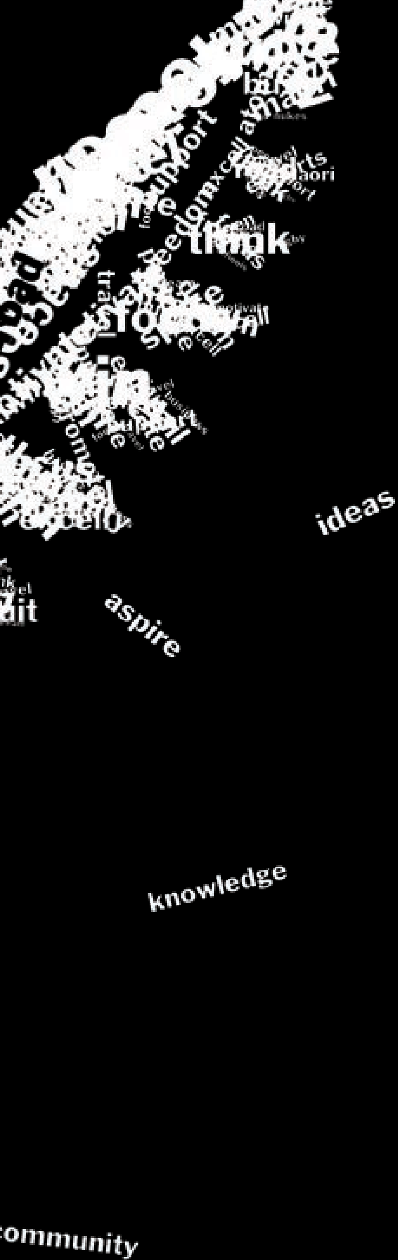

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DISCUSSION PAPER 2005 / 4

Dancing with the stars?

The international performance of the New Zealand economy

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DECEMBER 2005

The New Zealand Institute

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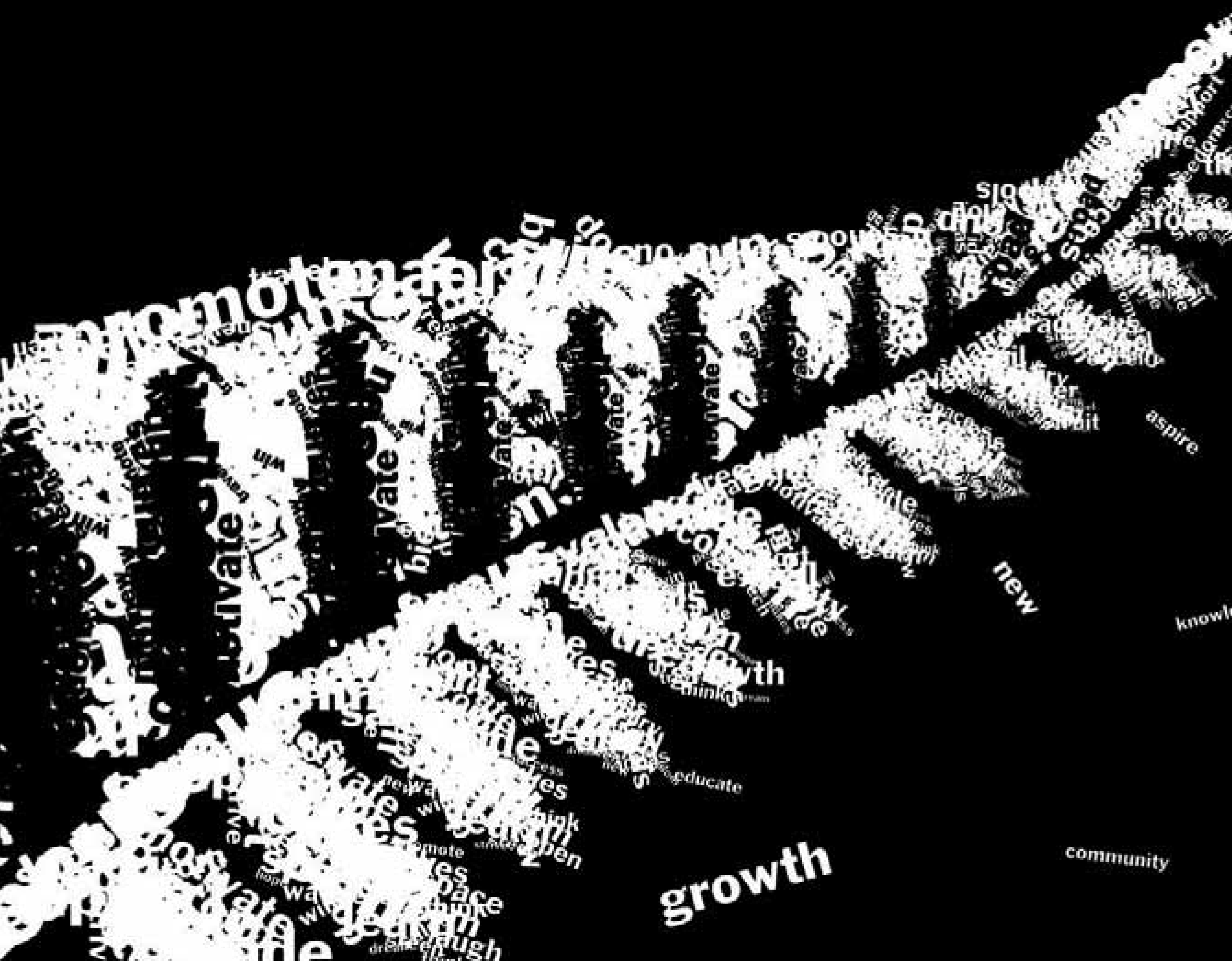
‘Dancing with the stars?’ is the second paper in a series that forms part of the New Zealand Institute’s research project on ‘Creating a global New Zealand economy’. This paper follows on from our first paper – ‘No country is an island’ – which was released in November.



FOREWORD: CREATING A GLOBAL NEW ZEALAND ECONOMY

The New Zealand economy has performed well over the past 15 years, with economic growth rates that exceed those generated in previous decades and that compare well against the US and Australia.

The challenge now is to build on this good performance, so that New Zealand's income levels converge to those of other developed countries. Sustaining high rates of economic growth into the future will necessarily involve a substantial increase in labour productivity growth.

New Zealand is a small economy, and substantially raising New Zealand's labour productivity will require much greater levels of exporting and foreign investment by New Zealand firms. Exporting and investing offshore provides scale, growth opportunities for New Zealand's most productive firms, and great learning opportunities for New Zealand firms. New Zealand cannot achieve and sustain high rates of productivity growth without making much greater use of larger markets through international activity.

However, New Zealand's international performance does not compare well against many other developed countries, and only a small number of New Zealand companies are substantially engaged in international markets in terms of either exporting or investing. New Zealand is not participating in increased international economic activity to the extent that many other countries are.

Of course, New Zealand firms do face particular difficulties in terms of moving into international markets because of the small size and remoteness of the New Zealand market. It is this combination of the importance of international engagement, and the difficulties that some New Zealand firms face in going global, that provides the motivation for this project.

This project is being undertaken to identify the actions and policies that will move New Zealand towards becoming a genuinely global economy, in which much more of New Zealand's national income is generated offshore and where New Zealand firms win systematically abroad.

Over the next several months, we will be releasing a series of reports examining different aspects of this issue. Initial reports will describe why taking the New Zealand economy to the world is vitally important, will examine New Zealand's current exporting and international investment outcomes, and will identify some of the key reasons that New Zealand's international outcomes do not compare well against other small, developed countries.

An important part of this project will be conversations with a wide range of business and political leaders about the key issues and the actions that can be taken to increase exporting and international investment by New Zealand firms.

This will provide the basis for reports that focus on a range of solutions. The aim of the project is to identify the actions of government, business, and others, which are required in order to take the New Zealand economy to the world in a material and successful way. Creating a global New Zealand economy is an important but demanding challenge, and will require sustained leadership from both the private and public sectors.

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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.

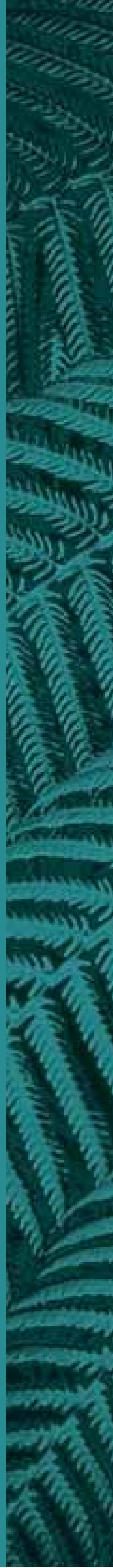
As a result of this domestic focus, the potential size of many New Zealand firms is constrained by the scale of the New Zealand market. Indeed, New Zealand has few large companies and very few genuine multinationals compared to other countries of similar size.

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.

1 INTRODUCTION

For a small country like New Zealand, raising the level of international economic activity is vital to achieving and sustaining higher rates of productivity growth. New Zealand's ability to generate economic prosperity will depend to a large extent on the ability of New Zealand's firms to compete successfully in international markets, either through exporting or international investment.

New Zealand has a history of being a trading nation, engaged economically with other countries. This began with the trading of seals, whales, and timber in the early days of European settlement, and then pastoral exports after the advent of refrigerated shipping in the 1880s and the creation of the "protein bridge" to the UK (Belich (2001)). As a small country, there has long been an understanding in New Zealand of the importance of international engagement to secure New Zealand's economic future.

But the world moves on. The past several decades have seen another wave of significant global economic integration, with substantially higher levels of international economic activity. International flows of goods and services, investment capital, companies, and people have increased considerably, and particularly over the past decade or two. The pace of change and the intensity of competition are likely to increase further as China and India continue to integrate into the global economy over the coming decades. This process provides a substantial opportunity for New Zealand, but it is simultaneously a major challenge.

This report considers the extent to which the New Zealand economy is successfully engaged in the global economy through New Zealand firms selling goods and services to world markets or investing directly in these markets.

The report begins by describing New Zealand's exporting activity in terms of its level and composition. The change over time is outlined and New Zealand's outcomes are compared with those of other countries, particularly small developed countries. The report then considers the level and nature of New Zealand's direct investment abroad, and compares this activity to that which is observed in other developed countries.

After this analysis of the aggregate data, the firm-level outcomes are assessed. How many New Zealand firms are engaged in exporting or investing directly abroad, and how have these firms performed in terms of growth and profitability?

These national and firm-level outcomes are then evaluated. Overall, how does New Zealand's international economic performance benchmark against other countries? And what are the prospects for New Zealand's future international performance?[1]

[1] *Additional data and analysis are available on the New Zealand Institute's website at www.nzinstitute.org*

2 NEW ZEALAND'S EXPORTING PERFORMANCE

This section considers New Zealand's exporting performance. In particular, it examines the level of exporting, both in terms of how it has changed over time and how it benchmarks against other countries. The composition of the goods and services exported from New Zealand is also considered, and compared to the export structures of other developed countries.

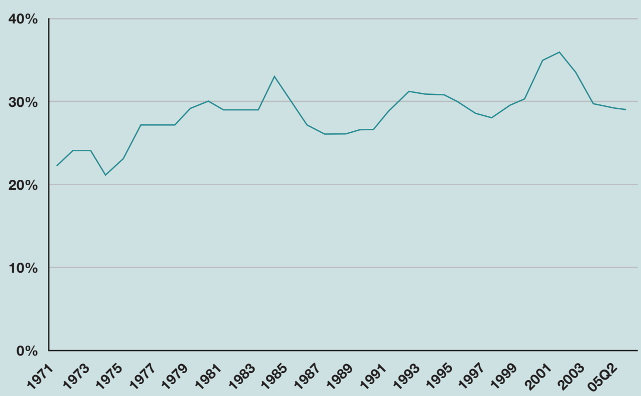
THE LEVEL OF EXPORTING

The standard measure of a country's exporting performance is the share of exports of goods and services in the overall economy. New Zealand's exports to GDP ratio has trended upwards over the past few decades, from 22% in 1971 to 29% in 2005, as shown in Figure 1. This rise in exports to GDP over the past few decades means that, on average, exports have grown slightly more rapidly than the overall economy and are making an increased contribution to New Zealand's national income.

New Zealand's exports grew as a share of GDP most rapidly from the early 1970s until the mid-1980s. Interestingly, aside from an immediate dip around 1973, there is no indication that the loss of preferential access to the UK market on the UK's entry into the European Community did lasting damage to New Zealand's export income. Rather it seems that New Zealand successfully found alternative markets for its primary exports.

