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DISCUSSION PAPER 2006 / 3

Competing to win:
An external strategy for a changed world

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NOVEMBER 2006

The New Zealand Institute

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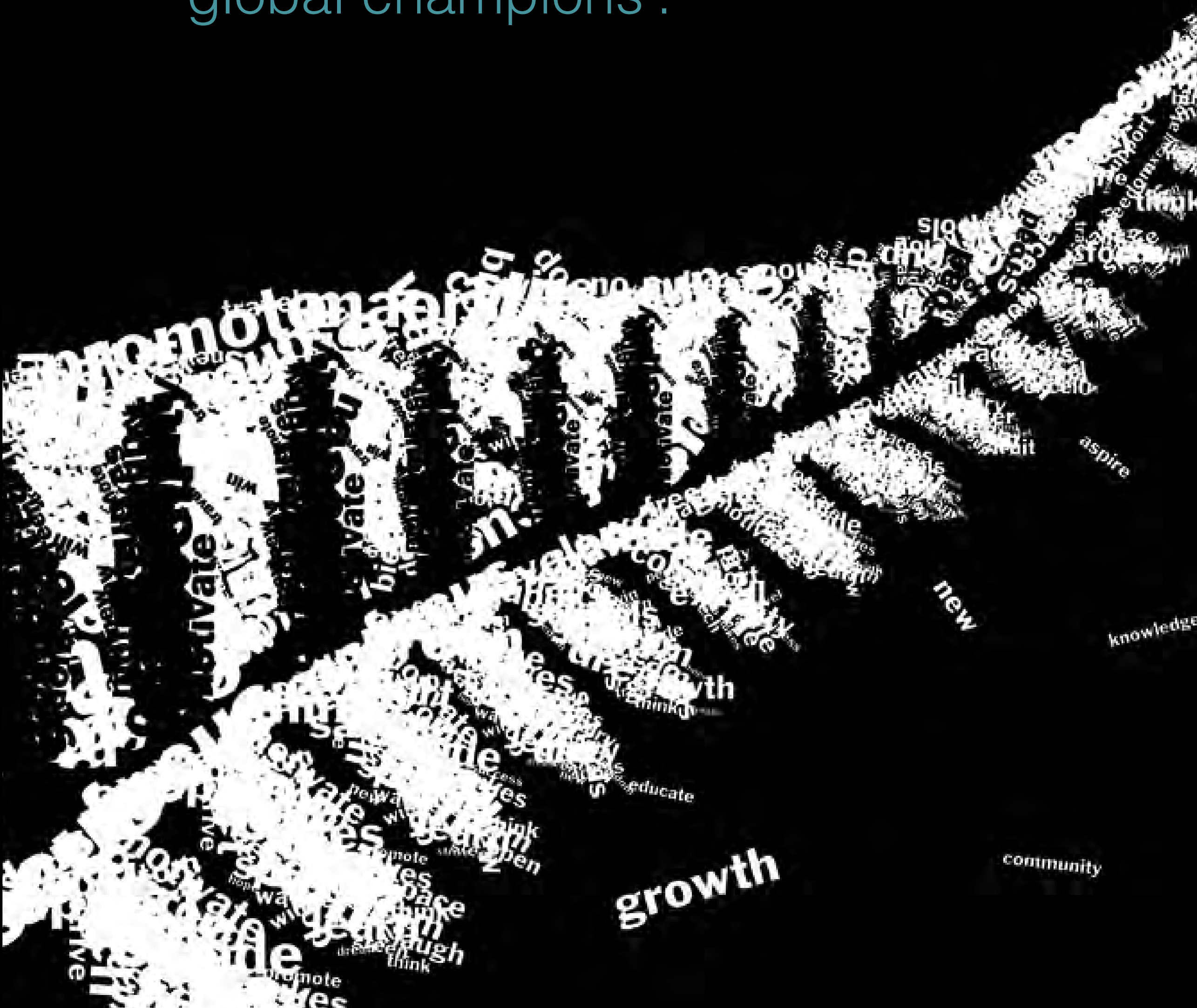
‘Competing to win’ is the fifth paper in a series that forms part of the New Zealand Institute’s research project on ‘Creating a global New Zealand economy’. This paper follows on from our first four papers ‘No country is an island’, ‘Dancing with the stars?’, ‘The flight of the Kiwi’, and ‘Developing Kiwi global champions’.



FOREWORD: CREATING A GLOBAL NEW ZEALAND ECONOMY

The New Zealand economy has performed well over the past 15 years, with economic growth rates that exceed those generated in previous decades and that compare well against the US and Australia.

The challenge now is to build on this good performance, so that New Zealand's income levels converge to those of other developed countries. Sustaining high rates of economic growth into the future will necessarily involve a substantial increase in labour productivity growth.

New Zealand is a small economy, and substantially raising New Zealand's labour productivity will require much greater levels of exporting and foreign investment by New Zealand firms. Exporting and investing offshore provides scale, growth opportunities for New Zealand's most productive firms, and great learning opportunities for New Zealand firms. New Zealand cannot achieve and sustain high rates of productivity growth without making much greater use of larger markets through international activity.

However, New Zealand's international performance does not compare well against many other developed countries, and only a small number of New Zealand companies are substantially engaged in international markets in terms of either exporting or investing. New Zealand is not participating in increased international economic activity to the extent that many other countries are.

Of course, New Zealand firms do face particular difficulties in terms of moving into international markets because of the small size and remoteness of the New Zealand market. It is this combination of the importance of international engagement, and the difficulties that some New Zealand firms face in going global, that provides the motivation for this project.

This project is being undertaken to identify the actions and policies that will move New Zealand towards becoming a genuinely global economy, in which much more of New Zealand's national income is generated offshore and where New Zealand firms win systematically abroad.

Over the past several months, we have released a series of reports examining different aspects of this issue. Initial reports have described why taking the New Zealand economy to the world is vitally important, examined New Zealand's current exporting and international investment outcomes, and identified some of the key reasons that New Zealand's international outcomes do not compare well against other small, developed countries.

An important part of this project is conversations with a wide range of business and political leaders about the key issues and the actions that can be taken to increase exporting and international investment by New Zealand firms.

This has provided the basis for additional reports that focus on a range of solutions. The aim of the project is to identify the actions of government, business, and others, which are required in order to take the New Zealand economy to the world in a material and successful way. Creating a global New Zealand economy is an important but demanding challenge, and will require sustained leadership from both the private and public sectors.

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EXECUTIVE SUMMARY

A key priority in terms of substantially improving New Zealand's level of international economic engagement is strengthening the ability of New Zealand firms to access foreign markets.

New Zealand's current approach

New Zealand's current approach to achieving enhanced international market access places heavy emphasis on multilateral trade liberalisation through what is now called the World Trade Organisation (WTO). This approach has recently been supplemented with a secondary focus on securing bilateral and regional free trade agreements (FTAs). In addition, New Zealand has invested in various export promotion activities in offshore markets through what is now New Zealand Trade & Enterprise (NZTE) as well as investing in some national branding, which is generally related to tourism promotion.

This emphasis on multilateral trade liberalisation exists because of the historical nature of New Zealand's exporting profile as well as the destination of New Zealand's exports. New Zealand's exports continue to be dominated by primary goods, which are subject to relatively high levels of import protection and other types of trade distortions. And New Zealand has a very wide range of export markets, with less of a regional focus than most other countries.

So New Zealand's current approach to securing international market access can be understood in part as a legacy of historical circumstances. But New Zealand's relatively low levels of exporting and outward foreign direct investment (FDI), and New Zealand's failure to participate meaningfully in the globalisation process over the past couple of decades, suggests that this approach needs to be reviewed. Is New Zealand's approach still appropriate given the major changes in the global economic environment over the past couple of decades?

A changed world

Two major changes in the international environment have particular relevance for the design of an external strategy for New Zealand. The first is the uncertain future of multilateral trade liberalisation, with the suspension of the Doha Round and the rapid spread of regional and bilateral trade agreements over the past several years. These developments have potentially significant implications for the ability of New Zealand firms to access key markets.

The second major change is that the market access challenges facing New Zealand firms are increasingly not about formal trade barriers. A growing number of New Zealand's internationally engaged firms, for example, are selling branded goods and services into competitive, sophisticated offshore markets. For many of these firms, the market access challenge is less about getting their products across the wharf without attracting a tariff as much as accessing the appropriate channels to market and getting in front of the consumer.

These changes have made the world a more demanding place for New Zealand and New Zealand needs to respond by competing in a far more determined and aggressive manner. If the world is changing, simply continuing with what has always been done is unlikely to generate improved levels of international economic engagement. New Zealand needs to develop an external strategy that is appropriate to current and prospective international economic conditions.

An external strategy for New Zealand

In particular, three areas of focus are proposed for an external strategy for New Zealand.

The first element is an explicit outcomes focus. Currently there are no outcomes-based targets in New Zealand's approach to international economic engagement and accordingly there is no monitoring or reporting on progress against relevant outcomes. Rather, progress is measured on process dimensions like the number of meetings between senior officials or progress towards securing an FTA.

Ultimately, however, what matters is achieving a substantial and sustained increase in the level of New Zealand's international economic engagement. Clear outcomes measures in terms of exporting and outward FDI should be the direct focus of New Zealand's external strategy. New Zealand needs to be clear as to what success looks like and then act so as to achieve this. Setting explicit and ambitious targets is likely to have a powerful impact on behaviour and resourcing decisions.

The second element is a much more deliberate regional focus. This reflects the need for New Zealand, as a small country, to focus the economic and political investments it is making to secure market access in a few key priority markets rather than investing small amounts across many markets. It is also a response to the increasingly regional flavour of the global economic environment, and the need for New Zealand to be on the inside of the emerging regional architecture.

The recommendation is that New Zealand's external strategy should focus to a greater extent on the Asia Pacific region. The Asia Pacific is a very large and growing market and is physically close to New Zealand. In particular, it is recommended that New Zealand make disproportionate investments in developing its economic relationships with Australia, the US, and China. Specific targets are proposed for these three key markets.

