

## Connecting New Zealand to the world

### Dr David Skilling

As a small country of 4 million people, New Zealand's economic prospects rest in large measure on the ability of New Zealand firms to expand into international markets through exporting or investment. By itself, the domestic market is simply too small to generate the income levels that we aspire to.

Unfortunately, however, New Zealand's level of international economic activity is low relative to other developed countries and is not growing rapidly, in terms of both exporting and outward direct investment. New Zealand is not actively participating in the process of globalisation. New Zealand's distance from international markets makes this a challenging issue to address, but it is vitally important nonetheless.

Acting to improve this situation requires a serious response from both business and government. Over the past several months, the New Zealand Institute has released a series of reports outlining the priority areas for action. These include domestic policy changes, such as international tax reform, savings policy, and SOE policy, an updated external strategy, such as a more aggressive FTA strategy and an increased focus on Asia, as well as improved firm-level aspiration and capacity with respect to international expansion.

And in a report released today, we make recommendations on improving the quality of New Zealand's international supply chains – the speed, cost, and responsiveness with which New Zealand firms can get their goods and services to offshore markets. Without an ability to efficiently get their products to international markets, even the most productive New Zealand firm may not succeed globally.

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 fallen sharply. However, despite these developments New Zealand remains disadvantaged in terms of its supply chain links with offshore markets.

It takes longer and costs more to get New Zealand's goods and services to market than from many other countries. For example, it takes over a month to get goods to Europe by sea and 15-20 days to get to the West Coast of the US. 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.

In other words, distance is not dead. 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.

This means that serious efforts need to be made to enhance the ability of New Zealand firms to get their products to market.

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 ports.

In order to strengthen New Zealand's international air links, in-bound tourism should be promoted, because tourism flows provide the major support for New Zealand's business travel and air cargo capacity, and we should act to ensure that New Zealand continues to be serviced by a national airline that is committed to connecting New Zealand to the rest of the world.

However, these actions are not game-changing and are unlikely to lead to substantial improvements in New Zealand's international connectedness. It will still take over a month to ship goods to Europe, even with more efficient ports. Some more creative actions are required.

In this regard, it is important to understand that developments such as the increased importance of speed to market and the decline in communication costs, are shifting the location of New Zealand's comparative advantage towards high value, low weight goods that can either be shipped by air or that are weightless.

A country's comparative advantage is a function of transport costs as well as production costs. Without the introduction of refrigerated shipping technology 125 years ago, for example, New Zealand would not have been able to develop its strengths in many parts of the primary sector.

Another important reason that a shift towards a lower weight, higher value model is desirable is the emerging concern about climate change. There is some evidence that consumer preferences abroad are beginning to change in a way that may penalise goods that are physically transported long distances. And emissions pricing may lead to increases in transport costs. So relying on shipping relatively heavy, low value goods long distances to markets is unlikely to be economically sustainable or desirable.

But it turns out that the value of each tonne that New Zealand currently exports is relatively low at \$1500 per tonne compared to \$3200 per tonne in the US. So the challenge is to think creatively about how to develop the supply chains of New Zealand firms in order to support the transition to a lower weight, higher value economy.

One way for New Zealand firms to achieve this 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.

In this approach, firms will control a global presence from New Zealand that will not rely to the same extent on physical transport from New Zealand. This type of business model allows New Zealand firms to compete on the same basis as their international competitors.

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 in a relatively low cost and low risk manner, to access high quality, large scale production facilities, and overcome New Zealand's 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.

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. By way of example, this could include activities such as the creative industries, financial services, and software development.

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 and that links New Zealand to the world.

Placing greater reliance on virtual supply chains reduces the disadvantages of physical remoteness and offers real potential for New Zealand. Indeed, these developments appear almost custom-made to benefit a small, remote economy like New Zealand.

Communications technology has the potential to transform the New Zealand economy, by allowing New Zealand-based firms to generate value through knowledge-based activities, either by controlling a global presence from New Zealand or by virtually distributing weightless services to global markets.

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. New Zealand need not be the 'last bus stop on the planet' any longer. 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.

***Dr David Skilling is the chief executive of the New Zealand Institute, a privately-funded, non-partisan think-tank. All of the Institute's publications are available at [www.nzinstitute.org](http://www.nzinstitute.org)***