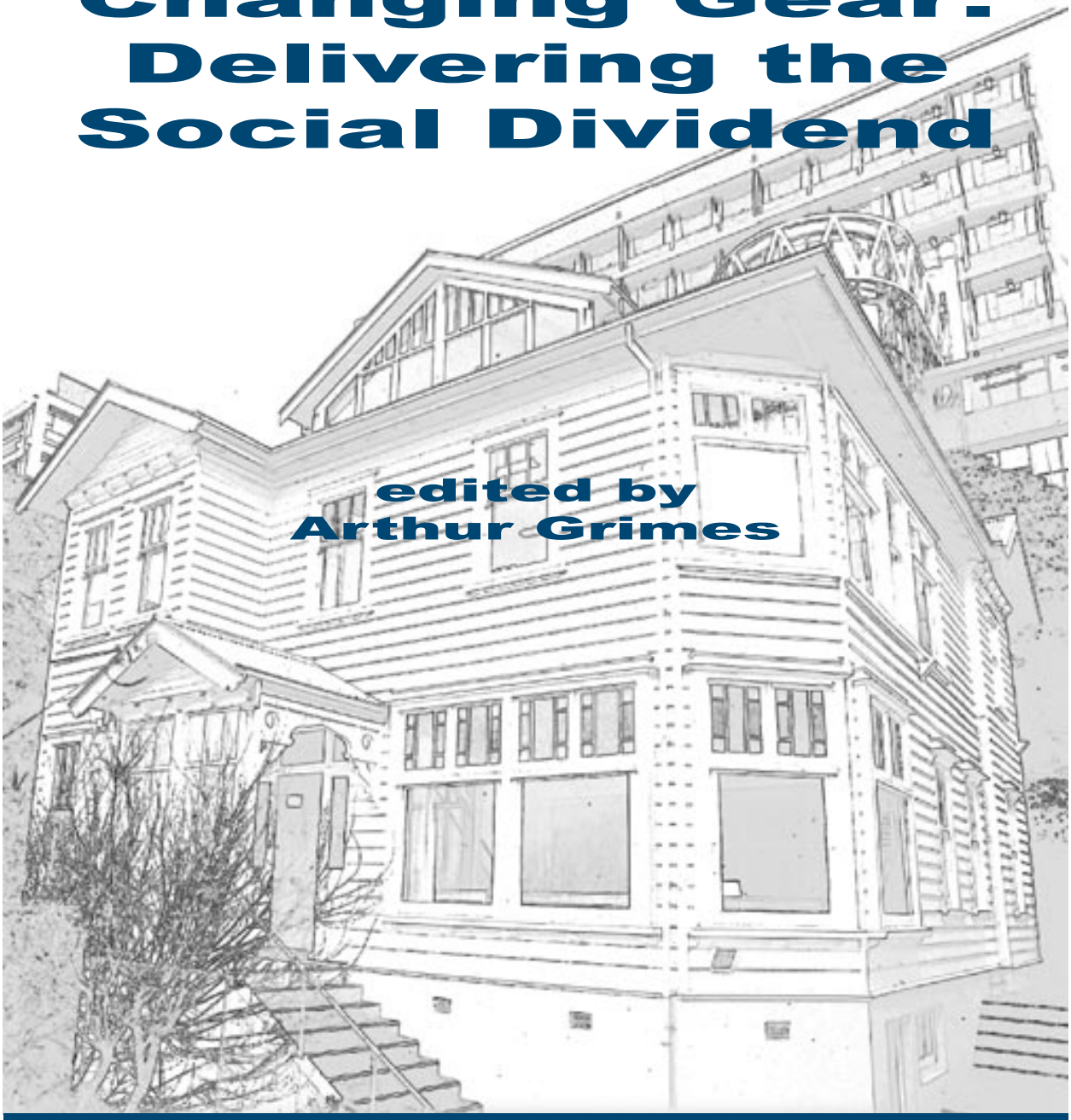
Institute of policy studies

ips policy paper

number thirteen / 2002

Changing Gear: Delivering the Social Dividend



edited by
Arthur Grimes

INSTITUTE OF POLICY STUDIES • VICTORIA UNIVERSITY OF WELLINGTON
Te Whare Wananga o te Upoko o te Ika a Maui

Institute of Policy Studies
Victoria University of Wellington
PO Box 600, Wellington
New Zealand

ISSN 1175-8201
ISBN 0908935-65-X

Telephone (04) 463-5307
Fax (04) 473-1261

e-mail addresses:
Acting Director: gary.hawke@vuw.ac.nz
Editor: ginny.sullivan@vuw.ac.nz
Design & Layout: david_pearson@paradise.net.nz
General enquiries / Book orders: ipos@vuw.ac.nz
Web Site: www.vuw.ac.nz/inst-policy-studies

Contents

Changing Gear: Delivering the Social Dividend

In December 2001, the Institute of Policy Studies and Business New Zealand co-hosted a one day symposium entitled 'Changing Gear: Delivering the Social Dividend'. It was addressed and attended by members of academia, the public sector and the business sector. This IPS Policy Paper brings together a number of the presentations to that symposium. It includes papers delivered by Arthur Grimes, Colin Campbell-Hunt and Ross Wilson, plus a summary of key points raised in the address by Glenn Withers, and some concluding remarks by Rod Oram.

Arthur Grimes is Principal, GT Research and Consulting, and Senior Research Associate of Motu Economic and Public Policy Research Trust. He teaches Money and Finance at Victoria University of Wellington and was formerly IPS Director.

Colin Campbell-Hunt is Professor of Management at Otago University and was formerly Associate Professor of Management at Victoria University of Wellington. He is a member of the Competitive Advantage New Zealand research team.

Ross Wilson is President of the New Zealand Council of Trade Unions.

Glenn Withers is the head of Public Policy at Australian National University. He has been an adviser to both the Liberal and Labor governments in Australia and is a former Director of the Economic Planning Advisory Commission.

Rod Oram is a leading New Zealand business and economic journalist. Prior to coming to New Zealand he worked as a business and economic journalist for major UK papers.

Growing a Healthy Society

Arthur Grimes

> A massive 93 percent of the sample wants an increase in spending on health services, with 58 percent in the "greatly increase" choice. The picture is much the same for the education system, 90 percent seek increased spending, and more than half of that is for the spending to "greatly increase". These results would seem to be about as close as one gets to a universal desire.

Social Expenditures and the Economy

The opening quotation reports results from the 1998 survey of the New Zealand Study of Values (Perry and Webster, 1999, p 78). In the questions referred to, 1,201 respondents were asked: "Suppose you had to make a choice between 'increasing government spending in particular areas even though this would mean paying higher taxes for this extra spending, or cutting government spending in these areas and thereby reducing taxes'; which would you choose?". In each area, respondents could answer one of: greatly increase, some increase, keep the same, cut, greatly cut, or can't choose. Overwhelming support was registered for increased government spending on health and education.

Strong support for increased government spending (with increased taxes) was also indicated for the fields of job training and assistance for the unemployed, pensions and protecting the environment. Only 0.6% of respondents voted for lower health expenditures (and lower taxes), 1.0% for lower government spending on education, and only 2-3% for cuts in spending on each of job training, pensions and the environment. Given the dominance of these areas in fiscal expenditures, a clear mandate is indicated simultaneously to increase social expenditures and taxation.

These indications are in keeping with the same survey's findings regarding New Zealanders' perceptions of the responsibilities of central government. Large majorities consider it a central government responsibility to "provide a job for everyone that wants one", "provide a decent standard of living for the old", "provide decent housing for those who can't afford it", "reduce income differences between the rich and the poor", and "to impose strict laws to make industry do less damage to the environment".

These findings are also consistent with the strong view expressed in the survey that there should be "tighter government regulation of big companies and multinationals". In turn, this view is consistent with the 70% of respondents who considered "that this country is run by a few big interests looking out for themselves" and with the 59% of people who consider that "the government is doing too little to help people in need".

What can we make of these views, especially the "near universal desire" to increase government expenditures on health and education? Concentrating specifically on health, international comparisons suggest that the view expressed on this matter in the Values Survey is quite understandable. Relative to other developed countries, New Zealand's real expenditure on health services per person is low.

An international comparison of real per capita health expenditures across the 29 OECD countries places New Zealand at 19th place in 1998 (Ministry of Health, 2000).[1] Apart from Ireland (which spends almost as much as New Zealand on health per capita), all the countries which spend less on health than New Zealand are those that would traditionally be regarded as middle income (rather than developed) economies. Compared with Canada and Australia (two small developed countries with similar histories to New Zealand and with substantially commodity-based economies), New Zealand's expenditures are very low. New Zealand spent $US1,440 per person on health compared with $US2,040 in Australia and $US2,250 in Canada. New Zealand's per capita expenditures were just one-third of those in the United States.

These figures include public plus private health expenditures. But even if we include just public expenditures, New Zealand still places only 19th in the OECD.

If we analyse health expenditures as a percentage of GDP, New Zealand shifts up the rankings. As a ratio of GDP, we are 12th ranked on the basis of total health expenditures (at 8.1% of GDP) and 13th ranked by publicly funded health expenditures (at 6.2% of GDP). Further, we are only 0.5% of GDP below the 6th ranked country in terms of publicly funded health expenditures.

It is not a coincidence that New Zealand is 19th in the per capita health expenditure stakes. We happen to be 20th ranked in the OECD by GDP per capita. Figure 1 (see p 16) graphs the relationship between total health expenditure and GDP in the OECD in 1998. The relationship is extraordinarily close. Indeed, 94% of the OECD cross-country variation in publicly funded per capita health expenditure (and 93% of the cross-country variation in total health expenditure) can be explained as a function solely of countries' per capita GDP.[2]

The statistical regression estimates (reported in endnote 2, see p 17) indicate that as countries become wealthier, they not only spend more on health (both publicly funded and in total), but the rate of extra health spending also increases. Each 1% of extra real GDP per capita on average increases total per capita health expenditure by 1.44%, and increases publicly funded health expenditure by 1.51% per capita.

Norway is now the third richest OECD country per capita, a spot once occupied by New Zealand. It spends an almost identical share of GDP on publicly funded health as does New Zealand (both at 6.2% of GDP). It spends almost as much as we do on total health care expenditure as a percentage of GDP. If New Zealand had held onto third spot in the income rankings (i.e. with Norway's current per capita GDP) and spent the same on healthcare as a percent of GDP as does Norway, we would now have real health care expenditures 45% above our current levels.

The evidence is abundantly clear. The only way to increase health expenditure substantially in New Zealand (whether publicly funded or in total) is to increase our per capita GDP. Similar results can be expected for other expenditure items such as publicly funded education. Thus those who wish to see greater social expenditures (whether in health, education, income support, environmental and conservation policies, police and/or defence) must realistically expend their primary energies in lifting the level of New Zealand's national income. Quite simply, New Zealand must grow faster.

New Zealand's Growth Record

Contrary to some impressions, New Zealand and New Zealanders are on average now significantly richer than they were in the 1950s. In a recent OECD publication, Angus Maddison (2001) documents the annual GDP, population and GDP per capita of 124 countries for the period 1950 to 1998. Other key statistics are also included (such as exports and, in some cases, migration flows).[3] Again, the GDP statistics are presented in purchasing power parity terms, so that the figures are adjusted to take account of changing living costs over time and different living costs across countries at each point in time. A country that has relatively low living costs (such as New Zealand) will have higher relative GDP in an international context on the basis of this measure than it will using conventional international comparisons.

Maddison's figures document that New Zealand's population rose from 1,909,000 in 1950 to reach 3,811,000 in 1998. On a PPP basis,[4] New Zealand's GDP grew from $16,136 million in 1950 to $56,322 million in 1998. Thus, by 1998, GDP was 3.5 times its 1950 level and GDP per capita was 75% above its 1950 level. Recalling that 1950 was a time of buoyant commodity prices (especially for wool), and that New Zealand was then the third richest developed country in the world (after the United States and Switzerland), the substantial rise in living standards appears to belie the pessimism often expressed in this country. This increase in income has enabled health and education expenditures to rise very substantially on a real per capita basis over the past 50 years.