Third, New Zealand needs to substantially increase its in-market investments to achieve these target outcomes. The type of activities that are important in this regard include providing in-market services to

New Zealand firms as they seek to enter and expand into international markets: for example, providing access to shared infrastructure, to world-class market research, and to local networks. These direct services to New Zealand firms should be supplemented by deliberate campaigns to showcase New Zealand, with particular emphasis on the three target markets, through national branding, cultural diplomacy, physical points of presence, and New Zealand business and government delegations. Lastly, these efforts should be supported by a more ambitious, pragmatic approach to FTA negotiations to enhance New Zealand's ability to secure FTAs with key partner countries.

Choosing to compete

Importantly, most of these actions are within New Zealand's control, allowing New Zealand to develop key economic relationships without waiting for other countries to move first. The response to events like the suspension of the Doha Round should not be to adopt a mood of resignation, but rather to make significant, sustained investments in key economic relationships.

New Zealand's approach to international engagement needs to be updated for the current global economic environment in which New Zealand is operating. The three key elements that have been proposed for an external strategy for New Zealand will provide a sharp focus for New Zealand's efforts to strengthen international market access.

Overall, New Zealand needs to become much more serious about competing to win in international markets, to set ambitious targets in terms of improved outcomes, and to act and invest so as to make good on these aspirations. New Zealand has choices available to it, but needs to act much more aggressively in order to generate substantially improved levels of international economic engagement.

CREATING A GLOBAL NEW ZEALAND ECONOMY: PROJECT STRUCTURE

No Country is an Island
The importance of international economic engagement for New Zealand's economic future

↓

Dancing with the Stars?
New Zealand's level of exports and outward FDI does not compare well to other countries

↓

The Flight of the Kiwi
Identifies four classes of solutions to create a global New Zealand economy

↓

Detailed Analysis and Recommendations
To be contained in four reports

1. Developing Kiwi global champions
2. New Zealand's external strategy
3. Connecting to the world
4. The New Zealand economy 2.0

1 INTRODUCTION

Increasing New Zealand's level of international economic activity is a vitally important part of enhancing the growth prospects of the New Zealand economy. A key element in achieving this is assisting New Zealand firms to overcome various barriers to entering foreign markets. These barriers range from tariffs and other types of import protection to informal barriers, such as the costs and risks associated with New Zealand firms establishing a presence offshore and investing in developing an understanding of foreign markets.

These barriers to international market access loom large for many New Zealand firms, particularly given the small size and physical remoteness of the New Zealand market, and make international expansion a daunting challenge. Accordingly, acting to secure enhanced international market access for New Zealand firms as they seek to go global should be an important priority.

The New Zealand Institute's last report detailed a range of actions to create a domestic policy environment that was more supportive of international expansion by New Zealand firms, and also identified some insights with respect to corporate strategy around international expansion. The focus of this report is on what can be done to assist New Zealand firms in offshore markets.

Historically, the key priority for New Zealand in terms of securing market access for New Zealand firms has been pursuing multilateral trade liberalisation through what is now the World Trade Organisation (WTO). But the prospects for a successful conclusion of the current Doha Round of trade talks are at best uncertain given the recent suspension of the Round. And more generally, the global business environment has changed significantly over the past few decades, such that increasingly the market access challenge is about much more than overcoming formal trade barriers.

These changes mean that New Zealand's approach to achieving international market access needs to be reviewed to ensure that it is relevant to the world that New Zealand firms are facing. The case for reviewing New Zealand's current approach is reinforced by New Zealand's relatively poor level of international engagement in terms of exporting and outward foreign direct investment (FDI).

Relevant questions to ask include whether the focus on multilateral trade liberalisation is sufficient to assist New Zealand firms into international markets. How should New Zealand respond to the proliferation of regional and bilateral trade agreements, and should New Zealand incorporate a regional focus into its external strategy? What is the role of on-the-ground investments in securing market access, and which activities provide the most value to New Zealand firms?

The report starts by considering New Zealand's current approach to securing international market access, and describes why New Zealand has pursued this path. The ongoing appropriateness of this approach is then evaluated in the context of the significant changes that have affected the international economic environment over the past couple of decades. The claim made is that New Zealand needs to develop a clear external strategy that is appropriate to this changed world.

In particular, the last three sections of the report describe three elements of a proposed external strategy for New Zealand: that New Zealand's external strategy contain a sharp regional focus, with particular attention on the Asia Pacific; that clear outcomes-based targets be specified for New Zealand's key economic relationships; and that New Zealand seek to grow these economic relationships through a much greater focus on providing in-market services together with bilateral and regional trade agreements.

2 NEW ZEALAND'S CURRENT APPROACH

New Zealand's top trade policy priority has long been to achieve progress through the World Trade Organisation in terms of reducing import protection and export subsidies, particularly with respect to primary goods. The Ministry of Foreign Affairs & Trade (MFAT) website notes, for example, that "the multilateral WTO process remains the top trade priority for New Zealand because it offers the largest potential gains". Similarly, Treasury claim that "the WTO Doha Round remains [New Zealand's] top trade priority".

Such statements have also regularly appeared in Ministerial statements from successive New Zealand governments.[1] This commitment is reflected in Ministerial and official share of mind and effort.

Several reasons are commonly given for this focus on the WTO. The first is that multilateral negotiations are the best, if not the only, way in which to deal with export subsidies and other distortions that depress agricultural prices and that significantly constrain market access for primary goods, which are the major component of New Zealand's export base. Second, multilateral negotiations offer the most substantial benefits from the perspective of a small country such as New Zealand that has limited negotiating power. There is a sense that small countries like New Zealand will achieve better results from a rules-based system that is less dependent on negotiating clout. Third, the WTO is the equivalent of negotiating 150 FTAs simultaneously, and is therefore a very efficient way of liberalising trade.

Indeed, multilateral trade liberalisation does provide significant gains to the New Zealand economy. It has been estimated that New Zealand has received an additional $1 billion a year in export earnings since the successful passage of the Uruguay Round in 1993, with similar estimates being made of the potential benefit to New Zealand from the current Doha Round. This gain represents about 2.5% of New Zealand's total exports of goods and services.

Over the last several years, New Zealand's multilateral focus has been supplemented with several FTAs with countries in the Asia Pacific region. Of course, New Zealand was an early mover in regional trade liberalisation, signing the comprehensive CER agreement with Australia in 1983.

But it is over the past several years that an increased effort has been made in this area. New Zealand has signed agreements with Singapore (2001), Chile (2005), Brunei (2005), and Thailand (2005). New Zealand is currently in negotiation with China, Malaysia, Hong Kong, ASEAN (jointly with Australia), and has just commenced negotiations with the six countries of the Gulf Cooperation

[1] *Trade Minister Phil Goff recently noted, for example, that New Zealand "has traditionally given top priority to multilateral trade rules and trade liberalisation under the GATT and World Trade Organisation" (September 7).*

Council. New Zealand has also indicated a desire to sign an FTA with the US, although there is no indication of imminent progress.

These FTAs are thought to offer a complementary track to the WTO negotiations, allowing for more rapid progress than through the WTO as well as providing a vehicle for relationship building with particular countries. There is also a sense that New Zealand should be negotiating these types of agreements, given that other countries are increasingly pursuing this course of action. But FTAs are not New Zealand's main priority, partly because the estimated gains from the individual FTAs are smaller than from a successful WTO Round.

In addition to these trade liberalisation activities, New Zealand's efforts to secure international market access are advanced through an international network of New Zealand diplomats, New Zealand Trade & Enterprise (NZTE) officials, and other government agencies involved in activities such as promoting export education. The activities undertaken by these agencies include trade missions, market research and intelligence gathering, and providing access to local networks.

New Zealand's offshore presence is spread thinly across international markets with relatively little strategic investment in particular regions and with few clear priorities. New Zealand has 49 embassies, high commissions, and consulates. Recent embassy openings have been in a diverse group of locations; the last four were opened in Cairo, Warsaw, Dili, and Brasilia. About half of NZTE's budget of $160 million is focused on offshore activities, which supports 38 offices in 32 countries.

Emphasis is placed on having New Zealand feet on the ground in a wide range of markets so that New Zealand has some visibility in many markets and can identify emerging challenges and opportunities. New Zealand has, in effect, adopted a multilateral approach to its offshore representation as well as to trade negotiations.

New Zealand also undertakes national branding activities to promote New Zealand. This is generally undertaken in the context of promoting tourism – the government's tourism budget is currently around $80 million a year. The government spending is supplemented by private sector and industry spending; for example, marketing of New Zealand as a tourism destination by Air New Zealand.

UNDERSTANDING THIS APPROACH

In important respects, New Zealand's current heavy emphasis on the multilateral track is the result of New Zealand's historical exporting profile, in terms of the composition of its exports and the destination markets for these exports.

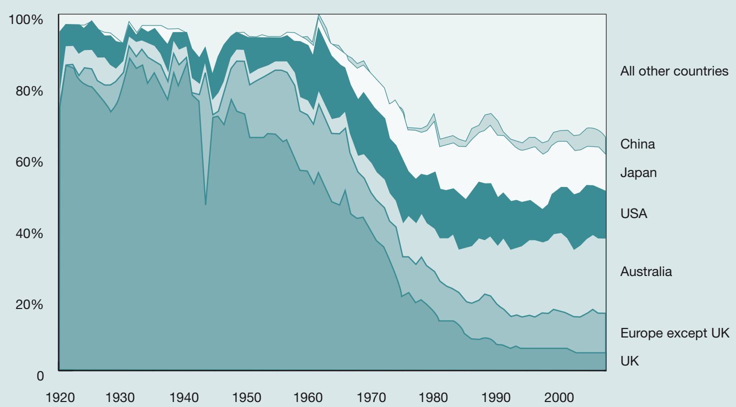
First, New Zealand's exports of goods have long been dominated by primary goods. These types of exports are subject to relatively high levels of import protection and export subsidies, which can best be addressed through multilateral trade negotiations.[2] The reduction of tariffs and the elimination of export subsidies can have a significant impact on profit margins, particularly for commodity products. So a key market access challenge for many large New Zealand exporters has been overcoming formal trade barriers.

Second, New Zealand's exports are evenly distributed across geographical markets. Historically, New Zealand's dominant export market was the UK. New Zealand had a very close relationship with Britain, which helped New Zealand overcome the effects of distance, supported by refrigerated shipping. In contrast, New Zealand had very limited trading relationships with Australia.

But from the late 1930s, the share of New Zealand's exports heading to the UK began to reduce, a process that accelerated with the anticipation of the entry of the UK into the European Commission in 1973. As part of this market diversification process, Australia, the US, the Middle East, and various Asian markets became much more significant export markets. Today the UK accounts for about 5% of New Zealand's exports, down from a high of around 80%.

