BUILDING NEW ZEALAND'S COMPETITIVENESS

Vague plans are not enough

Tony Caughey

▶ Central government should learn from Auckland's economic development goals.

LENGTH : **15 min** (3765 words)

AUCKLAND'S Economic Development Strategy was launched in September, 2012. It is a ten-year plan that supports the 30-year Auckland Plan approved by Auckland Council the previous March. Now, for the first time, a Supercity organisation exists with a timeframe, legislated by central government, that is well beyond the three year election cycle; an organisation that has formulated a unique economic development strategy for Auckland, based around its specific strengths.

THIS TIME horizon is particularly important given the now-accepted need for economic growth to be developed from the bottom up, rather than from the top down. We must get our cities and regions working better. Our cities rank highly on quality of life dimensions, but not on economic competitiveness measures.

The Auckland Plan set some explicit and ambitious goals—increasing GDP annually by a minimum of five per cent, regional exports by six per cent per year, and productivity by two per cent per year. The Economic Development Strategy (EDS) addresses how these increases are to be achieved.

There is much that central government could learn from Auckland about writing an economic development plan. Auckland's EDS is a long way ahead of the Government's Business Growth Agenda (BGA) on many fronts.

The first thing a plan needs is a goal against which progress can be measured. Auckland's goals, as outlined above, are specific. By contrast, government has four broad priorities:

• Responsibly managing government finances
• Building a more productive and competitive economy
• Delivering better public services within tight financial constraints
• Rebuilding Christchurch

The priority of most interest to me is number two—"building a more productive and competitive economy". While the concept is sound, the obvious question is: how will government know if it is has been successful in achieving these twin priorities? Productivity is relatively easy to measure, but by how much do we want to improve it? Auckland has a target of increasing productivity by at least two per cent a year. Is government's goal to achieve anything better than zero, and if so, will it be enough? Where is the debate about this?

Competitiveness is a much more difficult concept. There is no attempt within the BGA to define what it means to build a "more competitive economy", so how will government know whether it has achieved this priority?

One way would be to track New Zealand's progress on a variety of international indices that measure competitiveness. These include the World Economic Forum's *Global Competitiveness Report*, the IMD *World Competitiveness Yearbook*, the report released by the Chinese Academy of Social Sciences, and that of the Economist Intelligence Unit.

One might think that if government was interested in increasing New Zealand's rankings in these surveys it would have programmes to address the variables that the surveys measure—especially the important ones where New Zealand is ranked poorly. However, I can find no evidence of systematic government thinking that addresses the areas where New Zealand is underperforming.

Take the 2011 *Global Competitiveness Report* from the World Economic Forum, which assesses 142 countries on 113 variables. It ranks New Zealand as doing well on ease of starting a business (1st), lack of bribes (1st), and judicial independence (1st), but poorly on mobile phone subscriptions (48th), the availability of scientists and engineers (69th) and cluster development (60th).

There is no suggestion in the BGA that we should put more effort into cluster development, for example, where the country's performance is unacceptable. By contrast, the Auckland EDS does propose cluster development programmes.

To date, the BGA consists of six pieces of work. At the time of writing, four have been released: on building innovation, building export markets, building safe and skilled workplaces and building infrastructure. Two more papers, on building resources and building capital markets, are due by the end of 2012.

I would rate the four papers released to date as disappointing—with one exception. The export paper contains a goal to increase exports from 30 per cent to 40 per cent of GDP by 2025. This is the first major, concrete goal to emerge from the BGA process. (There are a myriad smaller goals that mean little and often address the wrong issues—for example, the goal to increase the percentage of 18-year-old students passing NCEA level 2 from 74 per cent to 85 per cent in six years. While worthy for a very small number of students, a much better goal would be to produce more enterprising students who know how to start their own businesses, using programmes developed by the Young Enterprise Trust.)

The export goal sounds attractive, but why would you want to do this if you don't know what you wish to achieve by it?

In the early 1990s I was part of a group that used a model developed by economic research company BERL to determine that if New Zealand wanted annual GDP growth of four per cent, then one way to achieve it, given certain other assumptions, was to grow exports by nine per cent a year—in other

I can find no evidence of systematic government thinking that addresses the areas where New Zealand is underperforming.

words, to double exports in eight years. So, the export goal in the BGA sounds about right, but creating an objective in a vacuum, without a broader, quantifiable goal, makes no sense.