If we only looked backwards or if other countries had not also grown substantially, the national mood might be one of celebrating our successes. However, that is not the case: other countries' living standards have grown substantially faster than have New Zealand's – both in absolute and in per capita terms. New Zealand is now a relatively poor developed country. Table 1 (see over) documents per capita living standards in New Zealand and in a number of other developed countries in both 1950 and 1998. From once being third richest in the world, New Zealand has slipped to twentieth. In absolute terms, we are considerably richer than we ever have been, but relatively we are considerably poorer.

Table 1: GDP Per Capita (PPP Basis, 1990 $s)
Selected Developed Countries

	1950	1998
Austria	3,706	18,905
Belgium	5,462	19,442
Denmark	6,946	22,123
Finland	4,253	18,324
France	5,270	19,558
Germany	3,881	17,799
Italy	3,502	17,759
Netherlands	5,996	20,224
Norway	5,463	23,660
Sweden	6,738	18,685
Switzerland	9,064	21,367
United Kingdom	6,907	18,714
Australia	7,493	20,390
New Zealand	8,453	14,779
Canada	7,437	20,559
United States	9,561	27,331
Greece	1,915	11,268
Ireland	3,446	18,183
Portugal	2,069	12,929
Spain	2,397	14,227

Source: Maddison, 2001.

Figure 2 (see p 16) compares the trajectory of New Zealand's per capita income relative to those of Australia and Canada, two other small, developed and predominantly commodity producing countries. Having been richer than each of these countries in the early 1950s, New Zealand's per capita living standard is now just 72% of that in these two comparators. On average, New Zealanders' material living standards are only 79% of average living standards in the UK and just 54% of the material living standards in the USA.

Another way of considering these figures is to note that if New Zealand's relative living standards had slipped since 1950, but only to the levels of those of Australia and Canada, and if our public sector health and education expenditures had been maintained at current percentages of GDP, we would now be spending 28% more in real terms on each of these important social areas than we are now. Even if the additional growth had been 'bought' at the expense of a 10% reduction in the social budget in comparison with the size of the economy, we would still be able to spend almost 20% more on health and education in real terms than we do now.

New Zealanders, while wanting more social expenditures, also consider that support for economic growth is a primary responsibility of government. The 1998 Values Survey found 91% of people supporting the proposition that "providing industry with the help it needs to grow" is a responsibility for central government. Indeed, 69% of respondents considered that priority should be given to the country achieving a "high level of economic growth" over three other choices presented to them.[5]

Further, 71% of people responded positively to the proposition, "Competition is good. It stimulates people to work hard to develop new ideas". Similarly, when asked whether "incomes should be made more equal or whether we need larger income differences as incentives", more people opted for greater incentives than greater equality.

Thus the picture of New Zealanders' perceptions is a confused one. People consider that priority should be given to achieving economic growth, support greater economic incentives and are in favour of competition. Government should do more to assist industry achieve growth. However, over 90% of people also support government imposing "strict laws to make industry do less damage to the environment". Huge majorities consider that government should increase expenditures on health, education, housing, pensions, job training, the unemployed, reducing income disparities and protecting the environment. In order for the government to achieve these aims, people are overwhelmingly in favour of higher taxes.

These confusions[6] may be a primary reason why New Zealand's growth record is so poor. Governments must meet the overwhelming social wishes of the populace which are at odds with achieving the economic growth aims. The latter (because they are longer term) are relegated to the realm of lip-service. The key, if we wish to raise both growth and social expenditures, is to look for the factors which produce economic growth and to ascertain how New Zealand can maximise the contribution of these factors.

Raising the Growth Rate

Economic growth – and hence increased living standards – occurs when people within a country increase the resources (especially labour and capital) available for production and/or when they use their resources more

effectively. This simple observation indicates a number of avenues that we must look at in order to raise our living standards to the levels of those countries to which we aspire and to which we once belonged. Potential avenues (each of which is analysed in more detail below) include:

- increasing the labour force through a more pro-active immigration policy;
- increasing savings in order to increase domestic investment;
- encouraging and/or maintaining the spirit of entrepreneurship in New Zealand;
- adopting a taxation system that encourages wealth creation;
- becoming an integral part of a larger economy, so enlarging the market for New Zealand products.

The first two avenues seek to increase the resources within the economy. The last three seek to increase the productivity of the economy's resources.

Migration

Between 1950 and 1998, New Zealand's population grew at an average annual compound rate of 1.45%. By contrast, Canada's population grew at an annual rate of 1.66% and Australia's grew at 1.74%. The differences between these nations' population growth rates was particularly apparent over the 1973-1990 period. New Zealand's annual population growth rate fell to just 0.76%, compared with the 1.21% and 1.39% of Canada and Australia respectively.

A key contributor to New Zealand's low population growth rate has been the net migration outflow of New Zealand citizens, only partially compensated for by immigration of non-New Zealand citizens. In a recent paper, ANU's Bob Gregory (2001) documents that since 1963, there has been net outward migration of New Zealand citizens in every year, accounting for a total of 598,000 people. This figure is approximately equivalent to the combined populations of Auckland and Dunedin in 1963, or equivalent to the current combined populations of Wellington and Christchurch.

Maddison's figures show that between 1974 and 1998 New Zealand's annual migration inflow amounted to just 0.12% of its 1974 population, compared with ratios of 0.48% and 0.64% for Canada and Australia. Even over the 1950-1973 period, New Zealand's annual migration flow (of 0.54% of its 1950 population) was below that of Canada and only half that of Australia.

The effect of migration on living standards is multi-faceted (see Poot et al, 1988, showing that the effects work in both directions). Migration opens up opportunities to introduce new skills to the economy, opens up new trade opportunities through deepening or broadening trade networks, and increases demand for housing and other domestic infrastructure while at the same time potentially increasing some aspects of social costs.

The latter aspect has often deterred government from "opening the floodgates further". However, Buckingham (2000) shows that it would be cost-effective for New Zealand to open up immigration to "elderly foreigners" under some circumstances. While social costs would rise, so would taxation receipts (especially GST) through the enlarged market for New Zealand goods. Effectively, New Zealand businesses (involved in both tradeables and non-tradeables) would enlarge their market by bringing the market to them.

The issue of immigration raises the question of whether New Zealand has a large enough population to reap economies of scale which may require a certain critical mass of people to achieve. These effects may stem both from the demand side of the economy (increased demand for housing, etc.) and from the supply side as the increased labour force is used more productively, especially in the larger cities. The studies of Poot et al and of Buckingham are both suggestive that there may be scale economies achieved by further enlarging our population through migration. In an international context, a number of recent studies suggest that such scale economies exist; in other words, there is a positive relationship between population size and economic growth (Diamond, 1999; Frankel and Romer, 1999; Frankel and Rose, 2000; Kremer, 1993).

Recent work by David Skilling (2001) and others within Treasury have emphasised that New Zealand may be too small in terms of current world production patterns to reap sufficient scale economies to have high and strongly growing incomes. While we produce quality commodities, skilled labour and good ideas, we do not have the scale of industry to add the same value to these raw inputs as can occur in larger economies. Thus our skilled labour, in particular, is drawn offshore to where

it can add greater value and so capture the benefits in terms of higher remuneration.

To examine this factor further, the Appendix to this paper presents some preliminary econometric results using Maddison's data studying the relationship between population growth and GDP growth over time and across countries. The results support the growing international evidence that enlarging our population (most likely through increased immigration) would be beneficial not just for growth, but also for per capita living standards.

The Appendix analyses the relationship between GDP growth and population growth across twenty developed countries after allowing for the effects of a number of other factors influencing the growth rate.[7] It finds that between 1950 and 1973 a 1% increase in population tended to be associated with a 1.39% increase in GDP, thus being associated with a rise in per capita GDP of 0.39%. Between 1973 and 1998, virtually the same relationship is found, with the strength of the association being 1.46%. The stability in this relationship across 50 years and across 20 countries suggests – in developed countries at least – that population growth may result in countries reaping scale economies that lead to improved per capita living standards.

If this link were causal, one aspect of New Zealand's slow GDP growth (relative, say, to Australia's) can be isolated. As indicated above, New Zealand's population grew by 1.45% p.a. between 1950 and 1998. If, instead, our population had grown at Australia's annual rate of 1.74%, our population would have reached 4.37 million by 1998 compared with its actual level of 3.81 million. Applying the estimated scale economies derived from the cross-country study (using a scale factor of 1.4), GDP would have been 21% higher and GDP per capita would have been 5.6% higher in 1998 than was the case.

It is possible, however, that the link may not be causal; rather, it may be reversed, with higher growth leading to greater migration and population growth. While the influence is expected to be bi-directional, we can test whether population growth leads to subsequent GDP growth and, especially, to subsequent growth in per capita living standards. Again, some preliminary work along these lines is presented in the Appendix. This more detailed study covers New Zealand, Australia and Canada. It examines the relationship between annual GDP growth and prior population growth across the three countries.

Whether the relationship is studied for all three countries or just for New Zealand, the results point to population growth having a pronounced short- and long-run effect on subsequent GDP growth. In New Zealand, in particular, the short-run (one year) effect of a 1% increase in population may be as much as a 1% change in real GDP. (Thus there is no negative short-term effect on per capita GDP arising from a larger population.) This effect is most likely to be realised through a boost to housing and other service provision (as was evident in Auckland in the mid-1990s). The effect on GDP may grow to between 1.2% and 1.7% over time, resulting in higher per capita living standards as population increases.

New Zealand is not a small country by area; thus our 'smallness' comes about through the size of our population. Following World War Two, the New Zealand government actively sought to increase New Zealand's population through assisted migration, which succeeded in attracting a large number of migrants from the United Kingdom, the Netherlands and elsewhere. Migration is thus, to some extent, a policy choice variable. It is determined both by how accommodating we are to immigration requests and also how active we are in supporting migrants potentially wishing to come to New Zealand. If greater inward migration were considered beneficial for New Zealand, strong emphasis could be given to considering active support for migrants, along the lines of the post-war scheme (but possibly from non-traditional country sources). Another policy could be to open up immigration to older migrants than those currently encouraged, as in the Buckingham proposal noted above. Additionally, New Zealand could target foreign students studying here. Almost by definition, these students will be skilled. Automatic permanent resident status could be conferred on all graduating students, relieving those who wish to apply from bureaucratic problems, and encouraging others to consider staying who had not already considered doing so.[8]

Increased Savings

Increased domestic investment raises the amount of capital available for production, so raising the level of national output. However, it must be financed either out of domestic or offshore savings. If it is financed out of offshore savings, a balance of payments current account deficit (equal to the investment-savings gap) results.

Claus et al (2001) document that New Zealand has a low net national savings rate relative to other developed countries. We also have consistently large balance of payments deficits that, at times, might act as a brake on expansionary policies, especially at times when such policies might be useful to combat a nascent economic downturn. This "balance of payments constraint", arising from our poor savings rate, may be one factor causing greater volatility in New Zealand's growth performance relative to all other developed countries (Skilling, 2001).

Claus et al find, however, that savings rates do not appear to be correlated internationally with economic performance. These findings may be due to an inability to distinguish the experiences of countries with active as against passive savings policies. A country with high expected growth will (in the absence of specific pro-savings policies) tend to generate low savings rates as people spend now in anticipation of high future earnings. On the other hand, a country which seeks to counter low expected growth through a policy of forced domestic savings directed to increasing domestic investment may obtain high growth performance as a result of these policies and at the same time have high savings rates. Thus high growth countries can have either high or low savings rates depending on their predisposition to growth and on their policies towards savings.

Singapore is an example of a country that explicitly embarked on a high savings policy to increase economic growth. It did so primarily through its state-run Central Provident Fund (CPF), which sought to increase national savings and domestic investment, while at the same time build funds to pay for people's long-term social needs. This scheme requires most workers to save 33% of their income via a government-run fund. Workers aged below 55 years of age contribute 20% of their salary while their employer contributes a further 20%. Thus a worker earning say $1,000 per week (before CPF and other tax deductions) has 'full income' of $1,200 per week (equal to their pre-tax income plus the employer's contribution) of which $400 (33%) is compulsory forwarded to the CPF.[9]

A large proportion of these savings is invested within Singapore (principally through investments in private sector firms based in Singapore).[10] This policy has greatly raised the capital base of the country since 1960. Singapore's average ratio (in percentage terms) of national savings to national output (S/Y)[11] and of investment to national output (I/Y) over the past three decades[12] is given in Table 2, which also presents the average annual percentage growth in real GDP per capita (RGDPP) in each of these decades.