As a consequence of New Zealand's success in finding new markets for its commodity exports, New Zealand has a very broad set of significant trading relationships, as described in Figures 1 and 2.

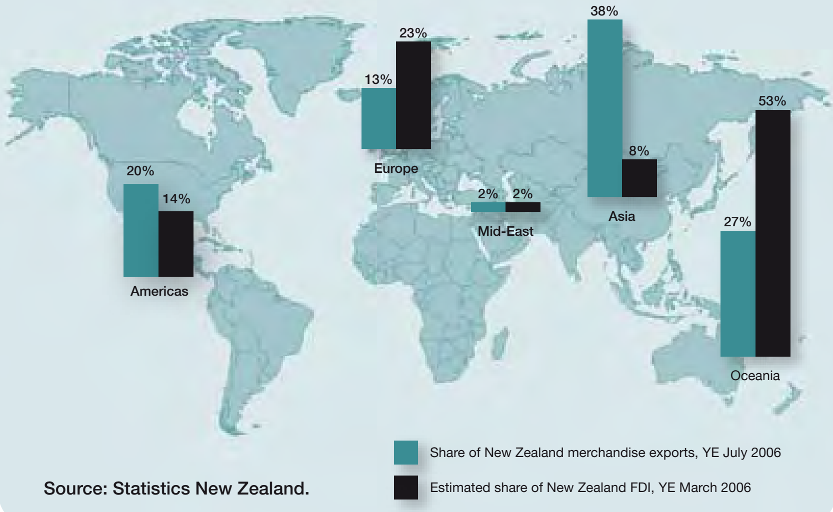
FIGURE 1: NEW ZEALAND'S EXPORTS OF GOODS, BY DESTINATION



Note: Data interpolated for the years 1932, 1942-5, 1950-3, 1960-2, 1969-70, and 1981.
Source: Statistics New Zealand.

[2] *In 2001, the average tariff on agricultural goods was about three times that for manufactured goods (Congressional Budget Office (2005)).*

FIGURE 2: DISTRIBUTION OF NEW ZEALAND'S EXPORTS AND OUTWARD FDI



Source: Statistics New Zealand.

This historical process is reinforced by the absence of large, proximate markets into which New Zealand can export, as is the case for European countries where there is a natural regional focus. In addition, the task of finding new export markets was assisted by the fact that selling commodity products requires less in-depth market understanding than does selling more sophisticated, branded products, making it easier to sustain a wider range of significant trading partners.

This wide geographic range of export markets is unusual as is the extent of New Zealand's emphasis on multilateral trade liberalisation. Most other developed countries have a much more regionally concentrated trading profile, and have external policy settings that reflect this focus. As an example, about two thirds of European trade occurs within Europe.

DISCUSSION

So New Zealand's heavy emphasis on multilateral trade liberalisation can be understood as having emerged out of its historical exporting profile, which involved selling largely primary goods into a wide range of markets with little regional focus.

But is this approach likely to be sufficient to support a substantial increase in international economic engagement by New Zealand firms? To what extent does an approach that is largely focused on reducing formal trade barriers, particularly with respect to primary sector exports, assist New Zealand firms as they seek to expand into international markets in a range of new ways?

New Zealand's relatively lacklustre international performance over the past decades indicates that serious questions should be asked in this regard. New Zealand's levels of exporting and outward FDI are low relative to most other developed countries, particularly other small developed countries, and growth in New Zealand's international economic activity significantly lags that of comparable countries. And there has been little change in New Zealand's export composition, with no substantial new export strengths having been developed over the past couple of decades. Bluntly put, New Zealand is not participating in the globalisation process to the same extent as most other developed countries (Skilling & Boven (2005)).

Given the importance of high levels of international economic engagement for New Zealand's economic prospects, active consideration needs to be given to whether changes should be made to the way in which business and government act to strengthen international market access for New Zealand firms. Central to this review process is understanding how the international business environment has changed over the past few decades, as this will have direct implications for the appropriate design of an external strategy for New Zealand.

3 A CHANGED WORLD

The global environment in which New Zealand firms are competing has changed in very substantial ways over the past few decades, and is likely to continue to change in disruptive ways. For New Zealand to compete effectively, it is imperative that these emerging challenges and opportunities are recognised and incorporated into decision-making.

In particular, there are two key developments to which New Zealand's external strategy will need to respond. The first is the increasingly uncertain future of the multilateral trade liberalisation approach, given the suspension of the Doha Round and the rapid spread of regional and bilateral trade agreements. The second is the changing nature of the international market place that New Zealand faces, and the growing importance to New Zealand firms of developing a deep understanding of offshore markets in order to compete effectively.

This section discusses the nature of these changes, and the next section identifies three major implications of these changes for the design of an external strategy for New Zealand.

THE UNCERTAIN FUTURE OF MULTILATERALISM

The latest WTO Round of multilateral trade negotiations, the Doha Round, was suspended in July because of an inability of the major parties to reach a compromise. There is now much speculation as to whether and how it can be revived. However, although it is possible that a compromise deal can be struck, the consensus view seems to be that a successful conclusion of the Round may have to wait for some time. The Indian Trade Minister has described the Doha Round as being "between intensive care and the crematorium".

Penalty shoot-outs and dead parrots

"We are realistic enough to know that waiting for the next WTO breakthrough is like watching England in a World Cup penalty shoot-out: there is always hope, but you have to accept that there is a chance that you will be disappointed".

Michael Cullen, 20 September 2006

"The increasingly desperate attempts to claim that there remains at least some life in the [Doha] negotiations are becoming eerily reminiscent of Monty Python's dead parrot sketch. Surely this trade round is dead, asks the watching world. No, it's not dead, comes the reply; it's just resting. Or it's paused. Perhaps the Doha Round is pining for the fjords? Meanwhile, the serial failures to reach any kind of agreement are pushing onlookers towards the inescapable conclusion that Doha is indeed deceased, passed on, expired and bereft of life. It is, in short, an ex-trade round".

**Mark Thirlwell, The Australian,
27 July 2006**

This experience also suggests that there may be relatively limited political capital around to support or underwrite future Rounds.

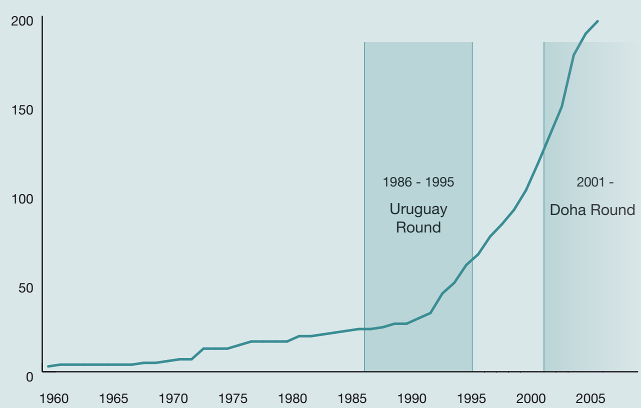
One indication of a general lack of confidence in the future of multilateral trade liberalisation is that countries have been devoting an increasing share of mind and resources to regional and bilateral trade agreements. Crawford & Fiorentino (2005) note that "between January 2004 and February 2005 alone, 43 RTAs [regional trade agreements] have been notified to the WTO, making this the most prolific RTA period in history". Countries have been shifting their trade policy focus away from the WTO.

There are now about 200 officially notified bilateral or regional agreements in force, as shown in Figure 3, with another 100 or so currently in negotiation. In Asia alone, there could be 90 FTAs by 2010; the so-called 'noodle bowl' of overlapping agreements. This rapid spread of bilateral and regional trade agreements is partly an insurance policy against the demise of the multilateral approach. FTAs have been an option for a long time, but their spread has become more rapid as the risks around the Doha Round have increased.

The increase in the number of FTAs also reflects strong growth in regional trading relationships over the past decades. A key driver of world trade growth over the past couple of decades has been 'intra-regional' trade growth (i.e. trade within Europe, trade within Asia).

The Asian Development Bank (2006) estimates that the intra-regional trade shares in 2003 were 54% for East Asia (and Japan), 46% for North America, and 64% for Europe. These

FIGURE 3: GROWTH IN THE NUMBER OF TRADE AGREEMENTS



Note: Trade agreements shown on year entered into force.
Source: WTO Secretariat.

intra-regional trade shares have all grown substantially over the past 25 years, and pre-date the proliferation of FTAs.[3] The significant growth in intra-regional trade in Asia is due in part to the emergence of fragmentation of production chains whereas in Europe it has more to do with large markets that are proximate and well-understood. Trade in services, more elaborately transformed goods, and FDI flows look to be particularly heavily concentrated within regions.[4]

There is an increasingly regional flavour to the global economic system, both in terms of flows of goods, services, and investment capital, as well as in terms of the agreements that govern these transactions (Baldwin (2006)). It is regional economic activity that is driving the growth in global economic interactions, powered by global production chains, regional trade liberalisation, and increasingly dense regional trading and investing links.

So although successful multilateral outcomes remain important for New Zealand, New Zealand's prospects are increasingly shaped by regional economic activity. Regionalism is here to stay. Given the risk profile surrounding the WTO, it makes sense to diversify New Zealand's approach to include a much more active regional focus. New Zealand's distinctive approach of being an independent country, not a formal part of a broader economic or political grouping, and placing its bets on the multilateral approach, becomes a higher risk approach in such a world.

The long-term outlook for these bilateral and regional agreements is unclear. A positive scenario is that the plethora of agreements will be built up over time into a comprehensive multilateral arrangement. The negative scenario is that the world trading system fragments into a myriad of overlapping and incompatible FTAs, or into a few competing trading blocs that are at least partly separate from each other. The nightmare scenario for New Zealand is that this fragmentation occurs and New Zealand is not included in any of the preferential trade groupings. Because of the uncertainty as to how the global trading system will develop, New Zealand needs to make sure that it is on the inside of at least one key potential grouping.

