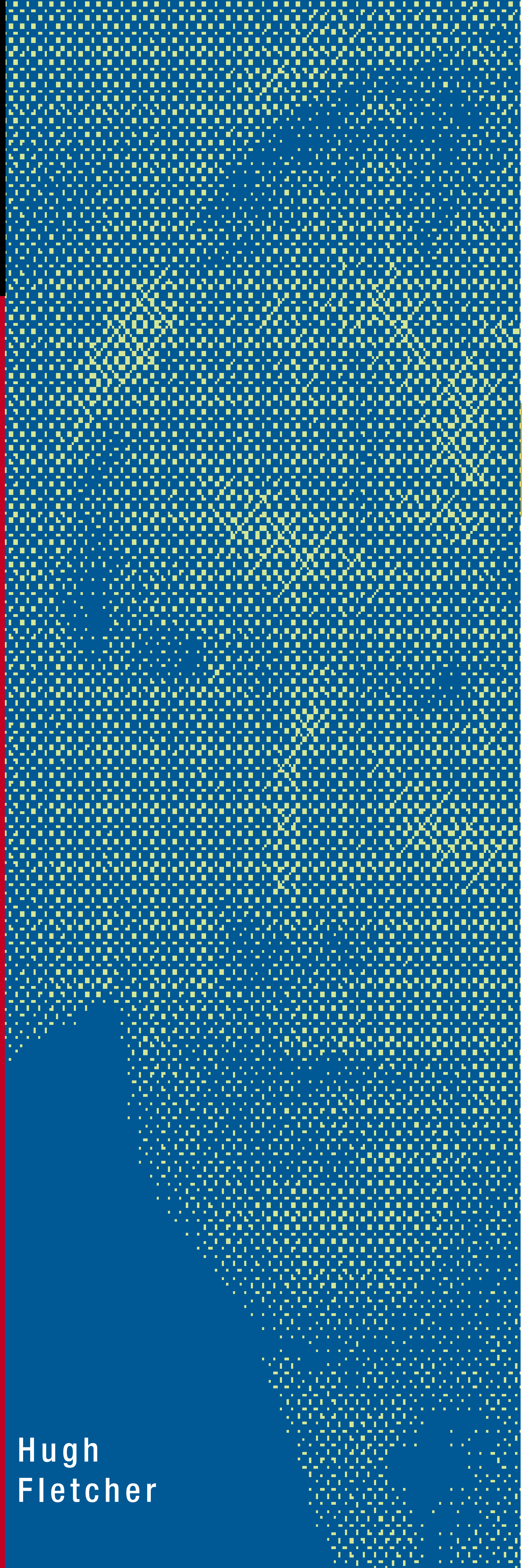
HOW CAN NEW ZEALAND WIN THE GLOBALISATION GAME?

Challenges for New Zealand business in the 21st century

"IN THE 15 YEARS SINCE THE LANGE GOVERNMENT WAS ELECTED AND NEW ZEALAND OPENED UP TO THE FORCES OF GLOBALISATION, WE HAVE PERFORMED DISMALLY, BOTH ECONOMICALLY AND SOCIALLY."



Hugh Fletcher

"Game Theory gives us more insight into how to enhance New Zealand's position than if we continue with our simplistic reliance on the theory of perfect markets."

In the 15 years since the Lange Government was elected and New Zealand opened up to the forces of globalisation, we have performed dismally, both economically and socially.

Economically this is unarguable. Our main economic objective should be improving per capita GNP. Instead it has declined by more than 10% relative to both the OECD average and Australia.

This has happened despite an unparalleled period of drawing on the savings of foreigners. The difference between New Zealand assets owned by foreigners and overseas assets owned by New Zealanders has more than doubled – to around a year's GDP. In terms of improving per capita wealth, our relative performance has been even more dismal than that on income.

Our performance on the social harmony front is more arguable, but only because there are no acknowledged objectives. This is a reflection of the visionless New Zealand to which I will return later.

Recent reports on the widening gap between those on high and low incomes, and the lack of any reduction in Maori/Pakeha inequalities – as well as the deterioration over the last 15 years in statistics on crime, youth suicides and so on – all support a dismal performance assessment.