Table 2: Singapore Savings, Investment and Per Capita Growth

Decade	S/Y	I/Y	RGDPP
1970s	28.1	35.6	7.8
1980s	41.9	40.0	5.2
1990s	47.7	34.7	4.2

Source for Tables 2 & 3: IMF *International Financial Statistics Yearbook* 1999 (updated for 1998 figures where necessary by IMF August 2000 IFS) using series for nominal private (or household) consumption (line 96), nominal government consumption (line 91), nominal gross fixed capital formation (line 93), nominal GDP (line 99b.c), real GDP (line 99b.r) and population (line 99z). Savings is equal to GDP less consumption.

Singapore's savings and investment ratios are very high compared with other industrialised countries. (For example, the S/Y ratio over the 1990s in Australia, Canada and New Zealand – measured on the same basis – was 21.8%, 20.5% and 21.7% respectively.) The result is that labour productivity (output per worker) has risen extremely strongly, although total factor productivity (output per units of capital and labour) has risen more slowly. Output per capita (RGDPP) has risen extremely strongly throughout the last three decades, even though by the start of the 1990s Singapore had already become an economically developed country.[13]

The Singapore experience is an example of a country choosing to implement a policy designed to boost long-term production while forgoing shorter-term consumption. Consumption was depressed by the compulsory savings scheme, although consumption per head now is almost certainly far higher than it would have been in the absence of the policy, given the huge growth in incomes over the past 30 years. One generation was 'penalised' by the policy, but all future generations have benefited. In standard discounted terms, the Singaporean approach may not have been warranted: the poor record on total factor productivity indicates (according to the standard model) that Singapore "over-invested".[14] However, it has led eventually to a high income country which can now afford to provide high quality health, education and other services, which less wealthy countries cannot afford. Further, it can

now attract top quality migrants, which hitherto were more difficult to attract, drawn by the affluent lifestyle.

New Zealand arguably remains on a low-growth trajectory that will not jump to a new higher trajectory solely through adopting market-oriented policies. It is likely (as postulated by Skilling) that there are multiple equilibria. One option is to remain on our current trajectory with a low population (including skilled emigration), low capital and slow growth economy. Another option is to seek actively to boost population (through the measures discussed above) and to boost investment and savings. If the latter is desired, the most obvious way to achieve this (as in other countries) is to link this policy to a private or public social security fund. This is particularly important for the future business outlook if future social expenditure costs are projected to rise (as they are) through an ageing population.

The New Zealand parliament recently took the decision to lock in future superannuation entitlements. If this lock-in is taken as given (and politically only one small party opposed the lock-in), there is a much increased need for a national savings policy – not only for business now, but especially (by preventing significant future tax hikes) for business in future. The national savings policy may be based around either a private or a public scheme. A compulsory private scheme was overwhelmingly rejected by the New Zealand electorate in the last term of government, and a public scheme (New Zealand Superannuation Fund) is now being established. International experience suggests that either public or compulsory private schemes of these types have some positive effect on national savings rates.[15] If the compulsory private option remains politically off the agenda, there therefore appears considerable merit in supporting NZSF (provided governance arrangements are appropriate) as a vehicle to help boost national savings and to prevent crippling tax increases in future that would further inhibit business expansion. The only other option is to reduce commitments to superannuation entitlements (and other implicit entitlements – e.g. to health) which politically does not currently appear feasible.

One option that is completely infeasible – and which would result in the worst of all possible worlds for future business growth – is to support current superannuation and related entitlements into the future and not to support either a compulsory private or public fund. The consequent, easily anticipated future tax hikes could permanently stifle business growth.

Encouraging Entrepreneurship

Entrepreneurship is a crucial ingredient for an innovative and dynamic economy, and evidence suggests that New Zealand is an entrepreneurial society. Recently released results from the Global Entrepreneurship Monitor (GEM) survey demonstrate that New Zealand has the highest rate of "opportunity entrepreneurship" in the world (Frederick and Carswell, 2001).[16] Opportunity entrepreneurs are those people "who spot a hot business opportunity and go after it" (they are distinguished from "necessity entrepreneurs" who create self-employment because of job-loss). Women and Maori are shown to be highly entrepreneurial relative to international and New Zealand norms.

These results are consistent with the prevalence of small businesses in New Zealand. Simmons (2001) shows that New Zealand business is characterised by a large number of small firms. In 2001, there were 234,000 firms employing a total of 1,380,000 people, an average per firm of fewer than 6 people. The bulk of firms (84%) employ 5 or fewer people. Less than 2% of firms have 50 or more employees. This prevalence of small businesses is unusual within the OECD (although Italy, Netherlands and the Czech Republic are in some respects similar), but it is entirely consistent with the entrepreneurship picture outlined in the GEM survey.

These results suggest that there do not appear to be major policy issues surrounding the prevalence of business start-ups in New Zealand. These start-ups are already at a high level.

The issues instead surround the growth of small firms once they have been established. The company statistics documented by Simmons indicate that most New Zealand small firms either stay small or expire; few grow to significant sizes. For instance, between 1996 and 1999, only 13% of small firms (those initially with five or fewer employees) became larger, 37% stayed the same size, 11% shrank and 39% perished. By contrast, 40% of large firms (those initially with at least 100 employees) became larger. Also, medium-sized firms tend to have higher value added per employee (and

hence contribute more strongly to overall living standards) than do small firms, but it is the latter that predominate in New Zealand.

Three responses can be considered to encourage firm expansion especially within the myriad of small firms. Changes to the taxation regime to encourage expansion, and greater economic integration with Australia and other countries to encourage exports are considered in succeeding sections. A third response – to change attitudes – is more qualitative. The KnowledgeWave conference identified New Zealanders' somewhat grudging acceptance of successful business-people as a matter to be addressed. The high scores for entrepreneurship and high levels of business start-ups in New Zealand suggest that the problem is not one of lack of acceptance of business people, but perhaps more a lack of acceptance of 'big business' people.

People may admire successful builders in much the same way as they admire Jonah Lomu – as successful individuals. However, once the builder is employing 50, 100 or 1,000 people, they become suspect. This, of course, is speculation, although some of the Values Survey responses are consistent with this speculation (especially the 70% response to the proposition that "this country is run by a few big interests looking out for themselves", and the strong majority stating that there should be "tighter government regulation of big companies and multinationals").

There is little that public policy can do about this attitudinal issue, except not to add to it (by unjust criticisms of successful businesses). Government can also seek to remove impediments to business expansion through streamlining planning approval processes that may inhibit expansion of some businesses (and provoke an 'us' against 'them' confrontation at times). Attitudes are more likely to be changed over long periods of time through school programmes such as those pioneered by the Enterprise New Zealand Trust which emphasise the role of business in individuals' and the nation's life.

Taxation

As long as public expenditure remains as currently projected, New Zealand tax rates will have to remain at moderately high levels. This is one reason to review certain areas of government expenditure. One area still in need of review is New Zealand superannuation (NZS) which, in 1999, absorbed 5.45% of GDP (Cox, 2001), a proportion which is projected to rise further as the population ages. Many people who receive NZS are still working or have high savings and so receive a transfer payment from government, funded by taxes, that they do not require. NZS entitlements therefore need to be reviewed. However, as noted above, it is politically unlikely this will be done in the near future given that both major political parties have recently voted in Parliament to protect existing entitlements into the future.

Even if the level of government expenditures, and hence taxes, cannot be reduced significantly, the structure of taxes can be altered to encourage expansion. Referring back to the structure of New Zealand business, the current level and structure of taxation does not appear to be holding back business establishment. However, it may be holding back business expansion, especially for smaller businesses.

Optimal taxation theory, which takes into account equity preferences of policy-makers, indicates that low earners should be taxed at low rates, with the tax scale being progressive at low to medium income levels. However, at very high income levels, efficiency considerations then take priority and the tax scale should decline as income rises above a certain level.

This is the model essentially seen in Singapore and in other countries with social insurance systems. The contributions to Singapore's Central Provident Fund are capped once earnings reach $6,000 per month. This means that the marginal tax rate on 'full income', which starts at 35% (for the first $9,000 p.a.), reaching a marginal rate of 46.7% on full income of $86,400, then falls to 16%, although it rises progressively thereafter to reach 28% on full income above $514,400. The average tax rate rises from 35% to approximately 42% before declining towards 28% on very high incomes.

Some European social insurance systems follow a similar model. For example, in the Netherlands a mandatory social insurance scheme for people below a certain income level is funded by a flat levy of 8.1% of employees' incomes up to a maximum of 55,900 guilders. New Zealand also follows this system to a minimal extent by capping ACC contributions once annual income reaches $83,017 p.a., resulting in marginal tax rates falling fractionally at that level.

Grimes (2000), Brash (2001) and the McLeod et al tax committee (2001) have all discussed the possibility of declining marginal tax rates at high income levels. For instance, marginal tax rates of between 10% and 20% at very high income levels would encourage the expansion of domestic businesses (especially where the business is predominantly owned by a single or a few owners) and would encourage the return of entrepreneurs operating internationally to New Zealand.

There are two criticisms of this approach. First is the empirical criticism that the loss of tax revenue from a lowering of tax rates on high incomes would not be compensated for by increased revenues from a larger tax base arising from business expansion. This is an issue on which further work is urgently required. My own judgement is that the imposition of low marginal tax rates on high incomes (say over $300,000 p.a.) would provide a significant incentive to business people to expand strongly and encourage internationally-based entrepreneurs to establish in New Zealand, thus further building the New Zealand tax base.

Second is the political economy criticism that reducing marginal tax rates on high incomes is not consistent with the wishes of the New Zealand electorate. However, this criticism ignores the fact that social democratic regimes in Europe do adopt such a taxation approach through their social insurance schemes. It appears quite justifiable (in political economy terms) to cap individuals' social security contributions at a certain (high) level which ensures that they still pay far in excess of any social insurance compensation that they may personally receive. If New Zealand were to adopt a social insurance model for more than just ACC (e.g. to include also health, superannuation and unemployment expenditures), it could use this model effectively to reduce marginal tax rates on high incomes.

Integrating with Larger Economies

In 2001, fewer than 4% of New Zealand's 234,000 firms were exporters and this proportion has been falling over time (Simmons, 2001). Yet, for a small country, exporting is a critical source of expansion given that the domestic market is so constrained. After adjusting for factors such as size of economy, distance from markets and product specialisation, international evidence indicates that high levels of international trade as a proportion of GDP are associated with high levels of per capita income (Frankel and Romer, 1999). This finding is borne out by estimates presented in the Appendix which indicate a positive relationship between a county's expansion of its per capita export receipts and its GDP growth rate (both over 1950-1973 and over 1973-1998).

New Zealand is not a particularly open economy relative to other small countries; this may be caused by existence of barriers to export. The step of expanding marketing efforts into a second economy, especially from a country as distant as is New Zealand from other markets, involves a substantial fixed cost that may be large relative to the existing small domestic sales of many firms. Faced with this fixed cost and with the risk that an incorrect calculation to expand into exporting could place the entire firm into jeopardy, many firms (96% in New Zealand's case) will choose not to expand and instead to service solely the (tiny) domestic market.

There are many sources of the fixed costs involved in taking the step into exporting. Some are inevitable (the price of an international flight) but some can be diminished through policy harmonisation between New Zealand and one or more other countries. If firms face the same institutions and policies in their prospective export destination as they do at home, the costs – and especially the risks – of venturing further afield are reduced.

One example is the choice of New Zealand to retain its own dollar. The survey of 400 New Zealand firms' attitudes to a currency union with Australia reported in Grimes et al (2000) showed a substantial majority supported adoption of an irrevocable link of the New Zealand dollar to the Australian dollar. Support was widespread amongst small and large firms, exporters and importers, and firms in the manufacturing, agriculture and services sectors. Overall, 58% of firms were positive towards currency union with only 14% negative (the rest were neutral). What was particularly instructive in this survey – especially in light of the fixed cost arguments relating to export barriers discussed above – were some of the patterns of support for a joint dollar.

