

Economic Strategy

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rather than a standalone document.*

Dr Rick Boven

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www.nzinstitute.org

www.nzahead.org

INTRODUCTION

New Zealand Institute purpose

- Economic prosperity, social well-being, environment quality, environment productivity
- Long term success depends on success in all these

Work over last 18 months includes

- Innovation ecosystem
- Focusing economic improvement efforts
- Successful firm internationalisation

Today's presentation

- High level view of economy and priorities
- First effort to pull it all together
- Directional, not yet comprehensive and definitive

ECONOMY – OUR PAST

Agricultural exports; protection from volatility and shocks

UK enters EU => protect more, agricultural subsidies develop self-sufficiency via think big

Financial crisis and reform; political consensus to follow “neo-liberal” policies => free market reforms of market institutions, macroeconomic management

Short term growth stimulus; increase workforce participation, borrow to fund asset growth and consumption, immigration drives investment stimulus

Now at a crossroads; high debt, low capital, skills deficits, low growth, outward migration of New Zealanders

ENVIRONMENT – OUR FUTURE

Global economy is getting very large relative to the environment

- On trend, population and economic growth will more than triple output by 2050
- Output is already too large for the planet to sustain

Scarcities emerging in land, water, energy, food, minerals. Real prices rising

Climate change continues unchecked

- Change is faster than the models predict
- Will not be a gradual change to a new steady state

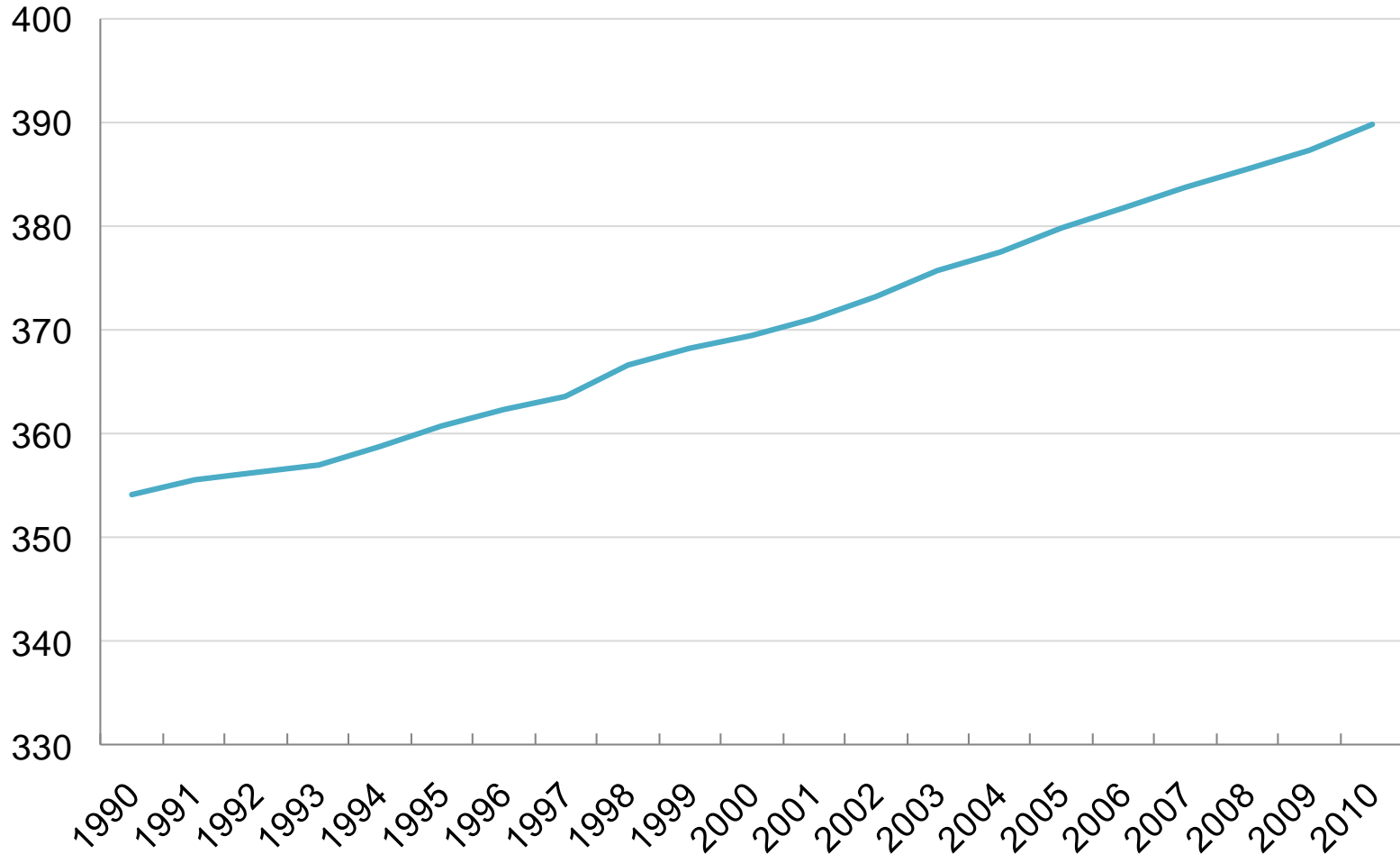
The ecosystems that support us are collapsing – bees, oceans, habitat, biosecurity