However, New Zealand's exporting level has been static since the mid-1980s. Despite several pronounced peaks and troughs in the export series, there has been no trend of increased exporting activity over the past 20 years. The share of exports in New Zealand's national income has gone sideways. Indeed, the level of exports in 2005 was the same as in 1983 at 29% of GDP. This suggests that increased exporting activity has not been an important driver of New Zealand's economic growth over the past 20 years. New Zealand's growth has been driven to a much greater extent by domestic activity, such as strong private consumption spending.

FIGURE 1: NEW ZEALAND'S EXPORTS AS A % OF GDP, 1971-2005



Source: World Development Indicators (1971-1987); Statistics NZ (1988-2005)

This reliance on the domestic New Zealand economy to generate economic growth has been particularly evident over the past several years. New Zealand's exports have reduced from a high of 36% of GDP in 2001 to 29% of GDP in 2005. This indicates that the export sector has not made a strong contribution to New Zealand's recent economic growth.

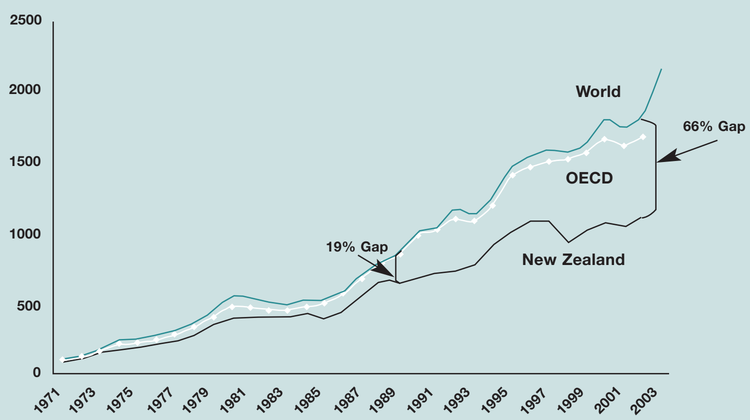
To place New Zealand's exporting performance in context, this experience needs to be compared to the level and growth of exports in other developed countries.

There has been a worldwide trend towards aggressive international engagement, with most developed economies substantially more integrated into the global economy than was the case 20 years ago. A common feature in the growth experience of the past few decades has been countries rapidly expanding their international economic presence.

This is reflected in the strong export growth observed across the world over the past few decades. Overall world trade grew by 9.5% a year between 1970 and 2002, substantially in excess of world income growth. And the World Trade Organisation (2004) reports that world merchandise exports grew by 6.4% annually between 1990 and 2000, considerably faster that world merchandise production at 2.5% per year. The trend for world trade growth to exceed world income growth has been a consistent phenomenon since the end of the Second World War (World Trade Organisation (2005)).

These export growth rates significantly exceed New Zealand's export growth over the past few decades, as can be seen in Figure 2. New Zealand's exports grew at 7.8% per year between 1971 and 2002, slower than the world growth rate of 9.5% per year. Indeed, of the 24 OECD member countries in 1971, New Zealand's export growth rate ranked 23rd over the three decades

FIGURE 2: VALUE OF GOODS AND SERVICES EXPORTS, INDEXED TO 1971



Note: 1971 = 100
Source: World Development Indicators

from 1971-2002. Only Switzerland generated slower export growth than New Zealand over this period.

So although New Zealand's level of exporting as a share of national income has increased slightly over the past few decades, this has been more than matched by other countries. This is reflected in a decline in New Zealand's share of world trade from 0.28% in 1980 to 0.22% in 2004, a reduction of 19% over a 24 year period.

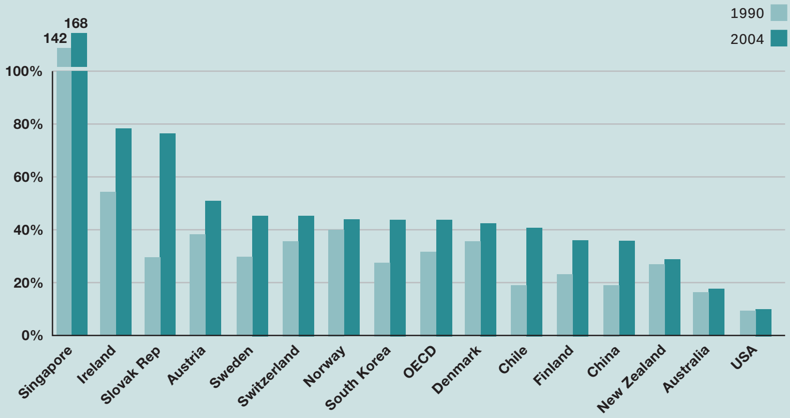
Over time New Zealand's slower rates of export growth have accumulated into a very large gap in the level of exports. Had New Zealand's exports grown at the world average rate since 1971, they would be 66% higher than they currently are, as shown in Figure 2. This gap is continuing to widen as world export growth continues to exceed New Zealand's export growth.

New Zealand's relatively slow export growth has been a consistent feature of the past three decades. However, slow export growth has been particularly apparent in New Zealand over the past several years with exports declining as a share of GDP. This contrasts sharply with the strong world export growth in recent years. The World Trade Organisation (2005) estimates that real exports of goods grew by 9% across the world in 2004, almost double the world's rate of real income growth. And real trade growth is projected to grow by 6.5% during 2005. Similar estimates have been made with respect to the growth of exports of commercial services.

As a consequence of New Zealand's consistently slow export growth, New Zealand's level of exports to GDP is now lower than in most other developed countries. This is clear from Figure 3. At 29% of GDP, New Zealand's level of exports is in the bottom third of the OECD, ranking 21st out of 30 OECD countries.

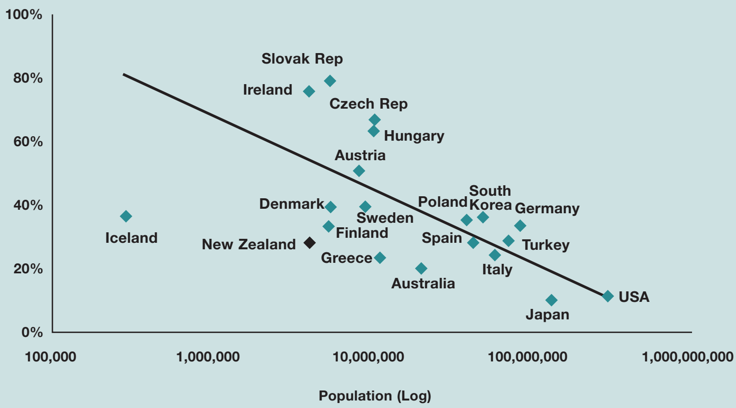
New Zealand's relatively low level of exporting activity is particularly apparent relative to other small developed countries. Small countries tend to have a greater reliance on exporting than do larger economies like the US and Japan, who have larger domestic markets to leverage. This is an important reason why Australia's level of exports to GDP is lower than that of New Zealand. The Australian market is over five times as large as the New Zealand economy, which makes export activity less of an imperative for Australia than for New Zealand.

FIGURE 3: EXPORTS AS A % OF GDP, 1990 AND 2004



Note: OECD average for 1990 and 2003
Source: OECD; National government statistics for Chile, China, and Singapore

FIGURE 4: EXPORTS AS A % OF GDP AND POPULATION, 2003



Note: Population displayed on a logarithmic scale. Line reflects regression against all OECD countries with 2002 data for Mexico, Netherlands, and Switzerland
Source: OECD; The New Zealand Institute calculations

The negative relationship between country size, as measured by population, and the share of exports in the economy, can be seen in Figure 4. Larger countries, such as the US, Japan, and Australia, tend to have significantly lower levels of exporting than do smaller countries. This suggests that New Zealand's level of exports ought to be compared to that of other small developed countries. It turns out that New Zealand's level of exporting is at the bottom of the group of small developed countries and is well below the trend line shown in Figure 4.

Most small developed countries have levels of exports to GDP that are substantially higher than New Zealand's level. The average level of exporting

Import content of exports

One factor to bear in mind when comparing exports to GDP across countries is the import content of these exports. Some countries with high levels of exports to GDP, like Hong Kong, have a high import content of exports in which a good is imported, some processing is undertaken, and then the processed good is exported. This may increase the level of exporting relative to countries in which there are fewer imported inputs.

New Zealand's exports have a low import content because primary sector exports have few imported inputs, and also because New Zealand's manufactured exports have a relatively low import content. Black et al. (2003) estimate that New Zealand's import content of exports is about 20% compared with the UK at 25%, Sweden and Denmark at 35-40%, and Singapore at 60%.

However, New Zealand has a low export share even after adjusting for this. And the exports to GDP ratio is still a useful measure as it gives a sense of the extent to which an economy is integrated into the global economy.

for the 15 OECD countries with populations of 10 million or less is 53% of GDP, almost double the level in New Zealand. There is no developed country with a similar population size that exports less than New Zealand. The countries ranking below New Zealand are considerably larger in terms of population, including the US, Japan, and Australia. The perception of New Zealand as a small trading nation is unfortunately well out of date.

It is also apparent from Figure 3 that many countries substantially increased their exports between 1990 and 2004. Across the OECD, exports have been growing more rapidly than the overall economy leading to higher levels of exports to GDP. The median increase in the level of exports to GDP across all OECD countries between 1990 and 2004 was 12% of GDP, which compares to an increase of 2% for New Zealand. Significant increases in the share of exports in the economy have been widespread over the past decade: the ratio of world exports to GDP rose from 20% in 1990 to 30% in 2003 (World Trade Organisation (2004)).

By international comparison, then, New Zealand's export growth over recent decades has been substantially slower than in most other developed countries. New Zealand has not kept pace with the substantial progress made by many other developed countries in terms of expanding their exporting activity.

Trade balance

New Zealand has traditionally generated a merchandise trade surplus of about 1-2% of GDP. However, a merchandise trade deficit has been run since 2002 and New Zealand's trade deficit is now about as large as it has been for about 30 years. As at September 2005, the annual trade deficit was $5.8 billion or about 3.9% of GDP. The merchandise trade deficit for the month of September was about $1.0 billion, which represents 42% of total exports for September. This is on the back of the $1.1 billion August trade deficit, which Statistics New Zealand noted was "the highest deficit recorded for any month".

These deficits are due to New Zealand's import growth consistently exceeding export growth over the past decade, with imports growing at 6.0% per year and exports growing at just 4.2% per year. Although there are some cyclical drivers of the trade deficit, such as the high value of the New Zealand dollar, there are also some important longer-term factors at work as suggested by the earlier discussion.

This merchandise trade deficit has been partly offset by an improvement in the balance of trade in services, which is now in surplus at about 0.6% of GDP on the back of strong tourism growth.

THE COMPOSITION OF EXPORTS

In addition to New Zealand's relatively low level and growth of exporting, New Zealand's exporting performance is also distinctive in terms of its composition. This is the case for the composition of New Zealand's exports of both goods and services.

New Zealand's exports of goods are dominated by primary goods, like wood and pulp, meat, dairy, and other food, with about two thirds of goods exports currently coming from the primary sector (NZTE (2005)). Manufactured exports comprise just one quarter of New Zealand's exports. The reliance on exports of primary goods can be seen by scanning the list of New Zealand's top 20 exports in Table 1. Much of New Zealand's export activity is land-based and involves New Zealand extracting value from its natural

TABLE 1: NEW ZEALAND'S TOP TWENTY EXPORT CATEGORIES

2004 Rank	Commodity Description	1980 Rank
1	Meat and edible meat offal: fresh, chilled, or frozen	1
2	Milk and cream	4
3	Fruit and nuts: fresh and dried	13
4	Cheese and curd	10
5	Butter	3
6	Wood: simply worked, and railway sleepers of wood	15
7	Aluminium	5
8	Starches, insulin, and wheat gluten; Albuminoidal substances; Glues	6
9	Wool and other animal hair (excluding tops)	2
10	Fish: fresh, chilled, or frozen	12
11	Edible products and preparations, not elsewhere specifed	79
12	Pulp and waste paper	9
13	Paper and paperboard	7
14	Other wood: in the rough or roughly squared	16
15	Crustaceans and molluscs: fresh, chilled, frozen	14
16	Alcoholic beverages	52
17	Vegetables: fresh, simply preserved; Tubers, not elsewhere specified	20
18	Household-type equipment, not elsewhere specified	29
19	Crude petroleum and oils from bituminous minerals	New
20	Veneers: plywood, "improved" wood and other, not elsewhere specified	23

Source: UN Comtrade 3 digit annual trade data resource endowment, particularly its land and climate.

