Essay

The New Zealand economy: the next 20 years

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Essays

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Good morning.

This morning I will be outlining my thoughts on the prospects of the New Zealand economy over the next couple of decades, and how we ought to think about approaching policy to improve the performance of the New Zealand economy over this period.

The main thing that I would like for you to take away from my talk this morning is that the way in which we need to approach what is a substantial economic challenge over the next 20 years will look and feel quite different from the approach used, successfully for the most part, over the past 20 years. The task is no longer simply to get rid of bad, inefficient policy but to build an innovative, internationally engaged, prosperous New Zealand economy. Meeting this challenge is absolutely within our reach, but will require deliberate, sustained, aggressive effort and a preparedness to take some risks. We need to get back into the nation-building game.

Where do we currently stand?

I'd like to begin by giving a sense of how the New Zealand economy is currently positioned.

The New Zealand Institute released research late last year that showed that New Zealand's economic growth rates since 1990 have increased significantly relative to previous decades.[1] New Zealand's economic growth rates were in the top quartile of the OECD, and compared well to countries like Australia, the US and the UK.

This improved economic performance since 1990 has enabled New Zealand to halt its decades-long relative income decline against other OECD countries. This decline had been going on since the 1950s when New Zealand was the 3rd richest country in the world on a per capita income basis. But from the early 1990s, we have held our own against the OECD average per capita income – at about 90%.

But despite this significant improvement, large income gaps remain between New Zealand and other developed countries. New Zealand currently ranks 21st in the OECD in terms of per capita income. Australia's per capita income remains about 30% higher than New Zealand's, and there has been no real trans-Tasman income convergence over the past 15 years. These income gaps matter enormously in a world of internationally mobile people, capital and companies.

And the pace of global change and the intensity of international competition is increasing not reducing; the emergence of Asia, new technologies, and the increased importance of knowledge all pose significant challenges – and generate opportunities – for New Zealand.

We have to run simply to keep up, and the data suggest that for much of the past few decades New Zealand has been standing still, and has not been participating in a meaningful way in some of the most powerful global trends of our time. The intense process of globalisation – with explosive growth in international trade and investment flows – has largely passed New Zealand by. And the increased importance of technology, ideas and knowledge has not made the impact on the New Zealand economy in the way that it has in many other developed countries. New Zealand will need to engage in some sustained sprinting in order to make any headway.

What do New Zealand's economic prospects look like?

So the immediate issue to consider is the nature of New Zealand's economic prospects over the next couple of decades.

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[1] The report, 'No country is an island', is available on the New Zealand Institute's website.

To understand these prospects, it is instructive to consider the drivers of New Zealand's recent economic growth. Over the past 15 years, New Zealand's growth has been heavily driven by increasing the number of hours worked – New Zealand has reduced its unemployment rate to among the lowest in the OECD and has increased its rates of labour force participation.

Indeed, labour force growth accounted for about two thirds of New Zealand's growth over the past 15 years, with labour productivity growth accounting for just one third. Labour productivity over this period grew at just 1.0% a year, which is around bottom quartile performance across the OECD.

New Zealand's level of labour productivity is well below the OECD average as well. New Zealand's labour productivity, in terms of output per hour worked, is just 79% of the OECD average. New Zealand's hours worked per capita on the other hand stands at 113% of the OECD average. Labour productivity, then, is the key factor that distinguishes New Zealand from other countries. This productivity performance can explain all of the income difference between New Zealand and Australia. There does not seem to be an issue in terms of New Zealanders not working hard.

Indeed, it turns out that New Zealand has held its own against the OECD over the past 15 years in terms of per capita income because New Zealand has increased hours worked per capita relative to the OECD average by almost exactly the same amount as the decline in the level of New Zealand's labour productivity relative to these countries. This is not a sustainable economic strategy.

New Zealand's heavy reliance on labour force growth to drive our economic growth over the past 15 years is relevant to understanding our economic prospects over the next couple of decades because it is not sustainable at its historical levels. Labour force growth over the next 15 years is projected to be about one half that of the previous 15 years, which will act to reduce average growth rates over this period by about one third. The growth rates we have enjoyed over the past 15 years cannot be sustained without a substantial increase in labour productivity growth; a doubling from 1% p.a. to 2% p.a.

