REPORT OF THE ECONOMIC COMMITTEE.

SECTION I.—THE BASIS OF PAST PROSPERITY IN NEW ZEALAND.

Influence of Export Prices.

1. The prosperity of New Zealand has been closely dependent on two main factors—the movement of export prices and the volume of overseas borrowing. When export prices rise, New Zealand tends to benefit, for several reasons. When it is remembered that pastoral and dairy products alone account for nearly half the total national income and 94 per cent. of the total value of exports, the significance of changes in the prices of primary products will be readily appreciated. It is a well-known fact that farm costs, and the expenses of placing farm products on the market, move much less readily than market prices. Hence, when export prices rise, there tends to be a proportionately greater rise in prices at the farm. Owing to the relative fixity of farm costs, the net income of the farmer tends to rise in even greater proportion. Thus, pending an internal adjustment to the higher prices, the farmer has a net gain over the rest of the community. The expansion of farm production is thereby stimulated, and the farmer's demand for other goods is increased. In this way the prosperity in farming industries stimulates prosperity in other industries. Furthermore, when export prices rise, New Zealand benefits because it is a debtor country. Overseas obligations are fixed in terms of overseas currencies. Hence, with higher prices expressed in such currencies, a smaller quantity of exports is required to meet external interest obligations. In other words, the amount of revenue required to pay interest on external loans remains unchanged, while the money income of the community is rising. There is also a tendency for import prices to lag behind export prices, because imports are, in the main, manufactured products, the prices of which fluctuate less than the prices of foodstuffs and raw materials. A rise in export prices then benefits the community as a whole, because a given volume of exports will exchange for an increasing volume of imports.

Influence of Overseas Borrowing.

2. Borrowing abroad is conducive to at least temporary prosperity, because the money thus obtained is used to buy materials and pay wages on public works, to finance land-settlement, or to increase production in other ways. Not only does it lead to a direct increase in spending-power, but also it results in additional production and a further increase in the national income, because the money spent in the first instance on public works or land-settlement is used by the wage-earners and others to buy other goods and services, the production of which is thereby encouraged. Hence borrowing abroad has exerted an important influence in stimulating economic activity within New Zealand.

Post-war Period.

3. The history of New Zealand abundantly demonstrates the importance of rising export prices and overseas borrowing as factors influencing economic prosperity. During the period from about 1895 to about 1921 export prices rose continuously while the practice of overseas borrowing was followed by successive Governments. So the country was carried forward on a wave of almost unbroken prosperity. The post-war boom marked the end of an era. The sharp fall in export prices in 1921 revealed extravagant over-capitalization in many industries, but particularly in farming. The years which followed were years of difficulty. Gradually capital values were being brought down to an economic level, and productive efficiency increased appreciably. This applied particularly to farming, in which the increased use of artificial fertilizers and improvements in farm-management led to a marked increase in productivity per head. Although export prices showed considerable fluctuations, they recovered to a high average level for the years 1923–1929, and it appeared as if the farm economy was becoming adjusted to the new situation. By 1929 the post-war over-capitalization in farming had been for the most part liquidated. Heavy overseas borrowing, involving a continuous over-capitalization of public works, helped to sustain the national income, but at the same time it added to the difficulties which faced the country when export prices again collapsed in 1930.

SECTION II.—CAUSES OF THE DEPRESSION IN NEW ZEALAND.

Economic Conditions, 1928–29.

4. When measured by present standards the years 1928 and 1929 are now beginning to be regarded as years of prosperity, though at that time business men were looking forward to a recovery from what they believed to be a trade depression. In certain important respects the situation in 1928–29 was markedly different from the situation at the present time. Reference to Table 1, paragraph 9, below, will show that in those years export prices were comparatively high, while import prices were lower than in any previous period since the war and were still falling. Hence a unit of exports represented purchasing-power over a high volume of imports. The banking position was sound and the ratio of deposits to advances was high. The stage appeared to be set for a continuance of prosperity, but a change of scene was already preparing. The movement of farm expenditure in relation to prices was far from favourable; compared with wholesale prices, nominal wages were rising and retail prices had remained high for several years, thus suggesting an unfavourable movement between industrial costs and selling-prices. Unemployment was increasing despite a fall in immigration and despite the record level of export values attained in 1928–29.

Capital Expenditure.

5. The level of business activity in those years was sustained only by the continuance of the policy of expanding public works with borrowed money. There was injected into the country from abroad during the few years preceding 1929 added