New Zealand as a Global Competitor

Jonathan Ripa

Lehigh University

Follow this and additional works at: http://preserve.lehigh.edu/perspectives-v27

Recommended Citation
http://preserve.lehigh.edu/perspectives-v27/6

This Article is brought to you for free and open access by the Perspectives on Business and Economics at Lehigh Preserve. It has been accepted for inclusion in New Zealand: new challenges in paradise by an authorized administrator of Lehigh Preserve. For more information, please contact preserve@lehigh.edu.
Introduction

During the long flight to New Zealand, there is plenty of time to dream about the unique experiences this isolated country has to offer. Images of grand mountains, vast coastlines, and fresh seafood materialize, leaving one eager to step off the plane. It is New Zealand’s economic history, however, that is one of the more interesting topics to consider. How has an island as secluded as New Zealand become so economically developed? Its remoteness has granted it both advantages and disadvantages through the years.

Although New Zealand began the twentieth century with one of the world’s most flourishing economies, it entered the twenty-first century in a much less prosperous position. The global economy has evolved rapidly over recent decades, but New Zealand has been unable to fully keep up. New Zealand’s ability to increase its competitiveness on a global scale will be one of its greatest challenges in the coming years.

In the first section of this article I examine New Zealand’s economic history over the past century. In the second section I discuss New Zealand’s current difficulties with remaining globally competitive. I then suggest some ways in which New Zealand might become more globally competitive through tax reform, increased innovation, and changes in the business climate.

Economic History at a Glance

The year 1840 is an important landmark in New Zealand’s history. During this year Great Britain signed the treaty of Waitangi with New Zealand, giving Britain sovereignty over the islands. New Zealand’s relationship with Great Britain was very instrumental in the early development of its economy. New Zealand was responsible for supplying Britain with many commodities, such as meat, dairy, and wool, and in turn was able to import many of the manufactured products that it lacked. The inven-
tion of refrigerated shipping in the 1880s allowed it to maintain a steady trading relationship with Britain. New Zealand’s export industry prospered due to this relationship, and it entered the twentieth century with a flourishing economy. New Zealanders were able to sustain much of their economic momentum through the end of the Second World War, achieving an average annual GDP growth rate of approximately 4 percent. (“New Zealand: Economic and Financial Overview — 2008,” p. 11)

Following the war, New Zealand emerged with a largely intact economy in a world facing great shortages in agricultural and consumer goods. Its economy was sustained by high agricultural prices resulting in a vibrant export industry. It was during this post-war era, however, that the initial signs of struggle within New Zealand’s economy became evident. In 1962 the Economic and Monetary Council released a statement informing the public that from 1949 through 1960 New Zealand had one of the lowest rates of productivity growth among the world’s top earning economies. (“New Zealand: Economic . . . ,” p. 11) This was due in part to its increasing reliance on the agricultural industry for the prosperity of its economy. It seemed as if the rest of the world was advancing too fast for New Zealand. It was the close trading relationship with Great Britain that helped New Zealand maintain its standard of living through these years. Serious threats to New Zealand’s economy, however, were on the horizon and would cause damage that subsequent governments would try to repair for years to come.

The 1970s were incredibly difficult years for New Zealand. Various external shocks to its economy (falling commodity prices, elevated oil prices, and a decline in investment due to high levels of inflation) were met with policies by the government that drove its economy downward even further. (“New Zealand: Economic . . . ,” p. 11) Finance Minister Robert Muldoon ignored predictions of staggering inflation and engaged in short-term expansionary monetary policies with the aim to increase employment and stimulate economic growth. This expansionary policy was too heavily concerned with the short term and resulted in increased inflation in the years to come. Muldoon then became prime minister in 1975 and engaged in a series of protectionist policies which resulted in the further deterioration of the New Zealand economy. (Nelson, pp. 163–64) As Michael Lusztig has said:

Under the premiership of National Party leader Robert Muldoon (1975–1984), New Zealand maintained rigid policies of economic intervention. Relying on wage and price controls, subsidies, and artificially low interest rates, the Muldoon administration was unable to defend the New Zealand economy against steadily deteriorating economic performance. (Lusztig, p. 131)

Muldoon’s policies were too protective of domestic industries. They were criticized for undermining competitiveness on a domestic and global scale, leading to macroeconomic instability as well as to increased government debt. (“New Zealand: Economic . . . ,” p. 11) New Zealand’s secure trade relationship with Great Britain was effectively ended in 1973 as its “mother country” joined the European Community. A second round of oil and commodity price shifts in the late 1970s left the economy hurting even more.