And in the short-term, New Zealand needs to ensure that it remains competitive in terms of striking bilateral deals with appropriate countries. For one thing, if New Zealand is not able to secure FTAs with key trading partners, New Zealand firms will not obtain the

[3] *Baldwin (2006) and Zebregs (2004) provide similar estimates of intra-regional trade.*

[4] *'Gravity models' that link economic interactions with physical distance show a stronger relationship for goods and services that have a higher degree of sophistication (Rauch (2001)).*

benefits of lower import protection on their exports into these markets. In some markets, and particularly for exporters of primary goods, the removal of these barriers can generate significant financial gains.

Even more significant, however, are the costs that New Zealand will incur if it does not secure agreements with key trading partners, but other countries do. There are real risks from the trade and investment diversion effects that flow from bilateral FTAs in the region. For example, while New Zealand would benefit from signing an FTA with Japan, these benefits are significantly smaller than the losses that New Zealand would face if Australia signed an FTA with Japan and New Zealand did not. This is because Australian exporters to Japan would be at a competitive advantage relative to competing New Zealand firms (Winchester (2005)).[5]

Similar concerns have been expressed in the context of New Zealand failing (so far) to secure an FTA with the US, while countries like Australia and Chile have signed agreements (NZIER (2002)). Another example is the recent FTA between Chile and Korea that will eliminate the 45% tariff on Chilean exports of kiwifruit to Korea over time, which may have a major impact on New Zealand's kiwifruit exports to Korea.

So the primary reason that New Zealand is interested in signing FTAs is from a defensive perspective. Although there is some upside from signing FTAs with key trading partners, this will generally be much smaller than the substantial downside if New Zealand is not party to FTAs that key trading partners secure. The major cost for New Zealand associated with the suspension of the Doha Round is not the loss of prospective upside gains but the increased exposure that New Zealand faces in terms of a proliferation of bilateral and regional FTAs.

In response, New Zealand needs to strengthen its participation in bilateral and regional arrangements. Although New Zealand has begun to sign some FTAs in Asia, New Zealand needs to place greater emphasis on integrating itself into regional economic networks.

THE CHANGING NATURE OF MARKET ACCESS

The international market access challenge for New Zealand was historically about getting the primary goods produced in New Zealand into international markets. Tariffs, quotas, and subsidies loom large for such products, because of the high incidence of import protection and trade distortions in this sector. Market access generally referred to issues relating to government regulation of access to the country's market, rather than with accessing the local consumers who make up the offshore market. Indeed, until relatively recently the export sales of dairy products were termed 'disposals'

[5] *Australia is further advanced in conversations with Japan about an FTA than is New Zealand.*

reflecting the fact that these exports were producer-driven – produce the output and then look for a market – rather than consumer-driven.

But increasingly, New Zealand firms need to work backwards from the preferences of the consumer. For an increasing number of New Zealand firms, the real challenges around securing access to international markets go far beyond getting exports across the border without attracting a tariff or overcoming other legal and regulatory barriers.

A previous New Zealand Institute report described the challenges facing New Zealand firms seeking to go global from a small domestic market base that is physically remote from other major markets (Skilling & Boven (2006a)). Among other things, New Zealand firms will tend to be smaller and younger, less capital intensive, and less productive than their competitors. As such, expansion into much larger international markets will often be a costly and risky undertaking for New Zealand firms.

Successfully moving into international markets depends on developing an in-depth understanding of that market, establishing efficient supply chains, getting access to local channels to market, and so on. This often requires making significant investments in learning about local market as well as the costs associated with establishing a local presence (Skilling & Boven (2006b)).

These investments are particularly important for New Zealand firms that are selling more sophisticated goods that depend on a high level of understanding of consumer preferences and being distinctive from their competitors. Market access is about having the contacts and networks that allow the firm to identify channels to market so that the firm can, for example, get its product onto the supermarket shelf.

These challenges to successfully accessing offshore markets are a significant issue for New Zealand firms even in respect of exporting into countries with whom FTAs exist, or where there are few formal barriers. For example, expanding sales into the Australian market remains challenging for many New Zealand firms even although CER has been in place for over 20 years.

Indeed, for many firms outside of the primary sector, tariff barriers and other legal restrictions are of secondary significance. There may be some barriers in terms of manufacturing and services but they are generally much lower than in the primary sector. Increasingly, the high growth areas in the New Zealand export profile, albeit off a small base, are in areas that are less affected by formal trade barriers than are primary goods.

Another significant change is that increasingly New Zealand companies are going global in different ways; for example, through outward direct investment or through establishing a production presence offshore. Conventional approaches to trade liberalisation will make less of a contribution to the success of such companies. New Zealand companies that establish production facilities in-market, for example, are less affected by formal trade barriers.

So in terms of enhancing international market access for New Zealand firms, a much broader set of market access issues need to be contemplated. Trade liberalisation will assist in this process, but for an increasing number of New Zealand firms it is not the dominant constraint on international expansion.

It is instructive that countries have grown their economic relationships substantially with markets like the US and China without the benefit of an FTA. And although New Zealand's exports have benefited from multilateral trade rounds like the Uruguay Round and several FTAs with countries like Australia and Singapore, New Zealand's export growth still lags that of many other countries. These experiences give a sense of the limits of what an FTA can do in terms of growing an economic relationship. Trade liberalisation needs to be accompanied by a broader set of actions to promote the economic relationship.

Indeed, trade liberalisation is just one of the drivers of globalisation. Other factors such as improvements in technology and transport, and new business models, have played a more important role in the explosive growth of international trade and investment flows over the past decade or so. Stephen Roach, Morgan Stanley's global economist, argues that "global trade dynamics" such as global production chains enabled by IT breakthroughs are a much more important driver of world trade than the outcome of the Doha Round. And he notes that world trade growth has been at close to record highs over the past several years despite the difficulties with the Doha Round.

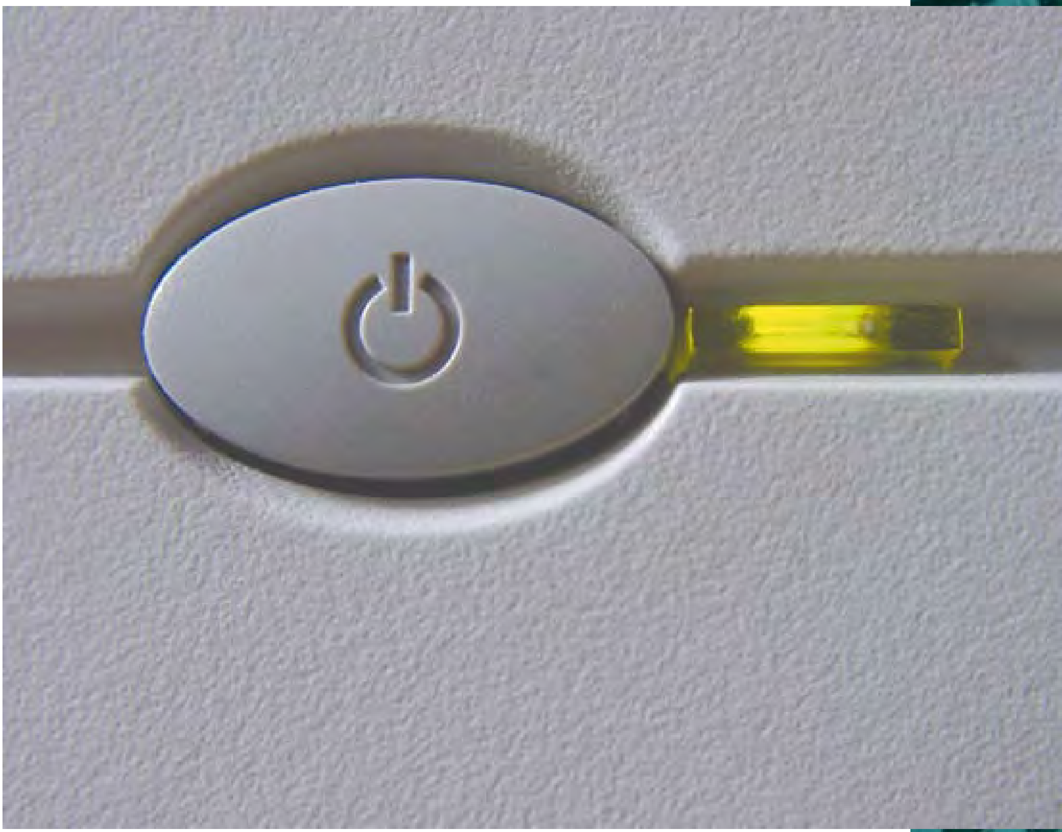
These experiences suggest that although securing improved market access through negotiating reduced trade barriers remains important, given that primary goods continue to comprise the bulk of New Zealand's exports, a broader range of activities are important in terms of supporting the international expansion of new types of New Zealand firms.

SUMMARY

These significant changes in the global business environment present real opportunities for New Zealand but also generate some substantial challenges. These changes mean that New Zealand cannot rely on doing things in the same way as has been done historically. Change is required.

In large measure, New Zealand's current approach can be traced back to its historical priorities. New Zealand's heavy focus on multilateral trade liberalisation, supplemented with some FTA negotiations and some export promotion activity in a wide range of markets, was appropriate for a world where New Zealand was focused on selling commodity products into as many markets as possible but it is less well-suited to the current environment. Of course, the WTO process remains an important priority, but there are other increasingly important priorities for action.

Although there has been some re-weighting of the different elements in New Zealand's approach over the past few years, with increased FTA activity, the WTO remains at the core of New Zealand's efforts to secure strengthened international market access. Other forms of trade liberalisation and export promotion activities remain secondary priorities. The changes made, although generally in the right direction, have not been proportionate to the scale of the changes in the international environment and are unlikely to have a material impact on New Zealand's international outcomes.



4 AN EXTERNAL STRATEGY FOR NEW ZEALAND

New Zealand's current approach to supporting international engagement by New Zealand firms is more the result of evolution over time than of a deliberate strategy. Indeed, there is no explicit external strategy that provides guidance on how the different elements are integrated. How are WTO participation, FTA negotiations, and NZTE activities prioritised, and what are the outcomes that these activities are intended to achieve? The purpose of the following sections is to contribute to a discussion on the design of an external strategy for New Zealand.

New Zealand needs to develop an external strategy that is focused on strengthening market access for New Zealand firms in a world that has changed significantly. New Zealand's external strategy needs to have a greater focus on New Zealand firms that are selling a wide range of goods and services into competitive, sophisticated markets and also recognise that New Zealand firms are going global in a much broader range of ways.