Strongest support came from firms with 11 to 20 employees with lower (but still strong) support from firms on either side of this level. The survey indicated that firms of this size tend to be at the threshold of exporting: surveyed firms with 6 to 10 staff on average export 6% of total sales, and firms with 11 to 20 staff

export an average 7% of sales. In contrast, firms with 21 to 50 staff export 14% of total sales, and firms with over 50 staff export an even greater share. Thus there is a substantial increase in exporting at a firm size of about 20 employees.

This is consistent with another finding of the survey which revealed that firms with fewer than 25 employees find foreign exchange hedging more costly than do larger firms, and hedge a substantially smaller proportion of their foreign exchange exposures than do larger firms. The survey indicates that smaller firms without specialist in-house foreign exchange expertise consider foreign exchange risks and associated costs a major impediment to expansion into export markets.

The dynamic impacts of retaining an independent currency may therefore be considerable and could help to explain New Zealand's relatively poor growth rate: New Zealand firms face a major constraint on expansion driven by the New Zealand-imposed non-tariff barrier to trade called the New Zealand dollar. These firm-specific costs of maintaining multiple currencies are consistent with the international findings that trade is diminished by the presence of multiple currencies.

The currency example is only one of a number of potential policy areas which could usefully be harmonised in order to reduce the significant costs involved in New Zealand firms becoming established as exporters. Evidence suggests that once firms expand into exporting, there is much less evidence of barriers to expansion. "Once firms start exporting even the smallest exporters seem to have the same likelihood of expansion as larger firms" (Simmons, 2001). The key, therefore, is to adopt policies which encourage firms (or at least do not discourage firms) to begin exporting. In many respects, the simplest way of doing so is simply to adopt Australian policies and institutions in all areas other than those in which we believe New Zealand policies or institutions are demonstrably superior. Where policies or institutions are similar, but not the same (including the currency), the presumption should be to adopt Australia's practice.

This prescription becomes tied up with issues of national sovereignty. However, the decisions to adopt Australian policies and institutions are decisions for New Zealand to make (and potentially to revoke if circumstances were to change abruptly), so there is no question of ceding sovereignty. Instead, it is a question of New Zealand policy-makers adopting policies which are most likely to result in the expansion of New Zealand business activity, and hence living standards in New Zealand. If this involves economic union with Australia (and in my judgement, it does) then this set of policies needs to be given urgent consideration.

Where to From Here?

If New Zealanders wish to have higher living standards – and particularly if they wish to enjoy better health, education and other social services – the country's economy needs to grow faster. There is no single magic bullet which will achieve a sharp increase in growth; and a climb up the international income ranks will inevitably be slow (if it occurs at all). However, policy can contribute to this desired turnaround. Specific suggestions, based on the analysis above, include:

- Boost migration by: – relaunching an 'assisted passage' scheme for immigrants (possibly in the form of a tax rebate after say 3 years' work in New Zealand);
- – facilitating immigration by older foreigners in certain categories (especially those with existing wealth);
- – granting permanent residence to foreign students who graduate with a tertiary qualification in New Zealand.
- Boost domestic savings by supporting either the expansion of the New Zealand Superannuation Fund (NZSF) or the establishment of compulsory private superannuation.
- Significantly reduce marginal tax rates on very high incomes, possibly through the introduction of a social insurance scheme along the lines of many European social democratic models or a scheme modelled on Singapore's Central Provident Fund.
- Seek full economic union with Australia, and prior to full union being established, seek to adopt as many Australian laws, institutions and business conventions as can feasibly be achieved in short order.

It is feasible to introduce each of these policies within a short timeframe. Other growth-oriented policies which are not discussed here (e.g. reviewing planning requirements for business development and reviewing educational policies to boost achievement in maths

and sciences, which are currently poor[17]) are just as important but may take longer to implement even if the will was there.

The importance of undertaking these policies in order to boost our sustainable rate of business growth cannot be over-stated unless we wish to keep becoming poorer on the world stage. New Zealanders know that our health system has to ration healthcare, that our education system is under-funded relative to top quality systems elsewhere, and that we cannot afford to play our full part in world security because we are relatively poor. If we want governments to deliver sustainable improvements in these and other services, there is no choice but to make an all-out effort to make this country rich. In turn, this means introducing a policy environment that makes our businesses as productive and profitable as possible. It is a big challenge, but failing to meet this challenge would be disastrous for the social fabric of our society.

Appendix

Some Preliminary Econometric Analysis

Using data from Maddison (2001), we conduct a cross-country regression[18] of the annual percentage change in each country's GDP (DGDP) against a constant term, CNST (to account for country-specific technological growth), the ratio of initial GDP per capita to that of the USA, CONV (to allow for convergence of income in poorer countries to that in the richest country over time), the annual percentage change in population, DPOP, and the annual percentage change in per capita export receipts measured in USD, DEXP (to capture the impact of changing openness on growth). If the coefficient on the population term equals unity, constant returns to scale are indicated[19]; if the coefficient is larger (smaller) than unity then increasing (decreasing) returns to scale are indicated.

The regression is split into two time periods (the precise choice of periods is dictated by the nature of Maddison's data) to test whether the relationship is stable across the past fifty years. The first period is 1950-1973, a period of generally buoyant economic conditions. The second period is 1973-1998, a much more turbulent period involving the two oil shocks, stagflation, disinflation, a stock market crash and a further stock market boom. The results of these two regressions are presented in Table A1 (t-statistics are in brackets beneath coefficient estimates).

The results in Table A1 indicate that, especially in the first half of the sample, poorer countries' GDP tended to converge on that of the USA and also that countries with strong per capita export growth tended to grow more quickly. In both samples, the coefficient on population growth is found to exceed one, indicating increasing returns to scale. The estimate is very similar in each period (however we cannot reject the null hypothesis that it is equal to one in either period).

Cross-sectional regressions do not indicate causality. To delve further into whether the population growth may be causing per capita GDP growth, we examine three countries with similar histories, stages of development and reliance on commodity exports: New Zealand, Australia and Canada. Again we look at GDP growth over the period 1950-1998, but use annual time series data across the three countries. The data are estimated both as a panel[20] for the three countries (with cross-equation restrictions) and for New Zealand alone (in case the New Zealand results are significantly different from those of the panel).

For the New Zealand case, the estimated equation is in a single equation cointegration format, regressing the annual percentage change of real GDP (DGDP) on a constant, the log of real GDP lagged one year (LGDP1), the log of population lagged one year (LPOP1) and a time trend (TIME) to take account of technical progress. The t-statistic on LGDP1 is used to test for cointegration (i.e. for a long-run relationship), and long-run coefficients are solved out for each equation. For the cross-country case, the same format is adopted, with the coefficient on each variable (other than the constant) constrained to be the same across the three countries (i.e. we are assuming that technological change and increasing returns to scale act in the same manner across the three countries).

The results for New Zealand are presented in Table A2; the cross-country results are presented in Table A3. For each of the unconstrained estimates, the t-statistic on LGDP1 exceeds 4.00 (consistent with a cointegrating relationship) and hence the long-run elasticity of GDP to POP ($\mathbf{E}_{GDP,POP}$) is presented in the table. In each case the coefficient on TIME is negative (implying negative technological progress). It is likely that TIME and LPOP1 are highly collinear. Hence we also present the estimates with the long-run coefficient on TIME

Table A1: Cross-country GDP Growth Regression

DGDP on	CNST	CONV	DPOP	DEXP	R^2
1950-1973	4.38	-4.25	1.39	0.148	0.75
	(4.00)	(5.00)	(4.48)	(2.12)	
1973-1998	0.51	-1.15	1.46	0.224	0.65
	(0.44)	(1.41)	(4.04)	(2.99)	

restricted to a range of specified levels to ascertain the effect on the long-run POP coefficient. The first line in each equation reports the results for the unrestricted coefficient on TIME (with the long-run coefficient being reported); the following four estimates give the equation estimates where the long-run coefficient on TIME is restricted to 0%, 0.5%, 1%, 1.5% p.a. respectively; the final line presents the estimate using the long-run value on TIME which gives $\mathbf{E}_{GDP,POP} = 1.0$; t-statistics for the short-run estimates are reported in brackets, short-run coefficients on TIME and CNST are omitted for clarity.

The unrestricted New Zealand estimates suggest huge increasing returns to scale: a 1% increase in population resulting in approximately a 2% increase in GDP. Even the short-run (one year) coefficient is greater than one. However, the equation also suggests technological progress of –0.21% p.a. which is not realistic. As the long-run coefficient on TIME is raised, the estimate of $\mathbf{E}_{GDP,POP}$ declines. The value of TIME for which constant returns to scale is indicated is 1.19% p.a. However, an F-test rejects the validity of this restriction, implying that technological change (in New Zealand at least) has been at a lower rate, and also implying that there are increasing returns to scale of GDP with respect to population.

The unrestricted panel estimates again suggest huge increasing returns to scale, with a 1% increase in population resulting in an approximate 2.5% increase in GDP. However, the short-run effect is now smaller. Again the unrestricted equation 'finds' negative technological progress over time, and as the long-run coefficient on TIME is increased, the returns to scale

Table A2: New Zealand Estimates for DGDP (1951-98)

TIME	LGDP1	LPOP1	R^2	$E_{GDP,POP}$
-0.0021	-0.54	1.11	0.33	2.08
	(4.53)	(4.38)		
0.00	-0.53	1.03	0.32	1.93
	(4.44)	(4.28)		
0.005	-0.43	0.67	0.26	1.55
	(3.71)	(3.50)		
0.010	-0.29	0.34	0.17	1.16
	(2.80)	(1.61)		
0.015	-0.19	0.14	0.12	0.73
	(2.10)	(1.61)		
0.0119	-0.25	0.25	0.15	1.00
	(2.51)	(2.15)		

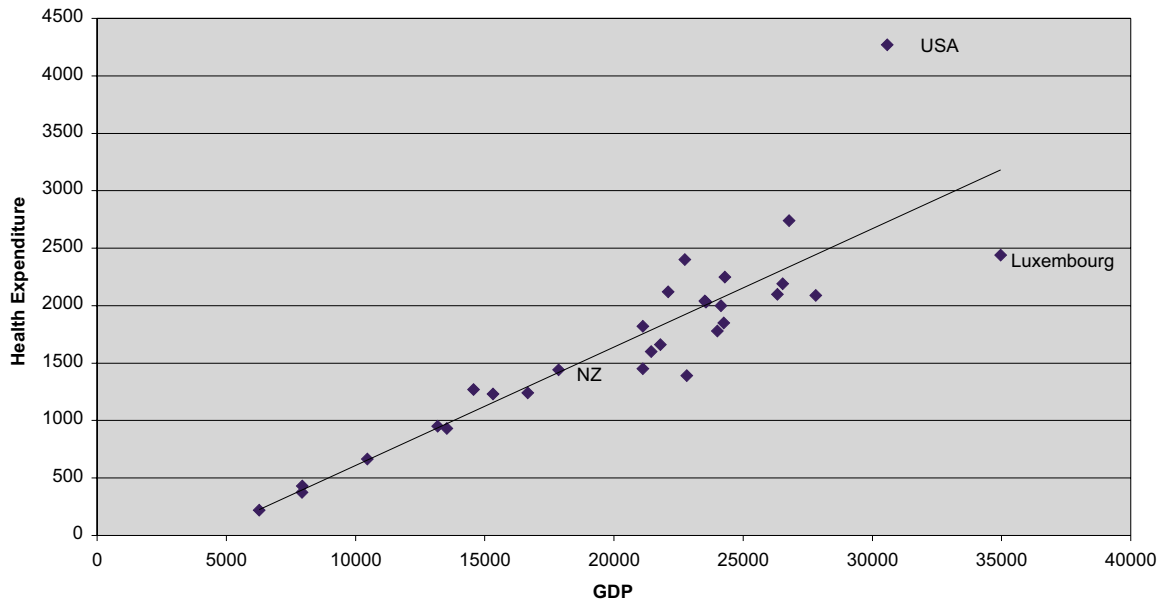
Table A3: Panel (New Zealand, Australia, Canada) Estimates for DGDP (1951-98)

TIME	LGDP1	LPOP1	R^2	$E_{GDP,POP}$
-0.0074	-0.15	0.37	0.18	2.51
	(4.01)	(3.71)		
0.00	-0.15	0.30	0.17	2.04
	(3.74)	(3.40)		
0.005	-0.13	0.21	0.15	1.70
	(3.29)	(2.88)		
0.010	-0.10	0.13	0.14	1.32
	(2.75)	(2.22)		
0.015	-0.07	0.06	0.12	0.9
	(2.22)	(1.50)		
0.0139	-0.08	0.08	0.12	1.00
	(2.33)	(1.67)		

parameter on population declines. Constant returns to scale coincides with an imposed rate of technological progress of 1.39% p.a., but again an F-test rejects the validity of this restriction, implying that increasing returns to scale exist.