Figure 1 shows New Zealand’s annual GPD growth rate from 1950 into the twenty-first century. The annual growth rates in the years surrounding the 1970s were only slightly above zero, even dipping into the negative range several times. The low growth rates largely reflect the inappropriate policies in place at the time. In response to the economic hardships and failed macroeconomic policies of the 1970s, a series of economic reforms was set in motion beginning in 1984. It had become very apparent to New Zealand policy-makers that something drastic had to be done about the economic growth trajectory. A change of government brought with it an era of liberalization in New Zealand’s economy with the aim to stop and reverse the economic damage that had been done over the past 30 years. The reforms were broad in scope and consisted of:

- Removing wage and price controls,
- Removing financial market controls,
- Floating the exchange rate,
- Decreasing import barriers,
- Deregulating and privatizing of industry, and
- Widening of the tax base.

(Cullen, “New Zealand’s Strategy . . . ”)
This time of reformation for New Zealand was an example of extreme economic liberalization and opened its economy to the world marketplace. After a period of slow growth following these reforms, New Zealand’s economy began to grow at a substantial rate, peaking at 6.8 percent in the mid-’90s, and continuing strongly into the twenty-first century. It appears that through the new government’s macro-economic policies and the privatization of numerous industries including telecommunications, the coal industry, and the railways (Brash), New Zealand was freed of many of the economic burdens which had plagued it for the past 30 years. (“New Zealand: Economic . . .,” p. 11)

New Zealand in the Twenty-First Century

Following this transitional period for New Zealand’s economy, there has been modest economic growth over the past decade. In the early 2000s annual GDP growth was in the range of 3–4 percent while elevated oil prices have suppressed growth moderately since 2004. (“New Zealand: Economic . . .,” p. 11) Yet, because New Zealanders have spent much of the past three decades trying to repair the damage done by the protectionist policies of the ’70s, they have become less competitive in the global marketplace.

The World Economic Forum, a non-profit foundation, each year publishes the Global Competitiveness Index. According to its website, this report assesses the ability of countries to provide high levels of prosperity to their citizens. This in turn depends on how productively a country uses available resources. Therefore, the Global Competitiveness Index measures the set of institutions, policies, and factors that set the sustainable current and medium-term levels of economic prosperity. (“Global Competitiveness Network . . .”)

To compile the index countries are scored and ranked with respect to a number of variables. Included are evaluations of business sophistication, market efficiency, technological readiness,
innovation, health and primary education, and infrastructure. At the end of the twentieth century New Zealand was doing well, ranking 13th overall. ("The Global Competitiveness Report 2000") Over the past decade, however, New Zealand has steadily fallen in the rankings, dropping to 22nd in 2005 and 23rd in the most recent report. ("Global Competitiveness Index Rankings 2006–2007") New Zealand's gradual decline over the years in global competitiveness has hindered its ability to realize its full growth potential. There are, however, several ways in which New Zealand can bring about a more competitive economy, as I discuss in the following sections.

**Role of Tax Reform in Increasing Competitiveness**

Increasing the global presence of domestic firms is a key condition for New Zealand to become more competitive and achieve higher levels of growth. New Zealand's business tax code has received a great deal of attention over the past few years and is seen as an area where reform can yield positive results. In 2006 Dr. Michael Cullen and Peter Dunne, Ministers of Finance and Revenue, published the "Business Tax Review," a document detailing how alterations in the tax code could foster innovation and increase global competitiveness. The goal of this document was not only to review the business tax code and make suggestions, but also to elicit discussion and encourage feedback from the public regarding the initiatives proposed. In the report they suggest that businesses should be supported through a reduction in the corporate tax rate, allowing them to be more competitive and increasing their growth potential. (Cullen and Dunne, p. 1) Their suggestion was in fact subsequently adopted by the New Zealand Government, and the corporate tax rate was reduced from 33 percent to 30 percent beginning in 2009. In their document, Cullen and Dunne outline a variety of ways that this tax reduction will increase productivity and competitiveness. As they put it, “It would encourage increased inbound investment by firms that have decided to locate in New Zealand. As a result it would tend to increase New Zealand’s stock of plant, equipment and buildings which would, in turn, boost labor productivity and wage rates.” (Cullen and Dunne, p. 9)