Now achieving this productivity target is possible, with a number of OECD countries sustaining productivity growth rates of this type. But it involves New Zealand moving from our current bottom quartile productivity growth performance in the OECD to the top quartile. So while it is possible, it is certainly a stretch target.

My judgement is that getting close to achieving this productivity target is unlikely to occur on New Zealand's current course and speed. Productivity may have increased slightly in New Zealand over the past several years, but there are no indications that we are moving to a position where New Zealand can sustain productivity growth rates at double their historical levels.

Moving the New Zealand economy into this position is a long-term process, and will require deliberate, aggressive, sustained action. It is not a short-term undertaking. But exactly because of the long-term nature of the payoff, this process needs to be commenced with real urgency.

This is a point that has been frequently made of course. But the disappointing reality is that little truly meaningful action has been taken over the past decade despite lots of talking around increasing economic growth. The task now must be to move beyond the talking, and take the actions required to generate a step change in New Zealand's economic performance.

There is no burning platform now, as perhaps there was in 1984, to motivate aggressive action. New Zealand has a strong primary sector, a large tourism industry, and an efficient, flexible economy with a skilled population. These factors will contribute positively to New Zealand's economic prospects and slow the relative income decline.

But even if there is no burning platform, we need to recognise that New Zealand's economic platform is gently subsiding, leaving us with less to stand on. Failing to address New Zealand's productivity challenge is unlikely to lead to catastrophic outcomes, but certainly will not lead to good outcomes. New Zealand's current economic path will lead to the ongoing exit of our best and brightest. Over the past 12 months, over 70,000 people left New Zealand on a permanent or long term basis – just under 2% of New Zealand's resident population – and relatively better incomes and opportunities abroad are one factor driving these location decisions.

Over time, New Zealand will be increasingly unable to provide world class opportunities and the type of health and education services that are available elsewhere. This may not happen overnight, but this is what the next few decades will likely look like.

So improving New Zealand's economic performance needs to be treated as a national priority. Much rests on our ability to strengthen the performance of the New Zealand economy. But how confident can we be that New Zealand's economic outcomes can be improved substantially?

One school of thought is that perhaps this is 'as good as it gets' – the New Zealand economy has been reformed extensively and there has been an improvement in its performance, but there has been little progress in closing the significant income gaps. Perhaps New Zealand will always struggle even with the best policy settings in the world because it faces the disadvantages of being a small, remote economy – "the last bus stop on the planet". Well, maybe.

The evidence shows clearly that size and distance do combine to exert a powerful effect on New Zealand. But the effects of these factors are not deterministic. It simply means that we need to be very thoughtful and deliberate about responding to the environment that we are in. Indeed, every country faces its own set of advantages and disadvantages and has to deal with them. Just look at countries like Singapore and Ireland – their advantages are apparent in hindsight, but not to many observers a few years prior to the start of their economic take-off. Leaders in these countries took deliberate, aggressive action to generate economic success.

The lesson that I draw from the international growth experience of the past several decades is that much improved economic performance is absolutely possible for New Zealand, but that it will not happen spontaneously. It will require deliberate, sustained effort. We need to adopt an action mentality if we want to transform the economy. It is a challenge, but there is no reason to be fatalist. Rather, resilient optimism is required coupled with a preparedness to do what it takes.

A new approach to economic policy

The task now is to chart the way forward for the next 20 years with a focus on identifying the actions that need to be taken by business, by government, and by others, to create a prosperous, internationally competitive New Zealand economy given the opportunities and challenges that New Zealand now faces.

I strongly believe that a different approach to economic policy will be required over the next 20 years to achieve these goals than that which we have used, successfully for the most part, over the past 20 years. A new generation of policy is required for New Zealand to prosper given the environment that we now face. I will begin by explaining why I think that a new approach is required, and then outline what I think this new approach should look like.

