Submission

by

Business|NZ

to the

Ministry of Economic Development

on the

Post-2005 Tariff Review

30 April 2002

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POST-2005 TARIFF REVIEW

SUBMISSION BY BUSINESS NEW ZEALAND

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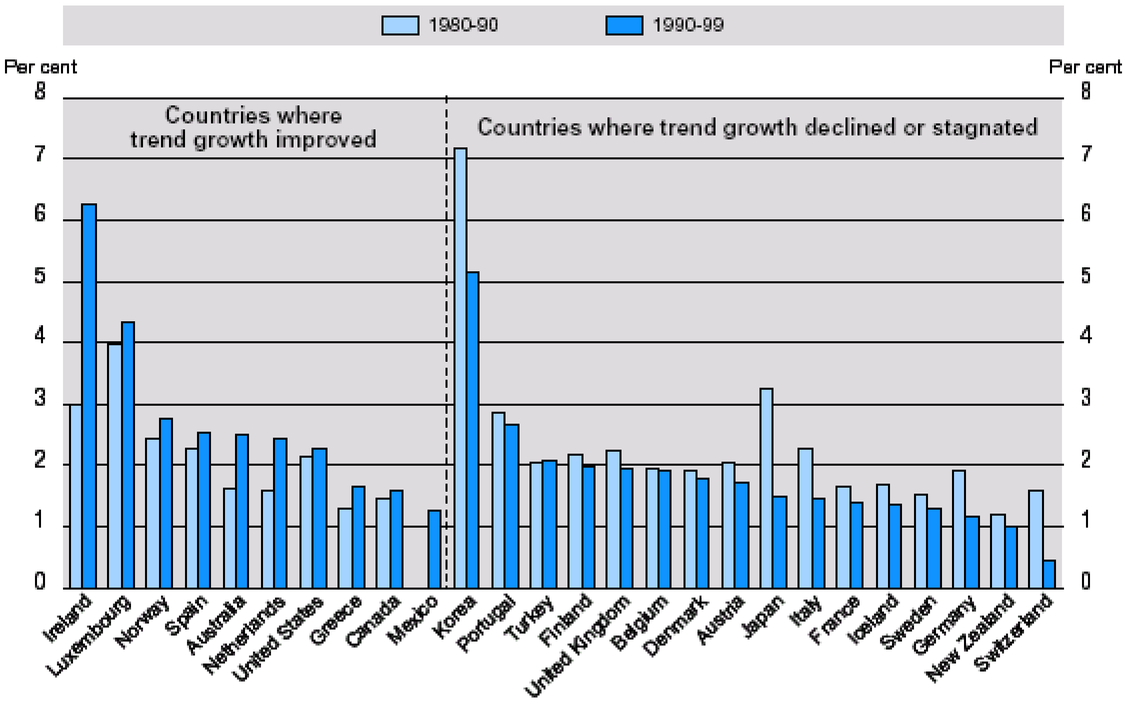
1. Introduction

1.1 This submission is made on behalf of Business New Zealand, incorporating regional employers' and manufacturers' organisations. The regional organisations consist of the Employers and Manufacturers Association (Northern), Employers and Manufacturers' Association (Central), Canterbury Manufacturers' Association, Canterbury Employers' Chambers of Commerce, and the Otago-Southland Employers' Association. Business New Zealand represents business and employer interests in all matters affecting those sectors.

1.2 One of Business New Zealand's key goals is to see the implementation of policies that would see New Zealand retain a first world national income and to regain a place in the top ten of the OECD in per capita GDP terms. This is a goal that is broadly shared by the Government. It is widely acknowledged that consistent, sustainable growth in real GDP per capita of well in excess of 4% per annum (and probably closer to 7-8%) would be required to achieve this goal in the medium term. Continued growth of around 1% (our long-run trend growth average) would only continue New Zealand's relative decline.

