

Connecting Internationally: Trade is Ancient History

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Good afternoon, it's a pleasure to be here.

Eight centuries ago a group of intrepid voyagers from East Polynesia made landfall in Aotearoa. And one of the things they brought with them, which would prove crucial to their survival, was the kumara. The thing is, kumara didn't originate in the Pacific Islands. The breadcrumb trail of history suggests the Polynesians picked it up in Peru, a good 8,000 kilometre round-trip on an outrigger canoe.

And just as a voyage to South America made life in New Zealand possible, international connections continue to profoundly influence our living standards. International connections are in our history, our blood, our bones, our soil. They are forged by adventurous people with a willingness to explore the unfamiliar, and enrich our lives in countless ways. But the unfamiliar can also generate fear, and it's important we don't allow fear to limit our opportunities and our prospects as a nation.

Today I'd like to highlight a few big areas of opportunity around New Zealand's international connections, and how we can make the most of them.

Setting the scene – the world economy today

Let's take a quick look at the world we live in.

It's no secret that things are changing. The world's economic centre of gravity is shifting east. You're all familiar with the story. Here are a couple of facts to bear in mind:

- Between 2011 and 2013, China consumed 6.6 gigatons of concrete – that's more than the U.S. used in the entire 20th century.
- The number of middle-class consumers in the Asia-Pacific region is expected to grow from half a billion in 2009 to 3.2 billion by 2030.

Questions have been raised in recent years about the quality and sustainability of growth in emerging markets. In some cases – like China – it is well recognised the sort of economic growth rates of the past five years were not sustainable. But the strong underlying drivers – catch-up in technology and further urbanisation – mean we have good reason to be confident that the global economic shift will continue. That includes consistent demand for New Zealand's high quality agricultural products from the world's growing middle-class.

After half a decade of sub-par growth our traditional trading partners are starting to fare somewhat better. The US and the UK economies are recovering, and growth forecasts for the Euro area and Japan have been revised upwards.

But the news remains mixed. Recent economic data suggest Australia is still having a tough time of it as growth slows, reflecting reduced Chinese demand for its mineral resources, and as its economy rebalances from mining investment. In Europe, the situation in Greece is still a concern, and there are still some troubling geopolitical situations in play, like the conflict in Ukraine.

Slow growth has created a significant amount of spare economic capacity. This has lowered inflation for a whole range of goods. Low inflation is a worldwide phenomenon, which is good for households as prices stay lower, but can make it harder for governments to reach fiscal targets as tax revenues don't rise as quickly as they might otherwise.

On balance, there are good reasons to be hopeful. There are some bright spots in the global economic recovery, and while we're still a long way from being out of the woods, the long-term trends are in our favour.

What's more, the world is increasingly open for business. International flows are rising like ocean currents – since 1990, global flows of trade and finance have risen five-fold to \$26 trillion US dollars. This is a megatrend that's just getting started – global flows of trade and finance are predicted to reach \$85 trillion US dollars by 2025. People flows are expected to double, to two billion short-term travellers, and – critically – data flows are expected to rise eight times over, to 330,000 petabytes per month.

So how do we approach this world? How do we negotiate the shifts? Are we adventurous, striking out to create new connections? Or are we fearful, venturing out only warily?

Trade, and how it is changing

Let's take a look at trade.

If there's a risk in our current situation from a trade perspective, it's that we won't take full advantage of the opportunity at hand.

Right now, New Zealand's export intensity is lower than what we would like, at around 30 percent of GDP.

And certainly, we need to find ways to keep growing our agricultural exports in a sustainable way. Being in the essentials business stood us in good stead in the wake of the global financial crisis, when people cut back on discretionary purchases. That remains important. But at the moment our focus on commodity products also leaves us relatively exposed to competition from other countries, and to price swings as global supply levels rise and fall.

We need to continue to expand how we think about trade.

To begin with, we need to increase our share of knowledge-intensive exports. High and medium-to-high technology industries already make up about 15 percent of our exports. Or take service exports. Services are rising as a share of exports globally, and while our service exports as a total share of exports are similar to other developed economies, over two-thirds of that is made up of tourism and transport. The challenge is to think about the kinds of services we lead the world in, and find opportunities to market and deliver them offshore.

And perhaps most importantly, we need to take our place in the global digital revolution. To put things in perspective, global goods trade grew by about 11 percent per year from 2002-2012. Services were close behind at 10 percent, followed by capital, at 6 percent. But this has been underpinned by a massive increase in data and communication flows, which grew by 52 percent.