Conflict, migration and failed states increasing

Paradigm conflict; many people living with 20th century models of the world

CO₂ CONCENTRATION IN THE ATMOSPHERE, 1990-2010

AVERAGE ANNUAL PPM



PARADIGM CONFLICT

Economic – 20th Century thinking

Economy is small relative to environment

With limited exceptions, resources can be taken from the environment and wastes can be released to the environment without adverse consequences

Environmental issues resolved by substitutes, technologies and market instruments

The future will be an extension of the past

Societal objective should be to maximise GDP

Environmental – 21st Century thinking

Economy is large relative to environment

Resource and waste sink constraints, and accumulated environmental damage threaten output growth and human well-being

Environmental threats increasing and responses are insufficient

The future will be different from the past

Societal objective should be to avoid risk

EXPLICIT ABOUT THE APPROACH

Strategic – meaning objective is to identify what is needed for long term success and take action

Diagnostic – meaning to identify obstacles to economic success and what is needed to overcome them

Non-partisan

- Ideas from left and right – driven by what works internationally and what research tells us
- Avoid temptations and imperatives of the political process
 - Not advantaging rich or poor
 - Not bidding for support from swing voters in the middle

RECOGNISE

Prosperity is useful

- Competition for capital and skilled migrants in a mobile world
- Wealth for investment and to afford shocks
- Technological capability to provide future options

Uncritical GDP maximisation should not be the goal

- Not all GDP is good – includes waste, crime and ignores erosion of environmental and social assets
- Risk management is increasingly important

Improvement is not the same as success

- Short term improvement may have long term costs – debt, consumption stimulus, immigration churn
- Many improvements may be insufficient to achieve the success targeted

ECONOMIC SUCCESS

Debt reduction and wealth growth depend on income

The most important driver of income is productivity growth

- Productivity is \$/hour worked

A small trading nation cannot import the goods and services it needs without being a successful exporter

- Export volume essential to fund imports and debt
- Export value essential to drive productivity growth

Labour force participation and quality, along with environmental assets are essential for long term economic success