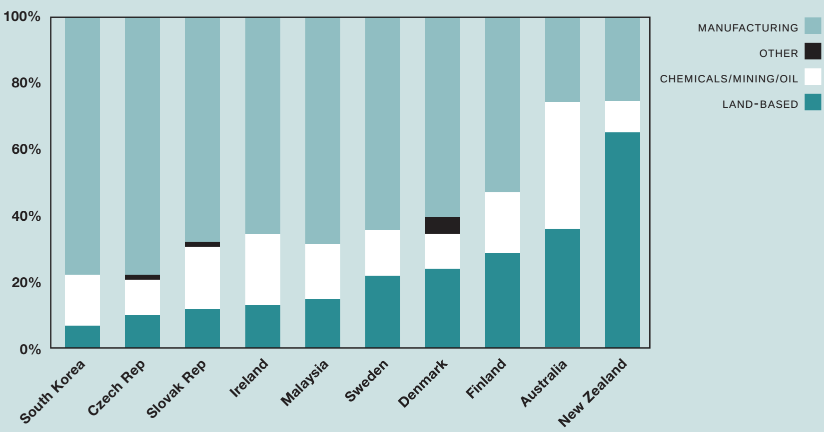
New Zealand's export composition is highly distinctive in comparison with other OECD countries. New Zealand has the highest share of land-based exports in the developed world, and this share is not reducing significantly over time.[2] This runs counter to the clear trend in other developed countries, in which the primary export share is declining as manufacturing and services exports increase. Figure 5 describes the export structure for several developed countries.

Most developed countries rely to a much greater extent on the export of manufactured goods. The World Trade Organisation (2004), for example, estimates that 75% of total world trade is manufacturing trade. Australia and Norway are probably the two most similar countries to New Zealand in terms of having a heavy reliance on commodity products like agriculture, minerals, and oil, but this is unusual in the context of OECD countries.[3]

The other notable feature of New Zealand's export composition is the absence of substantial change over the past few decades. Although there has been some change in the overall composition, this has been mainly due to a couple of large changes such as the decline in the export share of wool from 18% of goods exported in 1973 to 2% in 2004.

The most rapid change in the composition of New Zealand's exports occurred between 1970 and 1980. Since then, the pace of change has progressively declined. The composition of New Zealand's goods exports has not changed in a material way since 1990 relative to the changes observed in preceding decades.

FIGURE 5: COMPOSITION OF GOODS EXPORTS, 2004



Source: UN Comtrade

[2] The only significant areas in which New Zealand has a higher world export share than predicted by its relative economic weight are in the primary sector (Ballingall & Briggs (2002)).

[3] In 2003 about one third of Australia's exports were minerals, which is equivalent to about 7% of Australia's GDP.

One indication of this can be seen in Table 1. Most of the top 20 export categories in 1980 were also major exports in 2004. Indeed, the top 20 categories in 1984 accounted for 80% of New Zealand's goods exports in 1980 and these same categories accounted for 60% of export value in 2004, suggesting only modest change over the past quarter of a century.[4] This absence of change is also evident when more disaggregated analysis is conducted, examining the changes in more detailed export shares.

Although there has been some change in the composition of New Zealand's exports over the past decade or two, this is better described as incremental change rather than transformational. The majority of what New Zealand firms export today is recognisable from 25 years ago.

There are rapidly growing sectors in New Zealand, such as the wine industry, information and communications technology (ICT), and biotech, but these sectors tend to be growing from a low base and do not yet comprise a significant share of New Zealand's exports. Exports of goods from these sectors are small compared to New Zealand's total exports, and the emergence of these sectors has not been sufficient to lead to a transformation in the composition of New Zealand's exports. For example, Comalco generates over $1 billion annually in exports of aluminium, which is over twice the $435 million exported by the entire New Zealand wine industry in the 12 months to June 2005.[5] Indeed, wine exports comprise just 1% of New Zealand's total exports despite the rapid export growth of the wine industry.

[4] 14 percentage points of this 20 point reduction was due to the declining export share of wool, from 16% in 1980 to 2% in 2004.

[5] Winegrowers Federation 2005 Annual Report.

So although the emergence of successful new industries deserves to be showcased and celebrated, the extent of this success to date should not be over-interpreted. As yet, the new industries have not made an impact on the overall composition of New Zealand's exports. Many more years of rapid growth will be required before this will happen.

New Zealand's record contrasts sharply with the experiences of other small countries in terms of the pace and scale of change in the composition of exports. Small countries like Ireland and the Scandinavian countries have generated some rapid changes in their export structures over the past 15 years. This experience shows that major changes can be made in short periods of time, rather than taking several decades to accomplish.

For example, 25 years ago Finland's exports were dominated by forestry exports, with wood, pulp, and paper products making up 45% of their exports. By 2000, these categories accounted for just 27% of Finnish exports, with the export share of high-technology manufacturing having increased substantially. Routti (2001) reports that exports of electronics rose from 4% of Finland's exports in 1980 to 11% in 1990 and to 31% in 2000. This is a transformational change in Finland's export structure.

One argument sometimes made is that New Zealand's exports are changing in terms of the degree of value-adding processing rather than in terms of the export categories: for example, to the extent that New Zealand is exporting processed wood products rather than unprocessed logs. There has been a steady decline in the share of primary exports that leave New Zealand in an unprocessed way, from 27% in 1988 to 15% in 2001. And the share of elaborately transformed manufactures increased from 11% to 16% over this same period (Black et al. (2003)). But although this suggests some increase in the extent of processing, the extent of change has not been rapid or substantial.

Another measure of the composition of New Zealand's exports is in terms of the technological intensity of manufactured exports. New Zealand is at the bottom of the OECD in terms of the technological intensity of manufactured exports, ranking 29th out of 30 OECD countries in terms of the share of manufactured exports that are either high tech or medium-high tech (OECD (2005b)).[6] At 67%, the OECD average share of high tech and medium-high tech manufactured exports is over three and a half times higher than New Zealand's 19% share. The share in Australia is 31%, substantially higher than in New Zealand.

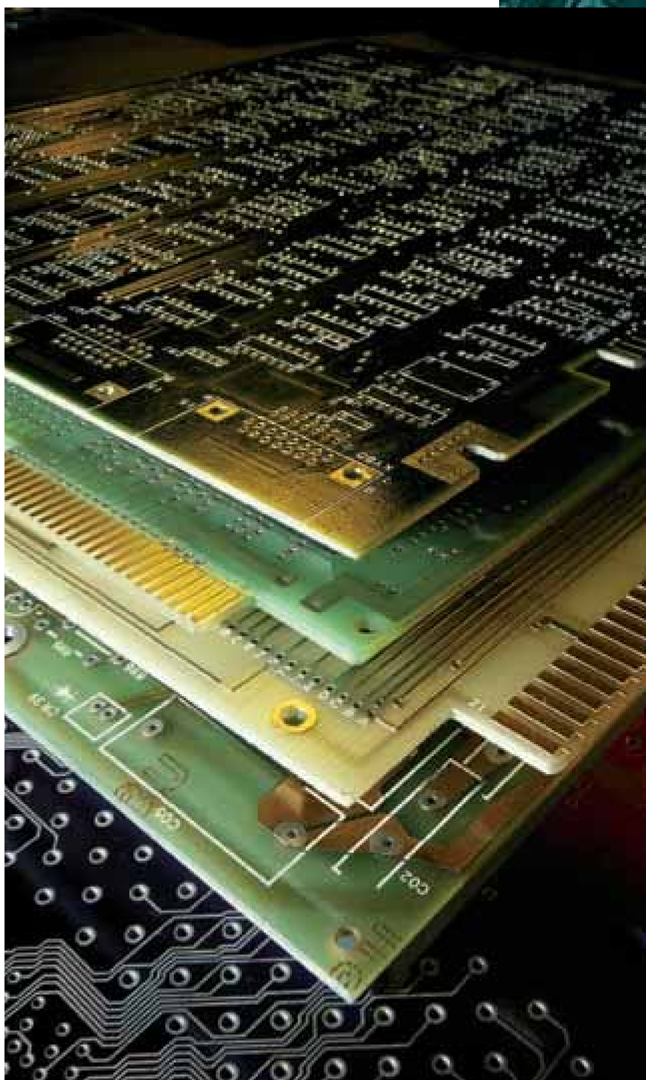
However, New Zealand has the largest share of low tech manufactured exports in the OECD. At 70%, this share is over three and a half times bigger than the OECD average. This reflects the low technological intensity of the food and

[6] The OECD estimates the technological intensity of an industry on the basis of its research and development (R&D) intensity. The pharmaceutical industry, for example, is regarded as high tech whereas the food and beverage sector is regarded as low tech.

beverage sector, which is New Zealand's main type of manufactured export.

The OECD also reports that New Zealand generated relatively low growth in high tech and medium-high tech manufactured exports between 1994 and 2003, despite its low starting point. Greece, the country immediately above New Zealand in terms of the technological intensity of its manufactured exports, grew its high and medium-high tech exports at twice the rate of New Zealand over the 1994-2003 decade. And this has occurred despite Greece having no obvious comparative advantage in this type of activity relative to New Zealand.

Taken together, this evidence suggests that, although improvements have been made, there has not been a substantial increase in the value added component of New Zealand's exports. Across a range of independent measures, the extent of change in New Zealand's exports has been neither rapid nor substantial. This is particularly evident when the scale and pace of change in New Zealand is compared to that observed in other developed countries. And a key test of whether New Zealand is adding more value to its exports is whether overall export value is increasing. From the earlier discussion, it is apparent that this is not happening in a material way.



This absence of change in New Zealand is perhaps surprising given the extensive economic reforms that occurred from the mid-1980s. Among other things, these reforms removed distorted price signals and impediments to efficient resource reallocation enabling changes to be made in New Zealand's export structure where there was an incentive to do so. However, there is little evidence of substantial change in the type of goods that are exported.

In essence, New Zealand is still a land-based economy that relies on generating export income from its natural resource endowment. This is likely to continue given the low levels of research and development spending in the New Zealand economy and the small size of New Zealand's non land-based export sectors.

Exports of services

29% of New Zealand's exports were comprised of services for the 12 months to March 2005 (MFAT (2005)).[7] The proportion of services exports has increased from 22% of total exports in 1990, indicating that New Zealand's exports of services have grown more rapidly than exports of goods. Indeed, New Zealand's exports of services grew at 4.6% a year between 1995 and 2003, well above the annual growth rate of 2.8% for the export of goods.

This is consistent with the standard OECD pattern in which the growth of services exports exceeds that of merchandise trade. But although New Zealand's services exports grew more rapidly than for exports of goods, New Zealand's 4.6% annual growth rate was still well under the 5.9% average growth rate in exports of services generated across OECD countries.

At 29%, New Zealand's share of services exports in total exports is slightly above the OECD average of 24%. New Zealand's services exports share is higher than in Australia (23%) but lower than in the US (30%) and the UK (32%). However, although the share of services exports is approximately the same as the OECD average, the composition of New Zealand's exports of services is quite different.

New Zealand's services exports are dominated by travel and transport, which together account for about 83% of total services exports. A large part of this category is personal tourism, which comprises over half of New Zealand's services exports. Export education is also an increasingly significant component of New Zealand's services exports, at $1.7 billion or 14% of services exports (MFAT (2005)). Both tourism and export education have enjoyed rapid growth over the past several years, and these industries have been the major drivers of growth in services exports. Export education, for example, has increased from under $500 million in 1999, more than a three-fold increase.

The basic composition of New Zealand's services exports has remained unchanged over the past 15 years, with the travel and transport categories consistently accounting for about 80% of services exports (The Boston Consulting Group (2004)). In contrast, the OECD average share from the export of transport and travel services is just 44%. The OECD (2004a))

[7] The services exports numbers are currently being revised by Statistics New Zealand and are likely to increase, perhaps by 0.5% of GDP.

estimates that travel and transport account for about 70% of Australia's services exports in 2003, about 50% across the EU, and just over 40% in the US.

Across most OECD countries, business services, such as finance, insurance, communications, and royalty and licensing income, are the major component of exported services. But only a small proportion of New Zealand's services exports come in the form of such business services. Indeed, at 17% of total services exports, New Zealand's exports of business services are almost the lowest in the OECD, with only Greece having a smaller contribution from business services.