The approach to economic policy that was followed from 1984 was an appropriate response to the challenges of the time but in large measure these challenges have now been addressed. It is now time to move on and direct economic policy towards the challenges and opportunities facing New Zealand in 2006 rather than those we faced in 1984.

In other words, a new approach is required not because the previous approach represented “the failed policies of the past” but rather because this approach has been largely successful. New Zealand now has a high quality policy platform on which to build. We have managed, for the most part at least, to stop shooting ourselves in the foot.

Of course, this is an ongoing task and we need to be continuously looking for ways in which to make further progress and to remain vigilant against slippage. Improvements can and ought to be made to the regulatory and tax systems, for example, and government spending does need to be disciplined. Given the New Zealand situation, and the scale of the challenge, New Zealand policy needs to be genuinely world-class across the board.

But we need to be realistic about the materiality of the economic upside from further improvements in these basic policy areas. New Zealand already compares well to other countries in terms of measures of regulatory quality, the quality of monetary and fiscal policy, and economic freedom. New Zealand’s basic policy and institutional settings, while not perfect, do not represent a major source of competitive disadvantage. And given that the New Zealand economy has already been extensively reformed but is generating labour productivity growth rates that are in the bottom quartile of the OECD, further reform, even though often worthwhile, is unlikely to unleash a torrent of economic growth.

Making ongoing, but likely modest, policy improvements is not the same as an aggressive growth strategy. Indeed, the international evidence shows clearly that whereas bad policy can destroy growth, improving already good basic policy settings is unlikely to generate much economic upside.

It is important to understand that the achievements of the past two decades are just the start of the process, rather than the end of the process. Removing gratuitous distortions, and putting the economy on a much more stable footing, was an important and necessary start. But getting rid of bad policy is not the same thing as putting policies in place that position the New Zealand economy to seize emerging opportunities and respond to emerging challenges.

The priority for New Zealand now is to develop a new approach to build on that which was successfully employed to meet the challenge of two decades ago, in order to build an internationally competitive and prosperous New Zealand economy that can sustain significantly higher rates of labour productivity growth and that provides world-class opportunities for all New Zealanders.

And given the pace and scale of change that is increasingly apparent in the global economy, and the size of the economic challenge New Zealand faces, New Zealand’s economic approach need to be completely focused on succeeding over the next 20 years rather than being focused on the way in which we addressed a past challenge.

In my view, economic policy in New Zealand needs to increasingly focus on identifying desired economic outcomes – like having world-class investment in R&D and ensuring that New Zealand firms are participating fully in the globalisation process – and then deliberately configuring policy so as to achieve these outcomes. Rather than having a primary focus on levelling the playing field and removing inefficiencies, with the general view that whatever outcome emerges is optimal, we need to be much more directly concerned with the outcomes generated. In this proposed approach, the purity of the process is secondary to the materiality of the result achieved.

To use a sporting analogy, the primary outcome of concern ought to be whether we are winning games or not rather than how nice the playing surface is. Although the quality of the playing field is one input into success, it is far from the only one. New Zealand ought to be focused on having the right players on the field and that they have what they need to win.

Although this more deliberate approach to economic policy is common across OECD countries, it is particularly important in the New Zealand context. The New Zealand economy is both small and remote from other markets, which makes New Zealand distinctive in an international context. In a world in which agglomeration pressures are strong, and in which labour, capital, and companies are increasingly mobile across borders, we need to be very thoughtful about what it takes to generate a growth-friendly environment in the New Zealand. Boilerplate solutions are unlikely to be appropriate to encourage growth in a small, remote economy like New Zealand.

Priority areas for action

I now turn to a discussion of what I consider to be the priority areas for action to create such an economy. There are three areas that I think deserve particular focus. These are not independent of each other, but need to be seen as a package of mutually-supporting actions.

These areas have been identified on the basis of an analysis of both the New Zealand situation and the key growth drivers in other successful countries. Successful countries put in place a package of policies to position themselves to succeed, from investing in research and innovation, to education and infrastructure, to encouraging international economic integration. Indeed, it is difficult to find a successful, growing country that did not place an emphasis on these three elements.