Uneven trend growth of GDP per capita
Total economy, percentage change at annual rate



Trend growth in the 1990s was higher than in the 1980's in Australia, Canada, Greece, Ireland, Luxembourg, Mexico, the Netherlands, Norway, Spain and the United States. But trend growth declined markedly in Italy, Switzerland, Japan and Korea. In some countries, including the United States, trend growth accelerated throughout the 1990s.
Source: OECD Statistics Brief, March 2002

1.3 Good trade policy is critical to the ability of the manufacturing sector to adjust to continued tariff reductions. The essential problem is that too rapid an exposure of the New Zealand industry may lead to internationally competitive industries failing simply as a consequence of differences of timing and liberalisation throughout the APEC region.

1.4 The tariff reduction programme post-2005 could have a significant impact on the viability of some sectors of Business New Zealand's membership, especially the textiles, clothing and footwear (TCF) sectors. This is an important issue for our broader economic performance since exports from the TCF sectors were $510 million in the year ended December 2001. This compares very favourably with frequently lauded "sunrise" sectors, for example wine exports ($282 million) or boat building ($140 million).

1.5 Other groups of manufacturers, that are in significant transition, also have concerns about the viability of their sector in a tariff free environment. These cover a diverse range of sectors such as food processing, building products, automotive components, plastics manufacturing and furniture. Each of these sectors has different needs and faces different pressures in reacting to a programme for further tariff reductions. These industries also have significant, and often unrecognised export contributions, with annual exports, for example, of $307 million for automotive components, $350 million direct exports of plastic products and $93 million exports of furniture.

1.6 Individual industry groups within Business New Zealand will therefore be making their own specific submissions. These submissions must be considered sector by sector, with each sector being taken on its individual merit. We support the Government's steps towards the development of sector specific industry strategies, particularly for the TCF sector, which can address particular international competition issues for those industries and the policies required to lift the performance of businesses in the sector.

1.7 The Business New Zealand overarching submission is that attention to a broader economic framework is required if further tariff reductions are to contribute to the goal of lifting New Zealand's economic performance. A trade policy that is conducive to increasing export activity in value added activities along with more effective macro- and micro-economic management could provide levels of economic growth that would greatly reduce the adverse impacts faced by the more tariff sensitive sectors as well as improving the economic and social well-being of all New Zealanders. This broad economic framework is lacking, explaining the continuing debate about whether the economic reform programme from the mid-1980's has improved New Zealand's growth performance.

2. Consistent Economic Framework for Growth Enhancing Policies Required

2.1 The commitment by governments to a more consistent economic framework for growth enhancing policies has been at best patchy. The evidence to date is that successive governments have been reluctant to pursue continuous improvements in economic management across a broad policy front and in some areas have introduced policies that are negative for economic growth. There is now a much greater commitment from the Government to achieving a higher rate of economic growth but in our view, its goals have not been underpinned by many of its policy decisions, many of which have negative implications for long-term economic growth prospects.

2.2 It is our view that there is a direct trade-off between tariffs and growth enhancing policies. The more competitive the business environment, the lower the costs of adjustment for the tariff sensitive sectors and the faster international commitments, such as those made in APEC and other bilateral agreements, can be achieved, and the benefits to consumers of tariff reductions delivered. People are also more likely to find alternative employment in a more competitive business environment. Recent OECD empirical work (The Cross-Market Effects of Product and Labour Market Policies; OECD Economic Outlook, December 2001) calculated that product market reforms in New Zealand and the United Kingdom were estimated to have added around 2½ percentage points to their employment rate in the non-agricultural business sector over the 1978-98 period. Countries where regulatory reform has made more modest progress have experienced correspondingly smaller employment gains, with Greece, Italy and Spain adding only around ½ to 1 percentage point to their employment rate via such reforms.