Royalty and licence fees account for just over 1% of New Zealand's services exports, or about 0.3% of total exports, suggesting that New Zealand is not participating successfully in the global knowledge economy. The OECD (2005b) ranks New Zealand last among OECD countries in terms of New Zealand's technology payments and receipts. Whereas "in most OECD countries, technological receipts and payments increased sharply during the 1990s" (OECD (2003b)), this source of export income has not increased much in New Zealand over the past decade.

There are two distinctive features about the services that are exported from New Zealand. First, most of the services exported are consumed by foreigners in New Zealand, such as tourism and export education, rather than being sold and consumed in foreign markets as is generally the case with exports.

And second, most of New Zealand's exports of services are essentially land-based. Tourism accounts for over half of New Zealand's services exports, and this is largely about marketing New Zealand geography. The Boston Consulting Group notes that "most other developed countries tend to export knowledge-based services rather than natural resource-based services, as tourism is in New Zealand" (2004). In this sense, New Zealand's services exports composition is similar to that of exports of goods in that they are based on exporting a natural resource endowment.

DECOMPOSING THE SOURCES OF SLOW EXPORT GROWTH

The above analysis shows that New Zealand's export growth has been consistently slower than the OECD and world averages, and that the composition of New Zealand's exports is markedly different from most other developed countries in terms of its reliance on primary exports. It turns out that there is a direct link between the composition of New Zealand's exports and New Zealand's relatively slow export growth.

A country can generate relatively slow export growth for two reasons. The first is where demand for the goods or services that the country is exporting is growing less rapidly than exports in general (the 'commodity composition effect'). The second is where the country is losing export market share in each category that it exports (the 'competitiveness effect').

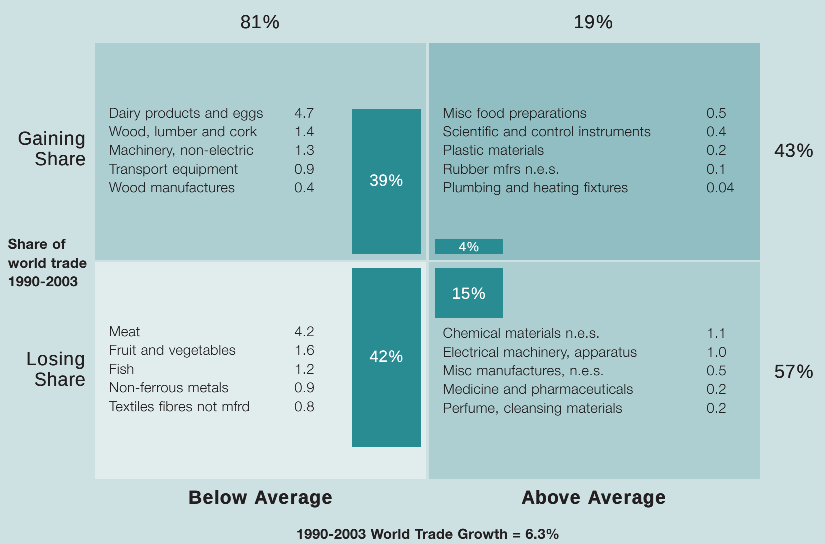
A major reason that New Zealand's export growth has been less than that of overall world trade growth is that world demand for the goods that New Zealand exports has grown less rapidly than overall world exports. The World Trade Organisation (2004) reports, for example, that agricultural trade growth in the 1990s was lower than for manufacturing exports and other types of services. And the OECD (2003b) observes that "technology-intensive exports accounted for much of the growth in trade over the past decade". High technology industries account for about 25% of total OECD trade, and generated the highest rates of export growth.

New Zealand's export composition means that it does not have a substantial presence in these high growth markets. In contrast, it has a large presence in slower growing markets such as those based on the primary sector. For example, New Zealand has a substantial presence in the (low technology) food, drink, and tobacco sector, which generated the slowest growth rates of all the categories in manufactured exports at about half of the overall average growth rate.

Intra-industry and intra-firm trade has also grown very rapidly over the past few decades. This has occurred as technology has made it possible to undertake various steps in the production process in different countries.[8] This type of trading pattern has been a major driver of overall world trade growth. But again New Zealand has not been significantly involved in these types of trading activities. As a result,

[8] Feenstra (1998), Hummels (2001), and OECD (2002) provide accounts of this process.

FIGURE 6: GOODS EXPORTS FROM NEW ZEALAND, 1990-2003



Note: Data shown is billions of New Zealand dollars, 2003 values;
n.e.s. is not elsewhere specified
Source: UN Comtrade 2 digit annual trade data; The New Zealand Institute calculations

New Zealand's exports have not grown as rapidly as have many other developed countries that are far more engaged in this type of trade.

Indeed, 81% of New Zealand merchandise exports by value were in categories that grew at a slower rate than average world export growth between 1990 and 2003. These categories included New Zealand's major exports like dairy, wood, and meat. Only 19% of New Zealand's exports were in high growth categories. This suggests that the commodity composition effect provides a powerful explanation for New Zealand's low export growth.

This has a substantial impact on the level of New Zealand's exports. If New Zealand's goods exports had grown at the world average growth rate between 1990 and 2003, they would be 28% higher than they currently are.

The effect of participating in slow growth markets may be offset by the competitiveness effect if New Zealand exporters are growing market share in these products. However, New Zealand lost market share in categories that comprise 57% of its exports by value between 1990 and 2003, with gains in market share occurring in categories that accounted for 43% of New Zealand's export value. This acts to compound the composition effect. Indeed, 42% of New Zealand's exports by value are in slow growing categories in which New Zealand is losing market share.[9] This combination is not a recipe for exporting success.

[9] Similar conclusions are also reached in other studies (The Boston Consulting Group (2004), Ballingall & Briggs (2001)).

The commodity composition effect can explain about 90% of New Zealand's slow export growth over the 1990-2003 period, with the remaining 10% due to the loss of New Zealand's market share in specific export categories.

Although this analysis has been undertaken for goods exports, the same effect can also explain the relatively slow growth in the exports of services. The services exports that New Zealand focuses on, travel and transportation, have grown less rapidly than have exports of business services over the past couple of decades (World Trade Organisation (2004)). This is an important reason why the growth of New Zealand's services exports has been slower than the OECD average over this period.

Increasing New Zealand's exports will require an increased presence in high growth markets as well as at least maintaining market share in those goods and services that New Zealand firms currently export. However, the evidence outlined above shows that New Zealand is not moving rapidly into new markets in which demand is growing more rapidly. So this pattern of relatively slow export growth is likely to continue.

SUMMARY

There have been some positive developments in terms of New Zealand's exporting performance over the past decade, such as a slight rise in the level of exports to GDP and the ongoing development of new strengths. Overall, however, New Zealand's exporting performance does not compare well to other developed economies.

New Zealand's export growth has consistently lagged export growth in most other small developed economies. And New Zealand's overall level of exports is lower than most other small developed countries, often by a substantial margin.

New Zealand's exporting activity is continuing to diverge from other developed countries that are taking advantage of a rapidly globalising world by increasing their export activity. Although New Zealand's exports have tended to increase as a share of GDP, this improvement in performance has not been nearly as significant as that generated by many other countries over this period.

The composition of New Zealand's exports is also highly distinctive. Unlike most other developed countries, New Zealand has not moved significantly beyond exporting based on its natural resource endowment. Over three quarters of New Zealand's exports of goods and services are based on this endowment. New Zealand's manufactured exports are unusually low tech in nature, and its high tech exports are growing slowly compared to other countries. The changes in New Zealand's export composition have occurred on the margin, rather than being material changes that have a significant impact on aggregate export outcomes.

A second mechanism for international engagement by New Zealand firms is in the form of outward foreign direct investment, which allows New Zealand to earn income from overseas business activity. Outward foreign direct investment (FDI) occurs when a significant investment is made in an overseas firm or where a New Zealand firm makes a new investment offshore such as the creation of manufacturing facilities or a distribution network or the establishment of a retail presence.

Direct investment offshore is a way for New Zealand firms to exploit their competitive advantage across a global market and to access a larger customer base. International investment allows New Zealand firms to access internal and external scale economies, and perhaps to produce more efficiently than from a New Zealand base.

Such outward FDI may be made to support exporting activity from New Zealand. For example, investments in international distribution chains can be made to enhance the ability of New Zealand firms to get their New Zealand exports to market. Alternatively, direct investment abroad can act as a substitute for exporting from New Zealand, where manufacturing facilities are established abroad to produce for foreign markets rather than exporting from New Zealand.

So in order to get a sense of New Zealand's overall international engagement it is important to look at the outward FDI outcomes as well as the exporting outcomes. Perhaps it is the case that New Zealand firms invest abroad rather than choosing to export from a New Zealand base.

The definition of direct investment is a foreign investment in which the investor has an equity ownership stake of greater than 10%, which provides some control over the management of the investment. Direct investment is different from portfolio investment in which the investment is in overseas financial assets, such as investing in a mutual fund.

This section examines the overall level of direct investment made by New Zealand firms abroad, how this has changed over time, and the income that is generated from this investment. These New Zealand outcomes are then compared to the outcomes generated in other developed countries.

THE LEVEL OF INVESTMENT

New Zealand's overseas direct investment has gone through several phases. Through the 1970s, there was relatively little outward investment by New Zealand firms. However, New Zealand direct investment offshore jumped significantly from the mid-1980s, with substantial international investments being made by large New Zealand companies like Fletcher Challenge. The average annual investment between 1982 and 1991 was just under $1 billion. This investment activity generated a significant increase in New Zealand's level of outward FDI, with the stock rising from 2.3% of GDP in 1980 to 14.7% of GDP in 1990 (UNCTAD (2005)).

However, 1991 was the high water mark for the level of outward FDI, and New Zealand's FDI outflows have been much lower in the 15 years from 1990.

The average FDI outflows from New Zealand between 1992 and 2002 were only about $580 million annually. And recent outflows have been very low, with total outflows of only about $500 million between 2001 and 2004 (OECD (2005a)). This is despite a high New Zealand dollar that makes international investment by New Zealand firms more attractive. These reduced FDI outflows have led to a reduction in New Zealand's stock of outward FDI as a share of GDP to 11.9% of GDP ($17.8 billion) as at June 2005, down from about 15% of GDP in 1990.[10]

There have been some significant negative flows over the past decade, reflecting substantial retrenchments during the 1990s as New Zealand firms reduced or sold their overseas investments. The reduced stock of outward FDI is also due to New Zealand firms becoming foreign owned, with the effect that their international investments are no longer recorded as New Zealand FDI. Although there were also some substantial outflows during this period, as New Zealand firms continued to invest offshore, the total outflows during this period were significantly less than through the 1980s.

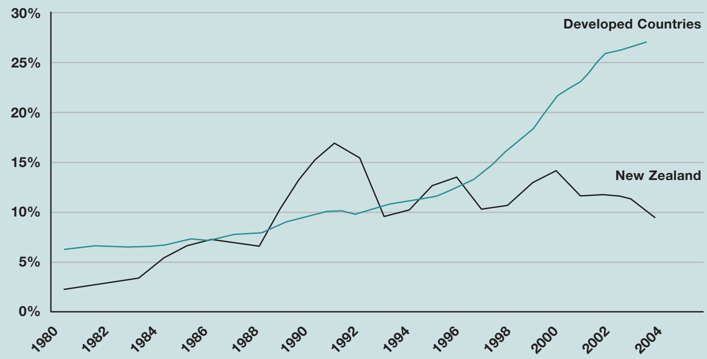
This stock of outward FDI is much lower than New Zealand's stock of inward FDI of about $79 billion in 2005, which represents about 52% of New Zealand's GDP. Overall, New Zealand has a direct investment deficit of over $60 billion, or about 40% of GDP. As a share of GDP, this is one of the largest FDI deficits in the OECD. New Zealand has been successful in attracting FDI into New Zealand, particularly into the domestically-focused sectors of the economy (Skilling (2005)), but has been much less successful in terms of New Zealand firms investing significantly abroad.

In addition to considering the level of outward FDI, it is also instructive to consider the returns generated on this investment. Unfortunately, the returns on the international investments that have been made are not that impressive. For the 12 months to June 2005, the return on New Zealand's equity FDI was 4.2%. This contrasts with the 14.1% return on equity investment generated by foreign investors on their New Zealand FDI in the year to June 2005.[11]

[10] Statistics New Zealand has recently revised these FDI numbers upward from 9% of GDP.