SOURCES OF DISADVANTAGE – PRODUCTIVITY DRIVERS

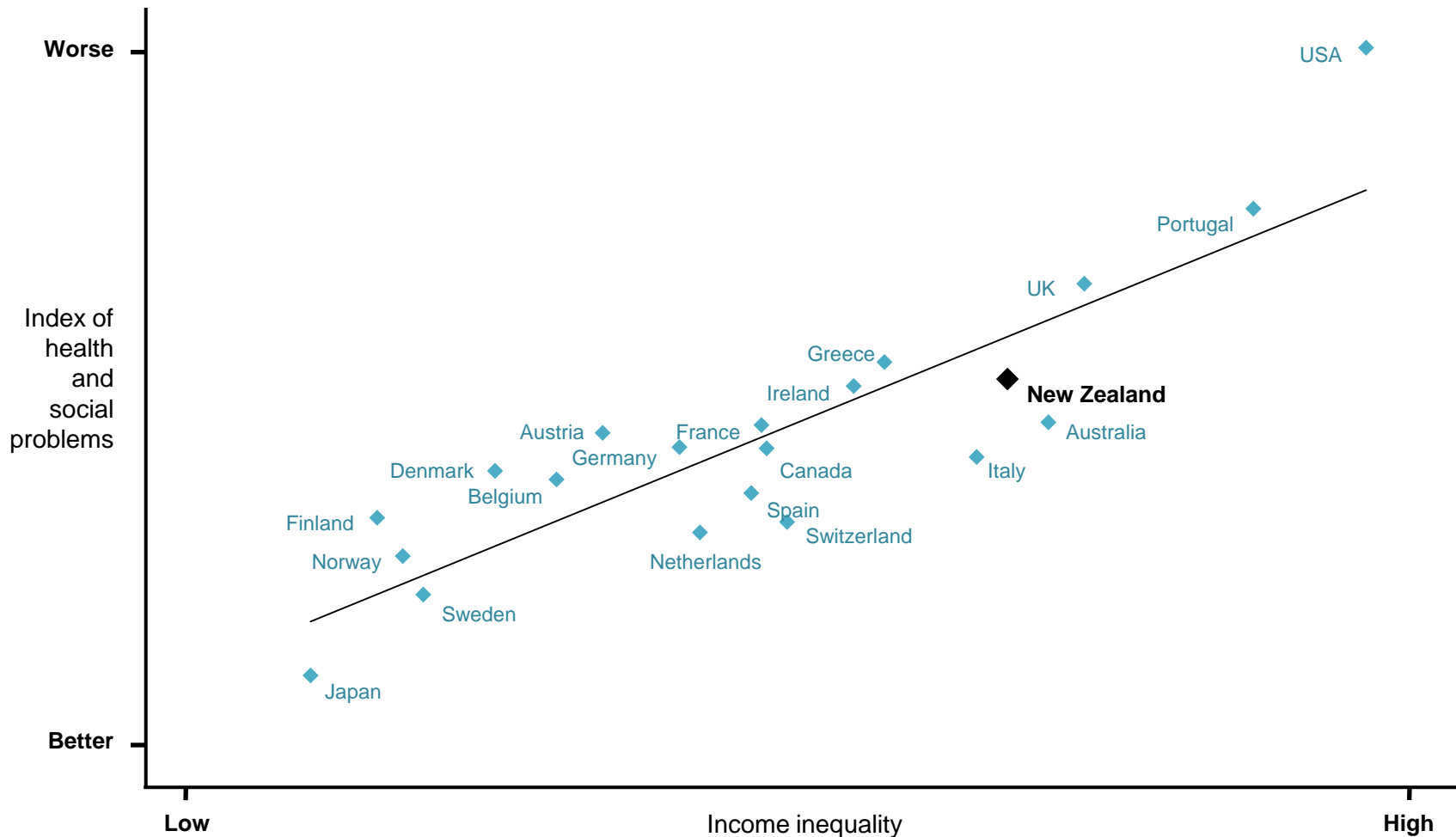
Disadvantage	Why?
Innovation	<p>Late starter – only got going around 2000</p> <p>Size and distance makes it hard to succeed from New Zealand and not enough is done to help firms overcome the barriers</p> <p>Less incentives offered than competitors</p>
Talent	<p>Brain drain</p> <p>Slow to align workforce needs with training investment</p> <p>Large pool of under-skilled people not being addressed</p>
Investment	<p>Low saving incentives leads to low saving</p> <p>‘Misallocation’ of investment via tax incentives for residential housing</p> <p>Not ‘investor-oriented’ for FDI</p>

NEW ZEALAND'S 15 TO 19 YEAR OLDS DISADVANTAGED

Percentage unemployed compared to percentage in the labour force, 15-19 year olds, 2009