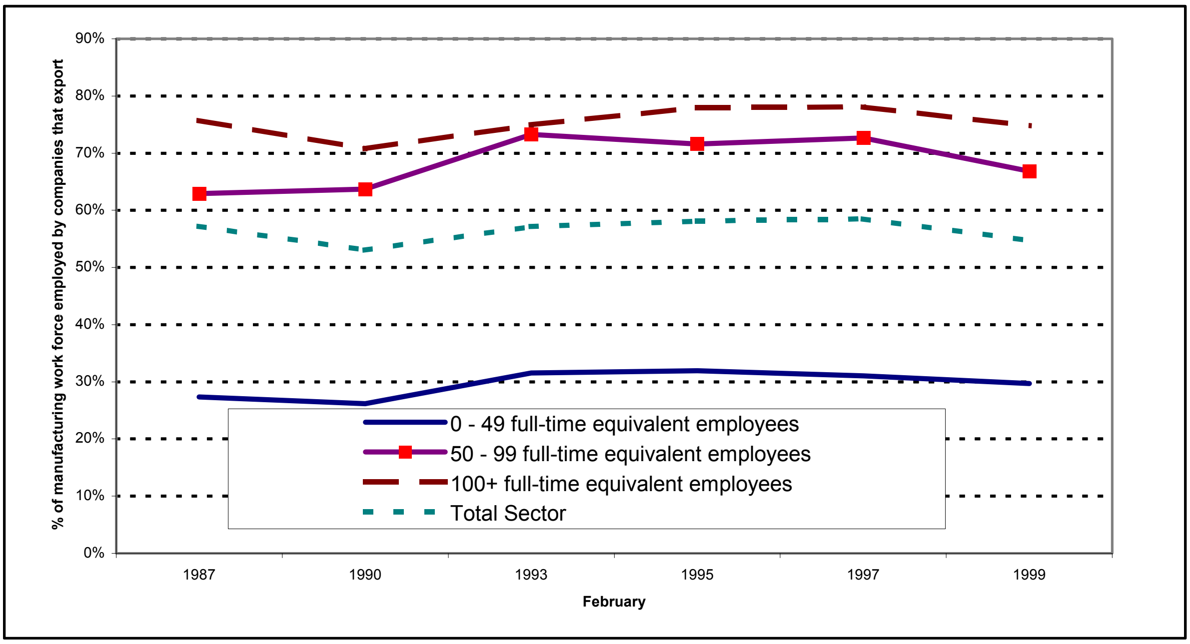
2.3 On the other hand, a less competitive business environment will mean a steady movement of skills and investment out of New Zealand, particularly given the free flow of investment and people across the Tasman. The adjustment to reducing tariffs will be more difficult and involve much greater dislocation of industry than is necessary. The social costs will be higher, particularly for people who have more limited employment prospects (tariffs predominantly benefit those who work in the affected industries). There has been a significant slowing in the rate of employment growth in the second half of the 1990's and a return to declining employment in the manufacturing sector since 1995. Between 1990 and 1995 manufacturing employment increased by 54,500 jobs while total employment increased by 230,200 jobs. Growth in government spending since 1995 and a slowing, and in some cases a reversal, of reform has seen manufacturing employment fall by 28,500 over the period from 1995 to 2000 and the total economy-wide employment rate of growth halve, with the number of people employed increasing by just 113,200 over the 1995 to 2000 period.

2.4 Problems with the management of monetary policy during the 1990's will have been one factor in the poorer than expected export growth for manufactured products between 1995 and 2001:

	% Change from 1989 - 1995	% Change from 1995 - 2001
Total Exports	39%	57%
Primary Commodities	25%	57%
Basic Manufacturing Sector (BMS) Exports	69%	58%
Manufactured Commodities	41%	58%
Elaborately Transformed Manufactures (ETM)	88%	58%

2.5 The rapid appreciation in the currency over the period from 1992 to 1995 has had a clear impact on the number of manufacturing enterprises involved in exporting. Both the number of companies involved in exporting and the total number of staff employed in exporting companies fell over the period from 1995 to 1999, slowing the rate of ETM growth over the 1995 to 2001 period. While the exchange rate has declined significantly since 1997, the major banks have been forecasting a significant appreciation in the currency since May 1997 (ManFed/Business NZ quarterly survey of the five main trading banks), discouraging additional investment in export activity.