Since the mid-1980s the average corporate income tax (CIT) rate in OECD countries has steadily declined. However, New Zealand’s had remained constant, until the recent reduction, at 33 percent since 1989. Figure 2 shows the change in these rates for 15 OECD countries in the years 1982, 1994, and 2007. As can be seen, many of the countries in Figure 2 have greatly reduced their corporate income tax rates. It is important to maintain a competitive corporate tax rate because as other countries levy lower rates, it becomes more attractive for firms located in New Zealand to move elsewhere and less attractive for other international firms to locate in New Zealand.

It is interesting to note that the corporate tax rate in Australia has been 30 percent since 2006. Keeping rates competitive with Australia is of great importance to New Zealand because almost half of foreign direct investment into New Zealand comes from Australia. (Cullen and Dunne, p. 9) There would be fewer incentives for Australia to maintain this level of investment if New Zealand's corporate tax rate had not been changed to 30 percent.

While it is important to create tax incentives to maintain foreign direct investment and to keep firms from moving elsewhere, it is also necessary that New Zealand remove tax disincentives for domestic firms to expand into the global marketplace. Currently, New Zealand businesses that have operations overseas pay taxes on two forms of income: active and passive income. Active income is any income from processes such as manufacturing or other industrial activities. Passive income, on the other hand, is income generated from royalties or interest.

Many globally competitive countries tax only the passive income of businesses with foreign operations. New Zealand, on the other hand, taxes both passive and active income, therefore giving businesses in New Zealand who choose to expand beyond their domestic borders an extra tax burden. In 2008 the New Zealand government proposed the exemption of active income earned by New Zealand-controlled foreign companies no matter where it is earned. For example, a company whose income is comprised of 70 percent active income and 30 per-
cent passive income would, under the proposed tax policy, see a substantial cut in its taxes paid to New Zealand. In a discussion document, the Inland Revenue Department of New Zealand has suggested that New Zealand firms operating abroad would benefit greatly from this policy change. (“Question and Answers . . .”) It would eliminate a tax burden not faced by other firms, thereby placing New Zealand firms on a more competitive level. (“Question and Answers . . .”) In an era when increased expansion into the global marketplace by New Zealand businesses is essential for developing a more competitive economy, it is very important that New Zealand make its tax code and tax incentives more competitive with those of other global economic powers.

The New Zealand Business Climate: Innovation and Untapped Growth

Innovation

For years New Zealand policy-makers have known that the economy must eventually evolve into one driven by innovation in order to become more globally competitive, but this end has yet to be achieved. The debate about the importance of innovation and what role the government should play in creating an innovation-driven economy has been ongoing for quite some time. In 2007 the OECD released an extensive report outlining New Zealand’s status as an innovator, highlighting its strengths and weaknesses and making recommendations for the future. Some of the points discussed in this report are mentioned below to provide a context for where New Zealand currently stands. (“OECD Reviews of Innovation Policy,” pp. 10–14)

- New Zealand is a very small country with a domestic market not sufficient for local firms to grow beyond a certain size. They need to overcome their size and isolation and tap into those industries in which the potential returns to innovation and expansion are greatest.
- There are factors which will help New Zealand achieve the goal of increased innovation. New Zealand’s openness as an economy and currently sound macroeconomic policies provide an
environment suitable for innovation. It is also apparent that government officials are aware of New Zealand’s deficiencies in productivity growth and competitiveness and see increased innovation as a viable remedy.

- There are also aspects which hinder New Zealand’s innovative capabilities. Business research and development is lacking. R&D is an essential component to innovation, and a lack of investment will hinder potential growth. Also the unwillingness of many New Zealand entrepreneurs to trade in their leisurely lifestyle for a lifestyle focused more on work and geared toward growing their business affects the ability of many firms to achieve their full potential.

The report goes on to state that a failure to utilize the strengths and to remove the roadblocks barring innovation could result in decreasing levels of GPD per capita and a possible migration of skilled researchers and entrepreneurs to more productive nations.

