

Essay

The role of Auckland in meeting New Zealand's productivity challenge

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The New Zealand Institute

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Essays

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Good evening.

My remarks this evening will focus on the productivity challenge facing New Zealand, the important role of greater international economic engagement in meeting this productivity challenge, and the special role that Auckland can play in this process.

Much of this talk is based on work undertaken at the New Zealand Institute over the past several months, which is detailed in reports and presentation available on our website at www.nzinstitute.org

New Zealand's productivity challenge

I want to begin by talking about New Zealand's overall economic performance over the past 15 years, and what this suggests for New Zealand's future economic prospects.

Over the past 15 years, New Zealand's economic performance has been strong – both compared to the growth generated in the decades prior to 1990, and also compared to countries like Australia and the US. This improved economic performance is to be celebrated.

The increased economic growth since 1990 has halted the steady decline in New Zealand's relative income position in the OECD that had been going on since the early 1950s. But there has not been any real convergence of New Zealand's per capita income to the OECD average.

A substantial economic challenge, then, lies ahead. New Zealand now ranks 21st in the OECD in terms of real per capita income, and is classified as a 'low middle income country' by the OECD.

To understand why New Zealand's per capita income is so much lower than many other OECD countries, it is useful to break income per capita down into its two component parts – labour utilisation, measured as hours worked per capita, and labour productivity, the value of output produced for each hour worked.

It turns out that New Zealand's income is low because of low labour productivity, at 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. There does not seem to be an issue in terms of New Zealanders not working hard.

And this positioning has become more apparent over the past 15 years. Since 1990, New Zealand has increased hours worked relative to the OECD to almost exactly offset a decline its level of labour productivity relative to the OECD average.

This emphasis on labour force growth can be seen in the sources of New Zealand's growth since 1990. Over the past 15 years only one third of New Zealand's overall economic growth – which came in at a 15 year average of 3.2% - has come from labour productivity growth, with the remainder coming from growth in hours worked. This is an unusual weighting – across the OECD, it is common for labour productivity growth to account for about two thirds of a country's economic growth.

Now while there is much to celebrate in terms of reducing unemployment and increasing labour force participation, this type of labour force growth cannot be replicated over the next 15 years. Indeed, over the next 15 years the median projection is that annual labour force growth will roughly halve, to 1.2%, due to factors like population aging, reducing migration flows and so on.

To sustain New Zealand's economic growth rates, then, a substantial increase in labour productivity growth is required. Achieving significantly higher labour productivity growth and

sustaining this over a 15 year period represents a substantial step-up – it will be a shift from bottom quartile performance in the OECD to top quartile performance. These growth rates are feasible, but it is a demanding target.

But unless we achieve a much improved productivity performance, New Zealand's relative economic standing will continue to lag and the income divergence is likely to widen steadily over time. Now a failure to achieve this productivity target is unlikely to result in catastrophic outcomes – New Zealand still has a lot going for it – but it will not generate great outcomes. New Zealand will continue to experience the exit of our best and brightest, and will struggle to attract and retain companies and capital.

The income gap between New Zealand and Australia, for example, is commonly linked to trans-Tasman migration patterns; about 600 people leave New Zealand each week for Australia on a permanent or long term basis.

Auckland's productivity challenge

So that is the national picture. How does Auckland fit in? I am inclined to agree with the results from recent Treasury work showing that Auckland has a slight productivity edge over other cities and regions in New Zealand – although the data is far from conclusive and there are no robust direct measures of labour productivity.

But even if true, these results do not change the priorities very much. New Zealand is a low productivity country, and so Auckland only looks good in reference to a low bar. In this context, arguments about whether Auckland is more or less productive than New Zealand as a whole are a little beside the point. Increasing Auckland's productivity level remains the key economic challenge.

Improving Auckland's productivity and income performance matters to the extent that increasingly it is cities rather than countries that are competing for people, companies, and capital. Countries matter, but often the location choice is not between Australia and New Zealand as much as between Sydney and Auckland. For Auckland to attract and retain people, it needs to be able to offer the wages that are generated by higher productivity growth.

The quality of Auckland's lifestyle helps, but it can only take you so far in competing for people and companies. Cities with which Auckland is competing, like Sydney and Melbourne, also offer compelling lifestyle options.