Investing in the productive base of the New Zealand economy

Increased investment in the productive base of the New Zealand economy, in terms of business investment, infrastructure investment, and so on, is an important part of driving New Zealand's productivity growth forward. Consistently low levels of investment in the productive base of the New Zealand economy has been a key reason for New Zealand's low level of productivity over the past few decades. Business investment as a share of GDP, for example, has been in the bottom quartile of the OECD, and this needs to be raised significantly for the target productivity growth rates to be achieved.

Such investment is particularly important for New Zealand's economic prospects given the small and remote nature of the New Zealand economy. High levels of investment in New Zealand, which raises labour productivity, will make it easier to attract and retain internationally mobile factors of production, like skilled labour. Investment is likely to make people more productive in New Zealand, and thereby create an incentive for these people, and companies, to locate in New Zealand.

So we need to put in place an environment in which investment in New Zealand, and international expansion from a New Zealand base, is encouraged. This obviously involves having a regulatory environment in place that provides sharp incentives for private investment, particularly in long-lived assets like energy, transport, and communications infrastructure.

But there are a range of other issues. New Zealand has a high cost of capital, relatively small and illiquid capital markets, a small pool of domestic capital, and so on. Given the strong agglomeration pressures, and the incentive for productive capital to be attracted to larger, more prosperous centres, New Zealand needs to be very thoughtful about ensuring that it positions itself to attract and retain productive investment.

A key part of this is to implement a bold savings plan to provide a larger pool of domestic capital and reduce New Zealand's reliance on importing foreign capital to finance domestic investment. A larger pool of domestic savings is likely to lead to increased domestic investment, and allow for the financing of international expansion of New Zealand firms. An increased savings rate will also mean a higher New Zealand ownership stake in New Zealand companies as they expand, which will mean that more of the subsequent profit stream will flow to New Zealanders rather than to foreign investors.

Increased private savings will also have a positive effect on New Zealand's capital markets, as has been the case with effect of the compulsory savings scheme in Australia, as well as reducing the cost of capital in New Zealand. This will make investing in New Zealand a more attractive proposition, encourage more companies to list in New Zealand, and will provide the capital to assist New Zealand firms as they expand.

The New Zealand Super Fund can also play an important role in increasing productive investment in New Zealand, both in terms of an increased allocation towards domestic equities and in terms of helping to create new asset classes in New Zealand, such as infrastructure, that will subsequently attract private investment. This can likely be done in a way that does not compromise the overall objective of the Fund, while helping to scale up domestic markets in a way that will provide broader economic benefits.

New Zealand should also get much more serious about attracting some targeted FDI into key areas of the New Zealand economy to provide capital, skills, technology and access to networks and so on. This will complement the activities designed to create areas of real strengths in the New Zealand economy, like strategic research funding.

Becoming a knowledge-based economy

Knowledge and innovation are increasingly the drivers of labour productivity growth across the world. For the New Zealand economy to develop new strengths over the coming years, significant investments need to be made in this space. And yet New Zealand is under-investing relative to benchmark countries in terms of its commitment to research and science.

There is a need to develop new strengths in the New Zealand economy, to supplement our historical strengths in the primary sector. The exporting sector of the New Zealand economy remains very heavily reliant on the primary sector. To significantly increase the level of New Zealand's international economic engagement, additional areas of economic strength will be required because demand in the primary sector tends to be slow growing and because New Zealand's primary sector is facing increasingly significant competitive pressure. This will require a significant national commitment to research and science.

If we are serious about transforming the New Zealand economy, we need to commit to at least getting into the top half of the OECD in terms of R&D spending in the next decade. Although New Zealand's low R&D spending is mainly due to low levels of business R&D spending, government leadership in this space is vital. The relative absence of large firms in New Zealand, combined with a large primary sector, which tends to have a lower R&D intensity than other sectors, means that it is unlikely that private R&D spending will increase significantly without the development of new strengths in the economy. A government commitment is required to create the conditions in which increased private spending will occur, and break out of this situation. Without such an aggressive commitment, we will likely be having the same conversation in a decade or two.