Certainly we cannot suggest that we have chosen to sacrifice relative economic performance for greater gains on the social front.

At the enterprise level, the record is also dismal. Of the 15 largest stock exchange listed New Zealand companies in 1984, only three today are New Zealand-controlled entities. And the total annual return to shareholders of the top 40 index, despite Telecom's stellar performance, has been less than 4% per annum.

Admittedly we can claim to have been in a transition period, from a very closed and regulated economy to an open one. But that argument would be of more comfort if, in recent years, we had seen more marked improvements in GDP growth, unemployment and the external current account deficit.

We should stop seeking refuge in denial and transfer of fault, such as to blame Asia, and enter into a more balanced contest of ideas as to how New Zealand can prosper in a globalised economy.

We must play the game substantially differently from the way we have been playing it for the last 15 years. I use the word "game" deliberately. Game Theory gives us much more insight into how to enhance New Zealand's position than if we continue with our simplistic reliance on the theory of perfect markets.

FROM THE BENIGN TO THE TRAUMATIC

Possible scenarios for the business environment over the next ten years range from the benign to the traumatic. Yes, the benign can happen, as best evidenced by the United States' remarkable last eight years. But so can the traumatic, such as the falling apart of the Asian miracle.

Similarly it is possible to predict that the social disharmonies of globalisation will lead to a swing back to protectionism, or that religious divisions will raise again the importance of military considerations.

There are indeed many possible scenarios, with widely varying impacts on the effectiveness of the game plan of either a country or a business. Your game plan must, therefore, be robust to different scenarios. And you must be able to monitor the evolving environment, and to take action decisively.

My own view though is that the most likely scenario – what we might call a base case scenario – is for random nasty exogenous shocks around a trend of increasing globalisation, combined with reasonable global economic growth and peace. At the very least we must be sure our game plan will deliver in this scenario.

Globalisation is nothing new. It has been dominant in other periods. But we are all inclined to view change against the immediate past. For us in New Zealand the immediate past means a closed and regulated economy. Incomes were relatively high, and wealth was generated from a controlled involvement in international trade, exploiting some privileged comparative advantages.

We have opened up our economy not only in a period when others are doing so, but also during a wave of technological innovation. Drivers of change are building on other drivers to create massive movements in the relative competitiveness of nations and enterprises.

When cross-border capital flows combine with a mobility of business best practice – and the two combine with technological advances that make low-skilled labour as productive as medium-skilled, and destroy the protection of geography – new winners are created, and previous winners become losers. All this happens at a frightening pace, and with relentlessly fluctuating fortunes.

It is within this context that nations and enterprises must develop their game plan. And note this is the base case, not a downside scenario.

Within the base case there is micro turbulence. And this turbulence can be rough. In a period of globalisation, the impact of exogenous shocks on nations and enterprises, and all their stakeholders, are much greater than they were in a closed economy.

What can we do about this? I suggest we consider separately what can we do about the trends and concerns that we cannot control, and those over which we do have some control.

THE UNCONTROLLABLE

Dealing first with the uncontrollable, we need to face up to what might happen – to be insightful in assessing possible problems, creative in developing winning strategies and effective in executing them. Easier said than done, whether you are talking about a nation, an industry or an enterprise.

In New Zealand's case it is even harder, because many of these uncontrollable globalisation drivers are reducing New Zealand's relative competitiveness across the field. This is true not only broadly, in the destruction of the comparative advantage of moderately skilled labour, but also in industry-specific situations.

An example is the advances being made in the understanding of fibres and the development of new processing technologies. Together they are enabling low quality wood residues such as palm oil trees and used newspapers to be turned into quality products in the markets that want them. This is destroying New Zealand's export competitiveness in products such as low grade logs and pulp, medium density fibreboard and paper.

It is not surprising New Zealanders take little comfort from statements that we are better off engaging in free trade than withdrawing from it. The across-the-board destruction of our comparative advantage is reducing our income and wealth.

What we must first face up to is the magnitude of the task before us. New Zealand must establish external current account equilibrium. The level of our savings must equal the amount needed for investment. (Ideally we should be running a surplus, to reduce non-residents' percentage claim on our GDP).