The Global Innovation Index (GII), put out by INSEAD,1 ranks 130 countries in order of their ability to respond to and take advantage of innovative technologies. This index also takes into account the strengths and weaknesses of each country’s policies and institutions pertaining to innovation. The goal is to be able to measure how countries compare with respect to their innovative capacities. The index is based upon eight “pillars” comprised of five inputs and three outputs (see Table 1 above) designed to capture a country’s capacity for innovation. (“Global Innovation Index: More on Methodology”) According to the 2008 innovation index, New Zealand was given an overall ranking of 27th. The eight pillars which make up the overall score and New Zealand’s ranking in each of these pillars are listed above.

For each category within the pillars, a country is given a score from 1 to 7. These scores are obtained from variables within each category that are subsequently averaged. For example, in developing a score for institutions and policies, there are 15 variables that are measured. They include the number of days it takes to start a business, political stability, control of corruption, soundness of banks, etc.

The scores for each of the categories are then averaged to give a general score for both the input and output pillars. A country’s overall scores for both the input and output pillars are once more averaged to give the country its final score for the innovation index. The sources for these measurements include the OECD, World Bank, and International Telecommunications Union. For cases where quantitative data are unavailable, subjective data are gathered from the World Economic Forum’s annual Executive Opinion Survey. (“Global Innovation Index 2008–2009,” p. 57)

As the rankings in Table 1 show, New Zealand’s lowest-ranked categories are knowledge, competitiveness, and wealth. Of particular relevance to this article is the competitive-

---

1INSEAD is a research institution and highly ranked international business school based in Fontainebleau, France.
ness category. Table 2 shows New Zealand’s performance in the different variables that compose this category. (“Global Innovation Index 2008–2009,” p. 154) Table 2 clearly shows New Zealand’s weakness in the international marketplace. The first three categories in the table, all having to do with the export industry, are where New Zealand ranks the lowest. New Zealand scores reasonably well in categories dealing with domestic competition and regional markets, indicating that what brings its overall competitiveness level down is its lack of global competition. In short, New Zealand’s inability to take advantage of the world market greatly limits the returns to its innovative endeavors.

Growth

In order for New Zealand to become more competitive, its businesses must become more competitive, both globally and domestically. New Zealand’s businesses are generally small, and most have not ventured into the global market. Furthermore, many companies do not even have boards of directors, mergers and acquisitions are rare, and most New Zealand business owners think in terms of when they can sell their businesses rather than how they can take their businesses to the next level. (Bell) For New Zealand to become a more competitive nation, its business leaders must desire to both expand beyond domestic borders and grow their businesses to full potential.

Table 2

Measures of Competitiveness and New Zealand’s Rank

<table>
<thead>
<tr>
<th>Competitiveness</th>
<th>37th</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods exports (current US$)</td>
<td>56th</td>
</tr>
<tr>
<td>Service exports (current US$)</td>
<td>46th</td>
</tr>
<tr>
<td>Commercial service exports (current US$)</td>
<td>44th</td>
</tr>
<tr>
<td>Merchandise exports (current US$)</td>
<td>57th</td>
</tr>
<tr>
<td>Intensity of local competition</td>
<td>14th</td>
</tr>
<tr>
<td>Extent of regional sales</td>
<td>24th</td>
</tr>
<tr>
<td>Presence of innovative products</td>
<td>18th</td>
</tr>
<tr>
<td>Breadth of international markets</td>
<td>31st</td>
</tr>
</tbody>
</table>

Source: “Global Innovation Index . . .”

The Three B’s

A common saying often used to characterize the ambition of New Zealand entrepreneurs is that of acquiring the “Three B’s”: the Beamer, the bach (beach house), and the boat. It is also said that, once business leaders in New Zealand become successful to the point where they can acquire all three of these B’s, they will step back from their working environments and enjoy more leisurely pursuits. While this mentality may contribute to happier lives2 for some of these entrepreneurs, it is extremely detrimental to New Zealand’s economy. Recognizing this as a problem for the economy, institutions such as the Icehouse, a business growth center, have focused their energies on teaching business owners to recognize the true potential of their businesses and helping them achieve it. Their goal is to combat the mentality of the Three B’s and to inspire entrepreneurs to make their companies as successful as possible. Not only does the Icehouse work with seasoned business leaders, it also educates and empowers new entrepreneurs to build businesses with potential for growth. Institutions such as the Icehouse are trying to change the business climate in New Zealand by creating more ambitious business leaders.

