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EXECUTIVE SUMMARY 2007/1

So far yet so close: Connecting New Zealand to the global economy

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EXECUTIVE SUMMARY

New Zealand is the most remote developed country in the world relative to international markets. This physical location means that the efficiency of New Zealand's supply chains – the ways in which New Zealand firms are able to transport their goods and services to offshore markets – is of significant economic importance.

The competitive position of firms is increasingly influenced by the speed, cost, and responsiveness with which they can get goods and services to market. So the success with which New Zealand companies can go global from a New Zealand base will be strongly influenced by the quality of New Zealand's connections with the rest of the world.

There has, of course, been major progress in international communications and transport over the past century. The time to ship goods to the other side of the world has reduced, the introduction of air traffic has enabled the rapid movement of people and goods, and communication costs have reduced substantially.

However, despite these developments New Zealand remains disadvantaged in terms of its supply chain links with offshore markets. Distance is not dead. It takes longer and costs more to get New Zealand's goods and services to market than from many other countries.

Transporting New Zealand's exports to market still takes a long time; for

example, it takes over a month to get goods to Europe by sea. In terms of air links, New Zealand's international connectedness does not compare well to other developed countries. As a consequence, New Zealand firms are not well placed to participate in areas of the global economy where speed to market matters.

New Zealand's international connectedness has improved but significant gaps remain relative to other countries, and it is relative positioning that drives the competitiveness of firms. Compared to firms in most other developed countries, New Zealand firms are at a competitive disadvantage in terms of the quality of their international supply chains.

This constrains the ability of New Zealand firms to go global, and goes some way to explaining why New Zealand's international economic engagement lags most other developed countries. Indeed, New Zealand's international economic performance provides little indication that the tyranny of distance has reduced for New Zealand over the past few decades.

So what can be done to strengthen New Zealand's links to the rest of the world? Three classes of response are identified: strengthening New Zealand's international air and shipping links; developing new business models in which production and distribution takes place close to the end-market; and developing virtual supply chains to enable weightless economic value to

be transported electronically from New Zealand to offshore markets.

Strengthening air and shipping links

84% by value of New Zealand's merchandise trade is transported by sea, and so it is important to ensure that shipping lines have an incentive to service New Zealand well, that New Zealand ports have appropriate incentives to invest in the next generation of infrastructure to service larger ships, and that domestic road and rail infrastructure is aligned with the investments made at the ports.

In terms of strengthening New Zealand's air links, there are two actions that should be taken in addition to continuing to invest in airport infrastructure. First, promoting inbound tourism should be an ongoing priority. In addition to tourism being a major export category in its own right, tourism flows are the major support for New Zealand's business travel and air cargo capacity. And second, ensuring that New Zealand continues to be serviced by a national airline that is committed to connecting New Zealand to the rest of the world. These strategic considerations should be central to any government decision-making around its ownership stake in Air New Zealand.

However, although worthwhile, these measures are unlikely to lead to substantial improvements in New Zealand's international connectedness. These actions are best seen as ways

to ensure that New Zealand's existing links are not degraded. Some more creative actions are required in order to lead to an improvement in the competitive position of New Zealand firms.

Re-thinking location

One way for New Zealand firms to overcome the constraints due to New Zealand's supply chain links is to change the location of their production and distribution activity. To the extent that New Zealand firms invest in offshore markets to establish a production presence closer to the end-consumer or to international transport infrastructure, or contract this production out to other firms in these locations, they will be able to access supply chains that are not subject to New Zealand's disadvantages.

This type of business model allows New Zealand firms to compete on the same basis as their international competitors. Indeed, such activity is widespread internationally, with many firms developing a global presence. Unsurprisingly, firms are much more likely to locate their production activities in a foreign market rather than export from their home market when the foreign market is a long way away.

In addition to these supply chain benefits, this approach also provides significant growth options for New Zealand firms. For example, contracting out production to offshore

firms may allow New Zealand firms to expand offshore in a relatively low cost and low risk manner, to access high quality, large scale production facilities, and overcome various input constraints that exist in New Zealand such as the emerging skills shortage.

A growing number of New Zealand firms are involved in this type of activity. However, New Zealand's overall levels of outward direct investment and offshoring activity are much lower than in many other developed countries. Taking advantage of this potential will require significant changes in terms of the capacity and aspiration of New Zealand firms, together with a more encouraging public policy environment in terms of promoting savings and capital markets, international tax, and the nature of New Zealand Trade & Enterprise's activities.

Virtual supply chains

Another way in which New Zealand can overcome distance is to invest in developing virtual supply chains to allow New Zealand firms to exploit strengths in the 'weightless economy': economic activity that can be exported through communications technology. This could include activities such as the creative industries, call centres, financial services, and business services like advertising or consulting.

Placing greater reliance on virtual supply chains reduces the

disadvantages of physical remoteness while simultaneously playing to New Zealand's strengths in terms of being creative and innovative. Producing high value, low weight goods and services is likely to be an area in which New Zealand can generate real competitive advantage.

At the moment, only about 5% of New Zealand's export base can be defined as weightless. But there is substantial growth potential. The ability for New Zealand firms to use virtual supply chains could be as transformational as refrigerated shipping was for the New Zealand economy over a century ago. But investments need to be made to develop these virtual supply chains in order to obtain these benefits. In particular, it is important to develop a world-class communications infrastructure within New Zealand that links New Zealand to the world.

Summary

It has never been easier for New Zealand to connect to the world, with the development of communications technology and new business models. The global economy is not so far away when New Zealand's connections are virtual rather than physical in nature. But in order to take advantage of these opportunities, New Zealand needs to act with real seriousness of purpose in terms of continuing to develop new business models and in terms of public policy.

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