Presentation for

New Zealand Productivity Commission Launch of Inquiry on Economic Resilience

Revised version of presentation om Thursday 24 November, 9.00 to 10.30am.

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Introduction

I have been commissioned to prepare a report for the New Zealand Productivity Commission's inquiry into economic resilience. The purpose of the report is threefold:

1. to describe how New Zealand has attempted to improve economic resilience over its economic history,
2. to outline how a sectoral and/or industry perspective might provide insights about the growth process, policy choices or path dependence, and
3. to outline key learnings from the past that can be applied in future policy.

The report is only part drafted. This presentation describes the work so far with particular emphasis on its learnings.

The presentation is structured as follows:

1. Preliminary thoughts
2. Economic resilience to earthquakes and other natural disasters.
3. The Great Depression and the Second World War
4. Business Cycles
5. The 1966 Wool Price Collapse
6. Oil Price Shocks
7. Financial shocks
8. Economic resilience to pandemics.
9. Conclusions

The topic order is roughly chronological, but similar events from different eras may be gathered together.

1. Preliminary Thoughts

Thus far I have found no satisfactory definition of economic resilience. Among those available are:

> Macroeconomic resilience has two components: instantaneous resilience, which is the ability to limit the magnitude of immediate production losses for a given amount of

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> asset losses, and dynamic resilience, which is the ability to reconstruct and recover. (*World Bank*[1])
>
> Economic resilience becomes inclusive of three primary attributes: the ability to recover quickly from a shock, the ability to withstand a shock, and the ability to avoid the shock all together. (*Economic Development Association*[2])
>
> Economic resilience is the ability of a local economy to retain function, employment and prosperity in the face of the perturbation caused by the shock of the loss of a particular type of local industry or employer. (*Simple English Wikipedia*)

Their essence is that economies experience (unexpected and external) shocks to which they adapt or otherwise, and that policy can improve the ability to adapt.

There are many such shocks. For instance, approximately 14-15,000 earthquakes occur in and around New Zealand each year. Most of those earthquakes are too small to be noticed, but between 150 and 200 (up to four a week) are large enough to be felt. With a few exceptions – the big ones – the economy responds reasonably well. We don't measure the number of other shocks but almost certainly they are as numerous, and generally the economy copes.

Rather than imposing a definition on the Productivity Commission, my research strategy has been to write a narrative about the significant shocks to the New Zealand economy over the last, roughly, century focusing on how the economy adapted and policy responded.

2. Economic Resilience to Earthquakes and Other Natural Disasters.
Since the beginnings of European settlement there have been four large substantial earthquakes with nationwide impacts

- the 1855 Wairarapa Earthquake (magnitude 8.2);
- 1931 Napier Earthquakes (7.4, 7.3);
- 2010-1 Canterbury Earthquakes (7.0, 6.1, 5.9, 6.0);
- 2016 Culverden/Kaikoura Earthquake (7.8).

There have been no other natural disasters (slips, tsunamis and volcanoes) of similar impacts, although the 233CE Taupo eruption had an enormous impact on much of the North Island which affected the New Zealand economy six centuries later.

Currently the report summarises the policy resilience measures for Earthquakes and Other Natural Disasters as follows:

- encouraging and regulating for more resilient structures;
- redundancy in the connectivity systems;
- insurance;

– research;
– public education.

It observes that policy responses can overreact.

3. The Great Depression and the Second World War

This section groups together three separate major shocks because they had intertwined policy responses:

– The Great Depression;
– The Second World War;
– The Postwar Dollar Crisis.

The learnings from the review were

– diversification of export destinations reduces the impact of a shock from an individual country.

– diversification of export products reduces the impact of a shock to an individual product.

– home supply displacing foreign supply – import substitution – is an alternative to external diversification (as well as a means of job creation).

- stock management can be important.

(Note: little attention was given in the period to diversification of import sources.)

The full report adds a number of cautions and caveats to these learnings.

4. Business Cycles

Most of New Zealand's business cycles are responses to external price shocks. Typically they are highly damped and one is aware of only one cycle per shock.

The learnings from the business cycle experience are that New Zealand has moved from responding rapidly to external macroeconomic shocks – 'minibudgets', 'fancy footwork' and 'fine tuning' – to a more cautious approach of 'steady does it' and 'touching the tiller'. This partly reflects a change of attitude but it also has a recognition that implementation lags reduce the effectiveness of countercyclical interventions. More commonly, more is left to the economy adjusting through less intervened markets at the microeconomic level and automatic countercyclical responses at the macroeconomic level.

5. The 1966 Wool Price Collapse

I am still working on this section and the next. The wool price collapse was dramatic and arguably the biggest single shock that the New Zealand economy experienced since the arrival of Europeans. Unlike the usual external price shock which was temporary – there may have been a long-term secular change in the relative price level – the wool price collapse was structural (largely permanent).

The (currently tentative) learnings are combined with those in the next section which deals with the oil price shocks.

6. Oil Price Shocks

This section is still being drafted. It deals with two issues: the price shocks themselves and some supply crises which occurred during the resulting turbulence. A key issue is why did New Zealand handle the oil price shocks reasonably well and the wool price collapse badly.

(After the presentation I was asked where Britain joining the European Community in 1973 fitted in. I explained that New Zealand had expected Brentrance and had been preparing for it over the preceiding decade; it was not a shock.)

7. Financial Shocks

To be addressed.

8. Economic Resilience to Pandemics

To be addressed.

9. Conclusions

This is work in progress. At this stage I don't see any overall conclusions which surprise me. The general ones might be:

– The economy is subject to ongoing unexpected and external shocks.

– Generally, the standard market responses deal well with small ones.

– Institutional design can matter. Quality design is not easy. There is a danger of overreacting.

– There is a need to maintain a capacity to think through the implications of new substantial shocks; that requires a research program which we have not always had.

Endnotes

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1. Hallegatte, Stephane. 2014. Economic Resilience : Definition and Measurement. Policy Research Working Paper;No. 6852. World Bank, Washington, DC. © World Bank.

2. https://www.eda.gov › ceds › content › economic-resilience