[11] These average returns are calculated by dividing the operating income from equity direct investment (not including capital gains) by the stock of outward equity direct investment.

FIGURE 7: LEVEL OF OUTWARD FDI AS A % OF GDP, 1980-2004



Source: UNCTAD

And over the past decade, from 1996 to 2005, the return on New Zealand's outward FDI was about 5%, which is considerably lower than the 9% average return on the New Zealand investments of foreign investors. This is despite the past decade being a period in which many of the destination investment markets have grown rapidly, which should have been conducive to generating higher returns. And the gap in returns has not closed over the past several years, indicating that this is not just due to the poor performance of legacy investments.

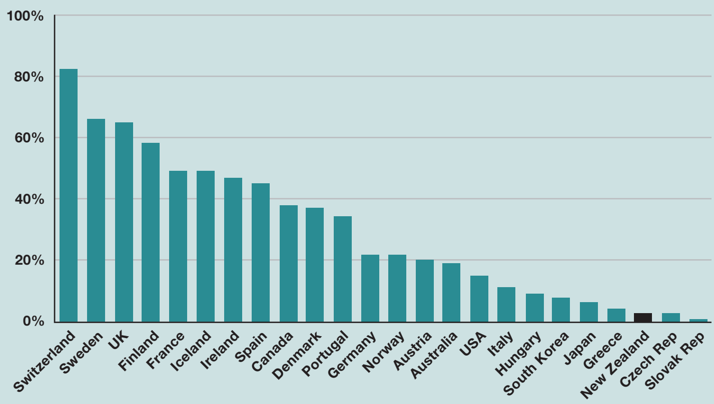
New Zealand generated a direct investment income deficit of about $7.0 billion, or 4.7% of GDP, for the year to June 2005. This deficit has been generated for two reasons. First, foreign investors generate higher returns on their New Zealand investments than New Zealand investors achieve on their foreign investments, as noted above. And second, there is the substantial direct investment deficit in which New Zealand's stock of inward FDI is higher than the stock of outward FDI by about 40% of GDP. This is compounded by New Zealand's very low level of household savings, which means that New Zealand is heavily reliant on foreign capital to finance domestic investment and consumption.

INTERNATIONAL BENCHMARKING

Internationally, FDI flows have grown very rapidly since 1990. The OECD (2005a) estimates that annual FDI outflows from OECD countries rose from about US$225 billion in 1990 to US$670 billion in 2004, having reached annual outflows of about US$1200 billion in 2000. So annual FDI outflows from OECD countries are over three times the level they were in 1990, and these outflows are expected to continue to increase over the next several years (UNCTAD (2005)).

The OECD (2004b) describes this experience as "rampant cross-border activity" by companies. Many multinational companies have expanded substantially over the past decade or so with significant assets spread across many markets.

FIGURE 8: AGGREGATE FDI OUTFLOWS AS A % OF GDP, 1995-2004



Source: OECD; World Development Indicators

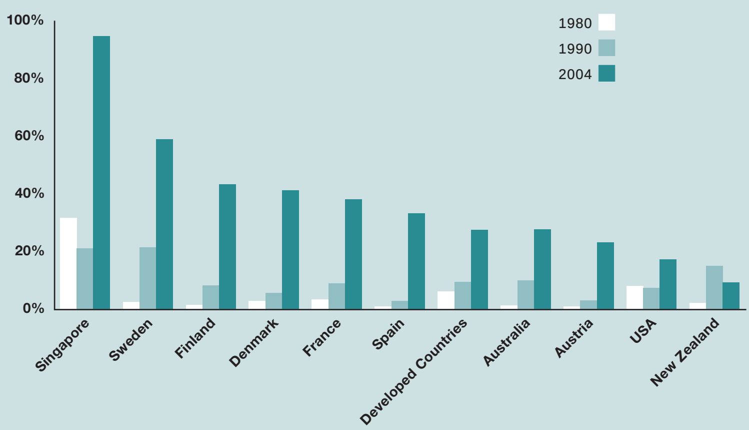
New Zealand participated in this process of intense FDI activity in terms of receiving substantial amounts of inward FDI, particularly in the early 1990s, but not in terms of substantial FDI outflows. Indeed, as described above, New Zealand's FDI outflows have been lower in the period since 1990 than they were in the 1980s. As with New Zealand's relative exporting performance, New Zealand's performance with respect to outward FDI has diverged from other OECD countries during the 1990s.

This divergence can be seen clearly in Figure 7. Although New Zealand's stock of outward FDI was above the OECD average in 1990, it has declined steadily since. This has occurred while the developed country average for the stock of outward FDI has grown strongly from about 10% of GDP in 1990 to 27% of GDP in 2004. This means that the stock of outward FDI as a proportion of GDP has increased by a factor of three while New Zealand's stock has reduced significantly. New Zealand's stock of outward FDI as a share of GDP now ranks 21st out of 30 OECD countries.

A significant reason for the reduction in the stock of outward FDI has been the low outflows of FDI by New Zealand firms over this period. While significant FDI outflows were being observed across the OECD countries, New Zealand's outflows were not keeping pace as is evident from Figure 8.

New Zealand's total FDI outflows over the 1995-2004 decade were considerably lower than for other OECD countries, at just 3% of GDP. This compares with total outflows of 19% of GDP for Australia, 45% for Spain, and 58% for Finland. Indeed, New Zealand's FDI outflows as a share of GDP between 1995 and 2004 were 25th out of 30 OECD countries. Only five OECD countries had lower FDI outflows than New Zealand over this period: Poland, the Czech Republic, the Slovak Republic, Turkey, and Mexico.

FIGURE 9: LEVEL OF OUTWARD FDI AS A % OF GDP



Source: UNCTAD

And New Zealand's low level of outward investing persists. The OECD (2005a) reports that New Zealand's FDI outflows between 2001 and 2004 were the second lowest in the OECD in absolute terms.

This pattern of FDI outflows is reflected in a low level of outward FDI as a share of GDP compared to other developed countries. Figure 9 compares the level of New Zealand's outward FDI to that in a range of other developed countries in 2004.

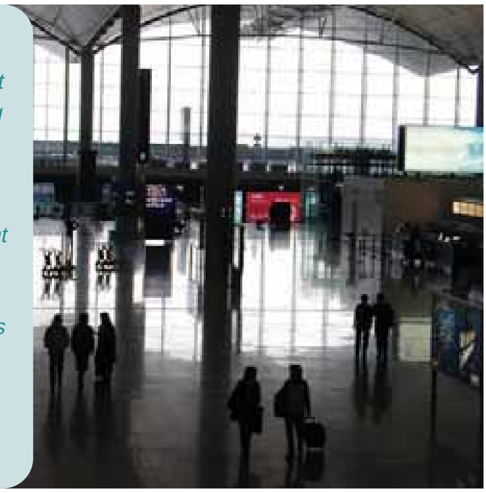
The latest available internationally comparable observation for New Zealand has the FDI stock at 9.5% of GDP. This compares with 27% for Australia, 65% for the UK, and an average of 27% for the developed world in 2003 (UNCTAD (2005)). In addition, several non-OECD countries have substantial levels of outward FDI, such as Singapore (95% of GDP) and Hong Kong (247% of GDP).

Although the relationship between country size and direct investment is weaker than for exporting – because larger companies make larger international investments, and there are more large companies in larger countries – many of the small developed countries also have substantial amounts of overseas direct investment. Small countries like Finland, Switzerland, and Ireland, have substantial amounts of outward FDI through companies like Nokia, Novartis, and CRH.

Moreover, New Zealand's outward FDI stock has reduced since 1990, which is a unique experience in the developed world. New Zealand's outward FDI stock as a share of GDP was well above the developed country average in 1990. But since then, New Zealand's outward FDI has reduced, which is in sharp contrast with the general tendency for FDI to increase and often by substantial amounts. Australia's stock of FDI, for example, rose from 10% to 27% of GDP between 1990 and 2004.

"The process of globalisation brought about in part through international direct investment shows little signs of relenting and has rather become an integral part of corporate strategies. While the bulk of investment flows are still accounted for by a handful of countries, a dominant feature of investment activity in recent years has been the diversification of investing firms and the industrial sectors they represent as well as the rising FDI flows from and to virtually all OECD countries."

OECD (2003a)



One of the most notable features of Figure 9 is the large and rapid increases in the level of outward FDI across many developed countries between 1990 and 2004. Many of the European countries, like Finland, Denmark, France, and Spain, increased outward FDI from under 10% of GDP to levels well in excess of 30% of GDP over this period.

SUMMARY

The flows of direct investment from New Zealand have been low by international standards, and have declined over the past decade. This is despite the past decade being a period in which direct investment flows have grown strongly worldwide as firms have increasingly sought to establish an international presence. Unfortunately New Zealand has gone backwards since 1990 relative to other developed countries and also in an absolute sense. And the returns generated from the investments that have been made by New Zealand firms have often not been strong.

As with New Zealand's exporting performance, New Zealand is not keeping pace with most other developed countries in terms of outward FDI. This divergence is becoming increasingly apparent, with a widening gap between New Zealand and other countries in terms of the level of outward direct investment.

So New Zealand's relatively low level and growth of exports cannot be attributed to a reliance on international investment as an alternative form of international engagement. Indeed, New Zealand's relative international investment performance is worse than its relative exporting performance.

This is troubling because international investment provides a relatively clean measure of the international competitiveness of an economy. Whereas a country can generate high levels of exporting through the local activities of foreign firms, outward direct investment is due to the qualities of domestic firms. The ability of a country's firms to compete successfully abroad provides a good indication as to how competitive the economy is. In this sense, New Zealand's relatively poor performance in terms of outward FDI does not provide a positive message about the competitive position of the New Zealand economy.

4 THE INTERNATIONAL ACTIVITIES OF NEW ZEALAND FIRMS

To better understand these aggregate exporting and investment outcomes, it is useful to consider exporting and outward direct investment at a firm level. How widespread is this international activity, how is it changing over time, and how successful are these international activities?

This section also considers the growth path of New Zealand firms, and compares New Zealand firm growth to that observed in other countries. Are New Zealand firms able to grow into substantial international firms to the same extent as firms located in other developed countries?

FIRM-LEVEL EXPORTING

As in all other countries, only a small proportion of New Zealand's firms export. Fewer than 4% of New Zealand firms are involved in exporting, which is a similar proportion to that reported in other countries. Austrade (2001), for example, estimates that about 4% of Australian firms employing less than 200 people export. The Boston Consulting Group (2004) suggests that the proportion of New Zealand firms exporting may be higher than in European countries, although the data make international comparisons difficult.

In any case, only a small number of New Zealand firms export with the vast majority of New Zealand firms focused on the domestic economy. New Zealand, of course, has some major exporting companies such as Fonterra and Zespri, but there are not many of them.

New Zealand's exports are heavily concentrated in the hands of a few exporters. In the year to September 2005, New Zealand Trade & Enterprise reports that only 361 firms exported more than $10 million and only 50 firms exported more than $75 million.[12] This means that a small number of New Zealand firms account for a substantial share of New Zealand's export revenue. For example, the 50 firms exporting more than $75 million represent about 60% of New Zealand's total export revenue and the 361 firms that export more than $10 million a year account for 85% of New Zealand's export revenue. The 12,105 firms that export less than $10 million represent the remaining 15%.

And even within these categories, there is a concentrated distribution. The top 10 New Zealand exporters account for about half of New Zealand's total exports. This is due to significant exports from large companies like Fonterra, Zespri, Comalco, Sanford, AFFCO, and PPCS. New Zealand's exporting distribution seems concentrated compared to other OECD countries. For example, the distribution of Australian exporting firms is less concentrated than in New Zealand, with the 700 largest firms accounting for 49% of total export revenues.

70% of the increase in New Zealand's export income between 1994 and 2005 was generated by the firms exporting more than $25 million. The increase in exports by smaller firms has not had a material impact on the level of New Zealand's exports. Only 16% of the

[12] *This only covers exporters of goods, not exporters of services like tourism or export education.*

increase in exports was driven by firms exporting less than $10 million a year.

4550 firms, over one third of New Zealand exporters, exported less than $10,000 in the year to September 2005. This suggests that small scale, 'opportunistic' exporting activity by New Zealand firms is widespread. Simmons (2002) notes that 49% of exporting firms between 1995 and 2001 were exporting for the first time, and 57% of these did not export the next year. And Knuckey & Johnston (2002) report that about half of New Zealand's exporting firms in 2002 derived less than 10% of their income from exports.

