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**1999 MAJOR AND MULTI STORES CONFERENCE**

**THE RETAIL SECTOR AND THE ECONOMY**

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## **THE RETAIL SECTOR AND THE ECONOMY**

The 1999 budget delivered some 10 days ago confirmed that the economy is on an improving path. Over the next three years, annual growth is likely to run at around 3 percent, according to the government's projections. They are not out of line with the consensus among economic forecasters.

For the retail sector, the improved outlook is good news. Consumer spending was flat in the first half of 1998, picking up in the second half of the year. It was supported by the July 1998 tax cuts and the reductions in motor vehicle tariffs. Consumer confidence has risen and the current low levels of interest rates are expected to buoy consumption growth. Offsetting factors include net outward migration and relatively high levels of household debt. Overall, private consumption growth is projected to average around 2.5 percent per annum and residential investment growth around twice that rate over the next three years. Tourism growth is projected to rise to an annual rate of around 9 percent over the next two years.

I believe this improved outlook is due in part to more stable and somewhat improved policy directions over the past 12 months. Winston Peters had commendable ambitions for the economy, but regrettably he was a disaster as treasurer. He never achieved credibility in the eyes of the business community; it was impossible to convince overseas investors and business people that he understood how the economy worked. His \$5 billion of additional government spending by itself killed any hopes that the economy would pick up during the term of the coalition government.

The somewhat firmer fiscal stance adopted by the government over the past 12 months has clearly been beneficial. In total its spending plans have been reduced by some \$800 million. It is regrettable that the government's fiscal policy decisions have not been bolder and more consistent. Only 6 months ago (in the 1999 Budget Policy Statement) it was telling us that:

It would not be desirable for the government to fully counteract the automatic stabilisers by implementing further policies designed to correct the short-term fiscal imbalance. Doing so

would risk exacerbating the weaker economic situation.

However, I am not aware that the short-term fiscal balance was the focus of any proposals for expenditure reductions. What critics of the government's fiscal strategy were saying was that it should be implementing a vigorous medium-term programme of expenditure and tax reductions. The idea that principled expenditure reductions could exacerbate the economic situation is a throwback to defunct Keynesian notions that have been discredited on many occasions in many countries.

In the recent budget, the government has moved to a somewhat firmer stance. It is now saying it is putting a cap on new policy initiatives of \$600 million in 2000/01 and a further \$600 million in 2001/02, and that these initiatives could include tax reductions as well as new spending. But the question still arises as to why the government hasn't set out plans over the next couple of years to undo more of New Zealand First's enormously damaging \$5 billion package of generally low quality spending.

In a report, *Moving into the Fast Lane*, published prior to the last election, the New Zealand Business Roundtable, in association with the Auckland and Wellington chambers of commerce, outlined a programme for further improving New Zealand's economic performance. As well as making some progress on fiscal policy, the government has taken other important decisions over the past 12 months that are consistent with the advice in that report. They include:

- the decision to phase out all tariffs, albeit on a rather extended timetable;
- some privatisation initiatives, in particular the sale of its shareholdings in the Auckland and Wellington airport companies and the sale of Contact Energy;
- the reduction in the rate of New Zealand Superannuation to a more realistic level;
- the partial opening up of the ACC scheme to competition, and
- progress on reform of producer boards, roading, water and sewerage and the

Resource Management Act, although decision making on all these issues is painfully slow.

These developments have contributed to the quite rapid turnaround in the economy following the recession in the first half of last year. The robustness of the economy also owes much to the greatly improved economic framework put in place over the past 15 years. The fall in unemployment, for example, testifies to the benefits of the more flexible labour market, despite the efforts of the Employment Court to undo the benefits of the Employment Contracts Act.

But we need to retain a sense of perspective. As the events of the past year demonstrate, the economic outlook can change quite rapidly. In last year's budget the government was projecting economic growth of 2.7 percent in the year to March 1999; now it is estimating that the economy shrank by 0.3 percent in that period. There is always the potential for unpleasant economic surprises, as events such as sharemarket falls, wars in the Gulf and Kosovo, droughts, floods, electricity crises and the Asian economic turmoil should remind us. Equally, the short-term outlook could turn out to be better than forecast, helped by improving world growth and price improvements for some commodities.