The discussion that follows outlines the three key elements of an external strategy for New Zealand. The next three sections then describe these three elements in more detail.

ADOPT AN OUTCOMES-BASED APPROACH

One of the characteristics of New Zealand's current policy approach to international economic engagement is that it is focused more directly on achieving particular process-related goals than on achieving improved outcomes.[6] New Zealand's current approach does not include any targets, and nor is there any regular reporting on New Zealand's level of

[6] *It is instructive that the annual reports of agencies like MFAT and NZTE contain no formal discussion of New Zealand's performance in terms of exporting or outward FDI.*

international engagement. Success is defined as achieving good results in the WTO or negotiating an FTA, rather than in terms of whether New Zealand's level of exporting and outward FDI is increasing over time.

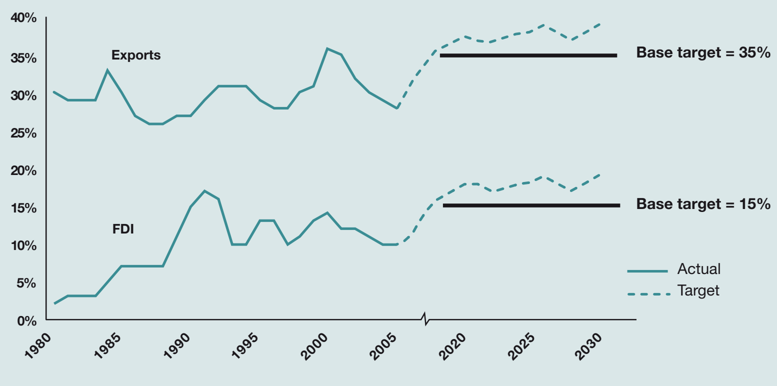
For example, most of the discussion about the New Zealand/US economic relationship has been focused on the likelihood of securing an FTA rather than the size and growth of New Zealand's economic relationship with the US.

Without a target, there is a tendency for drift as there is no way in which to benchmark New Zealand's progress against that of the rest of the world. Indeed, the absence of any official monitoring or focus on New Zealand's international outcomes contributed to the absence of any meaningful concern or action with respect to New Zealand's lacklustre exporting and outward FDI performance compared to other developed countries over the past couple of decades.

A vitally important element of an external strategy for New Zealand is the specification of clear outcomes-based targets for measures such as exporting and outward FDI. Specifying target outcomes gives a clear sense of direction, enables progress to be monitored, and also enables the business and government response to be calibrated appropriately. In this regard, the setting of targets will help to stimulate a constructive conversation in which firms, industry groups, and government agencies consider the actions that they can take to achieve improved outcomes.

A previous New Zealand Institute report proposed targets for the level of New Zealand's exports and outward FDI by 2020, as described in Figure 4 (Skilling & Boven (2006a)). It was proposed that a target of exports of 35% of GDP and outward FDI of 15% of GDP, both by 2020, was an appropriate goal. More specific goals to accompany the regional

FIGURE 4: EXPORT AND OUTWARD FDI TARGETS AS A % OF GDP



Source: UNCTAD; Statistics New Zealand.

focus that is proposed below will also be an important part of this outcomes focus.

STRONGER FOCUS ON THE ASIA PACIFIC

In response to the increasingly uncertain future of the multilateral approach, and the rise of regional economic activity and regional trading arrangements, New Zealand's external strategy needs to include a sharp regional focus. This regional dimension needs to be more than a second-order consideration that follows the preferred multilateral track. Increasingly New Zealand's prospects will be determined by New Zealand's participation in the regional economic architecture, and not just the state of play in the multilateral environment.

A tighter regional focus is also needed because the investments in the political relationship that are aimed at progressing FTA negotiations need to be undertaken alongside deep, sustained investments in developing the economic relationship. Such investments are demanding in terms of resource and capacity, and cannot be undertaken in a wide range of markets given the relatively small resource base available to a small country like New Zealand.

Making coordinated, substantial, and sustained economic and political investments in markets cannot be done well across a geographically diverse range of markets, but needs to be more deliberate and focused. New Zealand is competing with other larger, and much better resourced, countries to attract economic and political attention in offshore markets. In order to be visible, and achieve real impact in these relationships, New Zealand needs to focus its resources on the relationships that matter.[7]

The counter-argument is that New Zealand needs a presence in many markets because of uncertainty as to where future growth opportunities will come from. But New Zealand's current approach of diversification across markets makes it difficult to secure opportunities when they do emerge. Indeed, a key argument for tighter geographic focus is that New Zealand's current strategy of investing broadly across markets is generating poor outcomes in terms of international economic engagement. Risk may be reduced, in terms of New Zealand not being reliant on particular market geographies, but so too is the return.

Indeed, the changed nature of market access and the increased significance of regional and bilateral

[7] *Recent Treasury analysis is consistent with this perspective: "Global connectedness requires deep and rich links with other countries. However, as a small country, we only have the resources to focus on a handful of countries" (Rose & Stevens (2004)).*

FTAs have increased the amount of on-the-ground investment that is required to be able to grow the economic relationship. New Zealand cannot negotiate FTAs with everyone, or invest deeply in a wide range of relationships. New Zealand will need to make some hard choices about where its future lies and which economic relationships it most wants to develop.

In particular, New Zealand ought to be making much more significant investments in developing its economic and political relationships with the Asia Pacific, and concentrating its resources on this region to a greater extent. This focus is not intended to be complete, and New Zealand will need to continue to make some investments in other regions, but there should be a greater degree of strategic focus on growing key economic relationships in the Asia Pacific.

INCREASED IN-MARKET INVESTMENTS

In order to secure enhanced market access for New Zealand firms as they seek to expand internationally, New Zealand needs to substantially increase its on-the-ground investments in offshore markets. These investments should have a focus on both the economic relationship as well as on the political and diplomatic relationship more broadly.

Progress in building New Zealand's economic relationships does not occur in a vacuum but on the basis of deep, sustained investments in these relationships. Indeed, the shift towards regional and bilateral deals will mean that New Zealand needs to make an increased investment in building the economic and political relationships through more resources on the ground.

There is a need to ensure that the investments that are being made on the commercial and political tracks are well aligned. The investments made to assist New Zealand firms in foreign markets need to be related to the investments that are being made in developing the political relationship.

Government agencies and industry groups can provide a range of valuable in-market services to New Zealand firms to make international expansion from a New Zealand base a less costly and risky process. The Institute's previous report described some of the challenges that New Zealand firms face as they go global from a small, remote economy. Providing access to services such as shared infrastructure, high quality market research, and local networks, will make international expansion an easier and more attractive proposition. These activities are a direct response to the broader set of market access challenges that New Zealand firms are increasingly facing.

An emphasis on making in-market investments also reflects a desire to focus New Zealand's efforts on areas in which some control can be exerted over the outcomes. For example, although New Zealand can make a contribution to the WTO process, the unfortunate reality is that New Zealand has limited influence on the outcome relative to larger countries such as the US. And in terms of FTAs, a major obstacle to signing additional FTAs is the lack of interest from other countries in negotiating with New Zealand because of its small economic size.

But New Zealand can take a range of unilateral actions to grow and develop these relationships, in terms of greater economic and political investments in-market, rather than waiting for other countries to agree to negotiate with New Zealand. It is not sensible for New Zealand's external strategy to rely heavily on the decisions taken by other countries.

The emphasis on a broader set of actions to secure market access beyond trade negotiations also highlights the vitally important role of business and industry groups. The responsibility for securing international market access extends far beyond New Zealand's trade negotiators.

SUMMARY

There have been major changes in the global economy over the past few decades, and New Zealand's external strategy will need to incorporate some new features if it is to support much improved international outcomes. Although these recent developments have, on balance, made life more challenging for New Zealand firms as they seek to go global, the appropriate response is not fatalism. New Zealand does have choices available if it wants to compete.

This section has outlined three elements of an external strategy that will support increased international engagement by New Zealand firms. Of course, some of these proposed changes are already present to an extent in New Zealand's current approach. For example, New Zealand has signed some regional and bilateral FTAs in the Asia Pacific, and there are some innovative things being done in terms of in-market investments such as NZTE's beachheads programme.

But even if the proposed changes do not represent a radically different direction, they reflect a judgement that New Zealand's external strategy needs to be characterised by a much more aggressive focus on competing to win in international markets. This will involve a clear definition of what success looks like, which economic relationships matter most to New Zealand, and a clear strategy for making economic and political investments in offshore markets.

The next three sections elaborate on each of the three proposed features of an external strategy for New Zealand. Section 5 makes the case for a much tighter focus on the Asia Pacific region. Section 6 specifies a series of outcomes-based targets for these economic relationships in the Asia Pacific, and discusses accountability mechanisms to accompany these targets. Section 7 outlines the nature of the in-market investments required to grow New Zealand's economic relationships with these key markets so as to achieve the target outcomes.

5 FOCUS ON THE ASIA PACIFIC

Historically, New Zealand's efforts to secure international market access have covered a wide range of markets, as described in Section 2. However, the changes to the global economic environment mean that New Zealand's external strategy needs to have a much tighter geographic focus. New Zealand has to make some decisions as to where its future lies, and allocate resources accordingly. The discussion that follows makes the case for investing more heavily in the Asia Pacific region given its scale and growth prospects and New Zealand's proximity to this region.

THE CASE FOR THE ASIA PACIFIC

The 20th century was the American Century. And it is fair to say that at the start of the 21st century, this is still the case. But things are shifting. As recently as 1960, United States GDP was the same size as Asian GDP, but Asian GDP is now almost twice as large as the United States GDP.[8] The economic centre of gravity is shifting rapidly westwards across the Pacific, with the emergence of China, India, and many other Asian countries. Countries like Japan and Korea are already well-established. Whereas the world economy was based on the Atlantic economies in the 19th and 20th centuries, it is increasingly based on the Pacific economies.

The rise of Asia has been the economic story of the late 20th century. China is already adding an economy about 30% larger than the size of Australia every year. Over the past 20 years, China has grown at an average annual rate of 7% and India at 6%.