Priorities for action to raise productivity

So what are the priorities for action going forward in terms of raising New Zealand's – and Auckland's – labour productivity in a substantial and sustained way?

On most measures of policy and institutional quality, New Zealand benchmarks well against other countries. New Zealand's basic policy and institutional settings do not represent a source of competitive disadvantage. This is not a claim that they are perfect; improvements can and should be made to the quality of the government's spending, the quality of regulation, and so on. New Zealand – and Auckland – needs to be genuinely world class in everything that we do because of the disadvantages of small size and remoteness.

But we ought to be realistic about the magnitude of the benefits that will be generated by standard reform proposals. Over the past two decades, the New Zealand economy has been reformed extensively, and while more can be done, we need to look more broadly for guidance in terms of what needs to happen now.

One explanation that helps us to understand why New Zealand's labour productivity remains low is in terms of the small scale of the New Zealand economy.

There is strong evidence to show that the drivers of labour productivity growth are related to the scale of the economy. I am sure that many people in this room are aware of the international evidence that shows clearly that cities tend to generate superior productivity performance. This is due to higher rates of investment, knowledge spillovers, and the other benefits that result from agglomeration and so on, that occur in cities.

The same reasons that explain why cities tend to be engines of national economic growth can also explain why New Zealand's economic performance continues to lag that of many other OECD countries.

New Zealand is a small country, a long way from major markets, and this depresses productivity. The priority then, in raising productivity, is for the New Zealand economy to go global. The evidence is very clear on existence of a strong link between international engagement – either through firms exporting or investing abroad – and more rapid productivity growth. International expansion provides scale, allows for a country's more productive firms to grow, and also exposes them to international competition, knowledge and so on. These benefits are particularly strong in the context of a small domestic economy like New Zealand.

The same is true for cities. Analysis by Michael Porter at Harvard, for example, shows that internationally engaged cities and regions in the US tend to generate significantly higher income and productivity growth.

In general, successful cities are globally engaged cities (London, New York, Hong Kong, Singapore, Shanghai). They act as gateways for people, capital, and ideas, and are the hubs of the global economy.

Growth is obviously about getting many things right – such as tax, education, and infrastructure – but going global is a critical element. Otherwise, New Zealand will simply have a competitive, efficient (but small) domestic economy. The productivity upside from this will be necessarily limited – the big gains come where the increased efficiency of the domestic economy can be leveraged across global markets.

The conclusion is that aggressive international engagement matters enormously for the economic performance of both Auckland and New Zealand. Just as New Zealand's economic fortunes are very much linked to its ability to engage internationally, Auckland needs to be participating fully in the global economy in order to generate the type of productivity levels and growth rates of other world cities.

New Zealand's global engagement

So how does New Zealand fare at the moment in terms of global engagement? In short, not very well.

New Zealand's exporting performance has gone sideways over the past few decades, with exports to GDP currently at just 29% of GDP. New Zealand's exporting to GDP ratio compares poorly with other small, developed countries – about half of the level of the OECD small country average at 54% of GDP.

New Zealand's exports have consistently grown more slowly than the OECD and the world averages. For example, of the 24 OECD member countries in 1971, New Zealand's export growth ranked 23rd over the subsequent few decades. This divergence is growing over time.

And a similar picture is seen in the context of New Zealand's outward FDI – the making of foreign investments by New Zealand firms, such as the purchase of a foreign firm. Indeed, New Zealand's performance in this regard is even less encouraging. Over the past 15 years, New Zealand's outward direct investment as a share of GDP has fallen from 15% to about 10% of GDP, while the level of outward FDI across the developed world has roughly tripled from 10% to about 30%.

Overall, New Zealand is not participating in the process of globalisation in the way that other countries are. Trade and investment flows have been growing explosively across the world, but New Zealand is not participating – we are just proceeding along our historical course and speed.

Indeed, if anything New Zealand has gone backwards over the past 15 years in terms of the extent of its international economic integration. New Zealand is the only developed country for which this appears to be the case. The clear message is that New Zealand is not participating well in the globalisation process, and other countries are rapidly passing us by.