In a medium-term context, moreover, two things should worry us about the economy's growth path. One is that the present recovery is being largely driven by growth in consumption and housing investment. The second is that New Zealand is still massively underperforming relative to its potential.

Clearly the easing of monetary policy over the past couple of years and the current low interest rates are boosting domestic demand. But despite the large fall in the exchange rate over the same period, export growth prospects are only modest. Unlike the 1991 recovery, this one is not being led by strong export and investment growth.

It follows that a clear risk to the recovery is the weak balance of payments situation. Over the next three years, the current account deficit is projected to stay around 6 percent of gross domestic product (GDP); in the four years from 1991 to

1994 inclusive it averaged around 2 percent. New Zealand's external debt, at around 100 percent of GDP, is already the highest in the OECD. In the event of further shocks to the economy, political uncertainty or a deterioration in policies, New Zealand is clearly vulnerable to a further credit rating downgrade and a loss of investor confidence.

Similarly, although the long-run performance of the economy has improved, it clearly remains well below its potential. In the recent budget, the government made the point that over the decade to 2002, the economy is expected to grow by an average of 3 percent a year, three times faster than in the previous decade. On this basis the economy in 2002 will be a third larger than it was in 1992. But this comparison is very sensitive to the precise time period chosen. For example, for the 10 years 1990-1999 inclusive, cumulative growth is likely to be a little over 23 percent compared with around 20 percent in 1980-89 and 25.5 percent in 1970-1979. Given other achievements such as the virtual elimination of inflation and large reductions in net public debt, there has been major progress in the past decade, but it is hardly a stellar performance.

The unpalatable truth is that New Zealand has lost ground again in recent years, relative to its achievements in the early and mid 1990s. The big gains in terms of growth in productivity and output, falling unemployment, substantial fiscal surpluses and low inflation followed the 1991 budget and the Employment Contracts Act 1991. Had we maintained that performance, unemployment could have been around 4 percent by now instead of over 7 percent. Equally, we could have achieved a triple A credit rating instead of suffering a credit rating downgrade. In 1995 New Zealand was in 8th position in rankings of international competitiveness; this year we are in 20th position, below the ranking of 18th position we held in 1991. Many governments have pressed on with efforts to improve their economies while we have slid backwards.

The competitiveness story is important because of New Zealand's large current account deficit and external liabilities, and because the New Zealand economy never performs well for very long unless the export sector is in good shape. The retail sector has as large a stake as the community in general in a strong export

performance; in the long run exports are required to pay for imports.

What might be done to strengthen New Zealand's external position? We can consider this question in three different ways.

First, during the present recovery the government needs to implement more consistent macroeconomic policies. Monetary policy must be kept firm to avoid excessive domestic demand spilling over into imports. Government spending must be curbed so that the Reserve Bank is not forced unnecessarily to raise interest rates to restrain cost increases in the non-traded goods sector of the economy.

Secondly, many steps should be taken to reduce domestic costs and promote innovation in our export industries. These include further privatisation at both central and local government levels, more commercial approaches to the provision of infrastructure such as water and roading, full deregulation of remaining monopolies such as the ACC and producer boards, reform of the Resource Management Act, and changes to the Employment Contracts Act to overturn the job-destroying rulings of the Employment Court.

Thirdly, the current account deficit is the difference between national savings and national investment. Measures that would be positive for national savings include larger operating surpluses, reductions in income taxes and more targeted approaches to welfare and superannuation arrangements.

The important point to make about all these measures is that they would be positive for economic performance generally as well as for the balance of payments position. Economists rightly point out that the balance of payments should not be an economic goal in its own right, particularly when it is determined primarily by private investment, lending and borrowing decisions and not by the government accumulating external liabilities. However, the present external position poses risks, and vigorous efforts should be made to improve it, especially since they would be conducive to a better growth performance as well.

Improvements in economic management relative to New Zealand's record in recent years are more important overall for the retail industry than specific measures affecting your own sector. However, four current issues are worth mentioning briefly because they would benefit retailers and the community at large.

The first is the bill proposing further deregulation of shop trading hours. Despite strong opposition at the time, the changes made in 1990 turned out to be hugely popular and brought New Zealand into the modern world. Who would now propose a return to the old regime? Most of the remaining restrictions are absurd, and they should go.

