W. B. Sutch and his economics of national independence - a reappraisal.

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Abstract:

In these turbulent economic times, governments play an important role in the economy through the policies they implement. The Development Research Group at the World Bank recently wrote: "An important lesson from past experience is that the short-term responses to a crisis - macroeconomic stabilization, trade policies, financial sector policies and social protection - cannot ignore longer-term implications for both economic development and vulnerability to future crises."[2] One economist acutely aware of this 70 years ago was New Zealander William Sutch. His influence on economic policy during New Zealand's balance of payments crises of 1938 and 1958 cannot be understated. This paper examines those policies impacting on trade and his economic thought. In particular, his doctrine of 'manufacturing in depth' that formed the basis of his development theory aimed at reducing New Zealand's dependence on agricultural export earnings. Ultimately, his policies did not result in the type of development he had envisioned for New Zealand, but times have changed since his death over 30 years ago, and much of his economic thought has relevance in any current discussion about the future direction of New Zealand's economic development.

Introduction:

New Zealander William Ball Sutch was an economics-trained public servant who had a prominent career between 1933-1965. His first position was as an economic advisor to the Minister of Finance, the Rt. Hon. J. G. Coates, and his last was Permanent Head of the Department of Industries and Commerce. During those years New Zealand survived the aftermath of the Great Depression, World War 2, and recurring Balance of Payments crises. This paper specifically focuses on Sutch's economic thought pertaining to trade policy and economic development. For a broader critique of Sutch's economic thought see Endres (1986).[3]

Sutch completed a Masters thesis at Victoria University of Wellington titled "Commodity Control in New Zealand" (1927) before he was awarded a Fellowship in Economics and Banking to study at Columbia University, New York. He completed his PhD thesis "Price

[1] I am very grateful to Tony Endres of The University of Auckland for his support, comments and assistance with earlier drafts in preparation for this paper. Any errors are my responsibility.

[2] "Lessons from World Bank Research on Financial Crises", Policy Research Working Paper 4779, Development Research Group, The World Bank, November 2008.

[3] For more background material on Sutch's life, refer to Easton (2001).

Fixing in New Zealand" at Columbia in 1932.[4] Blyth has written about the economics curriculum in New Zealand at the time Sutch was a student.[5] One person to influence Sutch while he was studying at Victoria would have been Bernard Murphy, the first Macarthy Professor of Economics at Victoria.[6] "Murphy's contribution to economics in New Zealand was primarily in teaching and the application of economics to public policy." (Perrot et al. (1987))[7] Blyth commented on the British influence in the economics curriculum that was taught in New Zealand universities at the time: "If [the] examination papers were to be used as a guide to student (and lecturer) reading in the 1920s, Auckland students (and New Zealand students generally) would have been well in the mainstream of British economics."(Blyth 2006, p19). Sutch's decision to further his studies at Columbia reflected his interest in public policy, a possible influence of Murphy, and his desire to learn more from those at the forefront of the American Institutionalist movement.[8]

Sutch is remembered for the protectionist trade policies he helped implement and argued were necessary to avert future balance of payments crises, and later to assist with the development of manufacturing industries. He was also a strong advocate of economic planning and government's central role in the process. Since his retirement, there have been many influential and well-respected economists that have argued against protectionist import controls in favour of globalisation and trade liberalisation. None more emphatically than Krueger (1997) [9]:

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[4] A copy of his Masters thesis was not able to be found at Victoria University.
[5] Refer to Blyth (2006) and Blyth (2007). Blyth (2006) noted that until 1961 Victoria University was a "constituent college" of the University of New Zealand, and Blyth (2007) included mention of J. M. Keynes as the external examiner in 1919 for the University of New Zealand's BA Pass and Honours candidates in Political Economy.
[6] Blyth (2007) wrote that Murphy was professor at Victoria between 1920 and 1950, and was considered a 'conservative free trader'.
[7] Quote reproduced in Blyth (2007). Blyth went on to mention that "Murphy fostered and encouraged many good students…" (Blyth 2007, p153)
[8] Rutherford (2004) wrote that Columbia was "one of the leading American universities in the area of economics and the other social sciences. … Between 1913 and the early 1930s Columbia became the academic home of a particularly large concentration of economists of institutionalist leaning." (Rutherford, 2004 p32) Sutch would have been aware of Columbia's reputation before going there to study.
[9] See Krueger, Anne O., "Trade Policy and Economic Development: How We Learn." *The American Economic* Review, Vol. 87, No. 1 (March 1997) pp1-20. Incidentally, the subject matter and argument partly appear to be an updated version of the Public Lecture titled "Economic Liberalization Experiences – The Costs and Benefits." that Krueger gave as part of the *Treasury Public Information Programme* when

> "It was thought that import substitution in manufactures would be synonymous with industrialization, which in turn was seen as the key to development.
> The contrast with views today is striking. … Policy reform efforts removing protection and shifting to an outer-oriented trade strategy are under way in a number of countries. It is generally believed that import substitution at a minimum outlived its usefulness and that liberalization of trade and payments is crucial for both industrialization and economic development." Krueger 1997 p1.