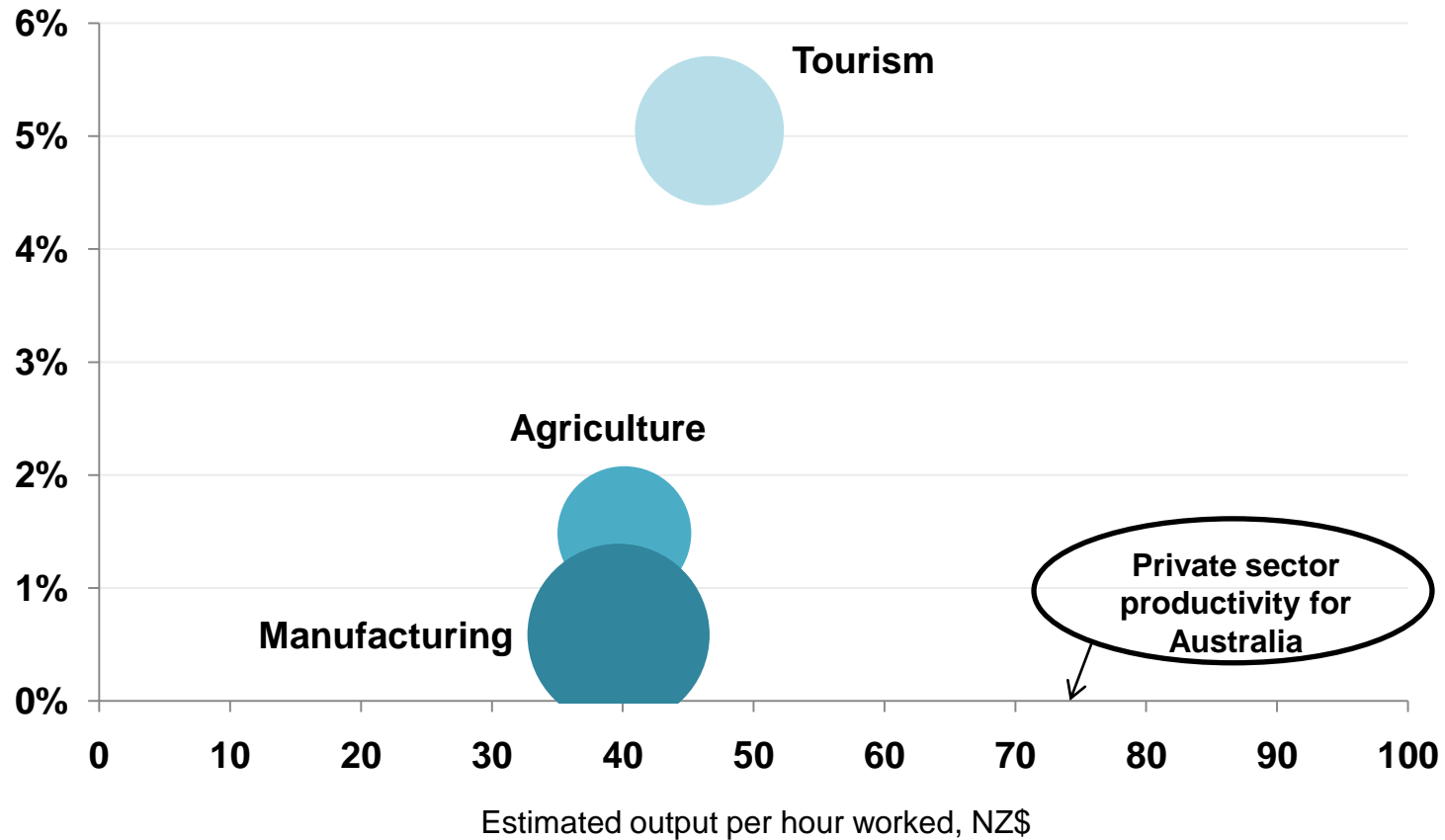
HEALTH AND SOCIAL PROBLEMS ARE CLOSELY RELATED TO INEQUALITY AMONG RICH COUNTRIES



SOURCES OF DISADVANTAGE – LOW PRODUCTIVITY EXPORT SECTORS

Compound annual growth rate
in output, 2000-2008

Size of bubble = Share of total workers



Notes: Mining excluded. Data includes export and domestic. Tourism based on FTEs but manufacturing and agriculture based on number of employees.
Source: Statistics New Zealand; Ministry of Tourism; Australian Bureau of Statistics.

WHY DO EXPORT SECTORS HAVE LOW AVERAGE PRODUCTIVITY?