Percentage of Manufacturing Workforce Employed by Companies that Export



SOURCE: Business NZ / Statistics NZ

2.6 In this period, there has been a failure to progress comprehensive reform of the protected industries in the services sector or to further significant reform of Government infrastructure. For example, the recent changes to roading funding are piecemeal and do not address the concerns of the commercial transport sector, instead focussing almost entirely on private motor vehicle and public transport concerns. Major Government policy decisions that have been negative for economic growth prospects can be grouped under three broad headings:

(a) Policies changes which have already been implemented, such as the top personal tax rate increase to 39% and the maintenance of a single export structure for dairy products; and

(b) Proposed policy changes, such as implementation of the Kyoto Protocol, local government policy changes, changes to the Holidays Act and proposed charges on import entries with a value of $500 or more; and

(c) Policy changes which would appear to have been ruled out because they are ‘outside present Government policy, such as a fundamental review of fringe benefits tax or of the Resource Management Act.

2.7 The ERA alone has had a significant impact on the manufacturing sector, with a high level of disputes under the new legislation and a marked increase in the time now taken to resolve disputes. Business competitiveness has been also affected by the failure to implement significant reforms proposed by Government review committees such as the Ministerial Panel on Business Compliance costs, the Winter Electricity Review and the Tax Review Panel. In addition there has been a failure to implement proposed changes to the RMA, uncosted proposals to change the Health and Safety in Employment Act and to implement the Kyoto Agreement and the core legislation providing for the operation of local government.

3. A More Open Trading Environment

3.1 There continues to be a need for a strong commitment to ensure that progress is made towards a more open and fair trading environment. Little progress has been made for the past 15 years on limiting the impact of Australian industry assistance programmes on New Zealand businesses and there are significant doubts about the commitment by APEC members to remove tariffs by 2010. While there was some early progress on general tariff reductions by APEC member economies, this progress has not continued. Efforts to accelerate tariff removal for some sectors failed and the recent global slowdown in economic activity have now raised pressures for increasing protection levels. Manufacturers are therefore more sceptical than ever over whether other APEC countries will meet the commitment to remove tariffs by 2010 and therefore have concerns about New Zealand continuing with that deadline. The recent US tariff decisions on steel, as an example, are a retrograde step in this respect.

3.2 While this is not necessarily an argument for not reducing tariff levels on New Zealand products, it becomes harder for manufacturers to remain competitive if they face tariff barriers in their export markets. As noted above, tariffs are only one component affecting the competitiveness of the sector but other recent Government policy decisions have, on balance, been negative for business competitiveness.

3.3 It is also relevant to note that New Zealand and Australian exporters have been losing market share in either country due to a lack of progress on options to enhance free trade between the two countries. It continues to become harder for exporters to meet the existing 50% ad valorem content rule, resulting in more products losing their tariff preference over imports from third countries. ASEAN countries have increased their share of Australian imports from 8.4% in 1992/93 to 14.8% in 2000/01 while the New Zealand share has declined from 4.7% to 3.9% over this period. Throughout the period Chinese exports to Australia have increased by 286% and to New Zealand by 336%.

3.4 While a free trade agreement has recently been signed with Singapore and one is under negotiation with Hong Kong, both countries already offer duty free access for goods imported from New Zealand There is a concern that not enough is being done to reduce tariff barriers faced by New Zealand's exporters. However, on the positive side, there is strong interest in the business sector in a free trade agreement with the United States and recent Government initiatives on this are welcome. It has also been encouraging to see greater Government interest in trade disputes affecting products outside the agriculture sector, such as the Government reaction to the US decision to impose safeguard duties on steel imports.

3.5 Given the relatively free flow of capital and labour across the Tasman, New Zealand industry is particularly vulnerable to being undermined by Australian industry. We must therefore ensure that the New Zealand business environment is competitive compared with Australia's. At present New Zealand has a major advantage in its lower real wages, but for the sake of the welfare of New Zealanders this is not an advantage we should seek to retain in the longer term.

3.6 This reinforces the points made earlier in this submission about the need for rapid and continuous improvement in government policies as they impact upon the business environment. The Australian Government has been able to pursue a more consistent programme of economic reform, well reflected in the much stronger productivity and incomes growth achieved by Australia in recent years (OECD Statistics Brief, March 2002).