[8] *These GDP estimates are based on a PPP calculation. Using prevailing exchange rates to make international comparisons would significantly reduce the relative size of Asia.*

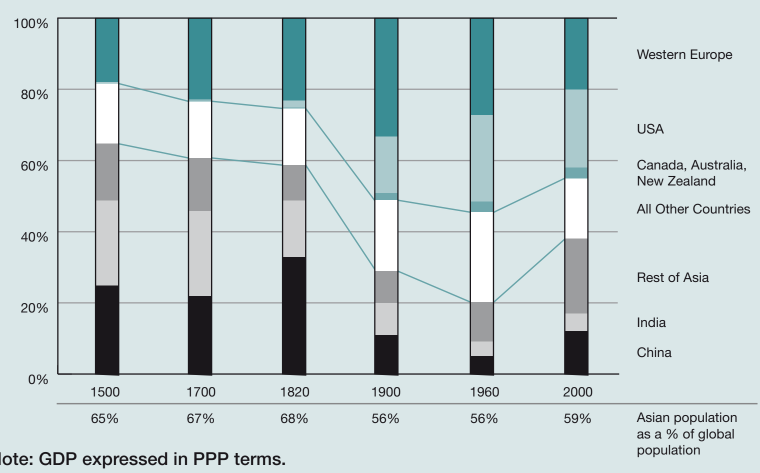
The economic return of Asia is likely to become an even more significant process over the coming decades, as Figure 5 indicates. There is a long way to go before countries like China and India achieve an economic weight that is proportionate to their population size, as was the case until about 1820. China currently has about 12% of world GDP and over 20% of the world's population, and India about 5% of world GDP and 17% of the world's population.

Analysis recently undertaken at Goldman Sachs forecast the economic potential of countries like India and China through to 2050 (Wilson & Purushothanam (2003)). This analysis projected that by 2020 Chinese output would be significantly greater than that of the US, and that this divergence would continue to grow over the subsequent several decades.

This process represents an enormous opportunity for New Zealand. Geographically, the Asia Pacific region is home for New Zealand, and so the economic rise of Asia is bringing world markets physically closer to New Zealand. New Zealand has established substantial commercial relationships with many of the countries in the Asia Pacific; indeed, about 70% of New Zealand's exports and 80% of its outward FDI are into Asia Pacific countries. In terms of metrics like market size and expected growth, and demand for the type of goods and services that New Zealand produces, the Asia Pacific is a region of substantial potential for New Zealand.

Overall, it is difficult to look past the Asia Pacific region as being the centre of attention for New Zealand. This is not to say that New Zealand has no interest in, say, European

FIGURE 5: DISTRIBUTION OF GLOBAL GDP SINCE 1500



Note: GDP expressed in PPP terms.
Source: Angus Maddison; OECD.

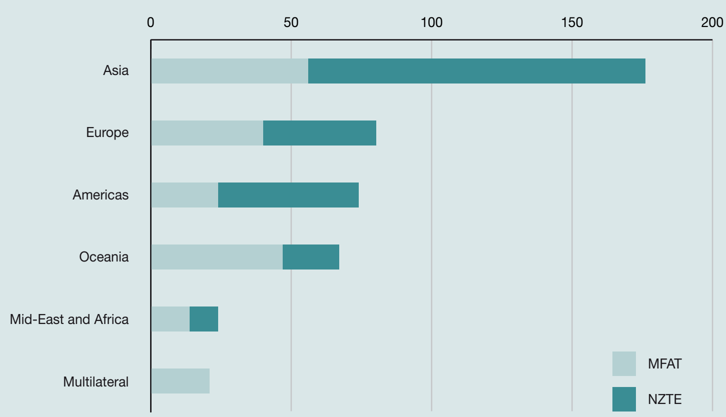
markets, which are important destinations for New Zealand's exports and outward investment. But in a world of scarce resources, New Zealand needs to make some hard choices as to where to deploy its resources. A recommendation that New Zealand should invest resource disproportionately in Asia Pacific markets seems appropriate.

As Figure 6 shows, New Zealand has an existing presence in the Asia Pacific region in terms of MFAT and NZTE staff. But the scale of the investments that need to be made in the political and economic relationships in the region suggests that more resource ought to be focused here. This will likely involve reducing some existing New Zealand presence outside of these priority markets, as well as making disproportionate resource allocations to these priority markets out of future resources as they become available.

The need for a strengthened investment in the Asia Pacific is also evident from New Zealand's current economic engagement with the region. Unfortunately New Zealand is not participating in the explosive economic growth in the Asia Pacific. New Zealand's export growth into the ASEAN countries, for example, has been consistently slower than ASEAN import growth over the past 15 years; New Zealand's share of ASEAN imports has fallen from about 0.5% to about 0.3% over this period. And only about 10% of New Zealand's small amount of outward FDI is directed towards Asian markets.

So while New Zealand talks about the Asia Pacific as a substantial economic opportunity, the outcomes that New Zealand has generated demonstrate that progress does not occur automatically. A rising tide does not lift all boats. To achieve

FIGURE 6: DISTRIBUTION OF NEW ZEALAND'S OFFSHORE REPRESENTATION, 2006



Note: MFAT figures exclude IT technicians, maintenance and clerical staff, those on language training, and other agency staff.
Source: MFAT; NZTE.

increased levels of economic engagement with the region, New Zealand needs to make an increased investment in these markets. Section 7 will describe the types of economic and political investments that are required to achieve this.

COUNTRY INVESTMENTS

The message of the above analysis is that New Zealand needs to have a much increased presence and visibility in the Asia Pacific region, and have more people and resources on-the-ground in these markets.

But the focus needs to be even more fine-grained than this. The Asia Pacific is a large region, and New Zealand cannot make substantial investments in all of the Asia Pacific markets simultaneously. So in order to operationalise this regional focus, three countries are proposed as being the initial priorities in terms of the investment of resources: Australia, the US, and China. These markets have been chosen because they are large and growing markets in the Asia Pacific region, and with whom New Zealand currently has substantial or growing economic relationships.

The focus on these three countries is not intended to be exclusive. New Zealand has interests in developing economic relationships with other countries in the Asia Pacific region, through FTAs and broader economic engagement. The ASEAN countries, for example, as well as countries such as Japan, Korea, India, and Canada, have substantial economic potential for New Zealand. New

Zealand should be making deeper investments across many markets in the Asia Pacific.

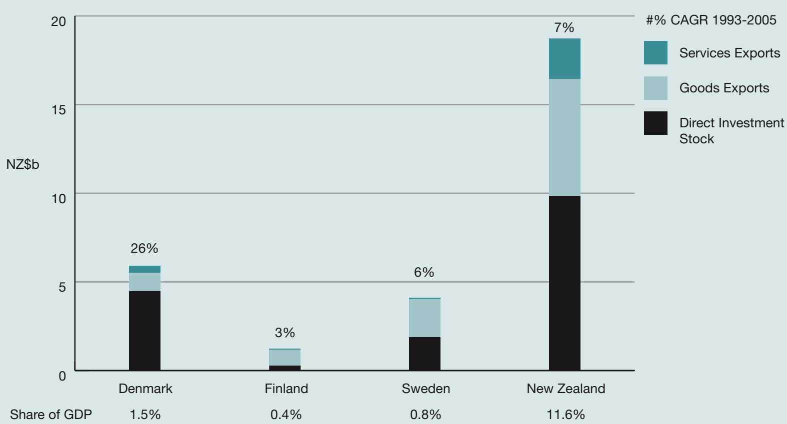
But the difficulty with having a broad focus on many markets is that the investments in each market become much more diffuse and likely less effective. To achieve real impact, there needs to be greater focus and hard choices do need to be made. This is the basis for proposing that, at least in the first instance, significant investments be made to grow New Zealand's economic relationships with Australia, the US, and China.

The current states of New Zealand's economic relationships with Australia, the US, and China are described below in Figures 7, 8, and 9. In order to benchmark the size of New Zealand's economic relationships with these countries, we have compared New Zealand's relationship to that of some of the Scandinavian countries. The Scandinavian countries were chosen because they have roughly similar population sizes as New Zealand, a primary sector background, and are also physically distant from the markets we are considering.

Australia is New Zealand's largest export market and is also the biggest destination for outward FDI from New Zealand. Australia accounts for about a quarter of New Zealand's exports and about one half of New Zealand's outward FDI. The total relationship in terms of annual exports and the stock of outward FDI is about $19 billion, or 12% of New Zealand's GDP.

Figure 7 demonstrates that New Zealand's economic relationship with Australia is much larger than for these other countries, mainly because of geographical proximity, but that its growth rate has not been growing much more rapidly.

FIGURE 7: ECONOMIC RELATIONSHIPS WITH AUSTRALIA, 2005

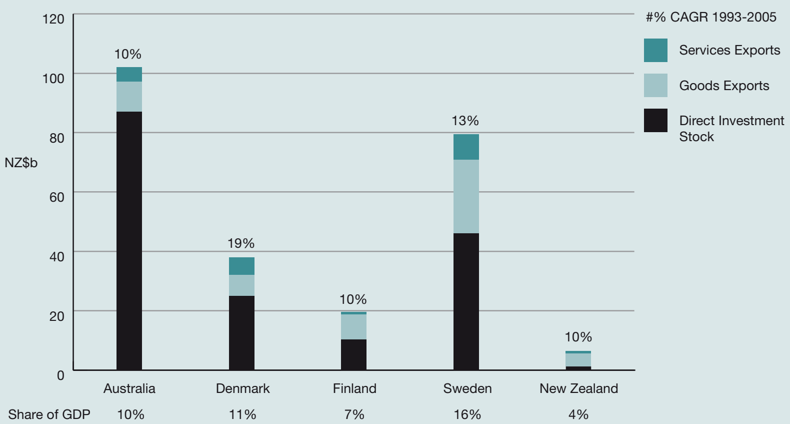


Note: CAGR is compound annual growth rate. Data to most recent year available, generally 2005.
Source: OECD; UNCTAD; Australian Bureau of Statistics; Statistics New Zealand; WDI.

The US is New Zealand's second largest destination for both exports and outward FDI, and the relationship is worth about $6.5 billion, having grown at 10% over the past decade or so. This is higher than New Zealand's overall level of export growth over this period, and has enabled New Zealand to almost maintain its import market share into the US.

However, compared to the benchmark countries, the size and growth rate of New Zealand's economic relationship with the US does not look impressive. As a share of the size of domestic GDP, New Zealand's economic relationship is significantly smaller than all of these comparator countries. Australia's economic

FIGURE 8: ECONOMIC RELATIONSHIPS WITH THE USA, 2005



Note: CAGR is compound annual growth rate. Data to most recent year available, generally 2005.
Source: OECD; UNCTAD; Australian Bureau of Statistics; Statistics New Zealand; WDI.