Productivity is measured in dollars earned per hour worked

- On farm efficiency improvement is not the same as productivity growth

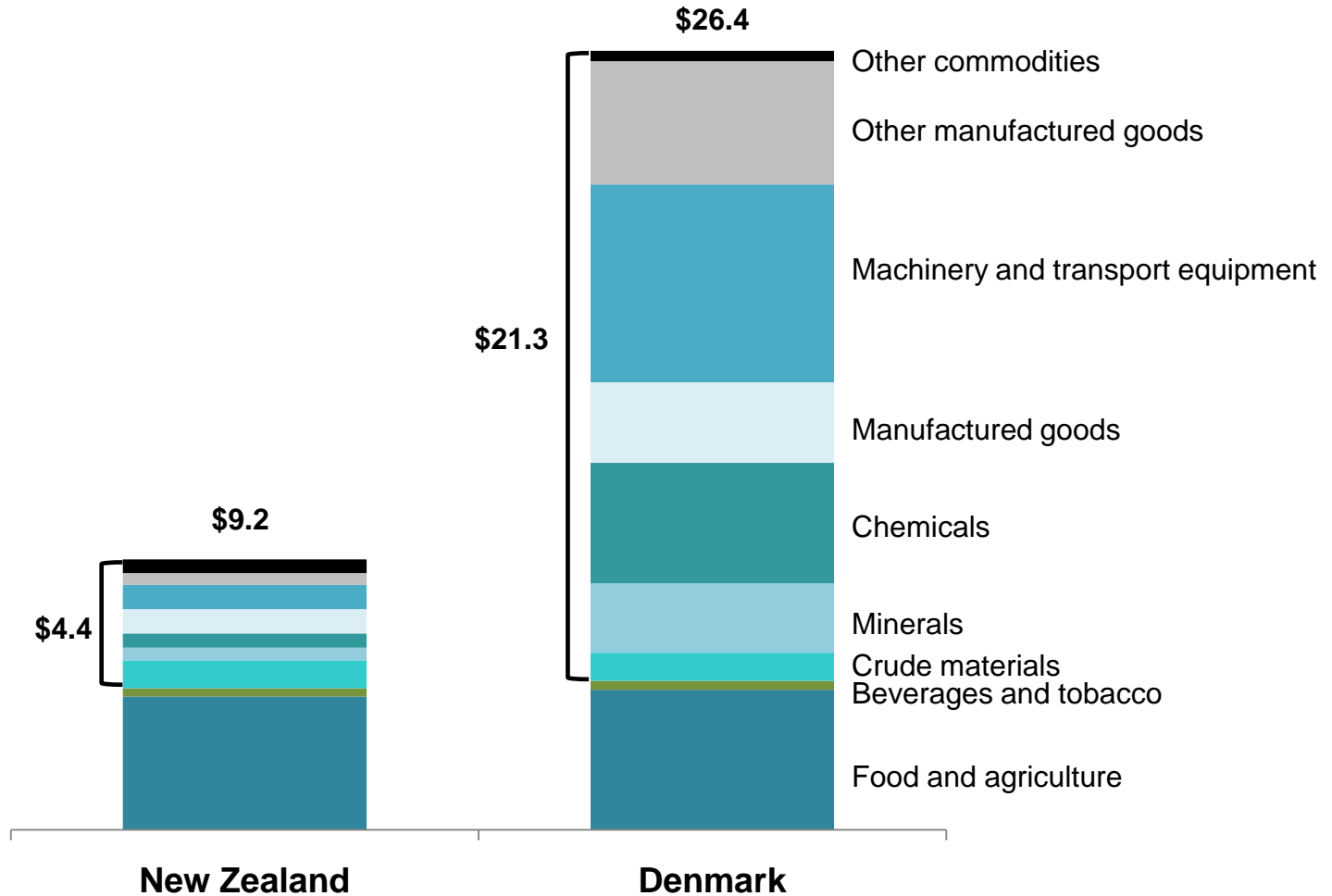
Agriculture competes with low cost developing countries and high efficiency developed countries close to market

Tourism competes with low cost competitors and most jobs are low-skill

Manufacturing is disadvantaged by low capital intensity, small scale, lower than average management quality, and distance from markets

DENMARK SHOWS HOW AN AGRICULTURAL ECONOMY GETS RICH

Exports per capita, 2009, NZ\$000s



MARKET FAILURES

Neoliberal economics aims to restrict economic intervention to remedy market failure only

Three market failures have combined to limit export success

- Less investment than optimal in innovative firms because investors cannot access spin-off gains
- Our exporters are small and remote at the time they internationalise
- Shortages of talent and capital

