private sector or there is a clear failure of collective action by the private sector, which can only be mitigated by action by extremely well-informed public officials and their processes. The evidence in this area to support these fundamental pillars is modest. It would be of value to set out the intellectual and then evidential terms of this debate. As a sometime participant observer in such processes, I personally have serious doubts about whether government officials possess sufficient information and the bureaucratic process can be so structured as to ensure that growth-enhancing investment decisions resulting in "picking winners" can be easily made and reinforced via the standard budgetary officials processes.

Finally, the macroeconomic data set from the NZIER from the *Quarterly Survey of Business Opinion* (QSBO) on the state of the macroeconomy captures a wealth of information from standard Statistics New Zealand data on GDP, producer and consumer prices and the labour market. These data are readily available and very rich, and I suggest that this is an important supplementary source of information the authors may wish to consider using in the future as appropriate for their intended audience.