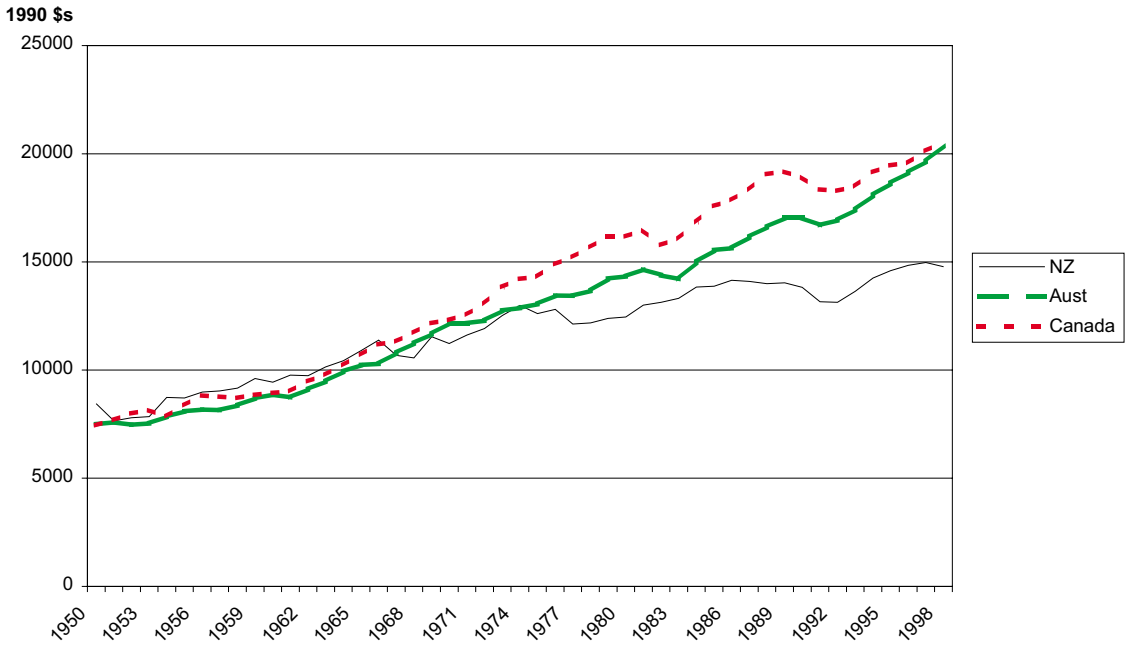
The time-series and cross-country estimates reported here are no more than preliminary. However, the consistency in findings using two quite different methods and two different samples over a half-century period at least creates a *prima facie* case to investigate further the possibility of increasing returns to scale for GDP with respect to population size.

Figure 1: Per Capita Health Expenditure and GDP, 1998 (US$ PPP)



Source: Ministry of Health, 2000.

Figure 2: Per Capita GDP - Australia, Canada, New Zealand (PPP basis)



Source: Maddison, 2001.

Endnotes

1 Expenditures in this section are measured in "purchasing power parity" (PPP) terms using data in Ministry of Health, 2000. PPP-based measures adjust for different living costs across countries. The 29 OECD countries, in rank order of per capita health expenditure, are: United States, Switzerland, Luxembourg, Germany, Canada, Iceland, France, Denmark, Norway, Australia, Netherlands, Austria, Belgium, Sweden, Japan, Italy, Finland, United Kingdom, New Zealand, Ireland, Greece, Spain, Portugal, Czech Republic, Korea, Hungary, Poland, Mexico and Turkey.

2 Letting LTOT be the natural logarithm of total per capita health expenditure, LPUB be the natural logarithm of publicly funded per capita health expenditure and LGDP be the natural logarithm of per capita GDP in each country, the two cross-country regressions (each for 1998) are as follows (with t-statistics in brackets):

$$LTOT = -6.93 + 1.44\ LGDP \qquad R^2 = 0.93$$
$$(9.09)\quad (18.65)$$
$$LPUB = -7.88 + 1.51\ LGDP \qquad R^2 = 0.94$$
$$(10.83)\ (20.42)$$

3 In some cases, data series are presented covering developments over the past 2000 years! All references henceforth to GDP and GDP per capita use Maddison's figures.

4 Measured in 1990 Geary-Khamis dollars.

5 The three other choices were "strong defence forces", "people having more say about how things are done in their jobs and communities", and "making our cities and countryside more beautiful".

6 At least, I assert there is confusion, since following the latter set of policies appears inconsistent with achieving stronger economic growth.

7 Other factors include the initial starting level of each country's per capita GDP relative to that of the United States, the rate of per capita export growth and a country-specific allowance for technological growth. The twenty countries are Austria, Belgium, Denmark, Finland, France, Germany, Italy, Netherlands, Norway, Sweden, Switzerland, United Kingdom, Australia, New Zealand, Canada, United States, Greece, Ireland, Portugal and Spain.

8 I believe that this suggestion may first have been put forward by Asia 2000 Director, Tim Groser.

9 The maximum monthly contribution is $1,200 based on a salary of $6,000 per month. These and further details on the CPF are available from Singapore Ministry of Information and the Arts, *Singapore: Facts and Pictures, 1999*, pp 105-109. See also the CPF's web-page: www.cpf.gov.sg.

10 Individuals can also withdraw some of their holdings in the CPF to invest directly in approved avenues.

11 The figure presented here, and for corresponding figures in subsequent sections, is the total of private plus government consumption to national output.

12 The 1990s decade is for the nine years to 1998.

13 Hence, 'convergence' to rich countries' living standards cannot be used to explain the fast 1990s growth.

14 The extraordinarily high savings rates of the 1990s accompanied by a significantly lower growth dividend suggests that there are limits to what can be achieved through extremely high savings ratios.

15 See Hubbard and Skinner, 1996.

16 Countries in the 'world' survey, in order of opportunity entrepreneurship are: New Zealand, Australia, Mexico, USA, Ireland, Brazil, Korea, Hungary, Italy, Finland, Canada, Norway, Denmark, South Africa, Argentina, Portugal, Spain, Sweden, Netherlands, UK, Russia, Germany, Poland, Singapore, India, France, Belgium, Japan and Israel.

17 See Education Review Office, 2000.

18 The countries that are included are the 20 countries listed by Maddison as Western European countries plus "4 Western offshoots", being the countries listed in endnote 7.

19 Even though the change in capital stock is not included in this equation, the same interpretation of the population coefficient is valid, provided the economy is on a balanced growth path.

20 Estimation is within a single stacked equation format.

References

Brash, Don (2001) 'Faster Growth? If We Want It', paper presented to the KnowledgeWave Conference, Auckland

Buckingham, Ken (2000) 'Would Immigration by Elderly Foreigners Benefit New Zealand's Economy?', paper presented to Wellington Health Economists Group, Wellington: Health Services Research Centre

Claus, Iris, David Haugh, Grant Scobie and Jonas Törnquist (2001) 'Savings and Growth in an Open Economy', Wellington: Treasury Working Paper 01/32

Cox, James (2001) *Middle Class Welfare*, Wellington: New Zealand Business Roundtable

Diamond, Jared (1999) *Guns, Germs and Steel*, W.W.Norton & Co.

Education Review Office (2000) *In Time for the Future: A Comparative Study of Mathematics and Science Education*, Wellington

Frankel, Jeffrey and David Romer (1999) 'Does Trade Cause Growth?', *American Economic Review*, 379-399

Frankel, Jeffrey and Andrew Rose (2000) 'Estimating the Effect of Currency Unions on Trade and Output', NBER Working Paper 7857

Frederick, Howard and Peter Carswell (2001) *Global Entrepreneurship Monitor: New Zealand 2001*, Auckland: UNITEC

Gregory, Bob (2001) 'Does Moving Away from Labour Market Integration Matter? Implications of Recent Changes in Australian and New Zealand Immigration Policy', paper presented to Off the Map in the Global Economy symposium, Wellington: Victoria University of Wellington

Grimes, Arthur (2000), 'Achieving a Productive Society: Dynamic Efficiency and Development', paper prepared for Poutama Trust, Wellington: Institute of Policy Studies

Grimes, Arthur, Frank Holmes with Roger Bowden (2000) *An ANZAC Dollar? Currency Union and Business Development*, Wellington: Institute of Policy Studies

Hubbard, Glenn and Jonathan Skinner (1996) 'Assessing the Effectiveness of Saving Incentives', *Journal of Economic Perspectives*, 10(4), 73-90

Kremer, Michael (1993) 'Population Growth and Technological Change: One Million BC to 1990', *Quarterly Journal of Economics*, 681-716

Maddison, Angus (2001) *The World Economy: A Millennial Perspective*, Paris: OECD

McLeod, Robert, David Patterson, Shirley Jones, Srikanta Chatterjee and Edward Sieper (2001) *Tax Review 2001*, Wellington

Ministry of Health (2000) *Health Expenditure Trends in New Zealand 1980-99*, Wellington

Ministry of Information and the Arts (1999) *Singapore: Facts and Pictures 1999*, Singapore

Perry, Paul and Alan Webster (1999) *New Zealand Politics at the Turn of the Millenium: Attitudes and Values About Politics and Government*, Auckland: Alpha Publications

Poot, Jacques, Ganesh Nana and Bryan Philpott (1988) *International Migration and the New Zealand Economy: A Long-Run Perspective*, Wellington: Institute of Policy Studies

Simmons, Geoff (2001) 'The Impact of Size and Distance on New Zealand Firm Size, Behavious and Performance', paper presented to Off the Map in the Global Economy symposium, Wellington: Victoria University of Wellington

Skilling, David (2001) 'The Importance of Being Enormous: Towards an Understanding of the New Zealand Economy', paper presented to Off the Map in the Global Economy symposium, Wellington: Victoria University of Wellington

"Bugger the Boxing, Keep Pouring the Concrete": Exploring the Foundations of New Zealand's New Economy

Colin Campbell-Hunt

The most powerful mechanism we have to re-invent New Zealand's place in the world economy is already hard at work. But until a few years ago, we knew very little about it; worse, it turns out that some of what we thought we knew we may have got badly wrong; and there remains much more to learn.

The mechanism I have in mind does not involve specifying some desired future portfolio of industries and world market shares and working towards that goal. Instead, New Zealand firms, left to their own devices, are building positions of remarkable strength in global markets that defy a priori prediction: a world leader in rock-crushing machinery in Matamata (Barmac); an 80% share of the global market for magnet arrays for ion implantation of all silicon chips made (Buckley Systems); a maker of ore sampling mills used in 1000 laboratories in 70 countries around the world (Rocklabs); the biggest movie project ever (Peter Jackson's *Lord of the Rings*).

Dozens of New Zealand ventures like these are growing out into the world in market niches of their own discovery, differentiating themselves from much larger global competitors with complex portfolios of capabilities that are unique to themselves. When they lock into global markets with their innovative products, they grow ten-fold in brief periods of rapid growth we call 'the gusher'. Collectively, they are – I suggest – the best mechanism we have to discover how New Zealand can create economic value from its distinctive array of natural, human, and cultural resources, and exploit these discoveries to create growth for the economy.