3.7 To avoid a tariff reduction programme undermining New Zealand's industry argues for New Zealand taking account of the speed of liberalisation by our APEC partners and obtaining strong commitments from them in respect of their ongoing tariff and non-tariff barrier reductions. Our tariff reduction programme should proceed at a speed that does not unnecessarily dislocate New Zealand industry.

3.8 Finally, as tariffs get lower the national economic benefit of their future reduction diminishes. Already 95% of goods imports are able to enter New Zealand duty free and the total Government tariff revenue is estimated to be around $300 million (Business NZ estimate from Budget 2001). This is lower than the 'Customs Duty' data shown in the Government financial statements since excise duty on imported products (alcohol, tobacco and petroleum) is also included in the 'Customs Duty' category.

3.9 The New Zealand economy is thus already very open, with imports in 2000-2001 estimated to supply 43% of domestic demand for manufactured goods while exports are estimated to be 44% of the estimated domestic market for manufactured goods. The import and export shares have risen significantly since 1986 when the export ratio was 22% and the import ratio 35%. The import ratio has risen more slowly than might be expected from the significant reform to import licensing and tariff levels which has occurred. Major investment in the 1980's to reduce our dependence on processed oil imports has significantly reduced the rise in the import ratio from that which would have occurred if those investments had not be made.

3.10 In any event, while the marginal benefits of eliminating all tariffs are likely to be relatively small, it is quite possible that the net national benefits of a rapid tariff reduction programme could be negative if economic policies to improve business competitiveness of New Zealand's exporters are not implemented.

4. A Commitment to Improving Per Capita Incomes must be Paramount

4.1 Our submission is that the New Zealand Government has a spectrum of options ranging from:

(1) A strong and on-going demonstrable commitment to action on pro-growth policies, which may allow the additional benefit of being able to implement tariff reductions without major social costs; or

(2) Less commitment to on-going reform (and reforms which reduce business competitiveness), and therefore the need for more measured movement on tariffs.

4.2 The latter is the low growth, low welfare improvement option, since other more important policy reforms are required to achieve a sustained improvement in our wealth levels. We would therefore stress that pro-growth policies are required (and will continue to be required) regardless of whether tariff reductions are occurring. The Business New Zealand ‘Changing Gear’ growth strategy released at the end of last year (Appendix 1) represents only a starting point in the economic reform agenda required to accelerate growth in per capita income levels. Tariff reform can contribute to that growth agenda, but only if it is not dealt with in isolation. There must be consideration of the negative impacts of other Government policies on business competitiveness.

4.3 We are not confident such a broader focus can be achieved within the current terms of reference for the review. The review is limited to developing options and recommendations for tariff policy beyond 1 July 2005, taking into account the Government’s economic development strategies and the desire to promote the development of prosperous and internationally competitive industries. While we support these broader principles, these are unlikely to be achieved when economic policy is addressed on a single-issue basis and when many policy options are apparently ‘closed for discussion’ as they are ‘outside Government policy’.

5. Support for Industries and Labour Force in Transition

5.1 We welcome the focus in the terms of reference on the need to give consideration to the social, employment and regional impacts of tariff policy on different groups. There has been a lack of effective transition policies in previous reviews to assist businesses or their employees to adjust to the impacts of tariff reductions on their industry. Education spending, for example, is still highly geared towards funding for the education of the future workforce, with less than 5% of Government education spending going towards upskilling and retraining of the existing workforce. Since 80% of the existing workforce will still be working in ten years time, there is a clear need to focus more resources on upskilling the existing workforce.

5.2 There has been a similar bias in funding for the business sector towards start-up and micro-enterprise rather than on improving management skills in medium sized enterprises. While there have been improvements in the focus of funding over the last two years, the funding processes are highly bureaucratic and discourage involvement by many companies. Recent surveys on best practice show a strong interest from companies in improving their performance but they often lack the resources to identify the best sources of expertise or to begin to engage this effectively.

6. Summary

6.1 Further tariff reductions will contribute little to economic growth if there is not a broader commitment to growth enhancing policies.

