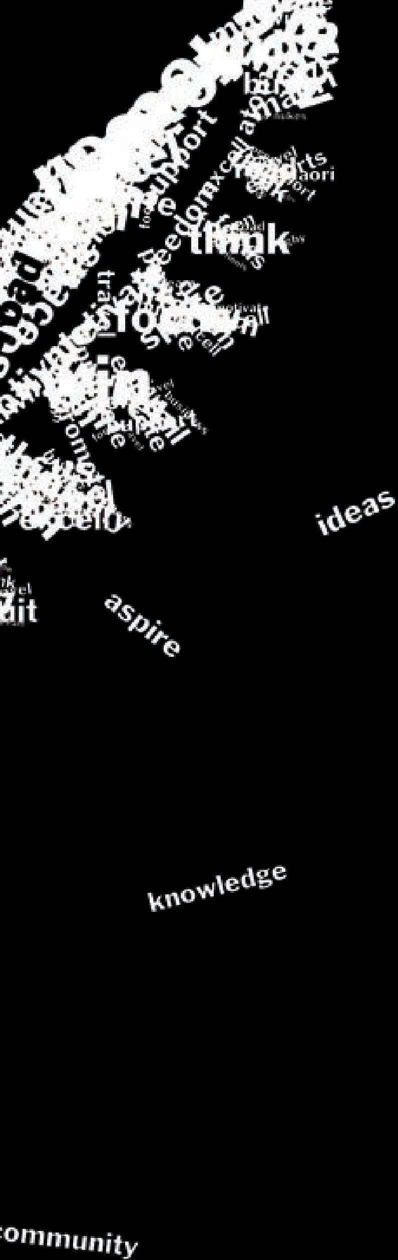


the new zealand institute

EXECUTIVE SUMMARY 2005 / 4

Dancing with the stars?

The international performance of the New Zealand economy

DAVID SKILLING | DANIELLE BOVEN

DECEMBER 2005

EXECUTIVE SUMMARY

As a small country, international engagement is vitally important to New Zealand's future economic prosperity. This report examines the extent of exporting and foreign direct investment by New Zealand firms, considering how New Zealand's international economic activity has changed over time as well as how it compares to other developed countries.

New Zealand's exports are relatively low as a share of national income, are not growing as rapidly as in many other countries, and are distinctive in composition

New Zealand's exports to GDP ratio is currently 29% of GDP, only slightly higher than in 1990 and at about the same level as in the mid-1980s. And New Zealand's exports have declined as a share of national income over the past several years, while the domestic economy has grown strongly.

New Zealand's export growth has been consistently below the OECD average over the past few decades. This slow growth rate has resulted in a low level of exports to GDP compared to other developed countries. This is particularly the case relative to other small developed countries that are more reliant on exporting to generate national income.

The composition of New Zealand's exports is distinctive in being dominated by land-based exports, with a low technological intensity of exports. This is also true for New Zealand's exports of services, which are dominated by tourism with relatively little income from the export of business services.

There has been little change in the composition of New Zealand's exports over the past couple of decades compared to the type of change observed in other small developed countries. The composition of New Zealand's exports looks very similar now to 25 years ago. New Zealand's exports of both goods and services remain heavily land-based.

This export composition is an important reason that New Zealand's overall export growth has been relatively slow. 81% of New Zealand's exports by value are in categories that have grown less rapidly than average world export growth.

New Zealand's direct investment offshore is low by international standards and has reduced since 1990

International engagement can also occur through New Zealand firms investing directly abroad. However, New Zealand's international investing performance does not benchmark well against other developed countries. At 9.5% of GDP, New Zealand's stock of outward foreign direct investment (FDI) is about one third of the developed country average, and New Zealand's FDI outflows have been among the lowest in the OECD over the past decade.

New Zealand's stock of outward FDI has reduced from about 15% of GDP in 1990, due to reduced investment outflows as well as retrenchment by many New Zealand companies. This reduction in New Zealand's outward FDI contrasts sharply with the international experience over the past 15 years. FDI outflows from OECD countries rose by a factor of more than three from 1990 through 2004, and the overall level of outward FDI has more than tripled across the developed world over this period.

The returns on New Zealand's outward investment have also been low. The average return on outward equity investment has been 5% over the past decade as opposed to a 9% return on foreign investment into New Zealand.

Only a small number of New Zealand firms are actively engaged in international activity, and many have not generated strong financial performance

New Zealand's exporting and foreign investing activity is dominated by a relatively small number of large companies, such as Fonterra, Zespri, and PPCS. Only a small proportion of New Zealand firms are engaged in significant international activity, either through exporting or investing. For example, only 361 New Zealand firms exported more than $10 million in 2005 and only 50 firms exported more than $75 million.

In addition, the firm-level data suggest that New Zealand firms that operate internationally do not generate the returns generated by domestic firms. Over the past decade, the group of large listed New Zealand firms with substantial international operations have generated lower shareholder returns than have domestically-focused firms.

As a result of this domestic focus, the potential size of many New Zealand firms is constrained by the scale of the New Zealand market. Indeed, New Zealand has few large companies and very few genuine multinationals compared to other countries of similar size.

These outcomes have been generated despite a positive environment for strong international performance

Overall, New Zealand's international performance over the past 15 years in terms of exporting and outward FDI does not compare well with other developed countries. At a time when global economic integration has been proceeding rapidly, with substantial increases in international trade and investment flows, New Zealand's exports have grown relatively slowly and foreign direct investment by New Zealand firms has reduced.