Furthermore, we must do this under a base case scenario that is likely to perpetuate declining terms of trade. Export prices are likely to fall, relative to import prices.

I suggest that if we do consider this honestly, we will be skeptical that a laissez-faire approach at the national and industry levels – relying solely on the initiative of individual enterprises – will deliver the goods.

Industries and enterprises that have based their competitiveness on cost are particularly vulnerable. We must shift their focus to strategies based on products or services that are difficult to duplicate. We need to develop capabilities unique to New Zealand.

THIS REQUIRES A COLLECTIVE RESPONSE, AS WELL AS INDIVIDUAL ENTREPRENEURSHIP, FOR TWO REASONS:

- Economies of scale and critical mass. New Zealand and its enterprises are tiny. If we are going to create differentiation that is sustainable and owned by New Zealand residents, we must in some activities aggregate to achieve the necessary critical mass.

In many of our industries, individual enterprises are simply not big enough to undertake the research and development needed to generate differentiation, let alone to put in place the distribution systems to capitalise on an innovation. When the world's largest drug companies are amalgamating for this reason, can we really expect to have more than one domestic player in areas such as the biotechnology of trees?

Similarly, rather than disaggregating components of the relatively successful dairy industry, shouldn't we look at where we might aggregate components of the relatively unsuccessful meat industry?

- The fallacy of composition, or the free-rider problem associated with common goods. While certain initiatives may benefit all New Zealand players, one player in isolation may not benefit.

Successive Governments understand this for the billion dollars they anachronistically spend on defence. But they can't apply the same thinking to our life-blood, the internationally tradeable goods and services sector.

“Palm oil trees and used newspapers are being turned into quality products in the markets that want them. This is destroying New Zealand's export competitiveness.”

“A move towards cash flow-based taxation – with immediate deductions for investment – would be much more beneficial than a cut in the corporate income tax rate.”

The under-spending on infrastructure components that support our tourism industry – from the Auckland Museum (the most visited tourist attraction) to our road network – is an obvious example.

CONTROL AND CONSENSUS

Turning to the economic drivers over which we can have some control, here there is no escaping the need for consensus and for that consensus to be right. So far, it has not been.

PRIMACY MUST BE GIVEN TO THE BEST INTERESTS OF THE INTERNATIONALLY TRADEABLE SECTOR AND THE OBJECTIVE OF EXTERNAL CURRENT ACCOUNT EQUILIBRIUM. THIS REQUIRES TWO SUBSTANTIAL POLICY CHANGES:

- The exchange rate cannot be hostage to an inflation objective.

Openness and globalisation make the level of demand for New Zealand's goods and services much more price-sensitive. If domestic as well as foreign customers don't like our prices, they now can go elsewhere. When we hike our real exchange rate, we administer an exogenous shock that cuts demand for all our internationally tradeable goods and services. That, in turn, traumatically reduces employment and returns to capital.

This – not the Asian crisis – is what caused our recent recession and current account disaster. A correct consensus on this includes changing the Reserve Bank Act. It should require price stability to be achieved in association with current account equilibrium.

- We must have an effective savings policy, so that New Zealanders fund the required level of investment.

A correct consensus requires compulsory superannuation. Just as few people will pay tax voluntarily, few will forgo current consumption by saving if, through the taxpayer, they are guaranteed a level of consumption in the future similar to that of the present.

If we can increase New Zealand's private savings, hopefully we can also increase the availability of venture capital. This, together with business mentoring (of which Business in the Community is a good example) is often the critical need for emerging businesses, particular those with innovative products and services.

We also need consensus behind a renewed passion for foreign exchange earning. This passion must encompass broad initiatives that assist our multitude of small enterprises (all but 1300 of our 250,000 enterprises employ fewer than 100 people), as well as industry-specific initiatives.

In the former category, I would suggest, for example, that a move towards cash flow-based taxation – with immediate deductions for some if not all forms of investment – would be much more beneficial than a cut in the corporate income tax rate.

> **"There is a huge social prize as well as economic prize in raising the level of Maori to that of Pakeha."**

Turning to industry-specific initiatives, we must galvanize investment in industries likely to develop sustainable differentiation, and customer and investor dependence on New Zealand.

