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ViewPoint

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The end of the tradeable sector?

It should be straight-forward, easy even – *price stability keeps inflation between 1% and 3% in the medium term* – if inflation increases monetary policy responds by increasing the cost of borrowing and slows the economy. Just like a speed limit, traffic moves to quickly increase and enforce the speed limit so the traffic slows.

Unfortunately in monetary policy terms, the speed limit only applies to some of the vehicles on the road and they are slowed down, the rest sail by doing what they like. Monetary policy has a differential impact, it has the capability to beat the tradeable (exports and imports) sector to death with barely a scratch inflicted on the non-tradeable (all other goods and services) sector. What is worse, it is the non-tradeable sector that is driving inflation. Conclusion: Monetary policy can control inflation at the cost of decimating the tradeable sector on which we rely to pay our way in the world, and pretty well ruining the livelihoods of some of the most vulnerable the government claims to protect.

At this point in this business cycle the problem can be seen as tactical, wait a bit longer and as inflation is squeezed from the economy interest rates will fall, exchange rates will fall, imports will cost more and the tradeable sector will see its terms of trade improve. Fine, but we have a strategic problem. Every time we pass through this pain we loose a little more capability, we loose another hard won market, we loose firms and jobs that, had things been more stable, we would not have lost. The bounce of the ball gets lower each time it hits the ground and the demise of the tradeable sector is a real possibility.

Who cares, maybe we should all care. The tradeable sector captures intellectual property in things that are traded, they add value to materials, they transform material and human capability into things. Don't get hung up on the physical nature of ‘things’, things can include software and the like. Capturing intellectual property in things is the essence of a modern economy that adds value. The absence of an effective tradeable sector will leave us all the poorer.

Inflation is evil, so is a manifest monetary policy that periodically strips the tradeable sector. So how do we control inflation without the disproportionate impact on the tradeable sector? Current investigations of “supplementary instruments” by the RBNZ may help limit the money go round driven by global interest rate differentials but as the name suggests, don’t expect too much from supplementary monetary policy instruments.

Monetary policy has its limits. We must look to fiscal and broader government policy to deal with this issue. Government has sought to support economic growth with grant based approaches through New Zealand Trade and Enterprise and the Foundation for Research Science and Technology – these don’t work, they recycle tax payers money back to individual companies and in the middle have ineffective and expensive bureaucracies. It would be better if these industrial interventions were all terminated, and the cash used to support tax incentives to encourage firms that are ready to take the risks and understand their markets to invest in R&D, product, plant, process and above all people.

The New Zealand economy is not balanced, the absence of balance has its roots in the absence of balance in policy. We love housing because we expect it to leverage savings and provide a good tax-free return. We have a capital depreciation regime that favours property over productive equipment, there is no balanced consideration to support for the development of tradeable activity. Lots of advice and grants for a few (apparently getting fewer) are the order of the day – it is not good enough to build a first world future.

Growth in tradeables is the only real growth for the economy. High value tradeables depend on long-term investment in research and development, equipment and people. These activities need support through the tax system. Further, policy must accommodate and recognise that this activity is undertaken, in the main, by owner operated small to medium sized companies. Unless the risk faced by these firms is better supported by policy, our future is bleak.

End

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