This investment needs to be made in a strategic, focused way, with the goal of developing world-class excellence in a few areas. New Zealand is too small to cover the field. Instead of continuing with the current, relatively, egalitarian approach to funding, New Zealand should focus on developing strengths in areas where it is more likely that we have some real competency.

This current approach is sometimes justified with the argument that giving relatively small amounts of money across a range of areas is sensible because we lack the knowledge to know where the gains will come from. But the flaw with this 'let a thousand flowers bloom' strategy is that after a year you are likely to have a thousand dead flowers because there has been no investment that has allowed these flowers to develop a root system. Picking a few key areas that matter and investing deeply in them is absolutely vital, as has been demonstrated by most developed countries.

This is also about people. Investments in tertiary education need to be made to ensure that we have the people in New Zealand with the knowledge and skill to participate in this research process. New Zealand should also seek to attract the world's best talent into this research endeavour. Having areas of world-class strength will act as a magnet for investment, from both New Zealanders and those overseas. In these respects it is critically important to have a genuinely world-class research university in New Zealand, rather than just several good universities, and achieving this will likely involve deliberate action.

It is also important that these educational investments are aligned with the investment in research infrastructure and with the FDI approach. At the moment, there is a tendency to make significant investments in internationally mobile human capital without thinking through whether the investments have been made to make these people more productive in New Zealand. As a consequence, New Zealand makes significant investments in educating the world. We need to be much more deliberate about investing in such a way that the benefits are more likely to be captured in New Zealand.

Given the increased importance of knowledge, we also need to ensure that all New Zealanders are able to participate fully in the economy of tomorrow. Everyone needs to have the opportunity to realise their full potential. New Zealand currently has a 'long tail' of educational under-achievement, and this needs to be addressed for both social and economic reasons. From an economic perspective, it is vital in a small economy like New Zealand that everyone can make a contribution and benefit from doing so.

Creating a global New Zealand economy

Achieving and sustaining higher rates of labour productivity growth will require New Zealand firms to expand beyond the domestic border; to acquire scale, to allow our most productive firms to grow, and to be exposed to international competition, knowledge and ideas. As a small country, our ability to successfully sell goods, services and ideas into global markets is fundamental to our economic prospects.

But New Zealand's international outcomes do not benchmark well against other developed countries in terms of exporting and outward FDI. And we have not been participating in the globalisation process to the extent that other countries have been.

Policy across an array of fronts needs to be deliberately directed towards increasing the level of international economic engagement of the New Zealand economy. This requires a range of policies to be evaluated in terms of how effective they are in terms of encouraging international expansion, from tax policy, to savings and monetary policy, as well as the nature of our policies specifically aimed at assisting firms offshore. Given the difficulties involved with going global, and combined with the fundamental importance of such international engagement for New Zealand's economic future, ensuring that all policy settings have a clear outward orientation ought to be close to an obsession.

This is the current area of focus at the New Zealand Institute, and we will be releasing a report with our thinking on the high priority areas for action in the next few months.

And, of course, improving these outcomes significantly requires New Zealand companies with the capacity and aspiration to expand internationally and win.

In summary, improving productivity will require a much more deliberate strategy to build competitive advantage in New Zealand, and ensure that a business environment exists that provides an incentive to invest for the future, supports innovation, and is integrated into the international economy. The task is to put in place the policies that will build real strength in the New Zealand economy and develop the ability to take this global and win internationally.

Calibration and materiality

Now some will probably argue that the recommended change in the direction of economic policy has already occurred, and further that the three areas discussed above have been identified and that action is underway. Certainly the public documents of government agencies and statements of Ministers over the past decade are replete with references to deliberately achieving economic outcomes, to promoting global connectedness, to becoming a knowledge economy, and so on.

Indeed there has been some movement towards a more deliberate policy direction with increased focus over the past decade on areas like R&D spending and New Zealand's international engagement. However in many other areas of policy, such as tax policy or the mandate given to the New Zealand Super Fund around portfolio allocation, there is no evidence of an increased deliberateness in economic policy.