The Development Research Group at The World Bank on the other hand, in light of the current global financial crisis affecting many countries, recently published a working paper summarizing what they have learnt from their study of past crises.[10] While they did not recommend governments returning to the days of protectionism, they lend some support to the *objectives* Sutch wanted to achieve through his policies.[11] Namely, the best prescription in a crisis is a set of policies that address the long term issues of economic development and resilience to future crises as well as manage the immediate crisis effectively.[12]

Sutch was not an academic economist and did not present a complete economic theory. He was involved in formulating economic policy, and his writings reflected the specific economic context of the times. Today, the economic context of Sutch's writings is undeniably out of date. This paper appraises Sutch's economic thought and argues that the underlying considerations he expressed remain relevant for present-day New Zealand and her future economic development.

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she visited New Zealand in 1985 under the title Vice President, Economics and Research, World Bank. The difference between the two is Krueger's emphasis on advocating liberalisation in her 1985 Public Lecture versus her focus refuting support for import substitution in her 1997 paper.

[10] See World Bank, The. (2008).

[11] The *objective* of policy aside, they disagree with Sutch's *choice* of policy for crisis management. "[I]mposing restrictions on imports is generally not an effective way of dealing with balance of payments problems – even for the country in question…. While import restrictions reduced imports, they frequently also reduced exports – particularly of manufactures – by raising costs and by starving the export sector of needed inputs." (World Bank, The. 2008)

[12] The paper does not go as far as recommend specific policies, but is practically a list of considerations depending on the nature of the crisis, since no two crises are the same.

Import Selection – A new approach:

As early as 1936 Sutch was in favour of import controls as a policy instrument "which could be chosen, not, as with most European countries, merely as a means of conserving foreign credits, but a definitely purposive method of developing the national economy." (Sutch 1936b p142) [13] However, no further mention of this argument for import controls is to be found in Sutch's writings until 1956.[14]

Until 1934, tariffs were the only form of protection seen in New Zealand. The Balance of Payments crisis in late 1938, while Sutch was secretary-economist to the Minister of Finance, led to a new government policy of import control and foreign exchange control in December 1938. The crisis was due to three main reasons. The fall in the world price of butter meant reduced export receipts; the Labour Government's policy of guaranteed prices to dairy farmers maintained farmers' incomes and consequently meant no decrease in their demand for imports; and the unexpected flight of capital, where approximately one third of New Zealand's overseas sterling funds was repatriated by foreign investors and speculators. The Government saw there were insufficient sterling funds to pay for the imports as well as service the overseas debt and its response was the import selection policy on 8th December 1938 to save foreign exchange as well as more generally to control the use of sterling funds.

Soon after the introduction of import controls, Sutch wrote in support of the policy in the December 21st 1938 issue of *Tomorrow* in two separate pieces of writing.[15] The focus was only on the short term objective of crisis management. It was not until May 1939, seemingly after the immediate crisis had been averted, that Sutch expressed a longer term

[13] Sutch does not make the distinction between the policy instrument per se and the appropriate use of a policy instrument in his support of import controls as a means of planning the economy. Justifying a policy in general is one thing, but implementing that policy to achieve the desired result is another.

[14] Internationally, the economic literature on development theories only started appearing after Rosenstein-Rodan's paper "Problems of Industrialization of Eastern and South-Eastern Europe" in 1943. Before that, Keynes' writings in the 1930s were the most significant recent additions to the literature. Sutch was occupied with many other things during those 20 years. In 1940 Sutch wrote first *The Quest for Security in New Zealand* then *Poverty and Progress in New Zealand,* both published in 1942 and 1941 respectively. In 1942 he joined the army but an injury cut short his service after one year. Between 1945 and 1950 he held several UN-related posts including Chairman of UNICEF. His economic thought on how import controls can assist in economic development was something he resumed in the 1950s after returning to NZ.

[15] Sutch (1938) is unsigned, while Sutch (1938b) is signed using the alias "W. H. Heard".

argument for the policy he had termed “Import Selection”.[16] In two almost identical articles Sutch argued that the import controls were necessary in the future and that import spending would have to be cut if the Government continued to pay for the policies of full employment and guaranteed prices to farmers.

There was no mention of economic development as an objective of the import controls in his writings around the 1938 crisis. Instead he reiterated the Government’s stance, that the objectives of the policy were “the payment of debt services and other commitments overseas, the purchase of raw materials for industry ‘to provide employment for all our people’ and the importation of essential commodities that cannot be economically produced in New Zealand.”[17]

Sutch also stated a second reason for the exchange controls. Not only were they introduced so that the Reserve Bank could control the use of foreign reserves, it also eliminated the risk of capital flight causing a sudden shortfall in sterling funds “due to partly to fear of the future, partly to political propaganda, partly to ignorance, partly to an anticipated better investment in Australia, and partly in anticipation of a further depreciation of the exchange rate.” (Sutch 1939 p803). Under the alias of W. H. Heard, Sutch uses more parochial rhetoric to defend the policy of exchange controls: “The use which is made of our sterling funds is obviously a matter of national concern, and we should not be ever placed in a position of having £10,000,000 taken from us at the whim of a few private people.” (Sutch 1938b p107) Thus the exchange controls had a precautionary function to prevent future crises.
Underlying Sutch’s choice of policy was the idea that the government plays a central role in planning for the economy. This approach had parallels with the American Institutionalist movement; a school of thought Sutch was familiar with having completed a Ph.D at Columbia University in 1932. But any influence Columbia had on Sutch appears to be limited. The publication of his Ph.D thesis by Columbia University Press and the mention of J. M. Clark in his preface would have suggested that the thesis was