The Security Technology Alliance is a good example of a group of New Zealand firms taking advantage of the growing international trade in services and a digitally connected world. The Alliance is a group of innovative technology companies who are joining forces to market their capabilities in critical infrastructure protection, law enforcement and intelligence, and emergency response and recovery.

Jade, Xero and Orion are other good examples of Kiwi software firms servicing global markets. But we need to think laterally, like Les Mills, the gym operator which sells its exercise programmes worldwide. More than six million people take a Les Mills class every week.

We are living in a time of tremendous opportunity as the nature of commerce changes. The digital revolution enables us to set aside the challenges of size and distance and focus on the value we have to offer the world that is weightless and freightless. We need to look at where our services are at the leading edge, and take them global.

Another opportunity is the growing trade in intermediate inputs – that's goods and services which contribute to finished products made in other parts of the world. This is the dominant trend in international commerce – intermediate outputs accounts for about 60 percent of OECD trade in goods and close to three quarters of trade in services.

One group of New Zealand firms finding a way into a complex value chain is the New Zealand Craft Beer Collective, which represents craft breweries from Wellington, Christchurch, Blenheim and Warkworth. Like the Security Technology Alliance I mentioned a moment ago, these firms are overcoming the challenges of scale by operating as a coalition. This is providing big benefits in terms of planning, freight, distribution, logistics and market representation. The Collective recently signed a deal with an international drinks distributor that will see them get more of their products into the UK than they would have working individually.

So trade is an important opportunity, but we need to continue to think about it differently. In addition to increasing returns from trade, greater integration into global value chains and networks will give us more exposure to fresh thinking and innovation, leading to productivity gains and higher incomes for New Zealanders over the long-run.

And if there's one point I'd like to leave with you today, it's that there's much more to international connections than trade. It's the other international flows – flows of capital and people, and the accompanying flow of ideas – which are the key to reinventing trade, and which will lay the foundation for a more prosperous New Zealand in the long-run.

Capital – more than money

Let's take a look at capital.

Foreign capital gives us the capacity to grow beyond New Zealanders' ability to save. In fact, one way to think about foreign investment in New Zealand is that it allows New Zealand businesses who want to invest and grow a means to finance that investment. Where domestic savings from New Zealand falls short, we turn to international investors who share, and even help to expand our aspirations, and are confident we'll succeed.

Foreign investment creates more jobs, and contrary to popular myth, much of the profit from this investment is reinvested. Here are a few more facts:

- In the year ended March 2014, just over 60 percent of foreign direct investment earnings were reinvested in the New Zealand economy.
- Employment expansion is greater in firms which have been acquired by foreign owners than in similar firms which remain in New Zealand ownership.
- New Zealand evidence also shows that firms with foreign direct investment pay higher wages, and that foreign acquired firms raise wages more than other similar non-acquired firms.

New Zealand's stock of foreign direct investment grew significantly following the economic reforms of the 1980s. And although our levels of foreign direct investment are about

average for a small, open, developed economy, at about 46 percent of GDP, the growth in foreign investment into New Zealand over the past 10 years has been slower.

We need to make sure we're continuing to attract these valuable flows of finance.

But it's not just the money we're interested in, or even simply the additional jobs created by foreign direct investment. We want the ideas, the technologies and the new business opportunities that go with investment – these are the things that will create a stronger platform for sustained growth and prosperity over the long-run.

New Zealand has a well known productivity challenge, and it's likely that one of the contributing factors is our distance from other centres of innovation. Cheaper transport and communication technology have helped to close the gap, but the evidence suggests that concentrating economic activity in particular locations is still a key way of increasing productivity. This reinforces the importance of making sure that Auckland works well as our main physical point of connection to the world, and our only global city. Auckland has to be a great place to do business, to study, to do research, to make connections, tap talent, and find creative solutions.

But even then, we have to do more. The rise of emerging markets in the Asia Pacific region has put us closer to the action, but Auckland is not much closer to cities in Asia than cities in Europe are.

We have to find other ways to bring the world closer.

Foreign direct investment is part of the answer, in that it often brings new thinking and skills from other parts of the world. New ideas and skills are transferred to New Zealanders through experience, observation and training, and spread through the economy as people move between firms, helping to improve productivity across the board.