FIGURE 9: ECONOMIC RELATIONSHIPS WITH CHINA, 2005

Note: CAGR is compound annual growth rate. Data to most recent year available, generally 2005.
Source: OECD; UNCTAD; Australian Bureau of Statistics; Statistics New Zealand; WDI.

relationship is over twice as large as a share of GDP, driven by a very substantial FDI stock in the US. Australia's outward FDI into the US is about $90 billion compared to $1 billion for New Zealand. The economic relationships that these countries have with the US have also tended to grow more rapidly than the New Zealand experience.

At about $2 billion, New Zealand's economic relationship with China is smaller as a share of domestic GDP than all the other comparator countries examined. Australia's relationship is significantly larger, mainly due to strong Chinese demand for Australia's natural resources. Moreover, the growth in New Zealand's relationship is not as rapid as these comparator countries, sometimes by a significant margin. Indeed, New Zealand's import market share into China has been going backwards in a significant way. From 2004 to 2005, for example, New Zealand exports to China fell by 10% while Chinese imports grew 35%. Although New Zealand's exports to China have since rebounded a bit, New Zealand will need to work harder to ensure that it participates in Chinese growth.

The overall sense is that there is potential for New Zealand to do significantly better in terms of its economic relationships with these three countries. Indeed, New Zealand cannot expect to make good on its overall target for international economic activity without making substantial progress in these three significant markets.

SUMMARY

New Zealand needs to focus its scarce resources so as to achieve real impact in key markets. New Zealand's existing on-the-ground presence in its key markets has not been sufficient to generate good outcomes. Compared to countries with whom New Zealand is competing to generate a presence, New Zealand is not that visible. Many countries have made substantial investments in developing their presence in Asia Pacific markets over the past several years.

Although New Zealand has existing economic relationships in the region, these are not as well developed as many other countries have with the region. And New Zealand's outcomes are slipping behind. Significant investments are required to be made by both the government and the business sector to grow these relationships.

In an unconstrained world, New Zealand would be able to make deep investments in every market in which a New Zealand company has a presence. But this is not realistic. The more markets New Zealand focuses on in terms of on-the-ground investments, the less likely it is that New Zealand will be successful.

New Zealand should aim to do a few things well.

Having identified the economic relationships that New Zealand should be focused on, the next section describes the targets that New Zealand should aim at achieving in the Asia Pacific. What does success look like in terms of growing these economic relationships?

6 SETTING TARGETS

A key recommendation for New Zealand's external strategy is to adopt a clear outcomes focus in terms of increasing the level of New Zealand's international economic engagement. In addition, targets should be specified in terms of New Zealand's economic relationships with key countries in the Asia Pacific region. This focus will add real sharpness to the efforts that are undertaken offshore.

Specifying an explicit target will enable decision-makers to determine whether changes need to be made to the activities and investments that New Zealand is currently undertaking. Having a numerical target enables the likely contributions of various actions, such as negotiating an FTA or increasing in-market investments, to be evaluated and also enables New Zealand's economic relationship with key countries to be readily benchmarked.

As noted above, a previous Institute report proposed national targets for exporting and outward FDI. In particular, an aspiration of raising exports to 35% of GDP by 2020 and outward FDI to 15% of GDP by 2020 was proposed. New Zealand's progress on these measures should be regularly monitored and reported on so as to provide a basis for evaluating the effectiveness of New Zealand's external strategy.

A substantial proportion of these national level targets will be met through New Zealand's performance in the Asia Pacific markets. New Zealand should be looking to generate a substantial acceleration in growth rates in terms of its economic engagement with the Asia Pacific region. New Zealand's engagement with the Asia Pacific should be benchmarked against other countries to assess whether New Zealand is participating meaningfully in the expansion of this region.

COUNTRY TARGETS

It is also important to specify targets for the economic relationships with the three key country markets – Australia, the US, and China. These targets should be seen as a starting point for a conversation with businesses and industries active in those countries in terms of the prospects for growing their relationships with these countries. And it provides guidance for industry groups and the government in terms of what economic and political investments need to be made in these markets to achieve the specified targets.

The targets proposed below are based on relatively conservative assumptions, and assume that New Zealand maintains its market share into these countries in terms of both exports and investment. These estimates have also been cross-checked using bottom-up analysis where possible, looking at the prospects of various sectors, to ensure they are reasonable.

These targets can be achieved through a mix of exporting and outward direct investment. 2020 has been chosen as the target date on the grounds that it is a medium-term target and allows time for investments by businesses and governments in these key relationships to generate a return.

Australia

New Zealand should aspire to grow its economic relationship with Australia from about $19 billion currently to $41 billion by 2020. The Australian economy is expected to continue to perform well, and New Zealand has made progress in shifting its export mix towards more elaborately transformed goods. New Zealand firms are also experiencing more success in terms of the returns from the FDI made into Australia. Taken together, this provides some confidence that there is a basis for ongoing good New Zealand performance in the Australian market. However, New Zealand will need to work hard to achieve the proposed target.

United States

The aspiration for the US relationship should be to grow the economic relationship from about $7 billion currently to $17 billion by 2020. This can be achieved on the basis of historical growth rates continuing, although many of New Zealand's exports are facing increased competition from Latin America and elsewhere. This competitive pressure may increase if New Zealand does not make progress in terms of securing an FTA, and New Zealand firms continue to face a competitive disadvantage relative to firms from countries with a US FTA.

China

The aspiration for the Chinese relationship should be to grow the relationship from $2 billion currently to $10 billion a year by 2020. Achieving this target requires growth rates lower than is expected from the Chinese market in general, but China is a challenging market and New Zealand will need to work hard to grow its economic relationship to this level. On the baseline target estimate, New Zealand needs to triple its exports of goods and services into China and build up an FDI stock in China from about $250 million currently to $2.6 billion. The prospective FTA with China is estimated to generate gains of $240-400 million a year, which is a significant gain but does not come close to delivering the desired target.

Achieving these three country targets will provide over 75% of the proposed national targets for exporting and outward FDI.

These targets provide a sense of calibration of the required response. Although these target outcomes are based on reasonably conservative assumptions, they are demanding and will require sustained, aggressive efforts from both business and government. The challenge is to grow these economic relationships by billions of dollars; this is more than modest improvements to New Zealand's current course and speed.

It is clear that actions in addition to trade liberalisation, through either the WTO or through negotiating FTAs, will be required to achieve the targets. Although the potential gains from trade liberalisation are not small, neither are they close to sufficient to achieve the export target specified in the previous report. This exercise emphasises the importance of New Zealand firms identifying and realising new growth opportunities in these markets. The next section discusses some of the business and government actions that can assist in this process.

ACCOUNTABILITY

Currently, there is little official focus on the state of New Zealand's international economic engagement or the state of New Zealand's key economic relationships. There are many overlapping responsibilities and no clear accountability for the outcomes generated. Outcome-based targets allow for greater accountability to be introduced into the system, and ensure that decision-makers are focused on allocating resources in such a way as to ensure that New Zealand's key economic relationships are grown.

Once targets are specified, a clear system of measuring and reporting should be instituted so that New Zealand's progress can be monitored. We have previously proposed that a more formal system of accountability be established around the national level targets for international economic engagement (Skilling & Boven (2006a)).

In addition, accountability arrangements should be established with regard to the country-specific targets. One part of this process is to give much greater visibility to the outcomes that are being generated through a system of public reporting. For example, there should be regular summits on the state of the economic relationship, with a view to getting firms, business organisations, and government agencies to focus on the nature of their contribution to the target, and thinking about how New Zealand firms can realise existing and prospective opportunities.

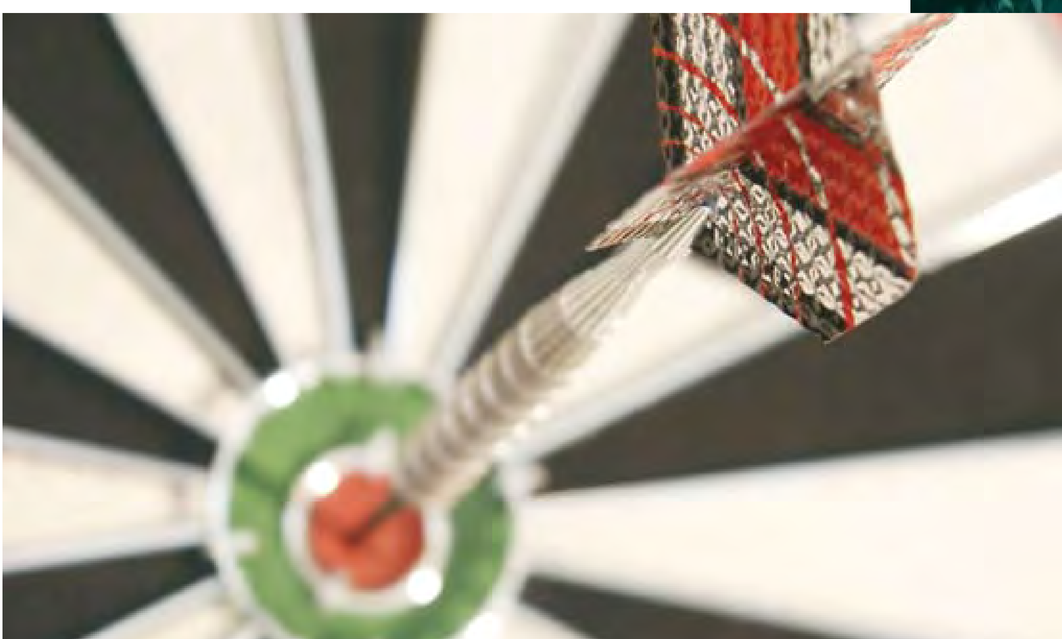
This allows for a more collaborative New Zealand Inc approach, in which growing the economic relationship is seen as a joint endeavour rather than being the responsibility of New Zealand's trade negotiators.

We also propose that formal accountabilities be established for the three key markets. In particular, we propose that a 'country CEO' be appointed in Australia, China, and the US, as the overall point of responsibility in terms of developing New Zealand's economic relationship with each of these key markets.

