THE UNIVERSITY OF AUCKLAND
BUSINESS SCHOOL

Speech by Mr Hugh Fletcher – 16 November 2011

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"What a great time to study economics. Seldom have both the global economy and individual economies been such test tubes for competing economic beliefs.

In macro-economics, 2009 saw triumphal proclamations that "we are all Keynesians now". Yet today we are swamped by the mantra of public sector austerity.

In 2009, when the global financial crisis began, there seemed to be little dissent from the view that the early 20th century British economist John Maynard Keynes had been right.

Right about not only the risks of unregulated markets, but also the prescription for preventing recessions turning into depressions.

His prescription was for governments to step in and increase spending to sustain employment and incomes.

But now three years on, the appetite for this fiscal stimulus seems to have all but disappeared – now governments must cut spending to get out of deficit and into surplus.

Rather worryingly this is termed "expansionary fiscal contraction". To me, a Keynesian, it invokes the Tui's billboard response "yeah right".

This cutting government spending follows the prescription of the Austrian economist Hayek, during the great depression of the 1930's.

So we are back to the same debate between Lord Keynes and Hayek that went on 75 years ago.

Did Australia and China, whose fiscal stimuli were a greater share of GDP than that in other countries, and who have both almost uniquely avoided recession, prove Lord Keynes right?

Can there be anything more exciting than delving into matters of the greatest importance where there is such a contest of opposing thought.

And it is one of the joys of studying economics in a bachelor's degree that you are at the frontiers of economics, and can thereafter stay there all your life.

While the Keynes – Hayek contest is probably the most obvious, it is but just one of the multitude of fascinating economic debates going on at the present.

For example, what is the right form of regulatory control?

Was it differences in how Canada, Australia and New Zealand regulated their banking sector compared to banking regulation in the United States, the U.K., Iceland and Ireland, that spared the formers' banking systems from most of the travails of the global financial crisis?

And what have we learnt on how to avoid having major banks go broke?

And if a large bank is insolvent, if it goes bust, what is the right way to deal with it?

Is it for the taxpayer to pick up the losses, as Australia has recently re-endorsed? Privatise the profits and socialise the losses.

Or is it first for shareholders to lose everything and then for the rest of the losses to be borne by those who have lent money to or deposited money with the bank; which is the approach proposed by the Reserve Bank of New Zealand?

Esoteric you might say. No way.

Look at the billion dollars plus cost to New Zealand taxpayers of New Zealand's partial guarantee of its tiny finance company sector. That's a sum that could build four or five buildings like this.

Or look at Ireland whose bank bail-outs took it from one of the lowest publically indebted countries to amongst the highest.

And now in euro land, we see this same debate occurring at the level of countries and the debts that have been incurred by their governments.

Is Greece insolvent? And if Greece is, are Spain and Italy also insolvent?

And if so, who is going to take the loss on existing loans to these countries?

And if it is the German taxpayer, what are they going to demand in return? Is Germany on the way to European political domination, without the use of military force?

Which also brings with it the fascinating area of currency unions. Who now naively talks of New Zealand having the same currency as Australia, without recognising what this means for sovereignty?

And while dealing with money, what about quantitative easing?

The central bank of the United States of America, the Federal Reserve, led by Ben Bernanke, who made his academic career studying the great depression, immediately engineered near zero short-term interest rates and has said they will stay until 2013.

He has also printed money, flooding the banks with cash, with U.S. dollars - so called quantitative easing.

These low interest rates and the banks having lots of cash are meant to encourage individuals and businesses to borrow and spend.

Yet despite these extreme measures, the so-called paradox of thrift continues, where everyone, engaging in seemingly praiseworthy savings or thrift, merely plunge the economy into deeper recession by not spending.

What are the lessons from economic history?

On the one hand, there is Japan's no growth deflationary experience of the last twenty years, despite near zero interest rates.

But long before that there was Germany's pre-second world war Weimar Republic, which, when it printed money, rather than having Japan's deflation had rampant inflation. Which, of course, led to the Nazi's and World War Two.

Why these two very different outcomes, and will one of these happen to the U.S.?

And what about the interaction between monetary and exchange rate policy?

How do the relatively attractive economies with floating exchange rates, such as Switzerland, Australia and New Zealand prevent the decimation of their internationally tradeable sectors?

Again esoteric? – and again no way.

If you are a New Zealand exporter thinking about whether to expand or even stay in business, the single greatest determinant of your future profitability is likely to be the exchange rate of the New Zealand dollar for overseas currencies.