But even if some of the policy developments have been directionally sound, and are likely to have had a positive effect, in most cases the commitments made have been immaterial. Actions taken have not been bold, with the scale of the action not being at all proportionate to the scale of the challenges and opportunities that New Zealand faces. My assessment is that there has been little, if any, bold and aggressive movement towards achieving these outcomes in terms of a material commitment of fiscal resources or meaningful policy change. We talk a big game here, but often do very little.

Take, as an example, New Zealand's commitment to R&D spending. New Zealand's current commitment amounts to about 1.2% of GDP, compared to an OECD average of 2.3%. And countries like Finland, Sweden, and Iceland have R&D spending levels in excess of 3% of GDP. Singapore has recently made a commitment to double its R&D spend over the next five years. These countries recognise the importance of investing in science and research to move their economies forward and to develop new areas of strengths. New Zealand has not come close to matching this commitment. Low private sector R&D spending is the key driver of this, as mentioned above, but government leadership on this is vitally important in New Zealand going forward.

The same is true in terms of the materiality of the policy and fiscal commitment to areas like savings policy and the investment in integrating the New Zealand economy into the global economy. New Zealand has not made the same type of commitments observed in many other OECD countries in these areas. For example, the government's recently introduced KiwiSaver scheme is a positive development but lacks materiality relative to New Zealand's low savings rate and substantial current account deficit. This lack of materiality in New Zealand's policy settings is particularly striking given the magnitude of the challenge facing New Zealand. Given the New Zealand situation, we ought to be aiming for top quartile performance to really move the country forward.

Too often New Zealand policy can be characterised as a 'sub-therapeutic dose'. We take some policy action but without the seriousness of purpose required to make a material change in outcomes. This is a classic manifestation of the statement that "the good is the enemy of the great". Enough is done to give the impression of action but in general the scale of the response is not close to the scale of the challenge.

This consistent failure to make sufficiently material commitments to change is a key reason that the New Zealand economy has not changed significantly over the past few decades. New Zealand's export structure, for example, is largely unchanged over this period and we have not developed new areas of economic strength in a material way. And, of course, New Zealand has failed to converge to the income levels of other developed countries, which is perhaps the ultimate metric of economic success.

New Zealand has been talking about economic performance issues for much of the past few decades, but has not responded to this problem diagnosis with a proportionate response. And unless we start to do so we can be almost guaranteed that, as a country, we will be having the same conversations in 10 and 20 years time. If New Zealand remains on current course and speed in terms of policy direction, it is most likely that New Zealand's economic performance will also keep on its current course and speed.

If we want change, we need to act like we mean business. An important way of doing a better job of calibrating the required policy commitment in New Zealand is to engage in a disciplined process of international benchmarking to inform a judgement as to what type of policies and resource commitments are required. This process can form the basis for specifying a series of hard targets with appropriate time horizons that we can then work towards.

And we need to recognise that because we are, for the most part, in catch-up mode, simply aiming at the OECD average is unlikely to be sufficient. To make meaningful progress in terms of economic transformation and income convergence, New Zealand will need to aim at top quartile performance in key policy areas like R&D spending, export growth, household savings and so on. Resolving New Zealand's economic challenges will require substantial changes. A handful of sensible but modest initiatives will simply not cut it.

Some objections

In the interests of truth in advertising, I want to acknowledge that the approach outlined above involves accepting increased risks. It involves making significant decisions with no guarantee of success. New Zealand could, for example, make substantial investments in science and research and education that could otherwise have gone into the health system or to finance superannuation, and find in 20 years that these investments have not generated the desired economic returns. The strategic choice is between being aspirational about the future of New Zealand and taking some calculated risks in the pursuit of this goal or the tidy management of the status quo with slow but steady relative income decline being the likely result.

I recognise that reasonable people can disagree about whether the balance of risks and rewards associated with the proposed approach is acceptable or not. But I am strongly of the view that New Zealand does need to take some calculated risks in order to move the economy forward, because I think that the upside can be achieved and because I view the consequences of inaction as much worse. There are significant risks associated with doing nothing as well as taking positive action. So despite these risks, my view is that on balance it is worth taking these risks in order to attempt to move the New Zealand economy to a position where it can achieve its full potential.