And, as you can imagine, there are similar benefits from New Zealand businesses investing overseas. Unfortunately we lag behind other countries on this front. Overseas investment by New Zealand firms is about 10.2 percent of GDP, compared to an OECD average of 42.6 percent. This might be another area where businesses need to think about international connections differently – not simply in terms of connections to new markets, but as an opportunity to gain exposure to different thinking that complements our own, and can be truly paradigm shifting.

For example, some New Zealand primary sector firms use offshore resources, usually land, to spread production risk and make sure they can service key markets. Research has found that the net effect of this investment is generally positive for profits, growth and competitiveness. Offshore investment is also thought to improve the business practices of New Zealand firms who deal with companies with foreign investments.

The Treasury has been looking into barriers to overseas direct investment. One key issue is the way we think about risk – some shareholders see investing offshore as a risky strategy because of the previous failure of New Zealand firms. But frankly, someone else's failure isn't a great reason not to try yourself. Investing offshore carries risks, but so

does investing onshore. We need to be risk aware, rather than risk averse. Rather than letting fear dampen our aspirations, we need to be ambitious on a global scale.

The main thing is that we learn from previous failures, and perhaps just as importantly, that we learn from the success of others. For example, success stories tell us the importance of preparing for the cost of establishing a brand in a new market, and taking the time to establish relationships with trusted local partners.

People, and the importance of relationships

Which brings me to my next point, which is people, and the importance of relationships.

New Zealand is experiencing record high net immigration levels at the moment. Last year, after subtracting departures, almost 51,000 more people came to live here on a permanent or long-term basis. That compares with a previous peak of 42,000 in 2003.

This largely reflects our positive prospects compared to other parts of the world. The economy is growing, there are jobs, inflation is low, and this country offers a very good quality of life overall.

For New Zealand, many of the benefits from high net migration levels are similar to those that come from offshore investment.

Migration helps to lift our productive capacity – it enables the economy to grow faster by increasing the size of the workforce, in much the same way that foreign capital allows us to grow faster than domestic savings alone would permit.

Right now, at a time when international demand for some commodity products is weak, strong net migration also has the benefit of bolstering demand for goods and services at home.

Like foreign investment, migrants also bring new skills, new ideas and a diversity of perspectives and experiences that help to make our businesses more innovative and productive.

And perhaps most importantly, migrants often retain strong personal and cultural connections to other parts of the world, which opens up, and helps us to pursue, new business opportunities. We are in a pretty incredible position in this regard, with so many New Zealanders – around 1 million people – living overseas, and so many people who live here having been born in another country.

Networks like KEA – Kiwi Expats Abroad – do a great job helping to keep us connected. KEA has 500,000 members, including what it calls its World Class New Zealand network, a group of over 400 leaders who draw on their experience to help Kiwis gain access into offshore markets. One of the great things KEA is doing is staying in touch with the thousands of offshore citizens who were educated in New Zealand. This group is the new wave of New Zealand “alumni”.

I suppose my question is: are we doing enough? We know there’s a huge desire from people to help. Are we asking enough specific, actionable questions of our diaspora?

In an era where our future lies increasingly with Asia, where relationships between individuals trump transactional, contract-driven relationships, these personal connections matter immensely. In this sense, person-to-person connections can provide us with create deeper, stronger connections than trade or capital ever could.

Harnessing the flows

So how do we get there? How do we create international connections which will stimulate strong, enriching flows of trade, capital, people and ideas?

Government's role

Certainly government has a role to play. From a commercial perspective, we can open doors for business by negotiating high quality free trade agreements.

We can also make sure New Zealand has a seat at the table when decisions are being made that affect our ability to prosper, whether at the United Nations, the IMF, the World Trade Organisation or the OECD.

As the world changes we're seeing the international architecture change too. The G20 has become a significant forum. Bilateral trade agreements are an increasing feature of the landscape. New institutions or initiatives such as the Asian Infrastructure Investment Bank and the G20's Global Infrastructure Hub are in the process of being established. Reform of the IMF remains on the agenda. As international frameworks evolve, the role of government is to balance increasingly intertwined economic and geopolitical relationships, and I'd like to recognise the work of my colleagues at MFAT, NZTE, and others in the public service who do a great job in this area.

The rise of different international markets for our goods and services also has implications for how we do things at home. Do we need to consider our emerging partners in the region in the way we approach and establish domestic policy settings? Do our domestic policies balance the immediate need to service growing international markets with a need to be sustainable over the long-term? Can we find ways to make doing business easier here and abroad while staying true to our values and our brand, and ensuring New Zealand remains an attractive place to live and work?