These market failures have not been addressed effectively

- Policies have not encouraged sufficient saving, have diverted capital to residential housing, and have not attracted sufficient foreign direct investment
- Exporters have not been helped as much as exporters in successful competing countries

Current improvements are in the right direction but are “too little, too late”

RESOURCE-BASED STRATEGIES NOT SUFFICIENT

Agriculture

- Limited land available for expansion, though intensification has potential
- Too many people in New Zealand to support from a small number of farms
- Price increase required to make New Zealanders rich would cause huge disruption in the world
- Concentration risk

Minerals and oil have potential, but drawbacks too

- Few jobs available – only 1.2% of Australian labour force in mining
- Likely to be funded with overseas investment and shipped in minimally processed form to overseas markets
- Environmental concerns over growing fossil fuel emissions

New industries with many high value jobs are needed

MANY OPPORTUNITIES TO GROW HIGH VALUE EXPORTS; FOR EXAMPLE

Value-added food businesses are anchored here

Niche manufacturing where a small exporter can be a world leader, avoiding scale disadvantage

ICT where distance and scale are less important barriers to success

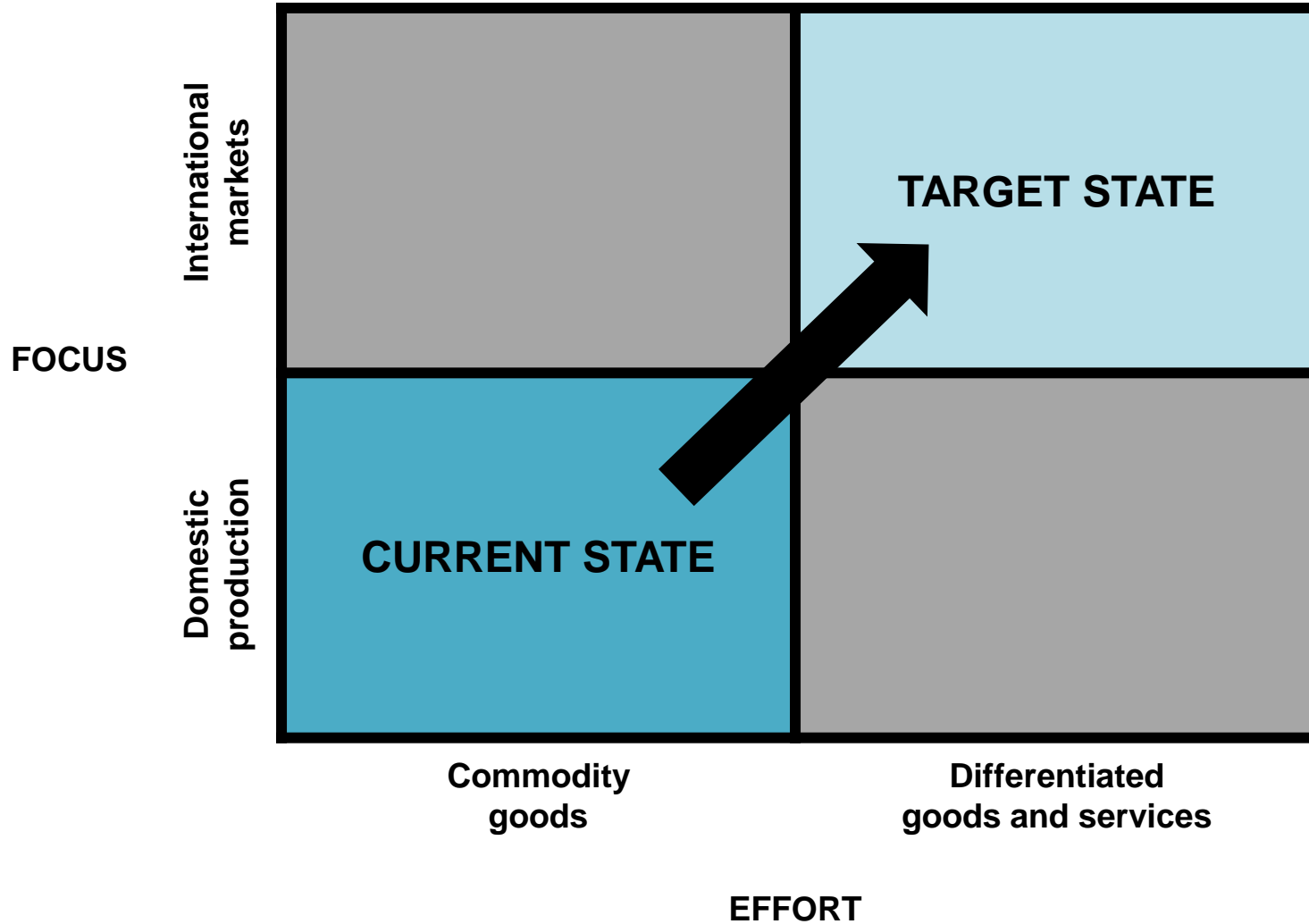
- Lifting capability in these industries helps domestic productivity too