But I have much less time for another common objection to the proposed approach. This is the argument that New Zealand governments cannot or should not undertake deliberate action to promote economic growth, often with reference to the Think Big projects of the Muldoon years. I think that Muldoon casts a very long shadow over current political and bureaucratic decision-making in New Zealand, and has led to a real aversion among politicians and officials to taking deliberate, purposive action. Many decision-makers, and others in the policy community, have spent much of their careers observing the damage that poor policy caused and subsequently being involved in the removal of many of these policies after 1984.

Because of this experience, it is perhaps understandable that there is a degree of wariness about deliberate government action to encourage growth among this group. But it seems to me that we have moved beyond this, pendulum-like, to the other end of the policy spectrum, which is hands-off for the most part. Proposals to get involved seem to be regarded as the thin end of the wedge and are resisted accordingly. The focus tends to be on policy as process, making it clean and tidy and neutral, with a lesser focus on the actual outcomes achieved. In general, the received wisdom is that we don't do deliberate policy any more in New Zealand.

The most common response to Think Big seems to have been to think small. This small thinking pushes policy towards small-scale intervention, as described above, which will almost inevitably not deliver the desired outcomes.

The most significant divide in the New Zealand economic policy debate, it seems to me, is not ideological in nature. Of course, ideology is not dead. History has not ended quite yet, and there are ideological differences over aspects of tax policy, government spending, privatisation, and so on. But the more important difference is related to the levels of aspiration, risk tolerance, and action bias that political decision-makers have. The relative absence of these characteristics has been a key reason for the lack of meaningful change in New Zealand over the past decade or so. A propensity for aggressive action is what is now needed to move New Zealand forward.

Of course we need to learn from history and guard against poor policy being implemented going forward. But it is equally dangerous to let a bad experience from a quarter of a century ago prevent us from doing what is now necessary to move the New Zealand economy forward over the next few decades.

Moving forward together

This task is obviously about much more than government policy. Policy does matter, both positively and negatively, but economic growth is driven by the decisions that are made by business around such things as investment, R&D, and international expansion. Governments cannot manufacture growth, or grow the economy by decree. Much therefore rests on the capacity and aspiration of the New Zealand business community. Growing the New Zealand economy is a joint responsibility, and the private sector also needs to put its hand up in terms of a serious commitment to going global, and much greater investment in research, and in both physical and human capital.

It is also important to note that the process of significantly improving New Zealand's economic performance is much more than a technical economic exercise. Economic policy does not proceed in a vacuum, and cannot be separated from the broader social and political environment. A key challenge, then, is to create an environment in which pro-growth policies can command widespread support. This will enhance the effectiveness of these policies and will ensure that they are sustained into the future.

The contribution of social consensus to improved economic performance is evident in the strong growth experiences of several small developed economies over the past decades, like Ireland, Finland, Singapore, and Australia. Although each of these countries faced different challenges, they all seemed to possess a sense of shared purpose about priorities and direction. This does not mean that there was universal agreement on all of the specific details of policy settings, but there was broad agreement on the strategic direction. This consensus enabled these countries to make the required changes and sustain economic policy over long periods of time, and has meant that, for the most part, there is continued widespread support for economic policy.

Unfortunately, there is little evidence of broad public or political agreement in New Zealand on the relative importance of raising economic growth and the appropriate policy direction to achieve this. A survey undertaken by the Growth & Innovation Advisory Board in 2003 suggested that

New Zealanders have a generally positive attitude towards economic growth, but that this support is lukewarm and there is not widespread public enthusiasm for the ongoing pursuit of economic growth. Rather, there seems to be a general ambivalence about growth. Given the importance of raising New Zealand's economic performance, a key challenge is to generate a sense of shared purpose around both the importance of economic growth and the broad direction of policy.

This is a particularly important challenge in the context of the perennial concerns about the level of aspiration in New Zealand – do enough New Zealanders want growth badly enough and are they willing to put in the hard yards to achieve these aspirations? A common view is that lifestyle is the key priority in New Zealand and that many New Zealanders are comfortable with the status quo, with little interest in making the policy and personal changes required to generate growth.