Over the last three years a team of researchers from Victoria University's Business School have undertaken an intensive study of firms like these. Called Competitive Advantage New Zealand (CANZ), and funded by the PGSF with further assistance from the New Zealand Trade Development Board and Victoria University, the project's aim is to build new theory about how firms like these create world-class competitive capability over time. We have yet to formally test the explanatory power of our theory of small firm internationalisation (for reasons I will explain below), but we have presented our ideas to hundreds of managers in dozens of seminars around the country, where they have received much informal support. In June of this year we published a book-length report on our work, 'World Famous in New Zealand', where you will find the detail that cannot be included here.

I want to report here some of the insights into these remarkable firms that have been produced by the CANZ project. First I am going to look at the current positions of strength from which they are growing their international businesses. It turns out that these draw important strength from the 'New Zealand-ness' of their experience. Second, I will look at the growth path they have followed – their internationalisation strategy. These too have taken forms dictated by New Zealand's smallness and isolation, and are quite unlike the internationalisation paths of received theory. Third, I will ask what we might do to help more of these precious companies develop. Here I will focus on one particular transition that carries distinctive risks for the firms that go through it. There are grounds to suspect that many firms are deterred from realising their full offshore potential by the challenges of this transition.

Because they grow in places and ways that we cannot pre-conceive, we run significant risks of suboptimising the potential of these firms if we constrain their growth to fit into some pre-ordained plan or theme. Hence the title for this address, borrowed from Ian Taylor, founder of one of these world-leading New Zealand enterprises,

Animation Research. "Bugger the boxing: keep pouring the concrete" sums up the process I suggest these companies are using to re-build the foundations of the New Zealand economy: flowing out from current positions of strength, constantly leveraging and building on their accumulated competitive capabilities, and growing from that base in whatever directions show promise.

Foundations of Competitive Advantage

How do exemplar firms like Tait Electronics, the Gallagher Group and Montana Wines achieve advantage over world-class competition?

In the first instance, we went looking for the attributes that contemporary resource-based theory suggests can differentiate a firm from its competitors in ways that are hard to copy, and thus allow the firm to build sustainable competitive advantage. We found clear evidence in the development of these businesses that they base their advantage on many of these foundations:

- relationships of mutual cooperation, dependency and benefit with suppliers, distributors, employees and customers (where the advantage could be called a reputation);
- innovations that can be defended from competitive response and 'locked in';
- organisational processes that encourage learning;
- mastery of multiple technologies;
- unique organisational cultures.

What was unexpected was that these leading firms typically make use of several of these sources of differentiable advantage: their advantage is broad-based.

But we found that a full understanding of the competitive appeal of these firms must also include attributes that stem from their unique experience as New Zealand firms:

- In every case, these firms have developed capabilities from their New Zealand setting that later served to differentiate them from offshore competition – for example, the early development of a mobile radio network by the Post Office that fostered a mobile radio industry here at a very early stage in the technology's development; and early experience in deregulation that helped companies like Nuplex to lead industry consolidation on both sides of the Tasman.
- They also tell us that they capture advantage from cultural traits that are distinctive to New Zealand: an ability to 'do more with less' that often makes these firms much faster to market and very cost competitive despite their small size and isolation; self-reliance and a willingness to have a go; a breadth of experience that larger, more specialised competitors cannot groom into their people; and an openness and breadth in social interactions that allows New Zealanders to assemble and operate diverse teams more readily than larger, stratified societies.
- They are led (over long periods) by people with attributes that suit the distinctive challenges these companies grow through: they are innovators, dynamos of energy, they are international in outlook, and have strong interpersonal values with a huge capacity for personal growth.
- Their most powerful competitive capability, they tell us, is the capacity of these relatively small firms to create what we call 'coherence' across the broad range of their activities, and thus produce a consistent, integrated value package to the customer. Their much larger, bureaucratically-organised competitors find it hard to achieve the same single-minded focus across the whole organisation.

The resource-based view suggests that firms can only establish sustainable advantage on the basis of attributes that are to a degree unique to the firm, and that competition will find hard to copy. New Zealand is thus most unlikely to create distinctive advantage by copying business models developed in Pittsburg and Rotterdam by much larger businesses. Instead the exemplar New Zealand firms we have studied have found ways to turn unique attributes of their local experience into sources of differentiable advantage offshore. This is what makes them so valuable as pathfinders for the country's economic development.

Paths to International Success

When we turn from sources of competitive advantage to the strategies these exemplary firms have used to grow internationally, we find the same distinctive New

Zealand realities at work. These exemplary New Zealand firms have had to find ways to grow global businesses from a tiny and isolated home base. The result has been internationalisation paths that are radically different from those predicted by theory developed for much larger and more integrated economies.

Contrary to current theory, the more global the scope of these firms, the more likely they are to have manufacturing concentrated in one facility at home; and the less likely they are to use their own marketing and sales staff in offshore markets. Companies that are primarily regional in scope, with the bulk of their business on both sides of the Tasman, in every case have manufacturing facilities in both countries and prefer direct sales representation. These preferences are the exact opposite to what contemporary internationalisation theory would predict, but they follow logically from the distinctive paths these firms have created to grow from their small isolated home market.

Furthermore, where current theory says there is one path to internationalisation and firms differ in how far they are along it, what we have seen in our New Zealand exemplars is a binary choice: about half of the firms are leaders on a global scale, who grew quickly to become active in 50-60 countries worldwide; and half are what we call 'regional leaders', with leading positions on both sides of the Tasman but with only minor market positions beyond that. The 'unusual' manufacturing and sales preferences adopted by these firms stem from the logic inherent in these two strategies:

- Global leaders in our study have, in every case, opened the door to global markets with a New Zealand produced proprietary innovation. The role that innovation plays in leading the international growth of these firms is one of the key lessons to be learned from their success. To deal with the rapid 'gusher' of sales growth, these firms have been virtually forced to focus their entire efforts on their leading product success. To quickly get the global market coverage their innovative product demands, they use indirect means of market representation through independent dealers. And because these very focused, but very globalised, firms remain relatively small (employing a few hundred people rather than several thousand) they retain a preference for indirect market representation offshore and consolidation of manufacturing in the home market.
- Regional leaders have not gone through this radical strategic reconfiguration. Their product lines remain broad. For them a key capability is that of cross-selling their products to the relatively small customer base of the Australasian market. For this reason, they value direct customer representation. While innovation has been an important part of the competitive success of these firms, they have not typically produced world-leading innovations (or if they have, they have chosen not to pursue their global potential). The result is products with a relatively low ratio of high value embedded knowledge to bulk, and a preference for manufacture or assembly on both sides of the Tasman (two of the companies in this group make furniture, another is a producer of volume chemicals).

Just as these firms have built advantage on attributes that stem from their distinctively New Zealand roots, so too they have discovered internationalisation strategies that take account of the New Zealand reality of being one of the smallest and most isolated economies on earth. This is not to say that these firms are ignorant of best practice overseas. Quite the contrary; many leaders spend a hundred days or more each year offshore, and they make full use of trends in the international industry to guide their own firm's development. But the strategies these leaders have invented to grow their businesses offshore have had to respect the distinctive New Zealand realities of isolation and small scale in ways that have simply not been observed or theorised in much larger economies.

Growing More 'Global Leaders'

In this last section I want to focus on the distinctive challenges and risks faced by tiny New Zealand firms when they confront the possibility of taking their world-leading innovations into global markets. There are many crucial transitions in the growth of firms. I choose this focus because getting through the 'going global' transition successfully produces enormous growth for the firm and the economy; and also because its challenges seem likely to be distinctively difficult for New Zealand firms to surmount.

The salient characteristics of this transition, as they emerge from the experience of companies in the CANZ project, are:

- A need to exploit the global potential of the innovative product rapidly and establish a leading position before imitating competition captures first-mover advantages. For example, Bill Gallagher built a European distribution network, and negotiated standards-access to all major European markets, in a frenetic period of just 3-4 years.
- The firm's ability to protect its IP on a global scale is severely limited until it has achieved the growth its IP promises. Several firms in our study do not even try to protect their IP, or can afford to police only the most salient breaches.
- A huge scale-up in operations. Scott Technology's first offshore installation of its innovative whiteware production lines was for a system 20 times bigger that anything it had previously done. Pressure on capital, quality, delivery and the firm's precious coherence becomes overwhelming during these periods.
- The firm is simultaneously exploring many new markets and the market potential of a new untried product.
- Each of these conditions represents a significant source of risk in its own right. For tiny New Zealand firms, the going global transition engages all of these sources of risk at the same time.
- The transition to global leadership is not another step in a series of incremental stages but a radical transformation of the firm's entire scope and business model. In the language of systems theory, it is a sudden and radical bifurcation from one attractor of strategic conditions into another that is quite unfamiliar to the firm. Technically, it is a catastrophe, albeit a promising one.
- The experience of the exemplars we have worked with is that New Zealand's venture capital market has yet to develop to play an active role in helping firms through these radical transitions with a combination of capital and some very distinctive expertise.

The going global transition has been a crucial transforming experience in the competitive development of all global leaders in the CANZ study. While not all of them experienced all of the challenges listed here, all have experienced several of them. Some have managed, or been forced, to pace the speed of their expansion offshore (Montana Wines). Others have limited the geographic scope of their expansion to what they could support from their own resources (PEC's electronically-controlled petrol pumps). All report that the stresses and risks of the transition have been intense.

We simply do not know how many firms have made this transition over the past five or ten years; nor whether more companies or less are making it now than 10 years ago; nor whether the transition is getting easier or harder. But to the extent that a government seeks to focus its interventions to support economic growth, encouraging firms through this transition deserves attention for the following reasons:

- The risks involved are inherently very high at the level of the firm and may require large portfolios to manage. There is evidence that an adequate market to manage this risk has yet to develop in New Zealand.
- Assistance to these globally tiny firms to protect the IP of the innovations that drive their internationalisation has the potential to increase their ultimate share of the global market significantly.
- When successful, the growth potential of this transition is very high as firms expand rapidly up to a global scale – the typical expansion factor during the gusher is ten-fold.

Exploring the Foundations of New Zealand's New Economy

I have suggested that we look at the country's community of internationalising, entrepreneurial firms as the best device New Zealand has to discover how to turn the country's distinctive assets and capabilities into economic value, wealth and jobs. The CANZ project suggests that this is exactly what our leading international success stories have done, and that they have done it with distinctive strategies that respect the special realities of growing a business of global scale from a tiny home market base. Those special realities also involve some very distinctive risks that may impede New Zealand's small-scale internationalising firms from exploiting the full value of the innovations that launch

them into global markets. It seems desirable to find ways to increase the number of firms going through this transition successfully.

I have suggested too that the businesses these firms discover can be expected to include many (delightful) surprises and take us in unexpected directions. I suggest that it would be foolish to pervert or impede any of these: "bugger the boxing, just keep pouring the concrete". In a global economy that can helpfully be thought of as an enormous complex adaptive system, the search strategy appropriate to a national economy seeking to re-invent itself must initially be broad: we need more concrete mixers.

But if this entrepreneurial community is the economic pathfinder that will explore for us what potential we have in the global economy, it is perhaps alarming that we know nothing about its size and the effectiveness of its functioning. To overwork the metaphor, we do not know how many concrete mixers we have going, nor whether there are more or fewer of them than we had before, nor whether they are working better or worse now than before. The lack of data on these firms is the reason we have not yet tested the general validity of our theory. I suppose you would expect an academic to end with a call for more research, but in the new research funding environment, it is people like you who influence where the funding goes. Your call.

Further Information on the CANZ Project:

- Project website is http://www.vuw.ac.nz/fca/research/canz, including several company histories produced during the project.
- 'World famous in New Zealand: How New Zealand's Leading Firms Became World Class Competitors', published by Auckland University Press, June 2001.

Only the author is responsible for the content of this paper. Other members of the CANZ project are John Brocklesby, Jane Bryson, Sylvie Chetty, Lawrie Corbett, Urs Daellenbach, Sally Davenport, John Davies, Ken Deans, Deborah Jones, Sid Huff and Pat Walsh.

Social Partnership Strategies for Growth

Ross Wilson

I am addressing the key question of how to obtain buy-in across the wider community to growth strategies that could deliver benefits to all New Zealanders.