2A happiness index put out by the Happiness Foundation ranks New Zealand in a three-way tie for 17th out of 144 countries. These measurements are based on surveys given out to citizens of each country. (Veenhoven)
Several success stories have emerged from collaborations with the Icehouse. One example is Vectek Electronics, a company that works on reducing power quality problems in industry and commerce. Since working with the Icehouse, Vectek’s business has grown considerably. Moreover, its exports have grown from 20 percent of revenue to 80 percent, and its staff has increased from 30 full-time employees to 90. (“The Power of the Network”) As Vectek CEO John Penny remarks, “It has been quite spectacular . . . we’re now exporting electronics to some of the highest, high-tech [sic] electronic manufacturers in the world, and it’s all New Zealand made.” (“The Power of the Network”) Success stories such as Vectek’s are indications of the potential that New Zealand firms have for further growth, both domestically and globally.

Going Global

If New Zealand is to become more competitive by increasing the number of its global businesses, the people running these businesses must also aspire to this goal. The New Zealand government can implement policies designed to spur global expansion, but whether increased global competitiveness is achieved ultimately rests on decisions made by individual firms. These firms must aspire to expand into the global marketplace and do everything within their ability to succeed internationally. (Skilling and Boven, p. 32) A report put out by the New Zealand Institute, a prominent think tank, entitled Developing Kiwi Global Champions: Growing Successful New Zealand Multinational Companies, lists four specific ways that New Zealand firms could make progress growing their businesses in the global marketplace:

1) Commitment to international success: A business does not go global overnight. New Zealand firms must recognize the limitations of operating solely in a small domestic market and focus on the opportunities available in the global marketplace.

2) Investing in competitive advantage: New Zealand firms who wish to go global must bring something marketable to the international table. Succeeding in the domestic marketplace does not ensure success in the global marketplace; therefore, New Zealand firms must identify those areas in which they would have a competitive advantage when competing globally.

3) International growth in steps: Firms must enter the global marketplace by making small, low-risk decisions, and grow slowly from there. This is important because many New Zealand firms do not have international experience and will need to test the waters before making big investments beyond domestic borders.

4) Putting experienced people on the ground: Competent and learned individuals need to be on site studying the international markets in order for New Zealand businesses to better understand the demands of the global marketplace. (Skilling and Boven, pp. 39–43)

Public policy can create incentives that will lead to a more competitive economy, but it is the mentality of the business leaders and the way businesses are run that will ultimately determine the future prosperity of New Zealand.

A Further Challenge

New Zealand, along with the rest of the world, is currently focused on combating the effects of a global recession. In discussing the state of New Zealand’s economy in the twenty-first century, it is important to note the considerable degree to which its economy is being affected in these troubled times. An executive summary put out by the Treasury of New Zealand in January 2009 noted that the economy had contracted during the previous September for the third time in a row. The Treasury also pointed out that the GDP growth rate of 1.7 percent in September 2008 was the slowest rate of growth in almost a decade. (New Zealand Treasury) Furthermore, the Economist forecasts that annual GDP growth in New Zealand will be negative 2.9 percent in 2009, and an average of only 1.9 percent a year from 2010 thru 2013. (“Country Briefings: New Zealand”) Currently, the New Zealand Parliament is committed to boosting its citizens’ incomes by engaging in tax cuts, eliminating inefficient government spend-
ing, and finding more ways to remove barriers to growth and competition. Finance Minister Bill English, in a speech on December 18, 2008, expressed the intention of the current administration in the following way: “We want to come out of this with an internationally competitive economy. We will do this in a way that is both fiscally responsible and provides New Zealanders with a solid platform to achieve higher and sustainable economic growth over the medium-term and beyond.” (English)

**Conclusion**

Over the past century New Zealand has had to reinvent itself from a country relying solely on trade with Great Britain to a more open economy focused on surviving in the global marketplace. Over the past decade, however, New Zealand has seen a decrease in its competitiveness in the global marketplace and now must take measures to become a more competitive country in an increasingly globalizing world. While the government’s efforts to reduce the corporate business tax shows that this issue is recognized, further efforts to reduce the tax on active income for New Zealand companies operating abroad would increase their global competitiveness. Efforts on behalf of local business leaders to expand their businesses beyond domestic borders will also help establish New Zealand as a more competitive nation.
REFERENCES