[16] Both Sutch (1939) and Sutch (1939b) were signed “W. B. Sutch”.
[17] Sutch 1939 p804, quoted words taken from speech made by the Minister of Finance addressing importers in Wellington and included in Sutch (1939) and Sutch (1939b).

grounded in the institutional school, but such a foundation was not picked up by the reviewers in academic journals. [18] They did not mention the presence of an institutional defense for government control similar to the economics expounded by J. M. Clark. The bibliography does not suggest a strong institutional foundation either. It included only one reference to E. R. A. Seligman, no other reference to a Columbian economist, but several references to the classical school, including texts by A. Marshall, A. C. Pigou, W. H. Beveridge and F. W. Taussig.

What influence J. M. Clark had on Sutch was therefore very indirect because despite the reviews, there are similarities between J. M Clark's "Social Control of Business (1926)" and Sutch's thesis. For example, Clark defined the purpose of government regulation of industry to be "adequate service at fair prices" (Clark, 1926 p285) and that the public interest argument for a just outcome involved striking a balance between satisfying consumers' and producers' interests. Sutch begins his thesis with the statement "The study of the fixing of "fair" prices in the past has been of great help in attacking the problem of Price Control in New Zealand." (Sutch, 1932 p11)[19]. From the perspective of an observer, Sutch did not agree with the approach taken by the New Zealand Government in many instances, believing that the balance between addressing consumers' and producers' interests was not met.

Post war reflection:

During the two years from 1945 to 1946 Sutch went overseas, first to Sydney then to London, working for the United Nations Relief and Rehabilitation Administration. In 1947 he then represented New Zealand's delegation to the United Nations in New York. It must have been disappointing for Sutch, after six years overseas to return in 1951 to a New Zealand still vulnerable to Balance of Payments crises after the part he played in

[18] Refer to Yale Law Journal 1933 p470; the Newman (1933) review in *The Journal of Business of the University of Chicago;* and the review by Stine (1933) appearing in the *American Economic Review*.
[19] Clark's *Social Control of Business* (1926) is not citied in Sutch (1932) but Sutch would have been familiar with Clark's book, and its contents relating to price control.

trying to deal with the problem.[20] From 1958 through until his retirement in 1965 Sutch was Permanent Head of the Department of Industries and Commerce, the ideal role to re-launch his crusade to develop New Zealand's manufacturing industries and reduce her dependence on agricultural exports.

Continuing on from the 1938 experience, Sutch's objectives remained full employment and developing manufacturing industries.[21] He maintained the belief that government planning was necessary to raise and maintain New Zealanders' living standards and more generally achieve economic security and prosperity. There is however a noticeable change in approach from Sutch (1958) onwards.

Sutch (1958) began by examining the effect import controls have had on certain manufacturing industries during the period 1950-1957 when import controls were mostly removed.[22] The picture is not clear, and meaningful conclusions cannot be made, only to say that import controls did not expand production even if they protected industry. With little gained from that exercise, Sutch stated the problem he wanted to address:

> The question is how to sustain production in New Zealand, including farm production, manufacturing production and the necessary investment in capital in the face of these difficulties. (Sutch 1958b p20)[23]

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[20] "We all recall what happened in 1952-53. Overseas prices dropped; the terms of trade went heavily against New Zealand; exchange control was introduced to conserve New Zealand's rapidly diminishing overseas funds;…; and the total result of this year of re-adjustment was that the volume of manufacturing production was reduced despite the fact that there was a continuing increase in population." (Sutch 1958b p 7)

[21] Sutch (1962) pp4-11 includes a reference to Sir William Beveridge's 1944 report "Full Employment in a Free Society" in support of the link between full production (where everyone who can work has a job) and higher living standards. Sutch did not distinguish between the types of jobs; his concern was keeping the quantity of unemployment low. Lang (1973) challenged that view in his address to the Institute of International Affairs in 1973, stressing the importance of the quality of work: "The maintenance of full employment in New Zealand is a permanent goal of economic policy. However full employment in the sense of everyone who wants a job having one is not sufficient. It is of equal importance that people get satisfaction from the work they do." (Lang 1973 p20). Furthermore Deane (1975) referred to 'external economies' when he wrote of the need to focus on the workers' productivity when considering the possible benefits of foreign investment (See Deane 1975 p7): "…New Zealand will gain to the extent that new techniques, skills, and know-how are disseminated throughout the economy."

[22] Sutch (1958b) recorded: "At the beginning of 1950 there were some 950 tariff items for which import licenses [sic] were required… By the end of 1957 about 80 items manufactured in New Zealand were subject to tight import control in that either no imports were allowed or individual applications were considered to import particular goods of a kind not made in New Zealand. In addition there were 133 items under which imports were permitted in controlled quantities." (Sutch 1958b p15)

[23] "these difficulties" refers to New Zealand still experiencing periodic balance of payments crises; the dependence on imports for goods we need but do not produce; the need to repay loans.

