Major and Multiple Stores Conference

Getting New Zealand Out of the Survival Frame of Mind

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GETTING NEW ZEALAND OUT OF THE SURVIVAL FRAME OF MIND

I may be wrong, but something tells me things are looking up. The title of this session is one indication. The Institute of Management is organising a Business Forum on 'Growth Through Optimism'. Similar conference themes are becoming more common.

On the other side of the ledger, a group of academics from Auckland University recently warned the government "in the strongest possible terms" that, "in the present state of the economy and in the midst of an international recession," the deficit cutting strategy was fatally flawed and would depress the economy further. We can perhaps take some comfort from the fact that 364 prominent economists in the United Kingdom put their names to a celebrated letter with similar advice to Margaret Thatcher in 1982. This was almost exactly the moment when, thanks to persistence with tough fiscal policies, the United Kingdom economy began its longest post-war expansion.

Other economic commentators have also staked their reputations on predictions of doom and gloom, and no doubt we have not heard the last of them. As a respected Australian policy adviser once noted, many aspects of the supply side of the market in economic commentary resemble those in, say, cabbages. For example, entry is rather easy and there is a sizeable fringe of subsistence growers. We also suffer from periodic gluts and, as distinct from the market for cabbages, we do not have intermediaries such as yourselves to cull out inferior products before they reach the general public. Another difference is that not many cabbages are produced in the public sector, whereas academic commentators in our public universities do not have to face normal competitive tests of survival.

Fortunately the public does have access to assessments which carry authority and credibility. Earlier this year the OECD urged the government to pursue price stability, reduce the fiscal deficit by cutting its expenditure and carry on the programme of microeconomic reforms, particularly in the labour market. It concluded:

> "To build on the reforms of recent years and to underpin the much-needed improvements in the country's medium term growth prospects, it is essential for New Zealand to consolidate and extend the policy orientation pursued since the mid-1980s."

The Porter study emphasised that countries can only become competitive by competing, not by cocooning themselves from world prices. As Porter told an Australian audience, competitiveness does not come from "one or two silver bullets like the exchange rate or some marvellous tax change." By comparison with other countries, he was clearly struck by the extent to which the New Zealand social welfare system had removed incentives to upgrade skills and to work and save.

More recently the rating agency Moody's confirmed New Zealand's current credit rating, citing the government's economic reform programme, and in particular its labour and social welfare reforms, as the basis for its decision. Moody's wrote that:

> "The present moment provides a key political opportunity for the National Party, after its clear mandate in the elections of October 1990, to regroup the political consensus that had been lost in the later stages of the Labour administration."

The agency saw "a large share of support across various sectors for the current policy framework," but warned that:

> "...the main benefits will only become evident after two or three years of slow growth and rising unemployment, so the strategy remains vulnerable to a loss of political support."

In other words, we are still living on borrowed time.

Of course, according to one school of demonology, the OECD, Porter and Moody's are just the latest recruits to the Treasury, Reserve Bank, Business Roundtable, Federated Farmers, Employers Federation, IMF, University of Chicago, New Right monetarist conspiracy. It must be demoralising to some that the demons are steadily multiplying and that the non-demon population is becoming something of an endangered species.

It was always idle to believe that years of fortress New Zealand policies, fiscal deficits, double digit inflation, accumulating debt burdens, rising unemployment and deteriorating credit ratings could be put right in a short space of time. Even a bold and coherent programme that is unwaveringly adhered to will take years to pay off, as the Eastern European countries will discover. In New Zealand's case, of course, a teabreak was called on an incomplete programme. As our organisation and many others warned, the costs of that decision in terms of increased unemployment and hardship have been immense. The incoming government inherited a set of problems which require extraordinarily difficult political decisions to resolve. A further loss of nerve and patience would be catastrophic.

Speaking in Australia earlier this year, the editor of *The Economist* suggested that transforming an uncompetitive economy like Australia (or New Zealand) would take much more than a decade, and might well take two decades or three. He mentioned that after the eleven year era of Margaret Thatcher, one of his colleagues had said to him: "Wouldn't it be nice now if we had a bit of a breather." His response was: "We need three Thatchers in a row before we get the economy right." Regrettably, Mrs Thatcher's government also lost its grip on policy, which contributed to her downfall, and Britain does not appear destined to have even two Thatchers in a row.

In the OECD area as a whole, however, and despite some aberrations, the consensus on economic policies that developed during the 1980s is holding firm, with the result that the world economy now appears poised for a solid recovery. The dangers of unsustainable growth achieved merely through whipping up demand have been well absorbed. A number of countries loosened policy excessively after the October 1987 sharemarket fall, leading to overheating and an acceleration of inflation. But governments and central banks clamped down fairly rapidly, with the result that inflation is falling again and growth in the OECD area is expected to pick up to around 3 percent in 1992.

