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# Sailing close to the precipice: Past, present and future

Tony Alexander
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## How We Got To This Point

From the time of the arrival of Europeans in the late eighteenth century New Zealand developed an economy built first on extractive activities such as whaling, sealing and kauri cutting, then wool farming, then from 1882 sheepmeat farming, with dairy from the early 1890s. With an export base almost exclusively dependent on the primary sector and an economy dependent upon imports for manufactured goods, periods of economic weakness were invariably caused by weak export prices.

Such periods included the Long Depression of the 1890s and the Great Depression of the 1930s, and hand in hand with such periods went a reduced government ability to raise funds in London and net migration outflows.

A desire to insulate society against economic shocks and the economy against funding shortages when shocks arrived, led to the development of the welfare state from the 1930s and the imposition of import and exchange controls from 1938. Both areas of control slowly expanded during the generally good economic environment based on wool and food exports to the UK which prevailed from the late 1930s until 1967.

Then a 30 percent collapse in wool prices, entry of the UK into the EEC, soaring oil prices, then fresh export price collapse produced major economic weakness. The government's response was threefold:

- Borrow and hope
- Encourage new industry with protection from imports
- Reduce dependence on imported energy

These policies were made possible by access to recycling OPEC oil dollars. But wasteful investments, policy flip-flops from fighting inflation to unemployment and back again, plus increasing controls produced structurally rising inflation, unemployment and business collapse, increasing rigidity in the economy, and ultimately people flight. A net 156,000 people left New Zealand between 1976 and 1982.

The ratio of GDP per capita in New Zealand to the OECD average fell from 122 percent in 1974–99 percent come 1979, then 82 percent come 1992 as the reforms of the late 1980s and early 1990s revealed and led to the shedding of the country's major economic inefficiencies. The 1987 sharemarket and commercial property market crashes also contributed.

The 1930s–1970s policy responses to economic shocks became the prime obstacle to our growth.

The lesson of the 1970s to us and other countries was that when shocks come one needs an economic structure which can adapt. Major deregulation from 1984–1992 stabilised the GDP per capita ratio against the OECD average – but since 2004 a new decline has set in and we are now at 80 percent. More changes are required.

In addition, the lesson of the past few years is that economic shocks are frequent and unpredictable and in our businesses and our economy we need to explicitly plan for other shocks which will inevitably arrive.

Recent shocks include:

- Asian crisis, drought 1997/98
- Dot-com crash of the late 1990s
- Terrorist attacks 2001
- SARs, Iraq invasion, US deflation worries of 2003
- Global Financial Crisis 2008–09
- Earthquakes in Christchurch

## How do we build a more robust economy?

From a purely economic standpoint, what we are after can be realistically summarised as follows:

- An economy which provides New Zealand citizens an income and material standard of living comparable with that enjoyed in other OECD economies on average.
- An economy and society able to adjust quickly to shocks.

Making no changes is not an option for the following reasons:

- Our GDP per capita ranking is already falling again against the OECD average and in particular against Australia which forms part of the natural New Zealand labour market toward which Kiwis will increasingly flock.
- As a migratory people we leave when conditions are bad and net outflows aggravate problems.
- An aging population will generate fiscal strains which cannot be met by raising taxes.
- The primary sector in which we expect to gain from rising global food demand and prices is not scalable using current production methods.
- Shocks come, on average, every three years.
  More will arrive.
- Over 40 percent of bank funding comes from offshore and the 2008 Lehman's collapse shows that there are times when renewing existing funding, let alone borrowing for additional lending, is not possible. Dependence on foreign financing must be reduced.

There is no shortage of things in need of change and opportunities which we can exploit. The challenge is deciding which to pursue and which to set aside. There are many identified factors associated with under performance of the New Zealand economy, some of which are causal, such as low savings, others of which are outcomes, such as low IT exports, lack of venture capital, and some like size and distance which cannot (realistically) be changed. The largely causal factors include the following:

- Inadequate infrastructure – roads, electricity, telecommunications.
- Low savings – limited expensive capital, over-reliance on and sensitivity to bank finance, high interest rates, and a high exchange rate.
- Low business R&D, especially by bigger companies and insufficient public/private technology cooperation.
- Burdensome tax compliance – largely GST & ACC.
- Weak management skills, especially HR and internationalisation.

- Inadequate childcare for lower socioeconomic groups and inadequate participation in education or training by 15–19 year olds.
- Low agglomeration of economic activity.
- Weak internationalisation of New Zealand firms.

But while policy changes can heavily influence these elements of our institutional and regulatory framework, they cannot easily change the following cultural factors which perhaps more adequately explain why we are newly slipping against other OECD economies.

We are highly individualistic, like to keep control, distrust experts, focus on rules and contracts rather than relationships, assume customers overseas are the same as us and design accordingly, focus on the short rather than long term, dislike feedback and giving it, take few risks, and use our inventiveness to drive down production costs rather than add new value. Essentially we are good at making and using but not making and selling things.

Improving our future will require selecting some of these institutional and cultural factors for change. At the same time we should consider selecting some of the many opportunities which present themselves. Here are some with an export focus:

- We are good at invention but not at implementation for a profit. As China grows they will run out of other country's products to copy and need their own ideas which in a non-free society are not fast in coming. Scope exists for blending our two strengths to offset our two weaknesses. Perhaps joint research/business institutes;
- Rising food prices traditionally led farmers to buy each other's farms, holiday homes etc. Now they are paying down debt. Once that is done an opportunity will exist to harness rising farmer capital into on-farm coproduction activities and off-farm investments rather than over-pricing a shrinking farmland area and investing simply to lower the cost of producing a largely unchanging quantity of food;
- Australian exporters are being priced out of business by an Australian dollar hitting record post-float levels due to soaring mineral prices. Scope exists for relocation of such exporters to New Zealand; and
- Migrants arriving in New Zealand tend to be specialised but work like the rest of us as generalists. A lot of expertise therefore remains untapped. Not only that but just as we often talk in terms of tapping into the network of 600,000 Kiwis offshore so too can we better use the existing network of migrants here to help further our need for knowledge of markets overseas.

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Tony Alexander graduated from Canterbury University in 1984 with a Master of Arts (Economics) degree with first class honours. After briefly working in Sydney for the Reserve Bank of Australia, he joined Westpac and in mid-1987 transferred back to New Zealand. Following this, Tony joined the Bank of New Zealand and was appointed Chief Economist in 1994. He spends considerable time researching and writing about the New Zealand economy and speaking at numerous functions around the country advising businesses on what the future is likely to hold. Tony also gives his views on the economy to bank customers through various written commentaries and public speaking engagements, as well as weekly columns in three regional newspapers.