In 1938 import and exchange controls were implemented to promote domestic production for domestic consumption while also saving foreign exchange. WW II notwithstanding, those policies did not work.[24] Additionally, the efficacy of restricting imports of finished consumer goods to save foreign exchange had been reduced because their percentage of total imports has decreased in relation to 1938.[25]

An alternative policy would have been to focus on increasing domestic savings but that idea only received passing mention in Sutch (1956) before suggesting government action as an equal alternative:

> Import control can preserve overseas funds, but without a corresponding restraint on demand will result in additional pressure on resources that are even more limited in supply. It is of course preferable that demand should be voluntarily checked – by saving – but if this cannot be done there must eventually be recourse to restraint; taxation is one of the appropriate methods in this case. (Sutch 1956, p19)

As a result, Sutch chose to address the need to earn foreign exchange. The ability to earn foreign exchange involves the export sector and developing the export sector requires capital investment. Sutch saw the 'chicken-and-egg' problem – preventing another balance of payments crisis by saving foreign exchange in the short term versus investing in capital to earn foreign exchange in the long term – and the government would again have a central role in terms of controls and planning. Sutch did not include a role for private savings to fund investment. [26] Or at the very least, Sutch did not see a role for government policy to encourage private investment.

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[24] An admission to this effect written by Sutch follows thus: "It is probably true to say that, until about 1949, manufacturing in New Zealand would have grown at its actual rate, in general, whether or not import control had been in operation over that time, since it was the war and its repercussions and the inability of overseas countries to supply goods that had the greatest effect on manufacturing development after the expanding purchasing power and capital development of the post-depression years had made their impression." (Sutch 1956 p10)

[25] Sutch (1958b) p 10 quotes figures for 1956: Imports comprised of producers' materials including fuels and lubricants (51.8%); consumer goods (19.3%); transport equipment (10.6%); and producers' equipment (18.3%).

[26] Private savings is absent in any discussion about investment financing by Sutch. For examples see Sutch (1960c p 25) and (1962 p 24). This is a point of difference between Sutch and his contemporaries for example Copland 1960 p 7, and Nurkse (1953).

Neither was Sutch in favour of foreign ownership.[27] His concerns included restrictions placed by the foreign owners with respect to, say, choice of export markets, new ideas or ventures able to be pursued, investment for future development because of short term profit goals, and the most obvious concern that profits will be repatriated back to the foreign owners' country.[28] Sutch acknowledged there are benefits from foreign investment, for example knowledge and experience, but that investment does not have to mean ownership.[29]

Deane (1975) and Brash (1964) were critical of Sutch making the distinction between foreign investment and foreign ownership. Firstly, there is no economic argument supporting the distinction. "the economic problem is not one of how to treat foreign capital specifically; it is rather one of how to ensure that all investment, regardless of origin, flows into those activities in which it will yield the highest return to the community." (Deane 1975 p12). Secondly, Sutch's position against foreign ownership is inconsistent with his policy of import controls. Import restrictions protect both locally owned industry and foreign owned industry. Sutch did not see the consequence that import controls encouraged foreign companies to set up manufacturing bases in New Zealand as a bad consequence. In his book *Takeover New Zealand* (Sutch 1972), he wrote: "The choice of developing an industry was left to those, mainly foreign manufacturers, who decided that New Zealand was a worthwhile market. Without import control, there would be fewer industries and even less New Zealand ownership." (Sutch 1972 p67). To be also against foreign ownership however, is a contradiction.

On the international front, the economics literature had been developing in different directions at a fast pace. Development theory had sprouted from International trade

[27] Sutch believed at the time that more foreign investment was forthcoming: "Here then is an avenue for increasing our formation of capital, that is more capital from abroad. And there is no doubt that we shall get it." (Sutch 1960b p 5) Foreign ownership however, is more than foreign capital funding investment, and Sutch was against key New Zealand industries being owned by foreign companies because it meant a loss of control from New Zealand's viewpoint. See Sutch (1963) p22, as well as of course the second half of Sutch (1972).
[28] See also Brash (1964 p84) "There is nothing *necessarily* disadvantageous about such control [by foreign companies] and it very often works to the benefit of New Zealand. It does, however, entail some disadvantages in practice." Brash then mentioned the same concerns as Sutch, concerns that have been subsequently shown to be unsubstantiated in Deane (1975 pp9-12).
[29] See Sutch (1963) pp 23-24.

theory and re-established the connection between trade policy and economic development.[30] Keynes gets a mention as being the most influential economist in the first half of the 20th Century. “Keynes irretrievably established the idea that tariffs and other import restrictions were reasonable options to be called upon in the arsenal of policies designed to maintain the full-employment level of economic activity.” (Irwin 1996 p201) That was his immediate influence, partly through his *General Theory* published in 1936, but also through his *Treatise on Money* published six years earlier.[31]

More importantly, Hicks in 1959 about the legacy of Keynes wrote: “Free trade is no longer accepted by economists, even as an ideal, in the way that it used to be…the preponderance of economic opinion is no longer so certainly as it was on the free trade side.”[32] This supports the view that Sutch was writing in an age where protectionist policies were to be expected, and commonly used as a tool to further national interests.