Overall, the OECD's latest *Economic Outlook* suggests economic fundamentals are as sound now as they were during the 8-year expansion in the 1980s. In particular, monetary regimes are more credible and there is a renewed emphasis on medium term fiscal policies. Unemployment remains a problem; the OECD's forecast is for an average rate of 7 percent in the coming 18 months unless significant labour market reforms are implemented. It calls for a shift away from labour market programmes which induce long run dependency on benefits and from wage bargaining structures which push up real wages and retard job growth. But overall, as a leader in last week's issue of *The Economist* puts it,

> "The next ten years hold out the promise of extraordinary, perhaps unprecedented, economic progress for the world."

The improving international economy will help New Zealand's recovery, even though no short term pick-up in our terms of trade is likely and the Australian economy seems set to suffer from a continuing period of policy hiatus. There is no shortage of potential demand for what we can produce, despite market restrictions. World trade expanded in volume by 80 percent during the 1980s, and imports into many countries in the Asia-Pacific region continue to grow rapidly. The basic task for New Zealand must be to improve its competitiveness and gain a larger share of that growing market demand.

There is good news on the competitiveness front. Relative unit labour costs are estimated to have fallen by around 4 percent since late 1988, and seem likely to fall by a similar amount in the year ahead. This trend has been driven by major productivity gains in areas such as manufacturing, ports and state-owned enterprises. Productivity gains should be strengthened with a recovery in activity. Following the June quarter CPI result, inflation is at a 25-year low and seems likely to stay that way. With the fall in interest rates and rise in the sharemarket, the nominal cost of capital to New Zealand firms has declined sharply. A further fall in real terms is likely if strong fiscal policy action is taken. Even those who have seen salvation in a lower dollar have had their share of the action. As the National Business Review pointed out on 5 July:

> "Against the US dollar the kiwi...is down 22% over the last three years. On the TWI the kiwi has eased 2.8% this year and 7.2% in the last 18 months. Would someone please tell Dairy Board chairman Dryden Spring."

In the last fortnight, the currency has fallen further. But we need to remember the economic fundamentals: currency depreciation counts for nothing if domestic costs, particularly wages, are not held. Last year, despite high and rising unemployment, real wages as a cost to employers still grew by around 2 percent. It is no use wringing our hands about unemployment and unprofitable export industries if past wage-setting practices re-emerge.

There are other signs of an economic turnaround. We have almost had an overdose of surveys indicating a pick-up in business confidence, not necessarily the most concrete or reliable of economic indicators. But manufactured exports are doing well, investment intentions seem to be on the rise, the number of people on welfare benefits has dropped sharply and the Telecom float has seen an international vote of confidence in New Zealand. These are signs of improving economic fundamentals.

There is now a good deal of market confidence that the government will deliver a budget that will strengthen this improving outlook. The backing which the prime minister has given to the need for tough and responsible decisions has been crucial in this regard. Attention will focus on the government's success in reversing the upward trend of spending relative to GDP, and to establishing a path which will yield a financial surplus by the mid-1990s. The quality of individual decisions will also be closely scrutinised. The efficiency gains available from structural reforms in areas like health, education, accident compensation and housing could easily surpass those achieved in state-owned enterprises in recent years.

The macroeconomic test of the budget will be whether it further eases pressure on monetary policy and inflation and consolidates the prospects of a recovery led by the traded goods sector of the economy. It is unlikely to do much in the short term to boost the domestic economy. The domestic economy is quite depressed, and there is still considerable restructuring to be done in both the public and private sectors. Tight policies will constrain growth in disposable incomes and hence consumption.

However, beyond the short term, I would put it to you that this is good news even for the retailing sector. The last thing we need is a recovery led by domestic consumption or investment in sectors such as residential housing. That would be simply unsustainable. A move to longer run growth must be based on a shift in resources to export and import-replacing industries, driven by further improvements in competitiveness and higher profits in them. If manufactured exports are increasing at double digit rates of growth in volume terms in a year or two's time, that would be one of the surest indications that policy is on track. By then, the benefits for the domestic economy would be starting to show up.

If the government delivers a further instalment of policy reform in the budget, it has every chance of achieving at least 5 of the 6 economic goals that it committed itself to prior to the election, namely:

- 0-2 percent inflation
- single digit business and mortgage interest rates
- a balanced budget
- a fall in the government share in the economy
- a growth rate reaching 3 percent by the end of its term.

The more problematical goal is a halving of the level of unemployment, but it is to be hoped that the government does not throw in the towel on this too easily. Employment grew by 3.8 percent or 47,000 in 1984/85 as the benefits of the wage freeze came through, and unemployment dropped by around 2 percentage points a year in the 1980s in several OECD countries as they emerged from a period of structural adjustment.