First of all, I welcome the implicit acknowledgement that community 'buy-in' is a pre-requisite to achieving a growth strategy. I think it was Craig Norgate who made the point at the Knowledge Wave Conference, that change leaders 'must take everybody along'.

This is not a day for looking backwards but I will do so briefly to explain the significant level of cynicism in the community about new ways to prosperity. New Zealanders have been through tremendous change during the past decade. In my own case, I negotiated many of those changes in rail and ports. In ports in the late 1980s, I persuaded our union to embrace and negotiate change positively. Our members accepted that and re-structured long-standing agreements and work practices to deliver huge efficiency gains in ports, but with some productivity sharing incentives for the smaller workforce which remained.

And then many of the same employers used the ECA unilaterally to vary the deals which had been done and reduce the wages and conditions again. That has been a common experience during the past decade.

More than anything else, I think workers felt that they were not respected, because they were seen as a cost rather than an asset.

And those of us who have read Paul Dalziell's comparative study will know that his view is that the overall effect of the 1990s policies was negative. Although the New Zealand and Australian economies tracked along the same prior to 1984, they diverged markedly after that. If the New Zealand economy had grown at its previous trend rate, or matched Australia over the same period, output would be a third higher than it is now. The amounts of personal and public income associated with this are staggering. At current tax rates the extra income would have generated an extra $11 billion of tax revenue per annum – enough to halve net government debt, or double spending on health and education.

The point I am making is that there is a general feeling, and considerable evidence, that the New Zealand experiment failed. Any suggestion that it should be resurrected, as some speakers seemed to suggest at the Knowledge Wave Conference, would be strongly resisted.

Having said that, it is not true to suggest that unions do not support economic growth. I was intrigued by Simon Carlaw's claim in the invitation letter I received that "business is the only group in the community that unequivocally backs growth".

So I dug out a CTU publication from the early 1990s. 'A Quality Future: Working Together for Growth in New Zealand', published in October 1992. The report identified the following commonalities in successful nations and enterprises:

- an emphasis on co-operation and consensus;
- recognising competition and change as a challenge;
- changing technology;
- quality at all levels;
- less hierarchical management;
- flexibility in the face of a constantly changing world;
- an educated and engaged workforce;
- innovation and creativity at all levels.

It also noted that:

> New Zealand needs a clear sense of direction. A government which sticks to a rigidly 'hands off' approach to economic management cannot provide the necessary leadership.

In a speech this week, Simon Carlaw welcomed the Government "transition from unthinking hands-off to helping hands". I agree.

The CTU has also been heartened by the increasing emergence of a more balanced approach both at the national policy level from government, and from many businesses. At the Government level, we have seen a Treasury paper on the inclusive economy; a document on social indicators; a focus on economic transformation through investment, science and innovation; economic development with industry and regional dimensions; and greater consideration of the component parts of a sustainable development strategy. At the level of the firm, we observe increasing interest in triple bottom line accounting principles.

We are not naive enough to believe that this means that costs do not matter. Cost will always matter – all other things being equal. But as we know, all other things are not equal. Therefore there needs to be more focus on revenue generation, new ideas, investment in people, research and development, and social inclusion.

So – we are interested in an investment and development approach to economic growth. We are not keen on jobless growth. We are not happy seeing some $7 billion a year as our investment income deficit due partly to repatriation of profits overseas. Imagine how much lower our current account deficit would be if the investment deficit was substantially reduced.

Even if we set aside the uncertain outlook in terms of a global recession, there are still some major economic issues to address in this country.

Problems with physical infrastructure, investment income deficit, low real wages, poverty, income disparity, and pressures in relation to health and education expenditure – also high levels of emigration to Australia.

The CTU has for many years advocated a high wage, high skill policy environment. This would involve interest and exchange rates that support employment growth, industry policy that promotes quality exports and import substitution, a more active role for government, and significant investment in skill development. Such an economic policy needs to be underpinned by an adequate floor of rights in the labour market, and improvements in the social wage.

But one of the keys to growth from our perspective is skill development.

Given that over 80% of the workforce of 2010 are already in the workforce of today, we ignore their skill development at our economic peril.

We recognise that we must be part of what some now call the 'knowledge wave'. This does not mean that we have to accept the characterisation of the knowledge society that others might impose. Our concerns about the Knowledge Wave Conference included criticism of the tendency to focus on a more élite, highly educated group with specialist skills, rather than on skill development at every level. We were also critical of the failure to address the question of what sort of workplace is required not only to ensure that lifelong learning is a reality, but also that knowledge is productively applied on a day-to-day basis.

I suggest that this will be a workplace characterised by information sharing, respect for employees, a teamwork approach to getting the job done, a concern about quality of life issues – and with good pay and conditions.

Put simply, workers need to be seen as an investment, not solely a cost. We are starting to detect a change in attitude. A training culture is emerging. Many employers from the late 1980s had been able to source skilled labour from those displaced through the state sector restructuring, privatisation process, and the closure of the so-called protected manufacturing sectors. But that is no longer possible and there is now an acute awareness of not only current skill shortages but also the fact that the age profile of those formally trained has risen.

For the worker of today – job security is not just about the current job. It is about lifelong learning ensuring that the combination of relevant skills and experience ensures employability in a global labour market.

So how do we obtain that buy in to a growth strategy? How do we, to use Craig Norgate's words "take everybody along with us"?

There must be leadership, integrity, process and commitment.

Leadership

From government, business and from unions. We have a job convincing union members that there will not be a re-run of the 1990s sometime in the future. Workers and their unions did get burnt in the 1990s. They believe the attack on unions was an attack on their social and employment conditions.

But we have to move on, and as the largest democratic organisation in New Zealand with a quarter of a million affiliated union members, the CTU does have the capacity

to influence many people in our communities. In fact communicating at that level is our business.

Whether we can commit ourselves to a particular growth strategy raises the second principle, integrity.

Integrity

There must be a mutual trust and commitment and a genuinely inclusive approach. I think we need a social partnership under which the CTU and Business New Zealand, and perhaps other organisations, actively engage with each other and with government to devise innovative and sustainable solutions.

The successful country models like Ireland, Finland and Singapore show that the systematic involvement of the social partners at national, industry and enterprise level can yield the best results in terms of long-term economic and social reforms, balancing flexibility with security, enhancing competitiveness and the quality of employment, and promoting economic and social security.

In its most successful forms, social partnership implies the replacement of an adversarial relationship, and expands beyond the workplace into broader economic and social-policy making bodies and labour market institutions. It promotes a more cooperative relationship based on mutual trust and respect and the appreciation of each other's concerns and objectives.

An ILO study published last year documented the remarkable economic and labour market recovery made by four small European countries: Austria, Netherlands, Denmark and Ireland.

The study shows that social partnership and the efforts of social partners and governments to arrive at new solutions played a critical role in their economic and labour market success.

Process and Commitment

But process is important too. If there is to be a social partnership approach, we have to put it up there in black and white. What are we committing to and what are the expected mutual obligations and returns?

In countries like Ireland the partnership objectives and commitments are formalised into quite detailed national agreements which are then debated and ratified by workers in votes at workplace level. But there is no 'best model' and we would have to develop our own.

The essential question is whether there is an ability for either the CTU or Business New Zealand to commit to such a model with integrity. For our part I would have to acknowledge that we would have lively debate within unions if we proposed a social partnership with Business New Zealand and the government. People are bruised by the 1990s experience. They have observed a strong employer attack on the Employment Relations Bill and now an attack on proposed changes to improve health and safety at work.

True, Bill English acknowledges that he would not go back to the ECA but Simon Power has told us that they would remove the current recognition and role of unions in the Act. So we are still a target for political attack.

Can we move on to a more mature relationship? We both have our cowboys. There are pockets of resentment from the 1990s. For example, there is no doubt that the current cauldron of dissatisfaction among nurses and other health workers in Christchurch is directly related to the actions, and aggressive style, of the health sector employers down there during the past decade.

I think it is your choice more than it is ours but, like any partnership, it would require a genuine joint commitment to make it work. I think we could deliver. Could you?

Building Capability

Glenn Withers

The quest for prosperity is a feature of my own country Australia as well as New Zealand. There are many similarities between us, in history, location and outlook. Looking back a century ago, New Zealand and Australia were tops – the most affluent, democratic and equitable societies on the planet. Not perfect, just the best.

International capital flowed freely, tariffs and minimum wages were few and regulation was minimal. Major technological change was created or imported and adopted quickly.

In my view, our two colonies were the world's cleverest, investing well in ideas, new physical assets, and in the number and talents of their people. In that sense they truly were the workingman's paradise. Our formula was an open, flexible economy, well equipped to compete.

But over the years both countries fell prey to creeping sclerosis, with inward-looking policies of tariffs, minimum wages, public employment and the full trappings of the welfare state. The policies grew from good intentions but were ultimately self-defeating; giving rise to a culture of dependence focused more on redistribution than of wealth creation.

The reform process that both our countries went through in the last two decades has been at times painful, but has softened the sclerosis to varying degrees. Australia's growth resulting from microeconomic reform has been beneficial; in New Zealand the linkages between reform and productivity growth and reform are still being debated.

In my view, more reform is needed. Improvements could be made in the areas of tax structures, resource management, and tariffs and trade agreements.

But a different kind of reform is also needed. The last round of reform created coalitions of losers and reform fatigue even for the winners. Getting public buy-in for more reform, no matter how worthwhile, will be difficult.

A new stage of reform, based on building capability as well as economic liberalisation, is likely to gain more public acceptance. Investing in building capability will allow us to capitalise on change while reducing the social costs of change.

How do we build capability? With more and better investment in plant, equipment and infrastructure, and more and better investment in education and training. The goal should be more skilled people. A more clearly targeted safety net and a renewed focus on skilled immigrants would help.

Population decline threatens this goal in both New Zealand and Australia. We need at least 1% annual population growth to sustain our standard of living and soon neither nation will be achieving this. Population growth has many spin-off benefits. An expanding population is essential for maintaining asset values and providing confidence for new investment. Population growth increases GDP and productivity – one study suggests that if the size of an industry is quadrupled, then the output per worker and per unit of capital employed is doubled. That increase in output then creates another benefit – innovation. Research shows that a 1% increase in total output increases innovation by 0.6%.

Improved education builds capability. Research shows skill levels can affect a country's economic growth. The Australian post-war experience shows that the increase in school and tertiary education participation added some 0.5% to the per capita growth rate.

Investing in maths and science skills in particular can build capability. A recent international study tested the influence of maths and science skills on economic growth, and found a profound impact – on average, a one standard deviation increase in test scores adds about 1% to a country's GDP per capita growth rate. In New Zealand, some attention to both the top and bottom ends of its education arrangements could enhance growth from this source.

These are areas where both the public and private sectors can contribute to capability building through education. Building capability requires both public and private investment. It can appeal to the politics of both the left and the right. Building capability rejects the great

trade-off between growth and equity. It says that growth with liberty, equity and sustainability is feasible; that fairness, equity and community also sustain growth.

Economic liberalisation combined with capability building could help us again be best in the world. A good analogy is with sport – we need exposure to world competition in order to achieve, but we also need the infrastructure – facilities and skills – to allow this to happen.

Summation: Into Top Gear

Rod Oram

It has been a great pleasure and hugely interesting to listen to the wealth of speakers and questions through the day. It is a challenge to try to draw some of the themes together in these concluding remarks.

Spend or Invest?

To start, I am going to suggest an alternative title to the day's conference. Indeed, that is rather bold and ungracious of me. However, should the debate be broader? Is it just a question of 'delivering the social dividend' or is it also about 'investing the social capital'?

The first is about disbursing, spending the fruits of the economy. The second is about using New Zealand's limited human and financial resources in a way which enhances the economy, which in turn will generate more social dividends that we can consume or reinvest.

As the day progressed we heard more about the latter. It is a good sign that the realisation is dawning here that New Zealand cannot carry on the way it is going. We need to change tack, and quite radically so.

The Core Message

Indeed, that was the crystal clear message running through the day: we need high growth to fund the society we need and the society we want. Arthur's excellent presentation on the health sector was the most chilling analysis of that. Right now, we simply cannot afford the healthcare we need and want.

