Realising the True Value of Exports for Exporters:
A Critical Issue for New Zealand*

Kerry McDonald**

Under the current system exporters do not receive full value for their exports. In fact, the system simply shares the value with non-exporters who receive a windfall gain – a substantial subsidy, to the detriment of exporters. This means that exporters' incomes are significantly lower than they should be, non-exporters arbitrarily gain significant benefit from the subsidy, the market price signals for new investment in export activities are less positive than they should be and there is a range of other unintended consequences

Given the critical role of exports in the economy and the various arbitrary and unintended consequences this is a serious issue that must be remedied.

New Zealand is a very small economy, which is highly dependent on imports for the many goods and services (and capital) that it can't produce economically.

The only sustainable means of financing imports is by exports. Borrowing incurs interest costs, increases debt, has a limited capacity and has to be repaid; and the capacity to sell assets or spend foreign currency savings is also limited. Neither is an economic or sustainable source of import financing.

Consequently, export growth is critical for efficient, sustainable economic growth and higher living standards; and exports per capita is a critical indicator of the economy's performance – alongside productivity though you wouldn't know it from public commentary on the economy!

The core problem is that the foreign currency receipts of exporters are undervalued when converted to New Zealand dollars. And, this is fundamentally a structural problem, not a cyclical one.

Export (including tourism) transactions largely generate revenue in foreign currencies, which is effectively owned by the exporter (allowing for intermediary transactions). Generally, the foreign currency is converted to New Zealand dollars (NZD**). But, the foreign exchange market does not properly value export receipts when they are converted to NZD as the export revenue transactions are a very small part of the total transactions in the market, which are mainly of a financial nature and irrelevant in this context.**

In fact, an efficient FX market should convert the foreign currency export earnings to NZD at a rate which reflects the economic value of the export earnings to the New Zealand. This economic value should be primarily based on the value to the economy of the imports that they finance; and the cost to finance them by other than exports. This "opportunity" perspective is a fundamental principle in economics - and cost-benefit analysis.

*This paper was the basis for a speech to Livestrands, Winton, * December, 2016.
** Economist/Company director – refer www.kerrymcdonald.co.nz

The current system means that the benefits of the exports are shared by all New Zealand residents. It reflects the assumption that the full value of the exports is reflected in the financial returns to exporters, which is clearly not the case – their value loss could be between 10% and 40%, or more!

You get a good sense of this value if you think of the loss from taking away the last $1bn of imports from the New Zealand economy; or of trying to finance imports by other than exports. Imagine an auction of foreign currency from export earnings, to be bought in NZD to pay for imports, including intermediate goods, consumer durables, capital goods, consumables, etc.; when the other possible means of payment are borrowings, foreign currency savings or asset sales. Then imagine the auction taking place every day for the foreseeable future, to pay for our ongoing import requirements. That gives a good sense of what the true value of export earnings in foreign currency looks like.

So, what should be done?

First exporters should exercise more effective control over their foreign currency receipts and ensure that their conversion to NZD realises their full economic value.

Control will probably be best achieved by establishing an alternative to the current system, probably by innovation – block chain might be applicable, which should be achievable with minimum Government involvement. However, there are alternatives, including fiscally via income taxation.

Establishing more effective control over the export revenue stream would then allow more realistic NZD values to be determined for export revenues, ideally by some form of a market based process. Or there are more radical options.

Realistically, it will up to exporters to lead the change process. It is, after all their revenue and incomes that we are talking about. However, regional and exporter organisations should be strongly supportive. Most export production and tourism is in the regions, which often suffer from lower incomes, poorer access to service and amenities and higher costs and which will benefit from the change.

Other comments:

- The present arrangements favour importers over exporters, which is good politics but poor economics. A strong export sector is critical for New Zealand's future.
- The more favourable price signal for new investment in export production growth will be important, given the critical role of exports and the Government's failure to make progress with its export growth agenda.
- Importantly, the changed prices signals should lead to various other adjustments, including in financial markets. For example, changes in incomes will reflect in credit worthiness and borrowing capacity, putting activities which add real economic value in a stronger position.
- The changed price signals will also impact on value adding processing, the economics of which are too often poorly understood and executed.

- This change will be much more effective that the current token regional development policies.
- In contrast Auckland produces relatively few exports on a per capita basis and is the major beneficiary of the subsidy from the regions.
- Few immigrants produce above average exports per capita, which means they have a negative impact on the living standards of New Zealanders.
- Fiscal policy etc. in some other economies is likely to be more reflective of the real economics of different industries and activities, including the value of exports. There is no sign of New Zealand interest in that data.
- Exporters are often criticised for the impact/cost they impose on the environment, but do not pay for. However this should be considered partial compensation for the subsidy they give to non-exporters to pay for imports. A more realistic level of payment to exporters for their exports will allow them to meet these costs directly – and remove the hidden subsidies to others.

So exporters – saddle up! It’s time for some changes!