You have to have a view on its future direction.

And remember "the shortest distance between two mistakes is a straight line projection."

Which might lead you to ponder where the rubber hits the road – employment and equality.

Why in the last two decades have income and wealth inequality exploded?

In the U.S. average hourly earnings haven't increased in 50 years; while chief executives have multiplied seven times.

Today the top 1% of Americans have 5% of the country's debt but 70% of the financial assets and 60% of net worth.

And what are the solutions to youth unemployment – double digit percentage here in New Zealand and nearly four times that in Spain? Yes, approaching 50% of Spanish youth are unemployed.

Paraphrasing the Wall Street Journal, "ten years ago Apple's founder Steve Jobs, country and western singer Johnny Cash and comedian Bob Hope were alive and well. Now we're out of jobs, outta cash and outta hope."

You are here because you are bright and have a strong work ethic. You are lucky to have both.

The evidence is overwhelming. University graduates enjoy a better life – clearly have higher lifetime incomes, but also more successful personal relationships, better health, more happiness.

There is no question you should go to university. It's not only enjoyable, it's the best investment you can make.

But I encourage you also to couple your economics (which should be your major) with broader study.

Do a con-joint and go to a university that offers the widest choice of subjects. In being exposed to a wide variety of disciplines you'll probably not only end up unexpectedly studying one or more of them (in my case economics), but also making fascinating friendships that you would otherwise never have had.

Both will enrich your life.

Of course, I recommend the University of Auckland, my alma mater where I did a Bachelor of Science, Bachelor of Commerce conjoint, and which is New Zealand's highest rated university and most comprehensive in its disciplines.

There is very little which economics does not touch on. There are several revolutions, or at least sweeping global strategic themes, going on at present.

There is, of course, globalisation, which has thrown onto a global labour market in internationally traded goods and services, several billion potential workers at less than a tenth of the cost of labour in developed economies.

And this lower labour cost is now coupled with a comparable low cost of capital and high productivity.

How do countries, companies and individuals compete?

We know the last two centuries are the aberration, and that for all the rest of the last ten centuries, India and China were the two largest economies.

That they will be again seems inevitable.

Already China has over 150 cities with more than a million people – all Europe has only 35 – with still 300 to 400 million more Chinese poised to migrate from the country to cities.

And then there is the more populous India.

And why has most of Africa not followed Asia, and more latterly much of South America, on this upward path of prosperity?

All of these are very important issues to me as a businessman, as they will be for you whatever your future employment, for example as a politician, a civil servant, an executive or an entrepreneur.

And they will also be important in how you manage your own personal financial affairs.

In all of these you need to make economic decisions in a world of uncertainty.

You will be better equipped to do so the more you can follow and digest the contest of economic views that will go on around you.

So for example, besides globalisation as a major economic theme, there is also the technological revolution, most obviously in the impact of the digital world.

Electronic media has in a few years, even within New Zealand's small economy, spawned 'Trade Me', valued at over a billion dollars, while newspaper companies have lost a similar quantum of shareholder value.

And Apple, combining technology and design, rivals Exxon Mobil as the highest valued company in the world.

Where else will new technologies provide the opportunity for new business models and destroy old established ones?

Where will globalisation and technology combine with other sweeping global strategic themes, such as climate change and aging demographics?

One example of the latter is health economics.

When the technology is there to lengthen and improve the quality of my life dramatically but at great cost, how much should be spent and by whom – me or you the taxpayer? And at what time of my life?

And where are the new business models? Do you know that the University of Auckland has 35 robots administering care to elderly people in the Anglican Selwyn Retirement Village – and the overwhelming majority of residents prefer the robots to humans.

Could you do a Bachelor of Engineering - Bachelor of Commerce conjoint and then combine the two in a new business?

I can go on about the great relevance of economics to so many matters. But I will finish with the economics of water. Low cost, clean fresh water is arguably the world's scarcest resource.

New Zealand is fortunately blessed here, with 38 times the per capita rainfall of China and five times Australia.

Yet under our current economic model of allocation, we use only 5% of the 500 billion cubic metres that falls on New Zealand each year.

While most runs out to sea relatively unused, we drain and pollute many of our streams, rivers and aquifers.

We need people like you to couple good economics with good science. And then we need your entrepreneurship with new business models to deliver superior outcomes.

So I finish by repeating. Go to a good university, seek a breadth of disciplinary exposures, but major in economics and reap the most of living in exciting times.