Overall, few New Zealand firms export a meaningful amount. There has been some progress over the past decade, with an additional 78 firms exporting more than $25 million in the year to September 2005 compared to 1994 and an additional 17 firms exporting more than $75 million. This represents close to a doubling in the number of firms exporting more than $25 million, which makes for a good percentage increase. But the absolute number of large New Zealand exporters is still small.

So there are many small and medium-sized exporters but in general they do not grow beyond this. Most of the New Zealand economy is domestically-oriented with firms servicing a small domestic market. And even of those firms that do export, most continue to derive the bulk of their income from the domestic New Zealand economy.

New Zealand has many rapidly-growing, successful companies. But these high rates of export growth often come from a low base, and the combined exports of these exporting firms are not yet sufficiently material to have a significant impact on New Zealand's total export sales. Although there is the potential for these firms to grow into substantial international operations, there are few examples of this happening to date.

Simply put, there are not enough new exporters and their sales are not yet large enough to generate substantial increases in New Zealand's overall export sales. These success stories deserve to be celebrated and showcased, but it is important to understand the materiality of their contribution to New Zealand's exports.

FIRM-LEVEL DIRECT INVESTMENT ABROAD

Firm-level data on outward direct investment are not as readily available as for exporting activity. But it is likely that fewer New Zealand firms are engaged in FDI activity offshore than are engaged in exporting. This is because outward FDI is more demanding than exporting. Such investing activity demands expertise in the management of operating assets abroad and requires a sustained commitment.

However, of the firms that do engage in FDI, the distribution is likely to be less concentrated for exports. Whereas exporting is dominated by a relatively small number of large firms, with a long tail of small exporters, FDI is likely to be more evenly spread across firms. Many listed New Zealand firms have some international exposure, although not many derive the majority of their income from international investments.

TABLE 2: MAJOR INTERNATIONAL COMPANIES FROM NEW ZEALAND

Company	Industry	Estimated International Revenues ($M)	International Intensity
Fonterra	Dairy products	10,475	High
Air New Zealand	Airline	2,281	Moderate
PPCS	Meat products	2,200	High
Fletcher Building	Building products	1,950	Low
Telecom	Telecommunications services	1,379	Low
Carter Holt Harvey	Wood and paper products	1,080	Low
Alliance	Meat products	1,045	High
Zespri	Fruit	969	High
AFFCO	Meat products	868	High
Nuplex	Plastic products and resins	769	High
F&P Appliances	Household appliances	644	Moderate
The Warehouse Group	Retail	567	Low
ANZCO	Meat products	500	High
Mainfreight	Transport	417	Moderate
Sanford	Fish products	315	High

Note: International revenue earned from exporting or international investment. High intensity is >75% of revenue from overseas, Moderate >50%, and Low <50%. New Zealand companies are those with significant New Zealand ownership
Source: Most recent relevant annual report. PPCS, Zespri, Sanford, and ANZCO based on best available public information

INTERNATIONAL PERFORMANCE OF NEW ZEALAND FIRMS

Exporting and international investment is, of course, not an end in itself. It is important as a means to improve the financial performance of New Zealand firms, and by extension the performance of the New Zealand economy as a whole. So in addition to examining the extent to which New Zealand firms are engaged in international activity, it is also important to examine the profitability of this activity.

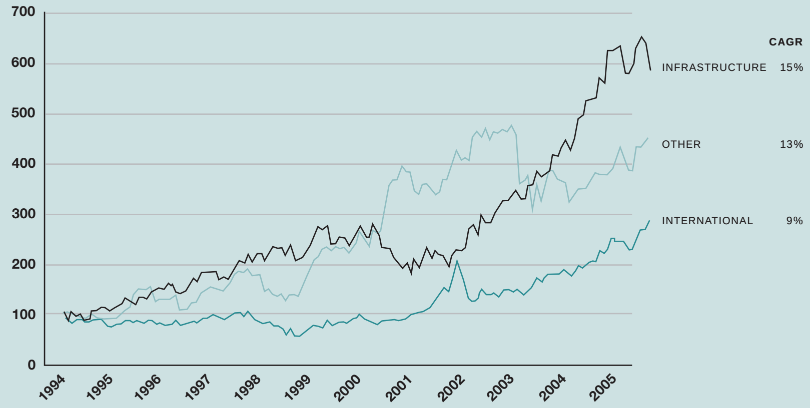
The aggregate returns on New Zealand's outward FDI noted above suggested that the overall performance has not been strong. But it is also important to examine the firm-level performance directly.

Consider, for example, the performance of New Zealand's largest listed companies between 1994 and September 2005.[13] Figure 10 shows that there is a considerable gap in performance between companies that are focused on the domestic economy and those that are focused on the international economy. The listed companies are divided into domestically-oriented companies – such as Sky TV and Briscoe Group, domestic utilities – such as the Ports of Auckland and Auckland Airport, and international companies who have a substantial international earnings component – like Air New Zealand and F&P Appliances.[14]

[13] This analysis started with the top 50 New Zealand listed companies in 2005, from which 13 foreign owned companies (e.g. ANZ) were removed. This is a binary measure and doesn't give a sense of the performance of domestic and international activities within a company.

[14] The 12 international companies are Air New Zealand, Carter Holt Harvey, Cavalier Carpets, Fletcher Building, F&P Appliances, F&P Healthcare, Mainfreight, Michael Hill International, Nuplex, Sanford, Tenon, and Tower.

FIGURE 10: TOTAL SHAREHOLDER RETURN INDEX, 1994-2005Q3



Note: Based on analysis of the top 50 New Zealand listed firms, excludes 13 firms with significant foreign ownership
Source: Bloomberg

Substantial variation in total shareholder returns can be seen between these different groups of companies. Domestically-oriented companies generated a return of 13% per year between 1994 and 2005. Returns were even stronger in the context of domestic companies that were in the utilities or infrastructure sector, with a return of 15% per year. Companies in this sector have generated substantial returns over the past few years on the back of a strong domestic economy.

In contrast, New Zealand companies who were focused on the international economy generated lower returns over this period, earning an annual return of just 9%. Companies with substantial exporting businesses and companies that have made substantial investments abroad tend to have under-performed companies that have focused on the New Zealand market over the past decade.

The difference in performance is systematic and is not driven by a few bad companies or a few bad years. This observation is consistent with the aggregate data on the strong performance of the domestic economy and the relatively weak performance of the external sector over the past decade.

The reality is that many of the large New Zealand deals offshore have not generated strong returns over the past couple of decades, such as those of Fletcher Challenge and Air New Zealand. Obviously there are investments by New Zealand firms that have performed well, particularly over recent years, but there has not been a consistent story of large, successful New Zealand investments abroad.

This New Zealand experience contrasts with the international experience described in Skilling & Boven (2005) in which returns generated by

internationally-focused companies tend to exceed those of domestically-focused companies. This makes the international performance of New Zealand companies even more distinctive. On average, New Zealand companies do not seem to compete well in international markets but can earn good returns in the domestic New Zealand market.

Although some New Zealand firms have generated substantial profits from their international activities, from a materiality perspective it is the financial performance of the large firms that has the biggest impact. If few of the large listed New Zealand companies are making good returns on their international investments, it is unlikely that this can be offset by good performance by small firms. In addition to the high-profile small success stories, it is important that large New Zealand firms generate substantial amounts of shareholder value from their international operations.

IMPLICATIONS FOR FIRM GROWTH

The relatively limited international engagement of New Zealand firms has direct implications for the growth dynamics of New Zealand firms. It means that the growth opportunities for most New Zealand firms are constrained to the domestic market. Indeed, there are some distinctive features of the growth of New Zealand firms and the distribution of firm size that this dynamic produces.

New Zealand has high rates of company start-up and of self employment compared to many other developed countries. One likely reason for this is the low costs associated with starting up a company in New Zealand (World Bank (2005)). Companies can be started in more of an experimental manner than in countries where it requires a greater investment of time and resource to get the company started.

But there are differences in terms of the subsequent growth dynamics of New Zealand firms compared to firm growth in many other countries. Although many New Zealand firms start small, they do not then grow in the way that is observed in larger markets like the US. The growth of New Zealand firms tails off more rapidly than in countries with larger markets.

As a consequence of this growth profile of New Zealand firms, New Zealand has few large firms by international standards. Mills & Timmins observe that New Zealand's large companies are not as large as those in many other countries, and that "bigger countries like the USA, the UK, Germany and France have a greater share of employment in large firms than do smaller countries" (2004, p. 17). In New Zealand 26% of overall employment is in firms employing more than 500 people, compared to 50% in the US and 47% in the UK. And the average size of firms in New Zealand that employ more than 500 people is substantially lower than in the US and the UK.

These size differences are particularly apparent in the manufacturing sector. For example, The Boston Consulting Group (2004) notes that the average size of a New Zealand manufacturing firm is 12 employees, compared with 86 in the US, 44 in Germany, 41 in Canada, 23 in France, and 17 in Finland.

This is consistent with the lack of instances of rapid, sustained firm growth in New Zealand of the type observed in the US, where companies grow rapidly from small start-up to companies of a substantial size. Microsoft, for example, grew from nothing to one of the world's largest firms in 25 years or so. Google provides a more recent example of explosive firm growth. These are extreme examples of firm growth, but New Zealand has few scaled-down examples of this type of growth performance.

Most large New Zealand firms can trace their history back for several decades. This contrasts with the international experience where many large firms did not exist 30 years ago. Foster & Kaplan (2001), for example, note the high and increasing turnover in terms of the companies that are included on the S&P 500 index. In 1998 there was close to a 10% turnover in the population of the S&P 500, with many new firms joining and existing firms exiting. This type of activity is not observed in New Zealand.

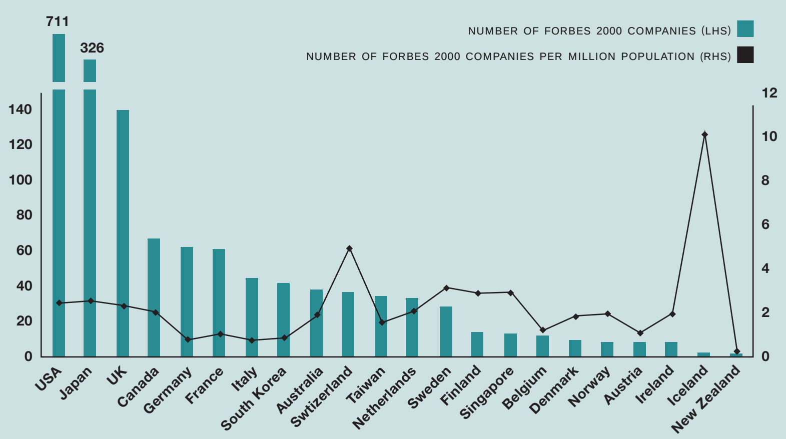
So New Zealand firms do not seem to become as large as firms in other countries. One illustration of this is in terms of the relative absence of large New Zealand multinational firms that operate in many countries. There are a few such companies in the primary sector, such as Fonterra and Zespri, but the number is small compared to most other developed countries.

A good measure of this is provided by the Forbes Global 2000 index, which ranks the world's 2000 largest listed firms annually based on a composite index of sales, profits, assets, and market value. In 2005, Telecom was the only New Zealand firm included on the list, ranked at number 988.[15] In contrast, Australia had 38 firms on the list, despite having a population that is only five times that of New Zealand. All developed countries with a similar population size to New Zealand have substantially more companies on this list, as shown in Figure 11. For example, Ireland has 8 firms on the list, Finland has 15, and Sweden has 28. Spain and Portugal, whose per capita income levels are now approximately the same as in New Zealand, have 30 and 7 firms respectively on the list.

Many of the Asian economies also have large numbers of multinational firms. Singapore, with a population the same size as New Zealand, has 13 multinationals. South Korea and Taiwan have 41 and 35 respectively, despite only integrating into the global economy relatively recently. And many less developed countries have several large multinational companies: Chile has 5, Pakistan and the Philippines have 2, and Indonesia has 8.

Figure 11 presents the number of Forbes Global 2000 companies for a range of countries and also expresses this as a share of the country's population. Most developed countries have between one and three multinationals per million of population. Iceland tops the rankings with three companies in the top 2000 despite only having a population of 300,000. In contrast, New Zealand has just 0.25 multinational companies per million population.