Having said that, there is much to applaud in this export goal. It is the first time in 30 years that the government has acknowledged a basic fact—that we are a small island economy at the bottom of the world which depends for its prosperity on exporting to a world that does not owe us a living. Treasury thinking since export incentives were abolished in the early 1980s has been dominated by the theory that a dollar earned in New Zealand is as good as one earned overseas—with the inevitable and unsurprising result that our exports have stagnated. At last we have a signal from government that exporting is a good thing. It is tantalising to speculate on what strategies government will put in place to achieve this goal, as we have seen almost nothing to date.

Such a goal will go some way to reaching the definition of competitiveness espoused by Michael Porter and others. They declare that a region is "a competitive location to the extent that companies operating in it are able to compete successfully in the global economy while supporting high and rising living standards for the average person in [that region]". A competitive location produces prosperity for both companies and citizens.

Rgrettably, the BGA hasn't yet got a definition of competitiveness.

It is a complex subject. In their research paper "The Determinants of National Competitiveness", Mercedes Delgado, Christian Ketels, Michael Porter and Scott Stern say: "Competitiveness has for the last few decades been a central feature of the economic policy debate. But the debate, both in policy and academia, remains mired in confusion about what the term competitiveness actually entails".

Government's business growth agenda is nowhere near world's best practice. Its language is far removed from that used by *Harvard Business Review* in its March 2012 special issue on US Competitiveness, which noted that: "Although the US retains profound competitive strengths—for instance, in higher education and entrepreneurship—those strengths are increasingly threatened by weaknesses in areas such as the tax code, basic education, macroeconomic policies, and regulation. Steps to reverse the loss will require a new focus by government and business leaders".

HBR goes on to describe 17 essential elements of the national business environment:

Macro Elements

- Macroeconomic policy: soundness of government budgetary, interest rate, and monetary policies
- Effectiveness of the political system: the ability of government to pass effective laws
- protection of physical and intellectual property rights and lack of corruption
- Efficiency of the legal framework: modest legal costs, swift adjudication
- Complexity of the national tax code
- K-12 education system : universal access to high-quality education; curricula that prepare students for productive work

Micro Elements

- Logistics infrastructure: high-quality highways, railroads, ports, and air transport
- Communications infrastructure: high-quality and widely available telephony, Internet, and data access
- High-quality universities with strong linkages to the private sector
- Context for entrepreneurship: availability of capital for high quality ideas; ease of setting up new businesses; lack of stigma for failure
- Availability of skilled labor
- Flexibility in hiring and firing of workers
- Innovation infrastructure: high-quality scientific research institutions; availability of scientists and engineers
- Regulation: effective and predictable regulations without unnecessary burden on firms
- Strength of clusters: geographic concentrations of related firms, suppliers, service providers, and supporting institutions with effective collaboration
- Quality of capital markets: ease of firm access to appropriate capital; capital allocated to most profitable investments
- Sophistication of firm management and operations: use of sophisticated strategies, operating practices, management structures, and analytical techniques