A substantial improvement in international economic engagement by New Zealand firms is required for New Zealand to achieve a significantly improved productivity performance.

Auckland's global engagement

So how does Auckland perform at the moment in terms of its international economic integration? In the absence of hard data on international engagement by region, we need to make an informed guess.

The traditional view of the Auckland economy is that it is heavily domestically focused, driven by consumption, real estate and locally-focused services. Indeed, it is the case that much of the exporting activity from New Zealand is based on primary production, which is obviously not based in Auckland but in provincial New Zealand.

But there is another way of looking at this. Most of New Zealand's largest international companies are located in Auckland; Fonterra, Carter Holt Harvey, Air New Zealand, Sanford, the F&P companies, Pumpkin Patch and so on. Many smaller high growth companies are also Auckland based, such as Navman, Phitek, and Right Hemisphere. And Auckland is a gateway for international tourism, and is home to a significant export education business. Auckland airport is the second busiest airport in Australasia, and the Ports of Auckland is a major export port.

So in many senses, Auckland is New Zealand's international city and has already developed links into the international economy. The challenge now is to build on this, such that Auckland becomes a truly global city. This matters both for Auckland and for the broader New Zealand economy.

The role of Auckland

New Zealand's economic prospects rely in large measure on its ability to create a global New Zealand economy. Auckland has an important role in this process, as major cities in other countries have shown. Auckland needs to be at the leading edge of this process in terms of connecting New Zealand to the rest of the world.

Significantly increased levels of international engagement by the Auckland economy will allow Auckland to become the productivity growth engine of the New Zealand economy. Auckland needs to aspire to becoming the city that drives the New Zealand economy forward significantly through a much improved productivity performance, in addition to being a great place to live.

Because it is New Zealand's largest city, Auckland has a particular role in making this happen. By New Zealand standards, Auckland has scale, density, and some critical mass – the factors that make cities 'cauldrons of creativity'. Economists have long recognised the special role that cities can play in the growth process.

Auckland often makes a (reasonable) claim for a disproportionate share of government funding and policy attention because of the importance of its economic role as New Zealand's largest city. But this position comes with a responsibility to make a disproportionate contribution to New Zealand's economic performance. In particular, I think that Auckland has a special responsibility to take the New Zealand economy global by creating an environment to encourage and assist many more New Zealand firms to go global.

Auckland is well-placed to achieve this:

- A large migrant community, lots of foreign students
- Major international connections, particularly in terms of air linkages
- Professional advisory community in Auckland, including the VC industry, incubators etc
- Critical mass in terms of a labour pool
- New Zealand's top ranked research university

Given these positive characteristics, Auckland is probably under-delivering on its potential at the moment. Many of the building blocks are in place – the focus now needs to be on ensuring that these deliver the desired outcomes.

So what should Auckland be doing? The importance of international engagement for Auckland has been previously identified, for example in the AREDS document, but the trick is to work out what to do in a concrete sense.

In terms of thinking through what needs to be done, we need to consider the areas in which Auckland can develop real competitive advantage internationally. My view is that Auckland can play a role in terms of activities that are based on knowledge, technology and ideas – like IT and biotech – and in the service economy (e.g. financial services). Innovation tends to happen in cities, and so Auckland has a special role to play in New Zealand's economic transformation. Auckland needs to position itself as an ideas city, which we can sell to the rest of the world

This emphasis on doing some new things in Auckland is particularly important because New Zealand's method of international engagement going forward will necessarily be different than the traditional model of exporting commodity goods to other countries. This strategy will likely involve an increased emphasis on outward FDI and new models of exporting (ideas, knowledge, managing virtual companies) to supplement New Zealand's strengths in the primary industries.

Seattle

The city of Seattle seems like a good aspiration city for Auckland. Seattle is about the same size as Auckland, situated on lakes, with a thriving cultural and music scene. Historically, Seattle was based around the primary sector – forestry, fishery etc – and was seen as peripheral to the real centres of economic activity. Seattle is now home to great companies like Amazon, Boeing, Starbucks, and Microsoft. These companies do not exist to serve the local market but the national and international market.

Because of this, Seattle does a good job in terms of attracting people to live there; coupling great lifestyle and a great economic proposition. This provides a good model for Auckland.