The ‘Manufacturing in Depth’ Doctrine:

The word “doctrine” is used here to mean a “system of political economy” defined in Schumpeter (1954) as “an exposition of a comprehensive set of economic policies that its author advocates on the strength of certain unifying (normative) principles such as the principles of economic liberalism, of socialism, and so on.” (p38) In the case of Sutch, those normative principles were of national independence, and the importance of the role of government. The scope of this paper does not extend to all of Sutch’s policies.[33] This section considers Sutch’s economic thought as a ‘doctrine of political economy’ narrowly

[30] Krugman (1994) determined that the heyday of development economics was between Rosenstein-Rodan’s “Problems of Industrialization of Eastern and South-Eastern Europe.” (1943) and Hirschman’s *The Strategy of Economic Development* (1958).
[31] Nevertheless, in his last major speech addressing the House of Lords on 18 December 1945, Keynes advocated free trade as the policy of choice stating free trade as his ‘first-best’ policy, and his ‘second-best’ policy was for *temporary* tariffs, yet as Eichengreen quotes: “[Keynes] described himself as ‘frightfully afraid of protection as long run policy’ in light of the danger that a temporary tariff might become permanent or be distorted by special interests. The question was therefore ‘how far am I prepared to risk long-period disadvantages in order to get some help to the immediate position.’” (Eichengreen 1984 p366)
[32] Hicks, J. R. “Free Trade and Modern Economics.” In *Essays in World Economics.* Oxford: Clarendon Press, 1959, pp41-42 quoted in Irwin 1996 p202.
[33] More broadly Sutch was concerned, amongst other things, with appropriate policies affecting education, health and the role of women in New Zealand society. Sutch discusses those issues in his writings, for example in Sutch (1964).

defined as being the policies that Sutch advocated for the development of manufacturing industries in New Zealand.

This doctrine was the culmination of Sutch's re-evaluation of the New Zealand experience up until 1958. Sutch realized that one reason why the import selection policy of 1938 failed was because it was not a complete prescription to the problem of averting future crises. The earlier attempt to make New Zealand more self sufficient and develop her domestic manufacturing industries by focusing attention on finished consumer goods only addressed the matter of saving foreign exchange. It ignored the opportunity for policy to also assist in the earning of foreign exchange. That included attention on the export sector.[34] Sutch's revised approach was to develop industries that would add value to cheaper less processed imports on a scale that satisfied domestic demand as well as niche export markets. There were three distinct stages to Sutch's 'manufacturing-in-depth' doctrine:

The first stage is at the industry level, where an industry develops and does away with the need to import costly capital goods (by increasing domestic capital) or processed materials. Instead it imports cheaper raw materials and adds value by processing them or manufacturing them into capital goods or finished consumer goods. An example Sutch gave was the tyre industry, where before New Zealand was spending foreign reserves on manufactured tyres, but with the development of a domestic tyre manufacturing industry, New Zealand only needs to import the cheaper raw rubber, and on rare occasions an odd-sized tyre.[35]

The second stage is the establishment of diversified industries that are vertically interrelated to already established industries. The packaging industry is an example Sutch used to illustrate the benefits and cost savings from this stage of manufacturing-in-depth. The main benefit to the economy arising from this stage is further conservation of overseas reserves.

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[34] But for Sutch, this 'export sector' did not mean agricultural exports. Its inclusion was limited to the exports of manufactured (value-added) goods.
[35] Refer to Sutch (1962c) p16

> For example, there are several brands of instant coffee on the New Zealand market. They are all made in New Zealand: some equipment, the coffee beans, tinplate and nail wire are imported, the New Zealander processes the coffee beans and makes the bottles, the printing ink, the nails, the tins, the container board and the wooden boxes.
>
> If overseas funds had been used to buy imported instant coffee, we would have been spending scarce funds on cases of cartons of bottles of processed coffee beans, and we would not have used our sand for making the bottle or our radiata pine for the cartons and cases, nor our skilled labour for all the quality processing that was necessary to bring all these things together. (Sutch 1962c pp11-12)

The third and most advanced stage of manufacturing-in-depth is when additional scale economies enable the industry to better utilize New Zealand's own natural resources and to export their manufactured products in addition to meeting domestic demand.[36] These industries then are able to earn foreign exchange, not only conserve it. Furthermore, Sutch saw manufacturing-in-depth as part of the government's role as economic planner.[37]

At the time Sutch introduced his doctrine, no identical theory existed in the international literature, but some comparisons are worth noting. Sutch first discussed the idea to develop manufacturing in depth in a paper he presented to the New Zealand Geographical Society on 10th September 1958 (Sutch 1958b p22). The first mention of the expression 'manufacture in depth' was in an address Sutch made on 17th February 1960.[38] In that same address, Sutch said "It is also preferable that new industries should stimulate growth of other industries – either supplying materials to them or drawing supplies from them." (Sutch 1960 p7) This quote alluded to the second stage of his manufacturing-in-depth doctrine, even if Sutch did not articulate it in that way.

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[36] Scale economies and spin off benefits from manufacturing in depth already existed when producing to meet domestic demand, but further scale economies could be realized if production was not only for domestic markets but also for overseas markets. Nevertheless, Sutch did not mention the possible benefits of further scale economies from this final stage of manufacturing in depth. He chose to focus instead on the argument of generating foreign exchange through the selling of highly processed and specialized exports, thereby reducing the reliance on agricultural exports to pay for imports. See in particular Sutch 1965 p37.