Secondly, parliament is considering further liberalisation of the Sale of Liquor Act 1989. Again the most recent changes have proved highly successful, and they should be taken further. Vested interests in the liquor retailing industry should be ignored. Opponents of liberalisation do not have the moral high ground: the same groups gave us 6 o'clock closing, which made New Zealand about the least civilised nation of drinkers on earth. I lived for four years in Belgium which has liberal drinking laws and no minimum legal drinking age at all, and Belgian attitudes towards alcohol are more mature and responsible than our own, in my view, despite our recent improvements. Beer, wine and spirits were available in supermarkets seven days a week in Belgium at least as long ago as 1970. With shop trading hours and liquor retailing, it is high time New Zealand shook off the last remnants of its repressive past.

Thirdly, I am aware that some major stores want to be able to operate pharmacies. This would be a convenient service for shoppers, and in all probability cut costs to consumers as well. Liberalisation of pharmacy ownership has been talked about for more than 10 years, but nothing has happened. New Zealand stands out as a country maintaining absurd restrictions on pharmacies, and also on optical dispensing, and it is disgraceful that governments have continued to bow to the self-serving lobbying of interests that would be threatened by deregulation.

Fourthly, the retail industry should be supporting deregulation of producer boards, especially the Dairy Board, in the interests of the economy in general but

also for the benefit of domestic consumers of milk. It is well known that dairy companies enjoy fat margins on sales of milk and other fresh products on the local market. A study published by the Business Roundtable last year concluded that New Zealand consumers may be paying about \$100 million extra a year for dairy products. True to form, the Consumers Institute has maintained a resounding silence on this issue, just as it has been on the wrong side of practically every other argument for greater competition over the past 15 years. The government should fully deregulate the dairy industry and spoil the industry's party, and the retail trade should be lending it its full support.

Finally, I was asked to say a word on the implications for the retail sector of a change of government following this year's election. What matters most for business, of course, is not so much whether the government changes but whether policies affecting the business sector change for better or for worse.

Labour and the Alliance, the most likely alternative coalition government, have not yet released all their election policies. On present indications, however, it is hard to identify Labour policies that would be positive for economic growth, and Alliance policies would be much worse. The most important point about Labour's policy to increase the top personal tax rate is that it wants to increase government spending over and above the already massive and damaging increases of recent years. Even so, the tax increase would not fund Labour's spending proposals. It would also, of course, worsen the distortions in the income tax system and accelerate the already disturbing outflow of skilled people and capital from New Zealand.

Other policy positions are equally worrying. Dick Hubbard told the Labour Party at its recent conference that changes to the Employment Contracts Act 1991 were acceptable provided they were not "anti-business". This is naive: the changes being promoted are explicitly pro-union and against the interests not just of business but of workers and the unemployed as well. Labour's current policy commitments also include an end to privatisation, a reversal of the ACC reforms, and increased expenditure on pensions and welfare programmes, all of which would be harmful for business and the economy.

Michael Cullen is reported to have fought "bitterly" against the tax rate increase, and it is to be hoped that some of Labour's policies may yet be reconsidered. Certainly its current economic ideas bear little resemblance to what the OECD recommended for New Zealand in its report earlier this month. The main weak features of the economic framework of the Labour government in the 1980s were a lack of fiscal discipline and an attachment to a regulated labour market. There is clearly a risk, as Yogi Berra would put it, that the country faces a case of déjà vu all over again.

For what should surely be at stake in the forthcoming election is not whether the country goes backwards a little or a lot, but how it can move forward and close the gap between its present performance and its potential. I last spoke to this conference in 1991, when the theme was "Getting New Zealand out of the survival frame of mind". There are some uncanny parallels between that time and now. In both cases the economy was beginning a recovery. I said in 1991 that:

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.

I made the point that 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 in this country if we wish to aspire to their living standards. I quoted the editor of *The Economist* as saying the process of changing attitudes may take two decades or three. I also said that the retail sector has a job to do to innovate, cut costs and make the consumer's dollar go further, and to contribute to the competitiveness and success of industries such as tourism.

I suggest that all those messages remain valid today. New Zealand did achieve a sound recovery from the early 1990s, achieving growth rates of 5 percent in 1993, 6 percent in 1994 and 4 percent in 1995. There is no reason why we could not do so again by correcting our policy mistakes of recent years and making up for lost time. That would be the best possible news for New Zealand households, and for the

retail industry.