FIGURE 11: FORBES GLOBAL 2000 COMPANIES



Source: Forbes Magazine; The New Zealand Institute calculations

[15] *Fonterra is excluded because the Forbes Global 2000 only includes publicly listed companies.*

This provides an indication that New Zealand has not been as successful in growing multinational companies as have most other small developed countries. However, the encouraging aspect of this international experience is that it shows that a small domestic market does not prevent the growth of large successful international companies. The Scandinavian economies, as well as small countries like Ireland, Israel, Switzerland, and Singapore, all have a significant number of multinational companies. And many of these companies, such as Nokia, have grown into large successful multinationals over the past decade or so as they have taken advantage of enhanced global opportunities.

In addition to the absence of large multinational companies, New Zealand has not yet fully developed the next tier of companies. As noted above, only 361 firms export more than $10 million a year and New Zealand has been described as an 'archipelago economy' in which there is only a scattering of medium sized firms. This contrasts with the situation in countries like Italy and Germany where small and medium sized firms, with sales ranging from $10-100 million and often focused on the international economy, are the backbone of their economies (Porter (1998)). In these countries, there are lots of small and medium exporters as well as large multinationals.

SUMMARY

A relatively small number of firms generate New Zealand's exporting and foreign investing activity. Meaningful international activity is not widespread in the New Zealand economy. And those firms that are participating in the international economy have tended to generate lower returns than have domestically-oriented firms.

Because of this, the growth of most New Zealand firms is limited to the size of the New Zealand market. New Zealand has few multinational firms and only a scattering of large firms. The aim should be to grow some larger New Zealand companies that engage internationally, including some genuine New Zealand multinationals.

This section summarises the evidence and analysis in the previous sections and offers an overall evaluation of New Zealand's international performance. What should be made of New Zealand's international performance over the past few decades, and what are the prospects for the future? Are New Zealand's exporting and international investment outcomes likely to improve over the next few decades and converge to those of other small developed countries?

INTERNATIONALISATION INDEX

On measures of both exporting and outward FDI, New Zealand lags considerably behind many other developed countries and particularly behind other small developed countries. Of the 30 OECD countries, New Zealand's level of exports to GDP currently ranks 21st in the OECD and New Zealand's stock of outward FDI as a share of GDP also ranks 21st in the OECD.

To summarise these outcomes, an internationalisation index is created that sums the level of exporting activity and outward FDI as a share of GDP. This index is calculated for developed countries in 1990 and 2004, and is shown in Figure 12.

The index does not capture the quality of international engagement, such as the profitability of the activity, the extent of processing and technological intensity, and so on. But it is a useful summary measure of the extent of international engagement of various economies.

New Zealand ranks 25th out of 30 OECD countries on the internationalisation index. This low ranking is unsurprising given that New Zealand has relatively low levels of both exporting and outward FDI. The only countries that have lower index values than New Zealand are Mexico, Turkey, the US, Greece, and Japan. All of these countries are substantially larger than New Zealand. The next largest country,

FIGURE 12: INTERNATIONALISATION INDEX, 2004

Note: Internationalisation Index = FDI/GDP + Exports/GDP
Source: UNCTAD; OECD; National government statistics for Malaysia and Singapore

Greece, has a population of over 11 million, almost three times that of New Zealand, and the US and Japan are large and prosperous markets.

It is the small developed countries that are the appropriate comparisons for New Zealand because small countries are much more reliant on international economic activity to achieve and sustain high rates of productivity growth. It turns out that New Zealand's internationalisation index value is considerably lower than other small developed countries. The average internationalisation index value for OECD countries with populations of 10 million or less is 89% of GDP, a full 50 percentage points higher than New Zealand's index value of 39%.[16]

Figure 12 also shows that Australia has a higher index value than New Zealand – 45% compared to 39% for New Zealand. Although Australia's level of exporting is lower than that of New Zealand, Australia has much higher levels of outward FDI.

This index gives a clear indication that the New Zealand economy is not well integrated into the global economy in terms of exporting and international investment, when compared to other small developed economies. For a small country, New Zealand is highly unusual in the reliance that is placed on the domestic economy to drive its economic growth.

The other feature of New Zealand's performance that is apparent from this internationalisation index is that New Zealand has gone backwards in terms of international economic activity since 1990. New Zealand's level of exporting has increased slightly from 27% of GDP in 1990 to 29% today, but New Zealand's stock of outward direct investment has declined from 15% of GDP to 9.5% of GDP in 2004. This generates an internationalisation index value for New Zealand that is three percentage points lower in 2004 than it was in 1990.

New Zealand is the only OECD country that has a lower internationalisation index value in 2004 than in 1990. Every other OECD country has increased its combined shares of exporting and outward FDI, often by substantial amounts. The average increase for small countries (those countries with a population of 10 million or less) was 42 percentage points to a 2004 index value of 89%. So for this group of countries, on average, the degree of international engagement roughly doubled. This is also true across the OECD, with an average increase of 33 percentage points in the index to an average of 72% of GDP.

The developed world as a whole has experienced a substantial increase in both exporting and FDI activity. Large and rapid increases in international engagement have been an important part of the recent growth stories of countries like Ireland and Finland. And non-OECD countries like Singapore and Hong Kong have also generated substantial increases in international activity.

[16] The calculations in this discussion exclude Luxembourg because it is an outlier and skews the average index value up substantially.

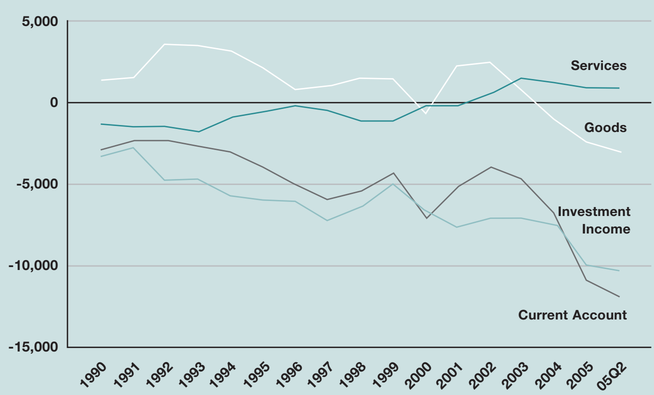
So New Zealand's decline contrasts sharply with the rapid increase in internationalisation in other developed countries. At a time when the rest of the world has been globalising, New Zealand has been going backwards in a relative sense and, to some extent, in an absolute sense as well. New Zealand does not benchmark well against other small developed countries, and is also being overtaken by less developed countries.

The profile of New Zealand's international engagement is continuing to diverge from that of other developed countries. The levels of both exporting and outward FDI as a share of national income have reduced for New Zealand over the past several years. Since 2000, exports have reduced from 35% to 29% of GDP and the outward FDI stock has reduced from 14.1% to 11.9%. This has occurred while trade and investment flows have increased substantially across the developed world. Between 2000 and 2004, for example, the World Trade Organisation (2005) reports that real world merchandise trade increased by an average of 4.2% per year, compared to real income growth of 2.5% per year, and the OECD (2005a) reports that the stock of outward FDI across OECD countries rose by 45% between 2000 and 2003.

New Zealand's poor performance on both international trade and investment is reflected in the current account deficit. Figure 13 shows that New Zealand's trade deficit has tended to increase over the past 15 years, as has the investment income deficit. Indeed, on both measures, New Zealand's deficits are close to record levels. These deficits combine to generate a current account deficit of 8% of GDP, which is projected to decline further.

And New Zealand's current account deficit is among the worst in the OECD. Only two OECD countries –

FIGURE 13: BALANCE OF PAYMENTS FOR NEW ZEALAND ($M)



Note: March year end except last observation
Source: Statistics NZ

Portugal and Iceland – have larger current account deficits than New Zealand.

PROSPECTS FOR THE FUTURE

So what about the prospects for the future? Unfortunately, a material improvement in New Zealand's international performance seems unlikely on current course and speed. Indeed, a troubling aspect of New Zealand's relative performance over the past 15 years is that the environment was in many ways conducive to a good international trading and investing performance.

International trade and investment flows have increased strongly over the past 15 years, and have continued to grow steadily over the past few years. And in addition to the generally positive global economic conditions, with robust income growth in many key markets and the emergence of major new markets, there were also a series of factors that ought to have benefited New Zealand disproportionately. Consider the following factors:

- *Reduced transport and communication costs*

Technological progress over the past decades has reduced some of the costs of transacting over a distance, with reduced costs of transport and communication. The internet, email, and technologies like videoconferencing have become widespread over the past decade. Given that New Zealand is one of the most remote developed economies in the world, it is often argued that these technologies ought to have generated particular benefits for New Zealand by reducing the costs of transacting and by making a greater range of activities feasible at a distance. There are many examples of the activities that have been made possible by advances in communications technology (Friedman (2005)).

- *Strong export prices*

Many New Zealand exporters have

benefited from strong average export prices over the 1990s relative to previous periods. And primary exports have benefited particularly over the past several years from historically strong commodity prices. Again this ought to have provided particular benefit to New Zealand given its export composition.

In recent years, these high commodity prices have been offset by the high value of the New Zealand dollar. And the appreciation of the currency has hurt those exporters that have not benefited from the higher commodity prices, such as those in the manufacturing sector. But over the past 15 years, the New Zealand dollar has been high as well as low and so cannot be blamed for the persistently low levels of exporting.

- *Trade and investment liberalisation*

Barriers to international trade and investment flows have tended to reduce over the past 15 years, which has encouraged increased international economic activity. One of the notable developments in this regard was the successful conclusion of the Uruguay Round of trade liberalisation in April 1994. Yet New Zealand's export growth has lagged that of many other developed countries over the past decade despite this positive trade deal.

One reason for this is that the benefits of trade liberalisation are relatively small compared to New Zealand's overall level of exporting. The Ministry of Foreign Affairs & Trade estimate export gains from this process at a total of about $9 billion over the 1995-2004 period, which primarily benefited exporters of agricultural products (MAF and MFAT (2003)). This translates into an annual increase in export income of about $900 million or less than 3% of total exports per year.

This gives a sense of the relatively limited materiality of the benefits from World Trade Organisation negotiations. For this reason, the successful passage of the current round of negotiations – the Doha Round – is unlikely to lead to a substantial improvement in New Zealand's exporting performance.[17] Current estimates suggest that the benefits of a successful Doha Round will be about the same size as from the Uruguay Round. Although welcome, this is not the economic panacea sometimes imagined.

Discussion

Taken together, these factors should have contributed to a strongly improved international performance for New Zealand over the past 15 years. However, New Zealand's international performance over the past 15 years has been poor, both compared to previous decades and also relative to the experience of much of the developed world. Over this period, New Zealand's export growth has been considerably slower than the OECD and world averages and New Zealand's stock of outward FDI has reduced while levels have increased significantly globally. There are now substantial gaps between the level of New Zealand's international engagement and that of other small developed countries.

[17] *And the prospects for the successful passage of the Doha Round are not at all clear.*

Moreover, the nature of New Zealand's international engagement, in terms of export composition or the existence of successful New Zealand multinational firms, has not changed substantially over the past few decades. As noted earlier, the past 15 years have been distinctive in terms of the absence of meaningful change despite some encouraging progress in small pockets of the New Zealand economy.

Many developed countries have used the recent process of globalisation to transform their economies. Countries like Finland, for example, have rapidly moved their exports out of the primary sector into high tech manufactures and services. New types of activities are driving the growth in trade and direct investment, but New Zealand has only a small presence in these areas. New Zealand has not participated in many of the powerful trends that have been driving the recent globalisation process.

Going forward, there are emerging competitive threats that will make aspects of the international environment more challenging for New Zealand firms. Some of these pressures are already becoming apparent, with the loss of market share in over half of New Zealand's export categories. This more intense competition will affect New Zealand's traditional areas of strength in the primary sector as well as in terms of exports of manufactured goods and services.

However, the process of intense global integration also provides some fantastic opportunities for New Zealand: three billion new consumers with an emerging middle class in India and China for a start (Prestowitz (2005)). But this potential upside will not automatically be realised. It will require deliberate, sustained effort.

The message is that New Zealand's current course and speed is not delivering good outcomes. New Zealand's international performance increasingly lags that of other small developed countries. To close the gap will require the development of meaningful new exporting strengths, as well as improved performance from existing exporting strengths, and much increased levels of international investment by New Zealand firms.

New Zealand needs to supplement its existing strengths in terms of primary sector exports with substantial new strengths in other parts of the economy. This is also important in increasing the proportion of the New Zealand economy that is substantially engaged in international activity, which should generate higher rates of productivity growth in these sectors. To ensure that more of the New Zealand economy can obtain the productivity gains provided by international engagement, it is important that New Zealand's export structure be much more broadly based.