So finding ways to bring people along, and excite the public around a vision of where New Zealand can be in 20 years time is critically important to achieving higher rates of economic growth. A drive to improve economic performance is unlikely to be sustained – and will probably not work as effectively – if New Zealanders are not committed to the vision. There needs to be a general sense that making investments in the future, through increased R&D spending or savings policy, and accepting some risk, is worthwhile.

Political leadership is an important part of this, as is leadership from business and other parts of the community, to motivate people and to give a sense that meeting the challenge is feasible. It is difficult to find a national economic success story that did not involve significant political leadership from the top, complemented with leadership from a range of other parts of the community. This will also involve a good degree of bipartisan commitment to the broad direction of policy, even if not on all the specifics.

But we cannot rely simply on politicians to move the country forward. Achieving this task will also require contributions from all of us. We need a genuinely Team New Zealand approach to building the economy, with a real partnership between the public and private sectors. Being small has some disadvantages, but it should make it possible to organise ourselves in such a way as to make success much more likely.

As a country, we probably have not spent as much time as we need to thinking about these softer issues over the past decade or two. Going forward, thinking through attitudes and culture and exercising real leadership around New Zealand's economic future is of critical importance, and we need to put these issues alongside the discussion of what policies need to be put in place.

Overall assessment

New Zealand's economic performance has been strong over the past 15 years relative to previous decades. This has halted the relative income decline. But a substantial challenge lies ahead. New Zealand is well placed in terms of the quality of its policy foundations, and has an educated population, a valuable resource endowment, and so on. But these advantages do not automatically convert into strong economic performance going forward.

The task now is to build on these foundations and deliberately focus on positioning New Zealand for international success over the coming decades. A new generation of policy will be required to make this happen, which will be far more deliberate and strategic in nature, focused on achieving progress in key areas like strengthening the productive base of the economy, investing in knowledge, and taking the New Zealand economy global. Policy ought to be deliberately configured towards achieving these policy goals.

This task needs to be approached with real seriousness of purpose and aggression given the size of the income gaps between New Zealand and other developed countries, and the increasing international intensity of competition for talent, companies, and capital.

Achieving much higher rates of productivity growth is a demanding task, but it is possible. There are many economic success stories that provide confidence that much improved economic performance is possible for New Zealand. But this goal is very unlikely to be achieved on New Zealand's current course and speed. Meaningful catch-up will not happen unless New Zealand makes a substantial commitment to the policy areas that will drive our growth forward. In most of the key areas, we are lagging behind our competitors and these countries are not standing still but are ramping up their commitments in areas like education and knowledge. New Zealand will need to engage in some sustained sprinting to begin to make headway.

So when I consider the economic prospects of the New Zealand economy over the next 20 years, I am a conditional optimist. I am optimistic that we can build a much better and more prosperous New Zealand, and that we have what it takes. But this optimism is conditional because it will not happen on current course and speed. It will require a commitment to deliberate, sustained, aggressive effort that is proportional to the scale of the challenge. This will require leadership and the creative and disciplined execution of deliberate policies to generate strength in the New Zealand economy.

Much improved economic performance in New Zealand will not occur spontaneously. Claims are often made about the significant benefits New Zealand will enjoy from a successful WTO round, by growing demand from the Chinese market, from the collapse of distance brought about by technological revolutions, among others. While luck and positive external developments are part of most economic success stories, these benefits are unlikely to fall into our lap. Serendipity is not a substitute for an economic growth strategy. Getting ahead as an economy is much like getting ahead in life; it requires investing in the future and hard work – as well as luck.

New Zealand needs to position itself to benefit from these developments. While all of these factors may confer some benefit on the New Zealand economy, the reality is that collectively we are the only people who are capable of moving the New Zealand economy forward in a meaningful way. New Zealand has been a country of nation builders in our past, and it is time that we got back in the game.

This is a long-term challenge. But exactly because of the long-term nature of the payoff, this process needs to be commenced with real urgency. The sooner we start, the better.