[37] An example of this was the way Sutch oversaw the establishment of the iron and steel industry, with the government taking a 46% shareholding in The New Zealand Steel Company (figure quoted in Easton 2001, p231).

[38] Sutch (1960) p 6. This was an address by Sutch as Secretary for Industries and Commerce to assembled businessmen called by the Hawkes Bay Branch of the Wellington Manufacturers' Association.

Albert Hirschman discussed the same idea in his unbalanced growth theory published in 1958, only two years before Sutch.[39] The theory advanced in Hirschman's book is based on economies of scale and the existence of externalities for the promotion of particular industries with strong backward and forward linkages. Those industries when established will result in the following additional benefits: 1) their demand for inputs will result in the creation of economies of scale for upstream industries (backward linkages); and 2) their economies of scale will result in lower prices for their outputs thereby making it economical for the establishment of downstream industries dependent on their products (forward linkages). Sutch (1964b) illustrated this idea using two other examples: the packaging industry and the chemical industry where economies of scale and positive externalities of the type described above potentially exist.

Ragnar Nurkse and Hla Myint were two other economists that wrote about possible ways to develop manufacturing industries around the same time.[40] Sutch's first mention of the idea predates both Nurkse and Myint, and a major point of difference was Sutch's adoption of a protectionist stance through import controls to assist in that objective.[41] Myint and Nurkse both did not advocate such a combination. However in this regard, Sutch shares a similarity to Raul Prebisch, best remembered for "The Prebisch Plan" of 1955-56 for the Argentinean economy.[42] Prebisch focused on the agricultural sector as the beneficiary of protectionism. That difference aside, Prebisch's short term objectives and long term recommendations were comparable to those of Sutch from 1958 onwards: the short term policies were for crisis management, while the long term policies were for economic development. [43]

[39] Refer to: Hirschman A. O., *The Strategy of Economic Development* (New Haven: Yale University Press 1958)

[40] The second of three lectures given by Nurkse and published posthumously in 1959 includes his material relevant for this discussion, while Myint (1964) p157 closely resembles Sutch's manufacturing in depth idea.

[41] Nurkse was critical of import substitution. Additionally, the examples of underdeveloped countries used by Myint to illustrate his theory did not include a case like New Zealand.

[42] See Sikkink (1988) and Meier and Seers (eds.) (1984) for useful overviews of Prebisch's development policy.

[43] Prebisch recommended a programme to modernize/technify the agricultural sector; establish key industries including steel, engineering, pulp and paper, chemicals and petrochemicals, address the need for more efficient infrastructure, and implementing a development programme to plan for long range capital investments.

Sutch saw the potential in a New Zealand iron and steel industry being able to achieve all three stages of manufacturing-in-depth:

> I have no doubt that within the next decade we shall provide a substantial part of our steel requirements from our own resources. This is important in itself, because it will enable us to make a very large saving in expenditure of overseas funds. It goes much further than that, however. We can look ahead to the growth of many associated metal working industries, to interesting and rewarding occupations for many of our young people, to increased demand for New Zealand coal and limestone, to the export of steel and steel-based products. (Sutch 1964b p18)

Sutch was closely involved in the setting-up of New Zealand Steel, a company that would operate an iron and steel works at Glenbrook and would be at the heart of the local iron and steel industry. An account of events from first beginnings through to the incorporation of New Zealand Steel in July 1965 is presented in Sutch (1965b).[44] There is no clearer quote outlining the objectives Sutch wanted to achieve from this policy than the extract below:

> The establishment of the iron and steel works will be, probably the most important single step taken in the industrialization of New Zealand.
>
> In the saving of foreign exchange alone, the industry will contribute substantially. … In designing the works, provision has been made for some slight excess capacity and if export markets can be developed, the company could make a further contribution to New Zealand's foreign exchange.
>
> In addition to helping the overseas funds position, the industry will remove some of New Zealand's economic vulnerability and provide a base and a stimulus for greater industrialization. (Sutch 1965b pp 33-34)

Sutch went on to claim "Within five years, exchange savings are calculated to be £5 million, and in twelve years this should have risen to £20 million a year. The consultants estimate that by 1983 the industry will be saving New Zealand about £30 million a year." (Sutch 1965b p34).[45]

Alas, the prosperity envisioned by Sutch through manufacturing-in-depth did not eventuate. After his retirement in 1965, the protectionist policies that Sutch had defended

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[44] Sutch's involvement included being a director of the preliminary New Zealand Steel Investigating Company, and a government representative associated with the provisional board of the New Zealand Steel Company before its incorporation in 1965. Through those roles, Sutch had a say in all the key decisions concerning the form that the iron and steel industry would take, at least initially. It was a joint venture between government and the private sector, with the government, and Sutch, monitoring every step.

[45] No reference for the calculated estimates was cited, nor did he identify the consultants that calculated the £30 million figure quoted above. Easton (2001) contextualizes the figures by stating New Zealand's total imports were valued at approximately £850 million in 1965, revealing the contribution from the steel industry to save foreign exchange to be a drop in the ocean.

throughout his career were replaced with trade liberalisation policies, starting with the New Zealand Australia Free Trade Agreement (NAFTA) in 1966 and the Economic Advisory Mission from The World Bank in 1968.[46] That said, at the time Sutch died in 1975 import controls still existed in New Zealand.