Services sectors where world class technology can be acquired and NZ labour costs are relatively low

- Successes in engineering, education, financial, medical etc.
- Competitive advantage can be increased by legal innovation

**TOP 100 INTERNATIONALLY ORIENTED TECHNOLOGY BUSINESSES
EXPORT AROUND \$5b pa WITH VERY HIGH PRODUCTIVITY**

NEW ZEALAND'S ECONOMIC TRANSITION



BUSINESS CULTURE CHANGE MESSAGE

Don't	Do
Assume you understand what the customer wants	Research & understand customer needs, wants, conventions & values and competitor offers
Turn up and demonstrate the product or service	Have a plan to establish & maintain the relationship and make the sale
Arrive in your normal clothes	Dress, communicate and behave to fit in with the customers' expectations, conventions & values
Assume you can do it all yourself	<p>Learn who can help you and how</p> <p>Invest in NZ and international networks</p>

GROWING HIGH VALUE EXPORTS REQUIRES FOCUS ON PRODUCTIVITY DRIVERS

Innovation

- Help firms overcome the disadvantages of size and distance – shared cost facilities, information, connections
- Specialise and build scale in target sectors
 - Nominate the sectors New Zealand will invest in
 - Establish sector specialised at-scale research and commercialisation institutions, clusters, colonies

Ensure capital is available for international expansion

- Saving, tax, FDI/ODI policies
- Incentives to invest in high value exporters

Talent

- Unlock obstacles to growing science, engineering, technical and international business talent
- Focus more academic effort on improving outcomes for New Zealand; reduce emphasis on publication
- Improve skill levels of adult workforce and of disadvantaged youth
- Strategic immigration policy

INTEGRATE ENVIRONMENTAL THINKING IN MAINSTREAM ECONOMIC POLICY

Include climate change, peak oil and supply chain risks in economic strategy

Grow cleantech exports and use a green lens to identify opportunities in all firms to make environmental and economic gains

Prepare the population for change

- Understanding of the changes that are coming to build mandate for domestic regulation, behaviour change and international citizenship
- Develop community and infrastructure resilience
- Build skills and resources for increased self-sufficiency

GET THE BALANCE RIGHT

Long term investment against short term costs

Infrastructure investment to grow economy now against obligations of future generations to pay

Drawdown of environmental assets now that will not be available for future generations

Interventions that will accelerate growth now against risk of capture by vested interests

Investing in disadvantaged children and youth against preserving entitlements for well-off older people

NAVIGATE EXISTING CONSTRAINTS – GOVERNING IS NOT EASY

Threat of debt downgrade

Funding earthquake response

Budgets to limit increase of aggregate debt

Meeting obligations to supporters

Differing views about how to succeed economically

Political imperative to avoid alienating voters

LEADERSHIP ...

Change comes from evidence, incentives, leadership or crisis

Leadership is NZ solution

- Tell the story of success to build consensus that change is needed and worthwhile
- Get people signed up by reassuring them that
 - It is not being done for the rich or the poor but for everyone
 - It is not just for money, but to secure our collective long term future

Build political consensus and involve civil society

Develop a transformation plan with actions, accountabilities, resourcing

... AND MANAGEMENT

A mobilising vision, high aspirations, specific goals

Learn what works from others, but adapt to local conditions and constraints

Clear accountabilities for actions and outcomes, aligned with authority and funding

Measure, report and review progress, and modify plans

Manage across the silos