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A goal is not a strategy:

Focusing efforts to improve New Zealand's prosperity

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EXECUTIVE SUMMARY

Economic prosperity is a worthwhile goal for New Zealand and Government has set a goal of matching Australia's GDP per capita by 2025. The dominant approach to economic development in New Zealand since the mid-1980s has been economic liberalisation. Economic liberalisation comprises a set of ten standard prescriptions that all countries are encouraged to implement to achieve economic prosperity.

An alternative, termed the 'diagnostic approach' has emerged more recently. It involves identifying the binding constraints to growth and establishing policies to overcome those constraints. As the diagnostic approach "is a framework for figuring out what to do (and maybe what not to do) in different kinds of cases and different kinds of countries" (Rodrik, 2005, p.1) it does not necessarily contradict economic liberalisation; they can be used together.

New Zealand had a relatively high GDP per capita prior to the early 1970s but the United Kingdom's entry to the European Union led to a relative decline until around 1990. Despite strong doses of economic liberalisation, New Zealand's GDP per capita remains lower than the Organisation for Economic Co-operation and Development (OECD) average and much lower than Australia's.

The main driver of GDP per capita is labour productivity and New Zealand's private economy labour productivity is 57% of Australia's. Labour productivity is not the only important measure of economic prosperity though. For a small trading nation exports are very important too. New Zealand's exports have grown much more slowly than the OECD average partly because global trade in commodities (where New Zealand exports are concentrated) has grown more slowly than trade in differentiated goods and services.

In recent years weakening trade performance has combined with imported private debt to erode the current account balance. Now New Zealand needs to improve labour productivity and grow exports enough to reduce the debt load and increase prosperity.

Lifting labour productivity depends on improving the drivers of labour productivity; entrepreneurship, innovation, skills and talent, investment, and natural resources. For some drivers New Zealand has made choices that differ from those made in other advanced economies and there is good reason to believe that those choices have eroded relative economic performance. New Zealand is fortunate that there is great potential for improving performance on the labour productivity drivers.

New Zealand's most important sectors for exports are tourism, agriculture, and manufacturing. All three sectors have average or lower than average productivity so simply growing these activities without also substantially lifting productivity would not lift GDP per capita materially.

Denmark is one of the world's wealthy countries. Denmark's food and agriculture exports per capita are similar to New Zealand's and Denmark's agricultural productivity performance is similarly low. But Denmark's differentiated goods and services exports are much higher and that difference explains Denmark's high prosperity.

There are many opportunities in agriculture, natural resources, and tourism, and these should be pursued where competitive advantage and high value jobs are available. But information, communications and technology (ICT), and niche manufacturing, along with value-added and differentiated goods and services based on primary production, are where New Zealand should invest most aggressively.

New Zealand's success at exporting differentiated goods and services has been limited by the obstacles of small domestic market size and distance from markets. Applying the diagnostic approach reveals internationalisation of businesses as a critical binding economic constraint. But over-reliance on economic liberalisation has led to New Zealand committing less effort than other small trading countries to overcome the internationalisation challenge. If the issue had been recognised sooner, and remedial action had followed, the country would be in a much stronger economic position now.

Examples of successful internationalising firms from New Zealand demonstrate that success is possible. Increased efforts to develop entrepreneurs, to train managers and others to become high-skilled workers, and to ensure adequate capital supply are all possible.

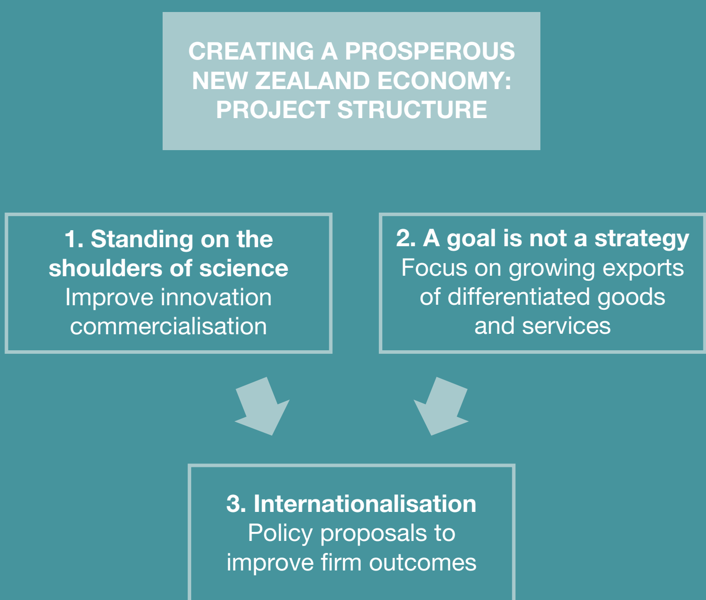
Other small countries are becoming prosperous by exporting differentiated goods and services and New Zealand must find a way to join them or find another strategy for success.

