

## *The world is not hanging around for New Zealand*

By Dr David Skilling

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One of the most notable worldwide trends of the past 15 years has been the rapid, substantial increase in international trade and investment flows. This intense international activity has allowed firms to substantially expand their activities beyond their domestic borders and access new growth opportunities, generating significant productivity growth.

The productivity benefits that such international economic activity generates are likely to be particularly significant for New Zealand, given the small size of our domestic market. Indeed, increasing New Zealand's exporting and international investing activity is vital to raising New Zealand's productivity growth rate. But New Zealand has not been participating in this process of globalisation to nearly the same extent as most other small developed countries.

Despite strong trade growth internationally, New Zealand's exports to GDP ratio has gone sideways over the past two decades. At 29% of GDP, it is at the same level as in 1983. And since 1990, New Zealand's exports to GDP ratio has increased by just two percentage points, compared to an OECD average increase of 12 percentage points.

New Zealand's relatively sluggish export performance is not just a recent phenomenon, driven by the high value of the dollar. New Zealand's export growth has been consistently below the OECD average over the past few decades. Of the 24 OECD member countries in 1971, New Zealand's export growth ranked 23<sup>rd</sup> over the next few decades. And, if anything, this trend has become more pronounced over the past 15 years.

As a consequence, New Zealand's level of exports to GDP is low relative 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 average level of exports to GDP in OECD countries with populations of 10 million or less is 54%, almost twice the level in New Zealand.

New Zealand's 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, and New Zealand is losing export market share in more categories than it is gaining share. And compared to the type of change observed in other countries, there has been relatively little movement in New Zealand towards higher growth goods and services over the past few decades.

New Zealand firms can also go global by investing directly abroad, either by making new investments or by buying foreign firms. However, New Zealand's international investing performance does not compare well to 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.

Uniquely among OECD countries, New Zealand's stock of outward FDI has reduced since 1990, from about 15% of GDP. This is due to retrenchment by many New Zealand companies, the sale of New Zealand companies to foreign investors, and FDI outflows that have been among the lowest in the OECD. This reduction in New Zealand's outward FDI contrasts sharply with what

the OECD describes as “rampant cross-border activity” by developed countries over the past 15 years. The level of outward FDI has more than tripled across the developed world from 10% in 1990 to 27% in 2004.

The bulk of the New Zealand economy is domestically focused and few New Zealand firms generate the majority of their earnings from overseas. Over the past 12 months, only 50 New Zealand firms exported more than \$75 million and only 361 firms exported more than \$25 million. New Zealand's exporting and foreign investing activity is dominated by a relatively small number of large companies, such as Fonterra, Zespri, and PPCS.

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. Although many of New Zealand's listed firms have some international component to their earnings, it is rare for these firms to be internationally focused with a majority of their earnings coming from offshore.

Indeed, New Zealand has very few genuine multinationals compared to other countries of similar size. To illustrate this point, New Zealand has just one company on the Forbes Global 2000, whereas Ireland has 8, Finland 15, Singapore 13 – and Australia has 38.

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. New Zealand's international performance has not kept pace with the substantial increases in international trade and investment flows across the world. And worryingly, this divergence seems to be growing rather than shrinking. Bluntly put, the world is globalising but the New Zealand economy is not.

Given the importance of meaningful international engagement for improved productivity growth in New Zealand, these outcomes are of real concern. Although there are some positive developments in terms of New Zealand companies competing successfully in international markets, the materiality of this activity needs to be significantly increased.

Going forward, 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 and as companies become increasingly global in reach. These developments will increasingly impact on New Zealand's exporting and investing performance. This globalisation process provides a substantial opportunity for New Zealand, but it is simultaneously a major challenge.

The world is not hanging around for New Zealand and a change in New Zealand's course and speed is urgently required.

The good news is that achieving a significant improvement in New Zealand's international performance in a short period of time is possible. Many small developed countries have substantially increased their exporting and investing activities over the past decade, and there is no reason that New Zealand cannot do likewise.

However, this will not happen spontaneously. And it will not happen if our response is limited to listing the reasons for New Zealand's relatively low levels of international economic activity, such as our isolation from major markets. Rather, the focus must be on identifying the actions that will lead to a substantially increased level of exporting and international investing by New Zealand firms given the challenges of going global from a small, remote country.

This is not an easy task. Improving New Zealand's international performance in a material way will require deliberate, sustained attention and action from both business and government. But making progress here is fundamental to New Zealand's economic prospects. And the sooner we start the better – New Zealand needs to get back in the race.

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