New Zealand is the only developed country whose overall degree of international integration has reduced over the past decade. Over the past few years, the levels of both exporting and the stock of outward FDI have declined as a share of the New Zealand economy. The world is globalising but New Zealand is not participating meaningfully in this process. New Zealand is not dancing with the stars on the international stage.

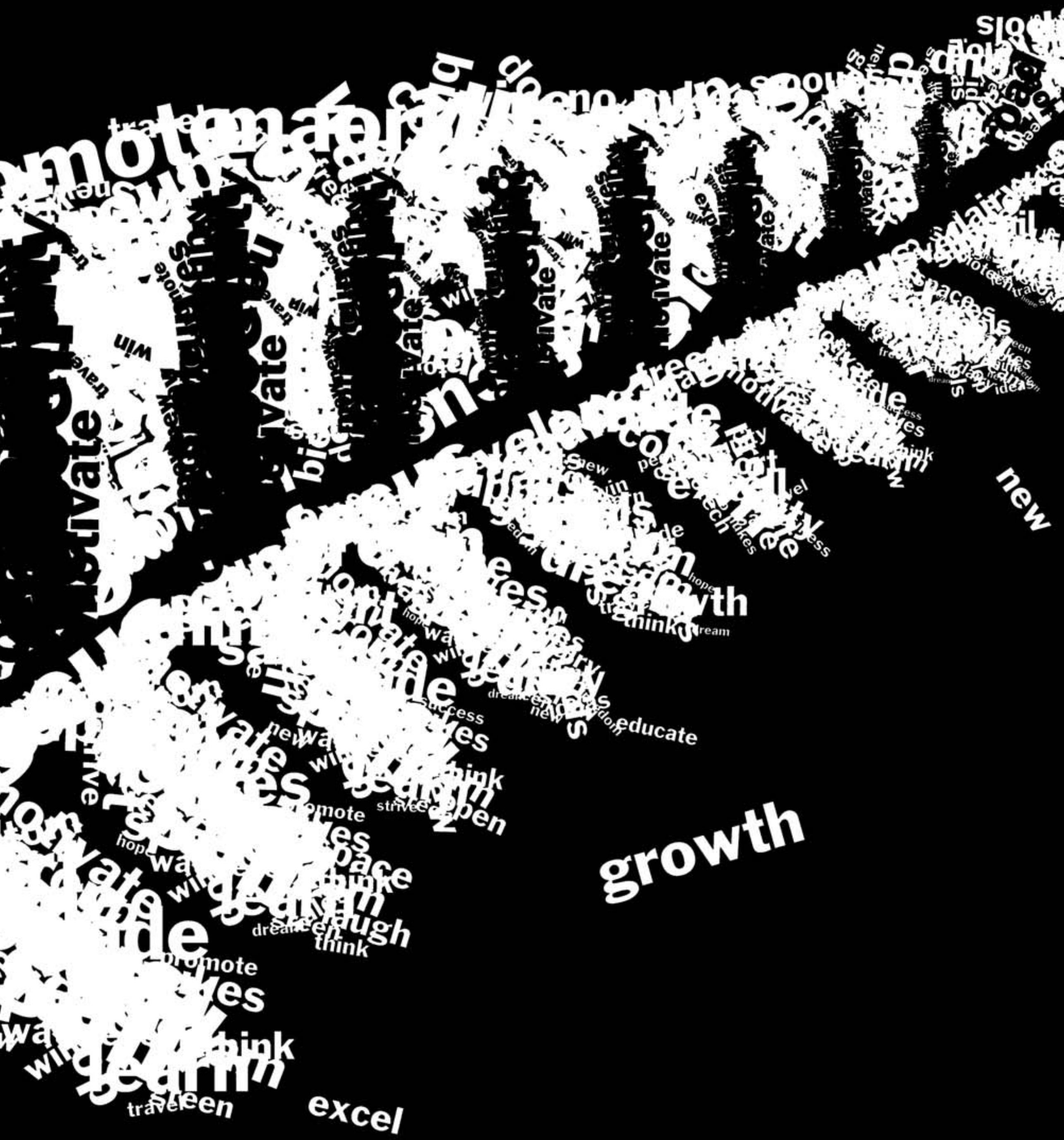
This is despite the international environment being conducive to improved trade and investment over the past decade or so. Strong income growth in world markets has been a significant factor in increased international trade and investment flows. And New Zealand has obtained particular benefits from the successful conclusion of the Uruguay Round of

trade liberalisation in 1994, reduced costs of transport and communications, and strong export prices.

The challenge going forward

The world is changing rapidly and countries are moving ahead quickly. But New Zealand's international performance has not kept pace with these developments, and worryingly, there are signs that New Zealand is going backwards in terms of the level of its international economic engagement. Going forward, significant competitive pressures are emerging that will affect New Zealand's exporting and investing performance.

But the good news is that achieving a significant improvement in New Zealand's international performance in a short period of time is possible. Many countries have substantially increased their exporting and investing activities over the past decade, and there is no reason that New Zealand cannot do likewise. The message of this report, however, is that New Zealand will not generate such an improvement on current course and speed.



www.nzinstitute.org The New Zealand Institute
PO Box 90840
Auckland 1030
New Zealand
P +64 9 309 6230
F +64 9 309 6231