6.2 A single focus on tariff reductions will have a greater dislocation impact on tariff sensitive sectors if there is not a commitment to broader pro-growth policies.

6.3 Greater urgency needs to be given to bilateral and multilateral trade agreements that will achieve reductions in tariff and non-tariff barriers faced by exporters.

6.4 The impact of tariffs on the economy is now small and the economy is now very open to imports.

6.5 It is important for there to be a clear linkage with industry strategies that recognise the need for ongoing support for industries in transition and improved funding for training for the existing workforce.

Appendix 1

BUSINESS NEW ZEALAND'S 20 KEY GROWTH STRATEGY PRIORITIES

All New Zealanders want higher incomes, better social services, and a clean environment. However, we simply will not achieve these important outcomes without a strong, vibrant, growing economy. We need a balanced set of policies that will promote our international competitiveness, foster innovation and encourage entrepreneurs to do great things for New Zealand. While by no means an exhaustive list, we believe that the implementation of the package of key priorities listed below would go a long way to delivering a better New Zealand for us all.

Policy Integration – Economic/Environmental/Social

1. Formulate a sustainable development strategy that (a) recognises economic growth as a precursor for social well-being and effective environmental management, and (b) fosters a climate of innovation and competitiveness.

Economic Fundamentals

Fiscal and Monetary Policy

2. Lower tax rates, with a priority of reducing the corporate tax rate in stages to 20% by 2010.

3. Reduce the proportion of government spending to GDP to less than 30% by 2005, to be achieved by ensuring that government spending grows at a rate slower than that for GDP.

4. Reduce the level of gross Crown debt to below 15% of GDP by 2010.

5. Pursue the adoption of a common currency with Australia.

Microeconomic Reform

6. Reduce business compliance costs, particularly for the SME sector, using both economy-wide and SME-targeted approaches to rationalising and improving the quality of business regulation, with particular emphasis on taxation issues and the Resource Management Act.

7. Improve the efficiency and effectiveness of local government, with a view of reducing local government spending to less than 3% of GDP by 2005.

Infrastructure

8. Increase investment in transport infrastructure, with an emphasis on eliminating those roading constraints that are impeding economic growth and development.

9. Improve New Zealand's broadband penetration rate to among the top 10 of OECD countries by 2005.

Trade and Exports

10. Pursue policies that would encourage export growth and increased trade, including the negotiation of a free trade agreement with the United States by 2005.

Innovation

11. Increase and improve linkages between research and commercialisation of ideas, and increase the amount of private sector funded research and development to the current OECD average of 1.5% of GDP by 2010.

12. Ensure that the regulatory framework is innovation-friendly and encourages the use of technology.

Human Capital

Education and Skills Development

13. Increase skill levels in the current workforce, by increasing the numbers of people involved in formal industry training from 80,000 to 160,000 per annum, and significantly increase the number of people with industry skill standards, by 2005.

14. Eliminate 'very poor' literacy and numeracy in the population (i.e., reduce the number of people with IALS Level 1 literacy to fewer than a statistical margin of 5%), by 2010.

15. Improve the outcomes of compulsory education, so that all completing compulsory education achieve basic literacy and numeracy standards, and attain at least NCEA Level 1, by 2005.

16. Improve the relevance of post-compulsory education, by more rigorous quality assurance, greater partnership with business, and a greater proportion of learning taking place within industry and on-the-job, by 2005.

Labour Market

17. Maintain the focus on the individual enterprise and ensure the flexibility necessary to promote employment growth, particularly in the SME sector, by recognising the need to respect freely bargained agreement terms and conditions whose integrity is respected by third parties.

Population Policy

18. Increase the number and proportion of highly skilled, talented, and motivated immigrants with good English language skills so that the ratio of working age to retired age population returns to 1990 levels by 2010.

Business Excellence

19. Develop a Best Practice Management and Governance Demonstration Project, delivered by business and industry associations with support from central government; and promote best practice and sector co-operation through key supply chain linkages.

20. Promote positive public attitudes towards wealth creation, business success and entrepreneurship.