The Porter concept of clusters is insightful here. Clearly, despite all the macro and micro reforms, we have failed to raise capital productivity. We do not seem to be capturing the potential of the technological revolution that is around us.

Maybe this gets back to the critical mass point. If so, then there is a need for leadership – leadership which, with three and a half million people, probably encompasses politicians and civil servants as well as industry participants.

I think of the horse industry. The cluster spanning the breeding of horses, their rearing, training, riding and equipping, and their role in entertainment and related business processes, is one where we should aspire to global pre-eminence.

But this will not happen without a New Zealand game plan, which explicitly sets out where we should use co-operative collective initiatives and where competitive individual initiatives. Together these initiatives must exploit the total potential, applying leading edge knowledge and business best practice and wisdom to this particular industry.

We will not attain this consensus passion for foreign exchange earning unless we can harmonise its pursuit with progress on the social front. To me this must start off with a re-instilled pride in a common vision of what makes New Zealand, and being a New Zealander, different.

My experience in helping to write a number of corporates' statements of purpose tells me that such a vision must ignore the many fine sentiments that should be common across the globe, and instead focus on what is unique about New Zealand.

An obvious unique differentiation, which we should delight in, is our Maori dimension. How do we integrate that into our passion to generate foreign exchange and to achieve broad social consensus? I would suggest we don't do this by having a petty minded Scrooge approach to settling legitimate Treaty of Waitangi claims, nor by adopting a Pontius Pilate approach after settlement.

The Fisheries settlement, for example, should be just the beginning of an integrated plan. Through continuing active Government sponsorship, we should aim at maximising both Maori economic and social gain from the resource and New Zealand's foreign exchange earnings.

Surely this requires an imaginative total game plan for the industry. There should be defined roles for the public sector, the education sector (there is a lot of evidence that the most effective way to learn is by integrating education with doing), and the research sector, as well as the Pakeha commercial fishing sector and the recreational and tourist sectors.

So, too, must welfare and tax policy be integrated. There is a huge social prize as well as economic prize in raising the level of Maori to that of Pakeha.

Globalisation will not permit the tax rates on internationally mobile labour and capital to be raised materially. From this fiscal perspective, alone, we must continue our efforts to make employment more attractive than welfare dependency.

But there is also the vision element. Surely we all want New Zealand to be a uniquely safe place. We might, therefore, acknowledge that, rather than spending one billion a year on an invisible foreign enemy[1] (most of the candidates are buying us anyway), we could invest it in initiatives that will get at such issues as the root causes for our deterioration on the crime front, or the relative slippage in the quality of our roads. The greatest threat to the New Zealand way of life is from within, not from without.

> **"A small player's best prospect of winning comes from playing the game differently. But we keep playing conventionally."**

UNIQUE CAPABILITIES

Game Theory tells us that a small player's best prospect of winning comes from playing the game differently. But we keep playing conventionally.[2]

Prospering in an age of globalisation requires us to determine very clearly what is really important to us, and then focusing on insightful and unconventional strategies that will deliver success. We need to exploit not only the spirit and drive of competitive individual entrepreneurship but also the power of co-operative endeavour. Both must be harnessed to make New Zealand residents the "owners" of unique capabilities, so that overseas customers and capital are dependent on these capabilities.

Superior productivity, and hence competitive cost, will always be a requirement. But we will increasingly need to gain our winning advantage from either a continuous stream of product or service innovations or a difficult to duplicate and remarkable customer intimacy.

These require a great ability to integrate ideas and execution. Individually and collectively we must be focused on doing this.

ACKNOWLEDGEMENTS

This article is based on a speech given by Hugh Fletcher in the Sir John Logan Campbell Executive-in-Residence Dinner Lecture Series, University of Auckland Business School.

1. The proposition that we have to pull our weight in the world to obtain trade access has no foundation in international trade policy or practice. Even if it was true, it would be the most gigantic subsidy to a limited range of exports. Nowhere else is such hidden subsidisation tolerated.

2. If we must succumb to the emotion of playing our defence part, why not substitute for our entire defence forces a rapid deployment mercenary peace keeping force. We could sell it to the United Nations, gifting the first quarter of a billion of expenditure. Turn it into a foreign exchange earner instead of a chronic drain.