It is not sufficient to claim that New Zealand's exporting and international investment outcomes simply reflect underlying differences between New Zealand and other countries, and that nothing can be done about it. For example, to argue that New Zealand's export performance is simply the result of comparative advantage and that this is the best that New Zealand can do.

But reliance on a static notion of comparative advantage does not necessarily make a country rich. Indeed, most other developed countries are deliberately moving in a direction quite different from New Zealand in terms of the nature of their international engagement and generating better outcomes than is New Zealand. Given the productivity and income gaps between New Zealand and other developed countries, and the importance of international engagement for improving New Zealand's labour productivity growth, it is clear that New Zealand's current course and speed is not sufficient.

SUMMARY

Improvements have been made in terms of the level of exporting and the number of firms who are exporting significant amounts. But despite these improvements, New Zealand's outcomes do not benchmark well against the performance of firms in other countries and particularly against small developed countries.

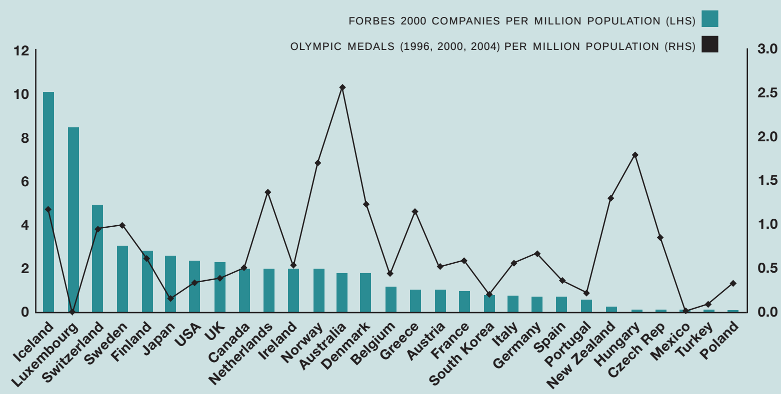
New Zealand has not globalised in the way that most other countries have.

And it is this international benchmarking that provides a clear guide as to the nature of New Zealand's performance in terms of exporting and direct investment offshore. It reveals how competitive the New Zealand economy is by illustrating how competitive New Zealand companies are in international markets. So although there are some positive aspects of New Zealand's recent performance, these improvements should not be overstated. Other countries are moving ahead much more rapidly than New Zealand.

Sporting and business success

New Zealand has a proud record of international sporting success. But the same cannot reasonably be claimed for business success on the international stage. Figure 14 contrasts New Zealand's Olympic medal count at the last three Games with commercial success, measured by the number of companies included on the Forbes Global 2000 index. New Zealand is in the top 5 of the OECD in terms of Olympic medals per million population, but is near the bottom of the OECD in terms of large New Zealand multinationals per million population.

FIGURE 14: NEW ZEALAND'S PERFORMANCE IN SPORTS AND BUSINESS



Note: Olympic medals from 1996, 2000, and 2004 per million population
and Forbes 2000 companies per million population
Source: Forbes Magazine; The New Zealand Institute calculations

6 CONCLUDING REMARKS

The key finding of this report is that, although there have been some positive developments in aspects of New Zealand's international performance, New Zealand's exporting and international investment activity does not benchmark well against other small developed countries. Moreover, this divergence is becoming increasingly apparent over time and looks set to grow further.

New Zealand's export growth has been among the slowest in the OECD over the past few decades, and New Zealand has a low level of exports to GDP for a small developed economy. While international trade flows have increased substantially over the past decade, New Zealand's exports have not kept pace.

In addition, the composition of New Zealand's exports is distinctive with a heavy reliance on primary exports and a low level of technological intensity. This composition has not changed significantly over the past decades, and certainly not in the way that has been observed in many other developed countries. In particular, New Zealand has not built significant areas of economic strength outside of its natural resource endowment.

New Zealand has not adapted to the changing world, and international outcomes have lagged as a consequence. The composition of New Zealand's exports contributes directly to the slow export growth. 81% of the goods that New Zealand exports are in markets that are growing more slowly than average export growth. In addition, New Zealand is losing market share in market categories that account for 57% of the value of New Zealand's exports.

New Zealand's stock of outward FDI is also very low by international standards. At 9.5% of GDP, it is about one third of the OECD average, and has reduced from 14.7% in 1990 when it was above the OECD average. New Zealand has among the lowest cumulative FDI outflows in the OECD over the past decade. And this reduction has occurred over a period in which global FDI outflows from OECD countries have increased by a factor of three and a half.

At a firm level, only a small number of New Zealand companies are engaged meaningfully in international commerce in terms of exporting and direct investment. The financial performance of many of New Zealand's international firms has been considerably worse than domestically-focused companies over the past decade. As a consequence New Zealand has grown few large multinational companies.

New Zealand's recent performance stands in marked contrast to the pronounced trend for economies, particularly small economies, to become much more integrated into the global economy. This is captured by the change in the internationalisation index over the past 15 years. New Zealand is the only developed country whose index value has declined since 1990. New Zealand's levels of both exporting and outward FDI have reduced as a share of national income since 2000.

Taken as a whole, New Zealand's international performance is not impressive when compared to most other developed countries. This is despite a very supportive domestic and international environment over the past 15 years or so. New Zealand has benefited from trade liberalisation, strong commodity prices, and strong world growth over this period. Because New Zealand's outcomes have gone sideways in a positive international environment, it does not seem likely that New Zealand's international outcomes will improve spontaneously.

At a time when the international flows of goods, services, and investment have risen steeply, New Zealand has largely maintained its historical course and speed. Of course there has been change, with new firms moving into export markets and firms investing abroad, but the extent of this activity does not benchmark well against that generated by many other small developed countries over the past decade or so.

Overall, the New Zealand economy is not participating in the globalisation process to the extent that other developed countries are. Instead, the New Zealand economy has a pronounced domestic bias, with much of the growth impetus coming from domestic sources rather than from the international economy.

To an unusual degree for a small developed economy, the New Zealand economy is heavily domestically-focused. And international economic activity has become a less significant part of the New Zealand economy over the past

15 years. New Zealand's economic prospects will not improve significantly until this changes and New Zealand becomes a more meaningful participant in the global economy.

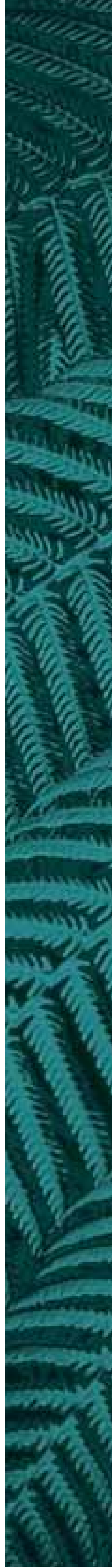
Although the number of firms exporting has increased over the past decade, many of the individual success stories are small and the growth is coming from a low base. Materiality is missing, as is evident from the national outcomes. These successful firms should be celebrated and showcased, but much more is required. The aspiration needs to be to create a genuinely global New Zealand economy in the way that economies the world over have become international.

The response is not to claim that New Zealand is somehow different and that the best that can be done is more of the same. Comparative advantage is not destiny. New Zealand's current approach is not generating good outcomes in terms of international performance. The world is changing rapidly and New Zealand must also change in order to remain competitive. Improving these international outcomes is of critical importance to securing New Zealand's economic future by significantly raising New Zealand's labour productivity.

The challenge ahead is substantial. New Zealand's outcomes compare poorly and are tending to decline over time. And this challenge is made more acute by the rapid, intensively competitive globalisation that is underway. New Zealand needs to run just to stand still.

But the good news is that significant improvement in international performance in a short period of time is possible, as is evident from the recent experience of many developed countries. There is no reason that New Zealand cannot achieve a similar outcome as well. The message, however, is that this outcome will not be achieved on current course and speed.

Understanding and improving these outcomes needs to be a major focus of attention. So over the next several months, the New Zealand Institute will be undertaking a major research effort on the best way forward. The next step is to understand what is driving these outcomes, and why the New Zealand economy has not adapted to a globalised world in the way that most other small developed countries have. This will provide the base for identifying the actions that business and government need to take in order to generate a material improvement in New Zealand's international performance.



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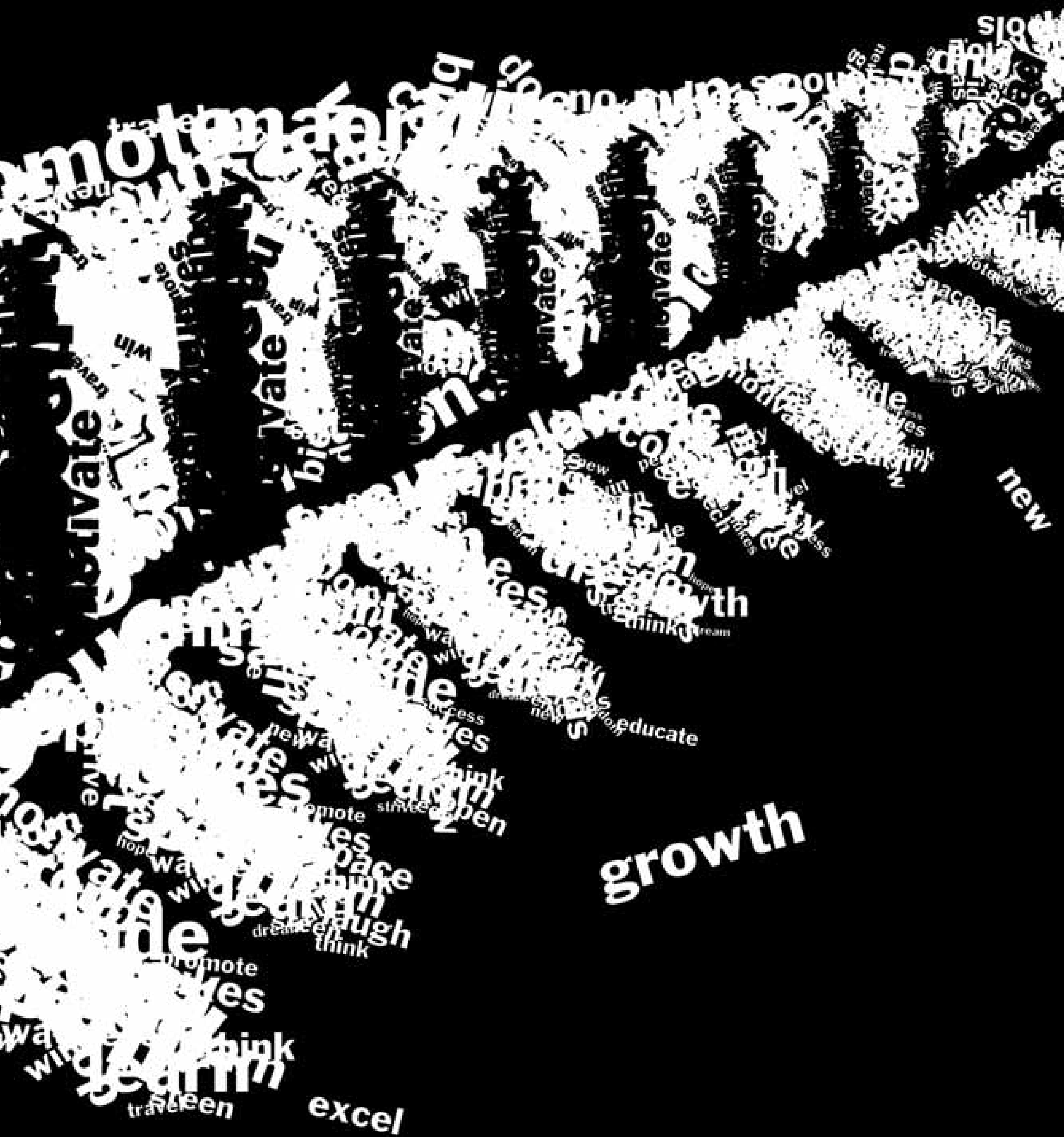
Danielle Boven

Danielle is a researcher at the New Zealand Institute. Danielle was previously a consultant at The Boston Consulting Group, where she advised a wide range of leading companies in New Zealand, Australia, the US, and Asia. Danielle has a Masters of Management from Northwestern University's J.L. Kellogg Graduate School of Management in Chicago and a Bachelor of Arts with majors in Economics, Accounting, and Government from Claremont McKenna College in California.



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