Taking Auckland to the world: some ideas

So what are the priorities going forward in the context of creating an internationally-oriented city?

In thinking through the solutions, the first point that I would make is around calibration; the scale of the response needs to be proportionate to the scale of the challenge. The challenge is not just to raise Auckland's exports to the rest of the world by a few million dollars a year, or by a few hundred million dollars a year. The gap between New Zealand's international economic activity and that of other countries is well in the billions of dollars, and growing. Small-scale initiatives will simply not cut it.

So we need to be thinking a lot bigger than simply identifying a handful of modest initiatives that are directionally sound but that will not generate materially improved outcomes even if they are successful.

The second point that I would make is that local and regional government have a very important role to play in this regard. Central government can and ought to do much more in terms of encouraging global engagement in a material manner, but having an Auckland specific focus to complement these national level activities is very important. So creating a global Auckland economy should be the focus of the joint efforts of local, regional, and central government. This task should be approached in a strategic, coordinated manner.

This is not just a governmental responsibility, of course, although leadership and commitment from the public sector is important. Leadership from the Auckland business community is also an important part of the mix.

I have identified three classes of possible actions, with some specific initiatives that I think are in the right space to make a difference. These are not specific recommendations, but they are designed to stimulate a conversation and I think they are worthy of serious consideration.

- Infrastructure

Infrastructure investment needs to be about more than encouraging the same type of activity. An efficient roading network is important, as is energy infrastructure, but this needs to be supplemented with a particular focus on the infrastructure to support a globally connected, C21 economy in Auckland. This may include initiatives like:

Upgrade transport links to the airport e.g. rapid transit, to make it efficient and quick to get to and from the airport.

Ensure that Auckland has a world-class communications infrastructure, that allows people and businesses in Auckland to send voice, data, video traffic quickly and cheaply. This would make Auckland more globally connected.

One possible approach here is the roll-out of wireless broadband across Auckland. It is interesting to see what many cities in the US are doing in this regard; there is an effort by local governments in cities like San Francisco and Chicago to get free or cheap wireless broadband rolled out. Google and several other firms have recently tendered for this contract in San Francisco. Can we get a Team Auckland approach to make wireless broadband available across Auckland, involving the private sector and local and regional government?

Research infrastructure is also important; for example, a life sciences research park could act as a cornerstone of the industry in Auckland. This is an important part of building new areas of strength in the Auckland economy. The role of Auckland local and regional government may not

be in terms of funding, but it can act as a catalyst to make it happen: for example, helping to secure land for development, clearing it through the consent process and so on.

- Position Auckland as the best place in New Zealand to locate internationally-focused businesses

Provide a rates holiday/rebate for Auckland-based international firms (e.g. those with international sales above some limit, or a proportion of their total income that is derived from offshore). This will provide financial encouragement and help Auckland to attract and retain internationally-focused firms. This may provide an incentive for some firms to stay in Auckland that may otherwise relocate.

Assemble the chief executives of the major international firms in Auckland and ask them what the city and region can do to help them expand globally from an Auckland base.

- Auckland as a magnet for talent

Auckland needs to be able to attract and retain world class talent. This means an ongoing focus on the lifestyle initiatives to make Auckland a great place to live in – outdoors, culture, public transport (civic infrastructure). Richard Florida's work, for example, points to the importance of this.

But this focus on civic infrastructure needs to be seen as part of a broader package of actions. Auckland does need to work on being a world-class city, but a key part of the value proposition to attract and retain people is the provision of world-class opportunities and returns; that you can take on the world from an Auckland base.

Concluding remarks

There is a big productivity challenge ahead of both New Zealand, and Auckland in particular. Going global is a critically important part of meeting the challenge.

Auckland has a particularly important role in meeting this challenge, and needs to be at the leading edge of New Zealand's international engagement. The goal of international engagement should be used as the organising framework for achieving the productivity aspiration.

Auckland has a lot of favourable environmental conditions, such as international transport links and the migrant community. But there are additional things that need to be done to realise Auckland's potential.

I have outlined a series of initiatives and actions that I think should be seriously considered in the context of taking the Auckland economy global.

This is a long term target, so we need to commence with real urgency and aggression and being mindful of the required materiality of the response.