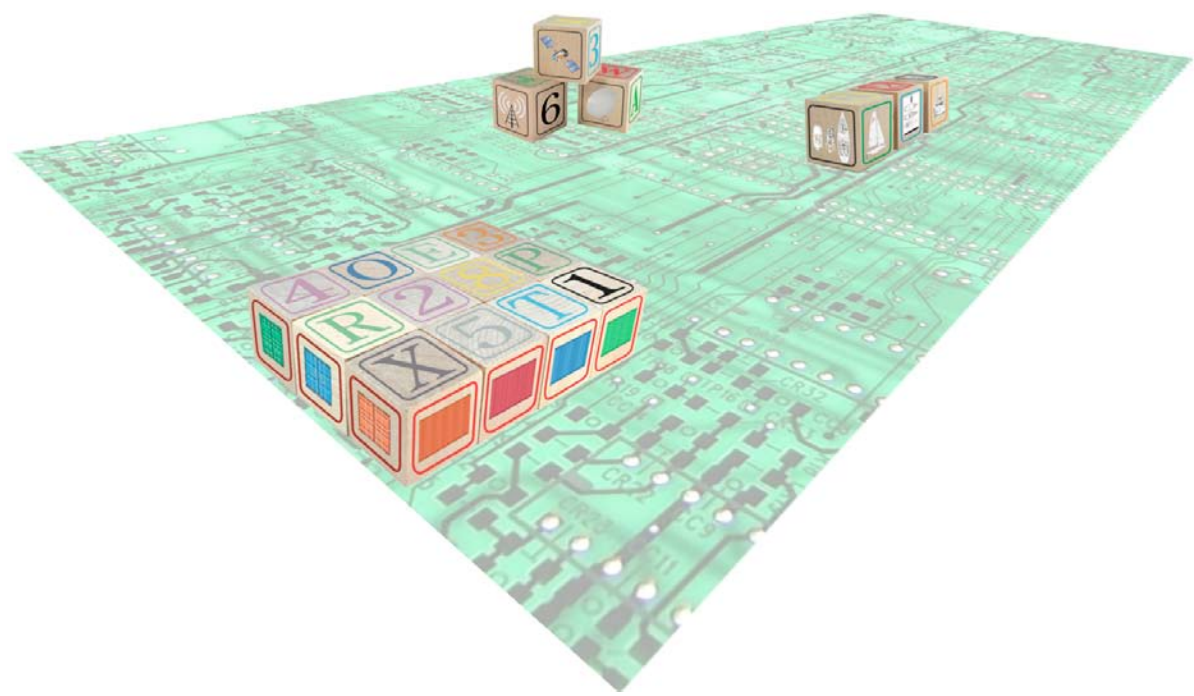
Again, I find the reference to clusters of interest. Likewise, the concept of promoting entrepreneurship, which is entirely missing from the BGA, as I have previously noted.

Clusters

THEN WE have the Economist Intelligence Unit's report at the end of 2011 on "Fostering Innovation-Led Clusters". That report began by stating that: "There are few economic development policies as popular as clusters. It is hard today to find a country, region, or even city that is not trying to develop a network of complementary and competitive firms."

Actually, it is not hard. You just have to look at New Zealand. Cluster development strategies are yet to feature in the Business Growth Agenda. Why? I contend that the main reason is a lack of understanding of active cluster development programmes in our Wellington institutions. On a scale of one to 10, I would rate the level of understanding somewhere between zero and one. In a straw poll I did of my assessment, I was told by one official that I was being too harsh. But a world leader in cluster development suggested that such a score was generous. There are a handful of officials with some experience of cluster development, most of it relating back to the Joint Action Group (JAG) initiatives of New Zealand Trade and Enterprise some 15 years ago. These people do not seem to be prominent in the writing of the BGA.

There are glimmers of hope that the understanding of cluster development programmes in government institutions in Wellington is about to improve. But



more on that later.

The big picture is that New Zealand is underachieving economically. This was alluded to by the Organisation for Economic Cooperation and Development almost 10 years ago. In the OECD's 2003 economic survey of New Zealand, it said:

"The mystery is why a country that seems so close to best practice in most of the policies that are regarded as the key drivers of growth is nevertheless just an average performer."

"The mystery is why a country that seems so close to best practice in most of the policies that are regarded as the key drivers of growth is nevertheless just an average performer."

Academic Phillip McCann later called this New Zealand's "Productivity Paradox". Such terminology was adopted by the late Sir Paul Callaghan, who used evidence-based research to enter the economic debate. He argued for a greater emphasis on education, innovation and the development of the high-tech manufacturing sector. This was all in the context, as he put it, that "we seem to have the market fundamentals right, but we still haven't got the productivity we are looking for".

So the problem is not new, and it has been well described. The question is, what do we do about it? Self-evidently, we need to do something different from what is embedded in the Business Growth Agenda. The implementation of this agenda would simply allow us to restate the Productivity Paradox year after year while remaining a merely average performer.

The Auckland Strategy provides answers on how we can break free of this paradox.

Its five priorities are not dissimilar to the government's business growth agenda: developing into the innovation hub of the Pacific Rim, becoming internationally connected and export driven, becoming business friendly and functioning effectively, growing skills and the local workforce, and developing into a vibrant and creative international city. In addition it has four cross-cutting themes: a sustainable eco-economy, an iwi/Maori economic powerhouse, an innovative rural and maritime economy and a diverse ethnic economy.