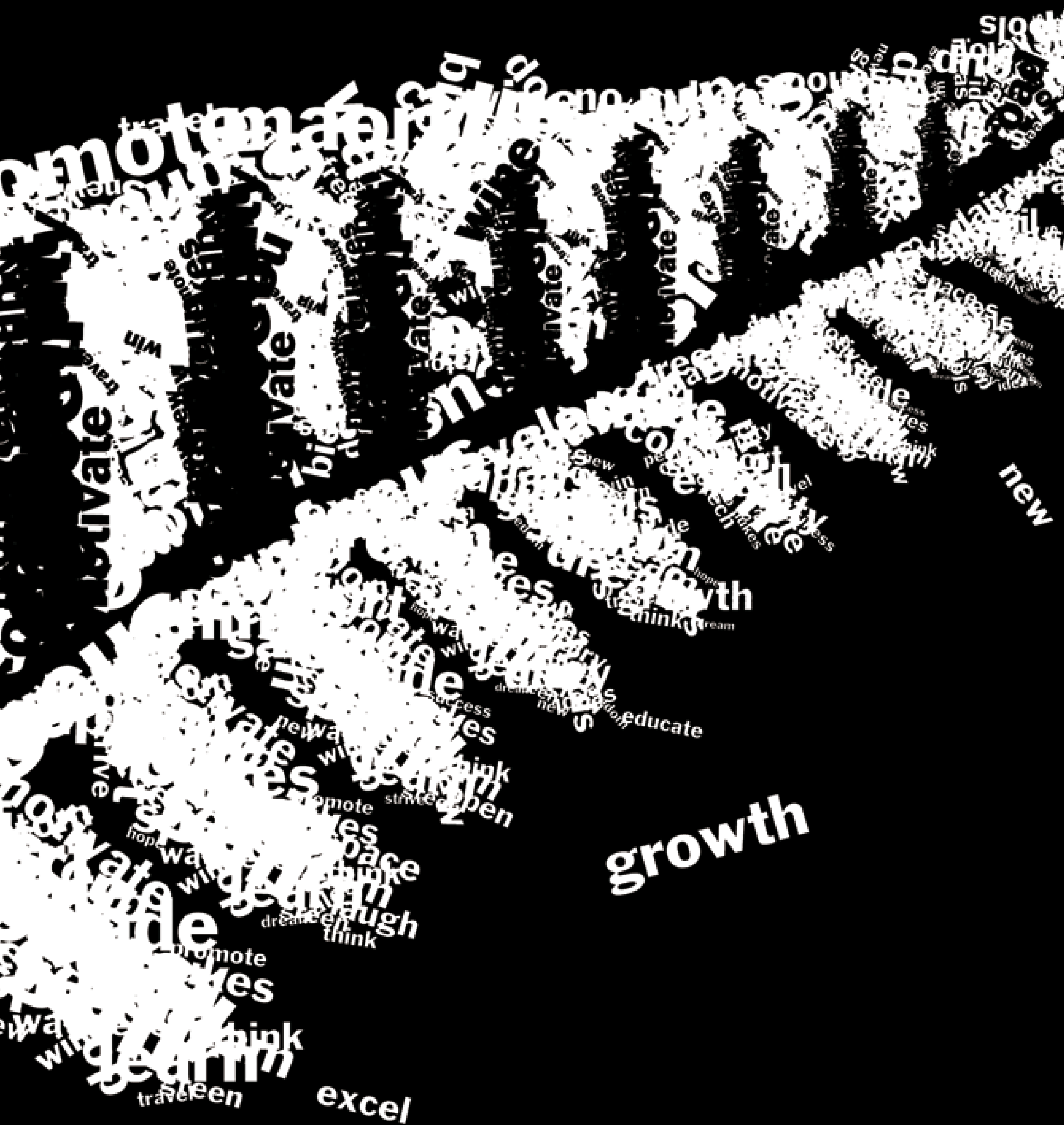
A strategy is a reallocation of resources to achieve a valued goal. If the goal is important and the strategy is sound then the reallocation should be material; sufficient to change the outcome. A few tens of millions of dollars is not material. Competing small countries are committing hundreds of millions of dollars to efforts they regard as strategically important.

Our conclusion that supporting internationalisation success for differentiated exports should be the economic strategy priority should be tested and debated. If the conclusion survives that scrutiny then a material reallocation of resources should follow.

While internationalisation is the main opportunity, the overall economic strategy proposed is to:

- Focus economic development effort on high value export sectors selling differentiated products and services;
- Prioritise labour productivity effort to improve performance of these high value export sectors with growth potential;
- Reallocate resources from low productivity domestic activities into high productivity export activities and sectors;
- Focus on the internationalisation stage of the business development process and ensure New Zealand firms can overcome the size and distance barrier successfully;
- Continue to defend agriculture competitiveness to sustain export revenues and provide a sound platform for differentiated exports based on primary production;
- Apply sufficient resource.





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