Playing Conditions

As we tackle that tough challenge, we have heard today that we are dealing with five basic playing conditions:

1. The economy is underperforming. Our long-term growth rate is around 2% as compared with the 3% we need to maintain our lowly position in the OECD, or the 4% we need to climb back into the top half of the OECD over the next 20 years, or the 6% if we want to get there in our lifetime!
2. People want the rewards now (spend rather than invest) as Arthur Grimes' analysis showed.
3. Far too few people understand how those rewards are earned.
4. There is little understanding around the country about how huge the challenge is and how great the competition is. Just think of how hard we have to work our land compared with the South American country Allan Freeth (chief executive of Wrightson) mentioned in his panel comments. It has 30 feet of top soil which has never needed fertilising in 100 years of cultivation. What happens when its dairy industry gets as big – and better – than ours?
5. But on a far brighter note, I am very grateful to Glenn Withers (head of Public Policy, Australian National University) for pointing out how great we once were. In the late 19th century, the New Zealand and Australian economies were the most spectacular achievers in the world. If we did it once, there is a chance we can do it again.

Health Care

Let me return for a moment to Arthur Grimes's analysis of health care. There was a second component to his presentation which is crucially important. It shows that our task is not simply to raise GDP per capita and thus the level of health spending. There is in fact no correlation between the two. The UK is rapidly increasing spending these days but without, so far, making the nation much healthier. So part two of the task is to find new and better ways to run health and other services. Yet there cannot be much enthusiasm left in our health or other sectors for yet more reform. Once again, we see the challenge is very big indeed.

Economic Drivers

At one level, economic growth is very simple. There are only a handful of drivers, only a few levers to pull. Here are four which were key to Arthur Grimes's analysis:

1. Population: More people, all being well, leads to more growth. We have 3.8m people today but if we had had a more accommodating immigration policy, a more welcoming society and better assimilation over the post-war years, we could have had 4.5m people today and growth of 6% a year. So, what can we do to be more welcoming now?
2. Savings: We are not a nation of savers. We expect the government to provide pensions, healthcare, education and the like. So we feel free to spend what we have (and more!). But a demographic nightmare is looming as the population ages. However, this government's attempt to ease the problem by diverting money each year into a long-term superfund will dampen not stimulate economic growth.
3. Taxation: There is much to learn from other countries about improving the taxation system. The recent McLeod Report was full of such ideas, but this government has made it abundantly clear it will not even consider most of them. That is a triumph, if I may suggest, of the government's political drivers over the nation's economic drivers.
4. Enlargement: We have tried to expand our home market through Closer Economic Co-operation with Australia. Right now, that is deeply flawed by considerable inequities and double standards. Yes, let us push for real CER but the message is that we should push for one which really works.
5. There's much to learn from the European Union on common markets. More important, though, is globalisation. Through an increasingly open world economy we are moving towards a virtual economic union of huge scale. But we need never to forget what is needed for New Zealand to play a vibrant role in those wider systems: education, science and entrepreneurship – in other words, the rewards of investing social capital.

Growing Companies

If new roads to prosperity are opening up in front of us, we will need some splendid vehicles to take us on that journey. In other words, we need more, bigger, better companies. On that score, Colin Campbell-Hunt delivered some excellent analysis of the best companies in the country, those which have gone global but remained firmly based here.

Here are some of their typical attributes: large shares (up to 1/3rd) of a niche global market; 90+% of their revenues are generated offshore; active in dozens of countries; have global reputations; are faster to market than their competitors; but they remain based here rather than spread their R&D and manufacturing around the world.

Above all, they have achieved – each in their own business model – a balance and coherence. They are also bold, as one such company told us today. "We didn't realise how abnormal we were. Barriers? I can't accept them", said David Boyd (chief executive, Foot Science International), in the panel discussion after Colin's presentation.

But clearly there are at least three big challenges for the corporate sector (and for the nation which has a role in nurturing them):

1. This is very hard work
2. We are an entrepreneurial nation (as shown by the recent Global Entrepreneurship Monitor of 29 nations: New Zealand comes top in "opportunity entrepreneurs". The report is available from Unitec in Auckland, the researcher for the New Zealand component of the study). But most of our entrepreneurs have very limited ambitions and skills. We need to find ways to enhance both factors.
3. Here I am adding my own observation. We cannot prosper by being a nation of entirely small companies. The arithmetic does not stack up into a big enough economy, particularly as our definition of a medium-sized company would still rate as a very small company in Europe or North America. So, we also have to find ways to build some very big companies. Unfortunately to date, our skill seems to lie in the knack of shrinking companies: witness Fletcher Challenge, Brierley Investments and Air New Zealand, to name but three recent examples.

Here's one example of how slow we are building companies. It is a comparison of Genesis Research & Development, our one and only real biotech company, and Corixa, is US partner in drug development. Corixa is already some six times larger than Genesis, yet they were established in the same year, 1994.

Science, R&D and Commercialisation

Many factors have held back Genesis, ranging from New Zealand's woefully inadequate capital markets to our inability to push our good science out of the labs and on up the value chain through R&D to commercialisation.

We heard today a bit about the efforts being made to improve than nexus of science and business substantially, but we have a very long way to go.

Compliance Costs

We also heard today how burdensome is the cost of compliance and the tax rate, to the point that they are retarding growth of companies here in New Zealand. I appreciate why business people believe that. But some perspective is helpful:

1. Society is always making tradeoffs. We have some 160 traffic deaths a year in New Zealand, a rate far higher than the UK but in line with France, for example. We could lower the rate by spending far more money on road building, stricter safety standards for cars, policing and on driver education. But we as a nation (through the government) realise our financial resources are finite. The government tries to allocate them in an optimal way. So we do not spend as much as we could on reducing traffic accidents. Similarly we have a rough notion as a nation how safe we want workplaces to be. So we have a regulatory process to try to deliver that. If we accepted a higher rate of workplace deaths, we could spend less. If we wanted fewer we could spend more. Which leads to the next point:
2. There are always better ways of doing things. We must always be seeking more effective, more efficient ways of achieving those goals.
3. By international comparisons, New Zealand's compliance costs are low.
4. Compliance costs per worker are lower for large companies than small. Therefore we need to find ways to grow companies and/or aggregate compliance demands on, say, a group of small companies so together they can achieve 'compliance critical mass', achieving the compliance efficiency of larger companies.

Government's Role

We have also heard a lot today abut the role of government. It is important to reflect how much that role has changed in the last couple of years from very hands-off to one of facilitation and co-ordination. And it is not just the role of the political drivers through a change of government that has changed but also the bureaucratic drivers in the civil service have changed too.

Clearly the first has served to redirect the second. But I think there has also been a hunger in the civil service to learn new things. They recognise as well as anybody that no analysis, framework or philosophy can keep serving well if it remains unchanged in an ever-changing world.

So it was tremendously enlightening to hear about that change of view and role from Alan Bollard (Treasury Secretary), Mary Anne Thompson (director, Department of Prime Minister and Cabinet), Geoff Dangerfield (chief executive, Ministry of Economic Development) and Bill Lennox (NZQA).

Four of the themes were:

1. The need to use the social dividend as an enabler for change, i.e. investing it in people, the need to rework policies to deliver that, and the need to find more money for that.
2. Treasury has been doing a lot of work on, for example, economies of scale. economic geography. knowledge development and application. These are all areas which will help us in New Zealand better understand who, what and where we are as a nation and how we can work more profitably in the global economy.
3. The Ministry of Economic Development is a big change to a facilitative role compared with the old Ministry of Commerce.
4. NZQA has developed a suite of four strategies to help ensure: students perform to international standards, courses meet international standards, qualifications are completely portable,and the education sector delivers a sufficient supply of skilled people.

But above all, the civil servants stressed, there is no magic bullet. Transformation can only be achieved by the careful blending of a very wide range of policies across economic and social fields.

Economic Performance – Social Dividend

Though the analysis we have heard today has often been grim and foreboding, we have also heard enough to gives us hope: growth, liberty, equity and sustainability *are* feasible. We could achieve another golden era for New Zealand.

Luck has very little to do with that – although it helps. But luck is so often something you make for yourself by seeking, creating and exploiting opportunities. It is impossible to sum up today's discussion, let alone reduce the course we need to take to a very simple formula. However, perhaps this might help keep our minds on the challenge:

Economic liberalism
+ capability building
+ social inclusion
= the top ranks of the OECD

Are We Getting Our Act Together?

Yes, to some extent.

1. Business New Zealand is developing an integrated series of policy proposals to address these diverse issues.
2. The government is learning how to play a more constructive role
3. The union movement is keen to play its part, but as Ross Wilson (president, Council of Trade Unions) pointed out, unions have a very strong sense of deja vu. What is happening now is exactly what the CTU were advocating in its document 'Quality Future' in 1992.

The view from the coalface was far less encouraging, though Kim Campbell (chief executive, PSM Healthcare) delivered a very lively, very blunt message about the serious inadequacies of the economy and policy to remedy that. "Our gearbox has no lubrication, no synchromesh and no overdrive," he said.

We are spinning our wheels because the social dividend has already been spent. We are hobbled by a culture of tribalism, sectional interests and welfarism. CER is a fiction in politicians' minds; ACC suffers from lack of transparency and OSH regulations cost a lot of time and money.

We will only progress when we 'get with the game'. Among other things, we must move on from tribalism to being members of a nation, from debt to equity finance, from command and control, from a sports-minded mentality, to believing in life-time employability (not life-time employment) and to being entitled to (not believing in) entitlement.

Kim drove home his point with a quotation from Jack Welch's new book, *From the Gut*, about his 40 years at General Electric, and in particular his 20 years as CEO and chairman. To re-quote that now seems like an appropriate way to try to capture the essence of this day's deliberation. What Welch says about companies is very, very true about countries:

> My objective was to put a small-company spirit in a big-company body, to build an organisation out of an old-line industrial company that would be more high-spirited, more adaptable, and more agile than companies that are one-fiftieth our size.
>
> I wanted to create a company where people dare to try new things – where people feel assured in knowing that only the limits of their creativity and drive, their own standards of personal excellence, will be the ceiling on how far and how fast they move.

IPS Policy Papers

• Number 1
Governing Under MMP:
The Constitutional and Policy Challenges
by Jonathan Boston, Simon Murdoch, Marie Shroff, Rt Hon. Sir Michael Hardie Boys
1999 • ISSN 1174-8982 • ISBN 0-908935-35-8

• Number 2
Partnership - From Practice to Theory
edited by David Robinson
1999 • ISSN 1174-8982 • ISBN 0-908935-41-2

• Number 3
Stability of Retirement Income Policy
edited by Arthur Grimes and Conal Smith
1999 • ISSN 1174-8982 • ISBN 0-908935-41-2

• Number 4
Counting the Beat:
Culture, Democracy and Broadcasting
edited by Arthur Grimes and Jo Tyndall
1999 • ISSN 1174-8982 • ISBN 0-908935-43-9

• Number 5
South Korea-NZ Relations at a Watershed:
Impact of the Financial Crisis
by Gerald McGhie
2000 • ISSN 1174-8982 • ISBN 0-908935-45-5

• Number 6
The Tomorrow's Schools Reforms:
An American Perspective
by Edward B Fiske and Helen F Ladd
2000 • ISSN 1174-8982 • ISBN 0-908935-49-8

• Number 7
Funding Our Culture
by Colin James
2000 • ISSN 1174-8982 • ISBN 0-908935-50-1

• Number 8
On Three Arguments For the Efficiency Criterion
by Paul Calcott
2001 • ISSN 1175-8201 • ISBN 0-908935-60-9

• Number 9
Defence Objectives and Funding
by Arthur Grimes and James Rolfe
2001 • ISSN 1175-8201 • ISBN 0-908935-61-7

• Number 10

Charity, Charity Law and Civil Society

by Richard Fries

2001 • ISSN 1175-8201 • ISBN 0-908935-62-5

• Number 11

Public Wealth and Trusts

by Peter McKinlay

2001 • ISSN 1175-8201 • ISBN 0-908935-63-3

• Number 12

Environmental Taxation in New Zealand: What Place Does it Have?

by Frank Scrimgeour and Ken Piddington

2002 • ISSN 1175-8201 • ISBN 0908935-64-1