More importantly, the Auckland EDS has explicit goals, as outlined earlier. It also has plans to develop specific industry clusters, and in this it has benefitted from a submission by the global conference of The Competitiveness Institute (TCI), held in Auckland in 2011. This Barcelona-based institute is a network of 9,000 professionals from more than 100 countries who are the world's leading practitioners in the economic development of cities, regions and countries. I was privileged to chair the steering committee for the 2011 conference.

In October, 2012, I attended the TCI's conference in the Basque Country in Spain, in company with 450 delegates from more than 50 countries. The Basque Country was quick to embrace many of the ideas of Michael Porter 20 years ago and is reaping the rewards of its cluster development programmes. Bilbao is an example of how a decaying industrial city can be transformed to a modern vibrant one, with some of the best infrastructure in Europe, and with no debt. Universities in the region have embraced the subject of competitiveness in both teaching and research.

The good news for New Zealand is that largely as a result of the TCI conference in Auckland last year, The University of Auckland Business School has announced that it will join the University of Otago and more than 100 leading universities around the world in teaching Porter's "Microeconomics of Competitiveness" course. This is a welcome development and will help raise the level of understanding among young people of these vitally important concepts. Over

Michael Enright on Clusters and Cities

Michael Enright, author of a new report on New Zealand's competitiveness, talked to the *Business Review* about the benefits of business clusters and the economic role of cities.

Business Review: Clusters are internationally recognised as stimulating economic activity, but they are not well developed in New Zealand. Why is that, and what can be done to foster them?

Michael Enright: Clusters—regional groupings of firms in the same or related industries—are very prominent all over the world. Now, there are many examples of successful clusters in New Zealand, including a marine-related cluster, a wine-related cluster and an aerospace-related cluster. But I think in other places in the world there is much more of an effort to organise firms, to try to figure out means of cooperation and coordination that would allow firms, particularly small and medium-sized ones, to collectively undertake things that no individual firm could do, and in particular to help penetrate international markets. There is a view that New Zealand perhaps needs a more institutionalised framework for identifying potential advantages, identifying potential collaborations and then for helping those take place.

BR: And some of the benefits of clusters would include the ability to very quickly identify such things as negative information—that is, where things don't work—and so fast-track innovation. Is that your understanding?

ME: Actually clustering helps the innovation process in many ways. First off, clusters tend to become aggregations and attractors of skills and capabilities, specific to an industry. Custers also tend to foster local competition. But another, often unrecognised, advantage is, as you put it, the value of negative information. People tend to publish their successes but not their failures. And since the innovation process is largely a process of trial and error, anything that allows you to understand what dead ends other have already tried vastly improves the efficiency of the innovation process.

BR: Megacities, and the areas of innovation surrounding them, seem to have a disproportionate influence on national economic activity. Do you think that lends weight to the argument that a city like Auckland should put more emphasis on developing infrastructure which is going to have some direct impact on economic development for the nation?

ME: Well, cities play a variety of roles. They are economic centres in and of themselves, particularly in service sectors but also in many research-intensive sectors. Cities also connect countries to each other and they connect hinterlands to national and international markets. So, when we see the development of megacities, on the one hand we see them managing the flows of information, finance, people and business between cities and between countries. We also see cities as repositories of expertise and knowledge. In particular, large cities tend to be the locations where you get the complementary skills and capabilities brought together in the same place that these days often power innovation. Today, a successful commercial innovation is not necessarily a single technology, but it is often the bundling of several technologies, of several different types of skills and capabilities, which we are much more likely to find in a large city than scattered around the countryside or in smaller cities.

BR: So although, at the moment, New Zealand has an initiative to introduce high-speed broadband so that we can work 'weightlessly', there is still a need for a physical concentration of economic ac-

tivities in addition to that move towards internationalisation through electronic means.

ME: Absolutely. There is a need for connectivity throughout New Zealand so that people anywhere in the country can connect to each other and also connect to the rest of the world. It is one of the ways in the modern world to try to overcome the disadvantage of distance and small domestic population. But at the same time, cities are also important. They are basically where the work of globalisation gets done. They are the places that connect one country to another, that connect one population to another. In addition, if you think about it, the process of improving communication and transportation, allows certain activities to be spread over space, but also allows other activities to be concentrated. And what we find is that industries and activities that depend on the creative process, that depend on knowledge that is difficult to write down, difficult to codify, require face-to-face interaction. And exactly the same communications and transport technologies that allow some economic activities to disperse over space actually cause other economic activities to concentrate over space and these tend, in many cases, to concentrate in cities.

time this will increase the level of knowledge in our institutions that can be harnessed to implement such policies.