In a competitive global market for capital and labour, we also need to make sure our policy settings attract the right kind of foreign investment, and people whose skills and experience are well matched to our needs, and will help to boost productivity.

Getting these things right will take us a long way. But it won't take us all the way.

The role of business

Government agencies have been actively looking for ways to push the policy frontier, and have been talking to a range of people in the business community to test our thinking and their views on government's role.

And while we certainly want to hear what we can do better, one of the messages we've been hearing from New Zealand businesspeople who have been successful abroad is that

to a very large extent, the initiative now sits with them. New Zealand is one of the easiest places in the world to do business. And while we'll keep striving to make it even better, increasingly, the main barriers left are those which firms impose on themselves.

It's businesses who use capital to create jobs, employ people to fill those jobs, seek out markets and create the connections which bring us closer to the world. Businesses are at the heart of New Zealand's international connectedness.

In the modern era, old fashioned operating models go extinct very quickly. Businesses need to look ahead, think carefully about their strategy, and invest in the capabilities that will enable them to build and sustain strong international connections.

So for example New Zealand has a free trade agreement with China, and that's delivering substantial benefits as we gain better access to a growing market. But China is still a challenging place to do business. If we want to take full advantage of the opportunities in China, more New Zealand companies will need to adjust to differences in culture, language, regulation and the importance placed on relationships. They need to think about operating with business models which go beyond relying on contractual agreements.

As a country, we have a lot to learn from Māori culture in this respect. Māori culture prizes people, relationships and connectedness. The Treasury is proud to have co-sponsored the Māori Excellence in Export Award at the International Business Awards, which was won last week by dairy exporter Miraka. Miraka and others have shown that business approaches grounded in Māori world views and cultural practices can be highly valuable in terms of unlocking foreign capital, and access to offshore markets.

What we can do together

There are things government and business can work on together too.

Productivity is one of them. There's a yin and yang dimension to this – the more productive our businesses are, the more successful we will be at attracting people, investment and ideas, which will in turn help to drive further productivity gains. Importantly, our productivity drive needs to go beyond exporters, and into the service sector, recognising that about half the value of New Zealand's gross exports can be attributed to value added from the services sector.

We can also work together on helping firms to internationalise. For example, one of the things we are thinking about is how to help businesses raise capital for the purposes of investment offshore, by raising capability in areas like due diligence and risk insurance.

And we can work together on the underlying infrastructure. For example, are our education and training systems producing a workforce that's Asia-ready, or Latin-America ready? And does our innovation system have the right balance between innovation in New Zealand and adoption of ideas and technology from overseas? Are there areas where we can harmonise our regulatory settings with those of other countries? And do we do enough to better inform the community at large about the importance of our international connections – that deep prosperity comes through connections not protections – so that the benefits I've outlined today are better understood?

When we stay true to our values, and have the courage to step out and pursue new relationships, it pays real dividends. We've seen that with our relationship with China and the benefits that have come from over forty years of diplomatic relations and our FTA. And just last week we finalised an FTA with Korea. We've also seen New Zealand become a prospective founding member of the Asian Infrastructure Investment Bank I mentioned earlier, a position the UK and a number of European countries have decided to adopt, along with Australia just a couple of days ago.

Being willing to take a lead showed openness and a continuing commitment to partnership with other countries in the region. Steps like this deepen our international connections, and help, among other things, to build resilience into our relationships. But it isn't just something for governments. Businesses also need to build relationships with their international customers, investors and business partners.

Conclusion

In conclusion, international connections will remain critical to New Zealand's future prosperity. This is no different from the past. What *is* different is that we're back in the voyaging phase, navigating the shifting global environment and forging relationships with new partners.

For millennia, international connections have been about trade. The Phoenicians in the Mediterranean, the Silk Road between China and the West, the Ptolemaic dynasty's trade with India: from ancient to more recent times, the world has understood international connections mainly through the prism of international trade. But here we are at the start of the twenty-first century and international connections mean so much more. The rapid flows of people, capital and ideas mean we are at a 'new normal'.

Trade is ancient history and part of our future history. Seizing the opportunities offered by the 'new normal' can play a big part in shaping our fortunes and raising the living standards of all New Zealanders. So much of this is about our attitude. In the spirit of the original East Polynesians, let's be ambitious and adventurous as we explore the possibilities in front of us. Stronger connections will increase our capacity for growth far beyond what we could achieve alone, through fresh thinking, innovation, productivity gains, and new business opportunities.