Moreover, the government can rightly argue that, in contrast to inflation for which it has sole responsibility, it cannot directly influence what happens to unemployment.

Much will depend on whether public and private sector employers and their employees adapt rapidly to determining pay on the basis of labour supply and demand factors or whether old habits of automatic increases and relativities persist. Pay should essentially be based on what is needed to get and keep staff. In a more productive and growing economy, the market will force up pay rates over time. However, the government also has a role to play. While it has greatly improved the framework for employment contracting, more needs to be done following the budget if it is to achieve its employment goal.

The key here is clearly not a raft of so-called job creation schemes, which do nothing of the sort. It would be futile to adopt a politically motivated strategy aimed at achieving the target in ways that were unsustainable. Instead there needs to be an all-out attack on all the impediments to training and employing labour. In the labour relations area these range from some of the extraordinary decisions of the Labour Court, which the Court of Appeal has recently moved to check, to the problem of a minimum wage pitched far above safety net levels. Some unions and people in secure jobs will claim that offering people work at initially low pay rates is exploitation; in reality callousness consists of leaving the unemployed to their fate. There is major work to be done in the area of non-wage costs such as accident compensation. The process of making the education and training systems more relevant and responsive to labour market needs will need sustained effort. The Vice-Chancellor of Victoria University is on public record lamenting the fact that too many students want to go to his institution. Any other business would be delighted with burgeoning demand. More resources would be applied to satisfying the customers. Yet almost alone among OECD countries, our universities have a complex about policies which involve tuition fees plus protection for students who would otherwise be excluded on financial grounds. By comparison New Zealand polytechnics are becoming much more entrepreneurial and market orientated.

More generally, there is an enormous agenda still to be tackled in areas of microeconomic reform. Many New Zealanders who have not lived and worked in successful countries overseas still do not appreciate the scale of the changes in policies and attitudes that are needed if we wish to aspire to their living standards.

For example, the head of a Japanese forestry company recently pointed out that our planning laws in Carterton are stricter even than those in Tokyo, and that construction of a mill here takes far longer than a similar project in Japan. Our largest mining company has recently stated that it takes on average about four years to get a mining licence in New Zealand, a process that is slower and more difficult than in even the most anti-development state in Australia. With few notable exceptions, local government remains an area of massive inefficiency. Electricity Supply Authorities have made only a fraction of the efficiency gains achieved by Electricorp, and they seem to be the latest group to be offering extraordinary salary packages - Warren Cooper please take note. Yet they were the first to criticise the Corporation's proposed price increase, and the resulting public clamour for government intervention and a return to politicised pricing was the stuff of a banana republic. Effective rates of protection to the motor vehicle industry are currently of the order of 150 - 200 percent; a rate of 100 percent means the industry receives a subsidy of a dollar for every dollar of value added. In your own sector we have restrictions barring supermarkets operating pharmacies and a marketing board monopoly on domestic apple and pear sales - restrictions which I venture to suggest are unheard of in other OECD countries. The list goes on and on.

We must keep sober about the economic outlook. The farming sector is having one of its worst years on record. There is a major shake-out ahead in the meat industry, and massive losses to farmers from the Meat Board's investments in recent years are going to have to be taken on the chin. Even if employment picks up, unemployment is likely to rise for a period as more people seek work. The next couple of years will be extremely difficult, but for the first time since 1987 they hold the prospect of moving forwards rather than sliding backwards. This was the conclusion of this month's review of New Zealand by the London *Financial Times*:

> "Thanks to the structural adjustment of the past seven years", it wrote, "the outlook for the economy looks more promising than for several decades, but more pain will have to be inflicted before the results of greater competitiveness start to flow through."

The period immediately ahead will certainly be difficult for retailing, although the industry's fortunes are not entirely outside your own control. You too have a job to do to innovate, cut costs and make the consumer's dollar go further, and to contribute to the competitiveness and attraction of industries such as tourism. There has been no shortage of such innovation on the part of many of the major operators, and no lack of response to the opportunities opened up by the deregulation of shop trading hours, another success story in the moves away from a controlled economy.

The retail sector has never been afraid of competition and change. It has not been one to seek government handouts. Its voice will need to be heard in the period ahead when sectors of the economy that have not faced competition and change will be arguing that they should not have to. Television and Radio New Zealand can be guaranteed to feature a procession of post-budget commentators telling the public why the government should have gone for softer options. Some of the Auckland University academics may well be among them. But if the government maintains its commitment to its economic goals over the next couple of years, I believe the good news will be that their bad news is wrong. In that event, in this era of accountability, I trust the university authorities will hold them accountable for their performance.