As for the NZ Steel case study, Easton reflects on the failed venture as the predicted savings of foreign exchange did not materialize:

> But if the physical body remains (temporarily anyway), the legal 'mind' – the ownership of NZS – went through a number of changes, eventually (well, in 2001 anyway) ending up fully owned by BHP, the Australian steel giant, and completely reversing the original vision of the nationbuilders to have a New Zealand-owned entity converting local resources into useful manufactures. (Easton 2001, p 237)

Sutch's Doctrine in the Light of Some Recent New Zealand Policy Problems:

The main idea of Sutch's economic thought, narrowly defined in this paper to be his doctrine of manufacturing-in-depth is still relevant for present-day New Zealand. This idea involves a skilled workforce able to utilize domestic resources to transform unprocessed inputs (imported or local) into value added goods thereby saving foreign exchange that would otherwise have been spent on imports. Industries that can achieve sufficient scale economies assist in the development of other upstream or downstream related industries and after satisfying domestic demand would be able to earn foreign exchange by exporting to niche markets.

Governments play an important role in economic planning and control. This includes appropriate use of economic policies to achieve full employment and economic development. Sutch's argument for the government to protect local industries has not been totally refuted either. Of all the arguments for protection, the 'infant industry' argument makes the strongest case for temporary protection. Irwin (1996) stated that J. S.

[46] Refer to Wooding (1987) for an overview of New Zealand's trade policy experience up until 1986. Those two events were mentioned, with the additional comment that NAFTA was hardly an opening up of the markets between Australia and New Zealand: "Perhaps the best thing that could be said for NAFTA was that it paved the way for the genuine free trade relationship which developed in the early 1980s." (Wooding 1987, p89)

Mill believed in the argument, while Bastable, Marshall and Taussig neither conclusively proved nor refuted the infant industry argument.[47] It was not until the second half of the twentieth century however, that economic arguments broke the connection between the infant industry argument and the argument for protection. Meade (1955) argued that private capital markets could perform the same function as governments if the incentive of future profitability existed.[48] One could agree with Meade and Irwin in his summing up of the shortcomings to the infant industry argument for protection:

> To the extent that government intervention is called for it is to improve upon existing conditions of appropriability of knowledge investments or improving the functioning of capital markets. Trade interventions are not directly appropriate because improvements may be desirable regardless of whether the industry in question is involved in international trade. (Irwin 1996 p137)

But in light of the current global financial crisis, there could be no better evidence supporting the American Institutionalists' belief that markets fail, including private capital markets, and the role of government in times like these is central to economic recovery.

Sutch's economic thought retains relevance to the debate on the future direction of New Zealand because of the existence of studies into the New Zealand economy since his death arriving at some of the same policy conclusions. One such example is the report "Upgrading New Zealand's Competitive Advantage" by Crocombe, Enright, and Porter in 1991. [49] Crocombe et al identified the same fundamental problem needing to be addressed as Sutch did in his lifetime:

> The fundamental structure of New Zealand's trade as an exporter of resource-based commodities in low-profitability and low-productivity industries and an importer of sophisticated products in high-profitability industries has meant that our exports have earned less over time and our imports cost more. (Crocombe et al. 1991, p55)

[47] This point should not detract from the views of Marshall, Bastable and Taussig who all supported free trade over protection. Their implicit acceptance of the principle underlying the infant industry argument is perhaps due to their classical bent, and respect for J. S. Mill.
[48] See Meade, James. *Trade and Welfare*, London: Oxford University Press, 1955.
[49] This report has been dubbed 'The Porter Report', but any extracts quoted from this publication follows the convention of referencing the authors as "Crocombe et al".

Addressing this problem entails, among other things, a look at what people wrote about the New Zealand economy in the past, and the ideas they introduced. Sutch was addressing the same problem, and his ideas and thought have more relevance than, say, someone addressing the growth in GDP problem because the starting point for analysis is different.[50] Philpott (1991) reviewed Crocombe et al (1991) in the *New Zealand Economic Papers*, and while he criticized it for its lack of scientific analysis, also included a reference to Sutch, first appearing in Gould (1991) regarding the similarity of the content of the report to Sutch's writings.[51]

One hardly needs "diamond analysis" to reach this conclusion which according to John Gould (1972) was even characteristic of our early 19th century economic history. Long ago it formed the basis of the drive to industrialization in the Sutch era and has ever since (see Gould (1991)). (Philpott 1991 p276)

Commenting on the difference in economic context between Sutch's day and the present day, certain specific examples in Sutch's writings, are now out of date, but can be replaced easily with modern equivalents. For example, Sutch mentioned the importance of sea travel. Today we can replace that with air travel. There were computers in Sutch's day, only they were not personal computers and the internet did not exist. These advances in technology only add to the domestic resource base if harnessed, and Sutch would want the government taking a leading role to provide high-speed internet access across New Zealand. Sutch also excluded the agricultural sector from his policy because at the time farmers were exporting unprocessed primary products. Today, agricultural sector exports include value added goods, consistent with manufacturing-in-depth. The development of the New Zealand wine industry is further evidence, if needed, that New Zealand's future involves industries producing value added goods for the domestic market as well as exporting to niche markets. Also the relatively recent focus on environmental concerns are not outside the scope of Sutch's thought when it could be argued that making a product with a process that respects the environment is another way of adding value.