The full name of the course is "Microeconomics of Competitiveness: Firms, Clusters, and Economic Development". The course outline explains that it: "explores the determinants of competitiveness and successful economic development viewed from a bottom-up, microeconomic perspective. While sound macroeconomic policies, stable legal and political institutions, and improving social conditions create the potential for competitiveness, wealth is actually created at the microeconomic level. The sophistication and productivity of firms, the vitality of clusters, and the quality of the business environment in which competition takes place, are the ultimate determinants of a nation's or region's productivity."

The problem that we face is that there are very few people in New Zealand who understand this.

Hong Kong-based Michael Enright, of research and strategy consulting firm Enright, Scott and Associates, has undertaken a study of New Zealand's competitiveness. It builds on research that he started more than 20 years ago when he worked on Upgrading New Zealand's Competitive Advantage with Michael Porter, Graham Crocombe and others. He is regarded as one of the foremost international academics and advisers on competitiveness and cluster development (*see sidebar interview, p13*), and his perspective will need to be carefully considered by all those working in this field in New Zealand.

We must also deepen people's understanding of clusters, because there are many misconceptions. It is very important to realise that a cluster is not a science park, nor a piece of infrastructure—like the Foodbowl—nor a precinct. Clusters are also not about "picking winners". Cluster development programmes, as practiced by every government in Europe, are development programmes for industries that are already winners.

There are many definitions of clusters. Porter calls them: "Geographic concentrations of interconnected companies, specialised suppliers, service providers, firms in related industries and associated institutions... in particular fields that compete but also cooperate."

The problem for us is that many places around the world have benefitted from active cluster development policies that New Zealand officials have not wanted to believe in. The Auckland plan offers some hope that these shortcomings will be overcome.

The final word should go to the 2012 TCI submission on the Auckland Plan—before the Plan's early drafts made any mention of clusters. TCI said: "Clusters are no silver bullet and they need to be part of a broader competitiveness strategy to reach their full potential. But they are a tool and perspective far too powerful for Auckland to neglect on the ambitious path that the region has embarked on."

I have just begun a programme driven by Auckland Tourism, Events and Economic Development (ATEED) and the Auckland Council to further develop a food and beverage cluster in South Auckland. I am looking forward to this challenge as part of a wider approach to enlightened economic development in New Zealand.

In summary, then, the Business Growth Agenda requires a fundamental rethink. It needs goals that can be measured. It needs to recognise what is happening elsewhere in the world. And it needs to reflect that thinking—aided by the experience of business people and people with backgrounds in economic development—in a revised BGA. I find it extraordinary that a set of documents can be produced about New Zealand's economic future that is completely silent on the twin pillars of cluster development and fostering entrepreneurship. The BGA emphasis on a top-down solution for economic development needs to be modified to deliver a solution which will be from the bottom up.

These three omissions—entrepreneurship, clusters and a bottom-up approach—put us out of step with *The Economist* ("Fostering Innovation Led Clusters"), *Harvard Business Review* (on US Competitiveness), the World Bank (elements of a Local Economic Development Programme), the World Economic Forum (The Global Competitiveness Report), The Competitiveness Institute and the world's most respected academics. Fortunately, the Auckland EDS goes a long way to address these shortcomings in New Zealand's largest region. With concerted pressure, action can be taken to revise and improve the BGA, break us out of our "productivity paradox" ■

Tony Caughey is a company director and business consultant. He was a co-author of *Upgrading New Zealand's Competitive Advantage* (1991), and more recently served on the steering group of the ESA (Enright) report on New Zealand's competitiveness. On behalf of Auckland Tourism, Events and Economic Development (ATEED), Caughey chaired the 2011 conference in Auckland of The Competitiveness Institute (TCI). He is also a member of Auckland Council's Business Advisory Panel and chairs the Young Enterprise Trust, which teaches financial literacy and enterprise education in primary and secondary schools.

caughey@clear.net.nz

KEY TAKE-OUTS

- **The government's Business Growth Agenda is poorly conceived and will not remedy New Zealand's inadequate economic performance.**
- **Cluster development strategies—a key component of strong economies around the world—are not well understood in this country.**
- **Auckland's new economic strategy suggests a way for New Zealand to break free of its "productivity paradox".**