[50] Trade policy was an integral part of the solution presented by both Crocombe et al and Sutch, as was taking an industry-level approach. One difference however was that Crocombe et al., were writing in the 1990's when economists were all in favour of trade liberalization, they being no exception. Sutch, as we know, favoured the protectionist route. Nevertheless these differences enrich the debate.
[51] Another difference however was the role of government.

Summary and Conclusion:

This paper has presented Sutch's contribution to New Zealand economic thought on trade policy and economic development. He was a strong advocate for the use of protectionist trade policy instruments, especially import controls, for the immediate purpose of managing balance of payments crises as well as for the longer term vision of developing manufacturing industries. Sutch did not focus on developing a complete economic theory that considered all sectors of the economy, nor did he focus on the international consequences of New Zealand adopting a protectionist stance over many decades.[52] He initially wanted his efforts in economic policy to result in a New Zealand that was largely self-sufficient, and less reliant on trade with Britain.

Throughout his career, Sutch saw the role of government to be central in economic planning and development. The importance Sutch saw for public policy and the application of economics in that area would have been influences from his time at Victoria, and more specifically Professor Murphy. The need Sutch saw for government to correct market failures and plan the economy were influences from his exposure to American Institutionalism while at Columbia.

Sutch's major contribution to the history of New Zealand's economic thought is his doctrine of Manufacturing in Depth. At the heart of this doctrine was the vision Sutch had to transform New Zealand into a prosperous nation, from being a colony of the British Empire reliant on the agricultural sector exporting unprocessed commodities to Britain. His doctrine was to develop the manufacturing industries sector so that the expected growth in the working population would be fully employed in diversified but inter-dependent industries able to manufacture more value-added goods using New Zealand's

[52] In his day, Sutch was not alone in favouring protectionism. Prebisch in the 1950s was hugely influential in Latin America's economic development through his work at the Economic Commission for Latin America (ECLA). "During its first five years, ECLA was elaborating the development doctrines reviewed by Prebisch… Latin American countries were advised to change their structure of production and of imports and exports. Industrialization via import substitution became the advocated strategy. Implementing this analysis, ECLA's policies emphasized the need for "programmed" industrialization via import substitution based on protectionist policies." (Meier and Seers (eds.) 1984, pp 11-12) The revival of the trade liberalisation argument for trade policy did not gain momentum until after Sutch's retirement.

natural resources and her skilled and educated workforce. The development of inter-dependent industries benefiting from economies of scale would drive an export sector of manufactures to niche markets after production had met domestic demand. Sutch had the prime position as the Permanent Head of the Department of Industries and Commerce to oversee the government's implementation of policies aimed at developing manufacturing industries.

Sutch used the NZ Steel mill at Glenbrook to illustrate how a key industry would have 'downstream' spin-off benefits for other industries. Sadly, for one reason or another, Sutch's vision was not realized, and the manufacturing industries sector continues its slow decline since his retirement and the revival of the efficiency argument for trade liberalisation.

Nevertheless, the considerations in Sutch's economic thought are very much relevant for New Zealand today especially as her trading partners have reinstated export subsidies earlier this year to assist their farmers through the global economic crisis.[53] These recent developments in trade policy abroad have a detrimental impact on New Zealand's balance of payments. They also highlight the continued vulnerability of her export earnings due to world commodity price slumps.

Finally, restricting consideration of Sutch's doctrine only to manufacturing industries would be denying the broader application of his ideas to the present world in which we live. Even when it comes to Sutch's focus on manufacturing industries, towards the end of his life, he realized the importance of the service sector to the economy, and made reference to it:

[53] In January 2009, the European Union reinstated export subsidies on dairy products including cheese, butter and skimmed milk powder, after it suspended the subsidies in June 2007. This has lead to doubt over the commitment made in December 2005 by the EU Trade Commissioner to eliminate such subsidies by 2013. In May 2009, USA retaliated by announcing export subsidies for its own farmers. "These allocations illustrate our continued support for the U.S. dairy industry, which has seen its international market shares erode, in part, due to the reintroduction of direct export subsidies by the European Union earlier this year." (U.S. Agriculture Secretary, 22 May 2009)

Tourism also is obviously with us and will increasingly supply foreign exchange and make its contribution to our necessary imports.

But when all this is said, and indeed done, it will be manufacturing which will have to take the main burden of New Zealand's economic future….

In speaking of manufacturing I do not mean to exclude those economic areas which are normally covered by the word "services". (Sutch 1969, p4)

Easton (2001) reached a similar conclusion at the end of his second chapter on Sutch. He wrote that Sutch would evolve his thought according to the times, but the main direction he would propose for New Zealand would remain the same based around his manufacturing-in-depth doctrine.[54]

To have an informed opinion on the best way forward for New Zealand, past lessons learned are not be forgotten, and on economic issues, the economic thought of Sutch is required reading.

[end]

[54] "[Sutch] gets misrepresented, by both left and right, who focus on his 1957 vision of import controls as the central issue for industrial policy, and do not allow that his approach pragmatically developed thereafter. If he were alive today, he would develop his ideas further, absorbing new theories and new circumstances. We misinterpret his intentions if we focus on his specific policies, which were of their times, to the detriment of his principles, which remain relevant into the future." (Easton 2001, pp176-7)

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