This would be a senior position, with candidates very likely drawn from the private sector, and would be a much expanded version of the current trade commissioner role. This person would have the flexibility to deploy resources as they saw fit in-market, including determining which activities to pursue and making employment decisions, with a focus on achieving the specified targets. A key part of the role would be to work with relevant organisations, such as firms and sector and industry groups to identify their contribution to achieving the target.

The Ambassador or High Commissioner in these countries obviously has overall responsibility for promoting New Zealand's relationship with the country, and perhaps acts in a Chairman of the Board capacity with respect to the economic relationship. But in terms of the operational responsibility for growing New Zealand's economic relationship with the country, it is important that there be one person with the overall responsibility and accountability. There would be an explicit performance-based component to the country CEO's employment contract.

This proposed combination of specific outcomes-based targets and an ability to deploy resources in pursuit of these targets has the potential to make a powerful contribution to growing New Zealand's economic relationships with these key countries. It is likely to spur new ways of doing things and provide greater accountability.



7 SUBSTANTIAL IN-MARKET INVESTMENTS

In order to secure greater offshore market access for New Zealand firms, and make international expansion easier and more attractive, New Zealand business and government organisations need to have a much more significant on-the-ground presence in priority offshore markets. The aim is to contribute to the success of New Zealand firms to a greater extent, and much more rapidly, than would otherwise occur.

This section describes three major types of actions that will be needed in this regard. First, services that can be provided to New Zealand firms in-market to ease the process of international expansion. Second, showcasing New Zealand to an international audience in a more general sense. Third, making the political investments required to progress FTA negotiations, and adopting an ambitious, pragmatic FTA approach.

IN-MARKET SERVICE DELIVERY

Three types of services are identified that can be provided in-market: activities designed to assist New Zealand firms to identify market opportunities; assisting firms to develop a presence in the offshore market as they pursue market opportunities; and providing access to local networks that can provide advice to New Zealand firms aiming to expand their presence in the market.

The proposed services have been identified through an analysis of the situation facing New Zealand firms, consideration of the current services offered and whether these work, and also through an examination of the type of activities undertaken by agencies and industry groups in other countries.

Resources to assist New Zealand firms to break into international markets are best located in the market rather than being based in New Zealand. For one thing, it is the challenge of expanding into foreign markets that New Zealand firms find most demanding, and where assistance is most likely to be of value.[9] Second, the provision of services in-market rather than in New Zealand means that more New Zealand firms will learn in an international environment and will develop with a focus on global markets rather than on the New Zealand market, which is likely to be very different. Third, providing the services in the international market will help to ensure that the firms receiving the assistance have genuine growth aspirations, and are committed to international markets.

So rather than NZTE and other agencies investing in getting firms 'export ready' in New Zealand, greater focus ought to be placed on assisting New Zealand firms in international markets. More value can be provided to New Zealand firms in Shanghai or

[9] *A discussion of the challenges facing New Zealand firms with respect to international expansion is contained in our last report (Skilling & Boven (2006b)).*

San Francisco than in Wellington. Given that about half of NZTE's budget is currently focused on domestic activities, there is considerable scope to shift resources towards in-market investments.

These in-market activities will complement the international market development tax rebate that was proposed in the Institute's last report, which is designed to provide some limited cost-sharing and make international expansion a more attractive financial proposition for New Zealand firms (Skilling & Boven (2006b)).

The private sector also has a substantial role in these offshore activities. This is a New Zealand Inc approach rather than simply the New Zealand government. In many other countries, there is significant private sector involvement in activities to help firms go global through business and industry groups. This can take the form of industry groups or collaborations of firms with shared interests. Currently many New Zealand business and industry groups have a relatively limited offshore presence and there is the potential for this to be strengthened considerably.

Opportunity identification

New Zealand firms seeking to break into offshore markets will often need to make significant investments to assess what type of strategies will be appropriate to succeed in that market. For example, firms will need to develop an understanding of local consumer preferences, the nature of competitive dynamics in the industry, and the nature of the channels to market. In addition to developing this understanding through an on-the-ground presence, firms will generally need to invest in obtaining research on both the country and the specific part of the market in which they will be engaged. This focus on the consumer in the offshore market is a vitally important investment for New Zealand firms, given what may be significant differences between the international and New Zealand markets.

Assistance with research to identify market opportunities is a common service provided by business groups and export promotion agencies internationally, including by NZTE to New Zealand firms. But providing valuable, insightful market research and advice requires deep market understanding as well as deep sector-specific knowledge. Such specialised information, expertise, and insight, is less likely to reside in a delivery agency like NZTE than in local professional advisory firms like accountants, lawyers, consultants, and banks.

For this reason, it is desirable for NZTE to contract with professional services firms located in offshore markets to provide the market research and assessment work for New Zealand firms and sectors. This will require NZTE and New

Zealand business groups to build relationships and partner with these professional services firms, so that a better quality and broader range of market research can be accessed on behalf of New Zealand firms. The emphasis has to be on obtaining market research that is of very high quality and that allows New Zealand firms to achieve some advantage in the market.

At the moment NZTE undertakes much of this market research in-house. We propose that there be a considerably stronger private sector role in preparing this research and that most of this work be contracted out to local professional services firms.

Some of this research may be general market research that can be provided by NZTE to New Zealand firms that are looking to expand into the relevant market space. Other research may be specific to a particular firm, where the role of NZTE is to provide access for the New Zealand firm to the local advisory firm.

Although many New Zealand firms that are breaking into international markets will have existing relationships with professional services firms with international networks, there is value in providing access to a broader range of world-class advisory services. Organisations like NZTE or industry groups may be able to act as a 'front' for New Zealand firms and negotiate preferential access and cost arrangements and help firms to access a broader range of advice than they could in isolation. This will be of particular value for small and medium-sized New Zealand firms.

However, although we are making a strong proposal that the offshore market research be undertaken by professional services firms, it is important that this external advice be supplemented by New Zealand staff within the market who have also developed a deep market understanding. The ability of NZTE to deliver this depends on increasing the number and quality of experienced, senior people in place in offshore markets who can add real value and have conversations at the right level. And of course, New Zealand networks in these offshore locations are likely to be a significant source of valuable advice.

In addition, there is a role for an expanded programme of business delegations to introduce New Zealand firms to key Asia Pacific markets. In these missions, organised groups of New Zealand firms travel to the market, to learn about the market and its opportunities in a way that is difficult to do from New Zealand.

It is vital to bear in mind that the focus of this market research will be broader than just the firms who are exporting goods from a New Zealand base. Increasingly New Zealand firms are expanding into international markets using different business models: for example, making direct investments in other countries to establish a market presence or companies developing a global production presence.

The market research that NZTE commissions should be of relevance to these firms as well as to those firms undertaking more conventional exporting activity.

In addition, NZTE and industry groups may be able to work with groups of firms, or sectors, to jointly commission specific pieces of market research and share the costs between the firms. Providing this 'collaborative infrastructure' may allow the New Zealand firms or sectors to access a quality of market research that would otherwise not be affordable. In some sectors, this may require the contribution of government agencies; for example, in the context of export education. These government agencies should be proactive in terms of identifying and securing international market opportunities.

Attention should also be paid to commissioning more substantial pieces of market research on an occasional basis. For example, what emerging opportunities are there in the Chinese or US markets that New Zealand firms could conceivably take advantage of? These projects are in the transformational space – are there multi-billion dollar opportunities for sectors or industries in New Zealand, which may not exist in significant measure at the moment?

These major projects may not be able to be funded by the private sector because the industry may not be significant at the moment. But NZTE should have a portion of its budget that can be deployed on substantial projects like these. The choice of projects should be proposed by a senior private sector advisory board in the relevant country, and approved by the country CEO.

Assistance with market entry

Once opportunities are identified, a range of activities can be undertaken by business groups and government agencies like NZTE to help New Zealand firms establish a presence in the offshore market. International expansion can be a very demanding process for New Zealand firms, particularly for small and medium-sized firms (Skilling & Boven (2006a)). There can be substantial set-up costs and up-front investments that need to be made, as well as what will often be a very substantial learning curve about how to succeed in a market that may be very different from the domestic New Zealand market.

To respond to these challenges, there are a variety of services that can be provided in-market to assist New Zealand firms to develop an international market presence.

Legal set-up assistance

Establishing a local presence in offshore markets can be an expensive and time-consuming process, with New Zealand firms having to deal with very different legal systems and local red-tape. These issues include incorporating a company, tax and employment issues, and the many other issues associated with starting up. This is an easy process in New Zealand but is much more difficult in many other countries. The World Bank's Doing Business survey, for example, found that New Zealand was the second easiest country in the world to start up a new business whereas China ranked 130th.

Providing an easy way for New Zealand firms to establish a legal and physical presence can be of enormous benefit, and will allow New Zealand firms to 'plug in and play'. Relevant services here may include standardised contracts, advice manuals, and access to approved local service providers such as lawyers and accountants.

Shared infrastructure

Providing access to shared physical infrastructure will make the establishment of a local presence in foreign markets easier for New Zealand firms. This shared infrastructure may include access to serviced office space where New Zealand firms can locate for a period of time, with associated meeting space and basic office services. A related service is providing access to showroom or exhibition space. These facilities should be available in all major markets, and would likely be operated on a cost recovery basis, perhaps with some initial subsidy.

New Zealand offers some of these services at the moment, but this type of activity needs to be expanded considerably. This is a common service provided by government delivery agencies and private sector industry groups in other countries.

Supply chain infrastructure is also an important issue for many small New Zealand firms that are considering exporting goods into international markets. How can New Zealand firms get their goods into the market in an efficient way? One contribution to resolving these issues is to establish a vehicle that pools many small organisations and arranges shared warehousing and distribution within market, and perhaps also consolidated shipping to the market. If small New Zealand firms want to exploit the emerging 'long tail' by selling into small market niches, providing a shared platform that New Zealand firms can easily participate in may be of significant value.[10]

In terms of assisting firms that want to go global using different business models, the services provided may include relationships with local industrial parks or manufacturing facilities.

The idea is to share costs, pool risks, and give firms access to services that they would not otherwise be able to afford. This physical space also provides the ability for networking and collaboration between New Zealand firms, which may be a powerful form of learning and knowledge sharing. This should assist New Zealand firms, particularly small firms, to break into new markets much more rapidly and with greater confidence.

Troubleshooting

New Zealand firms operating in foreign markets will inevitably confront legal and regulatory barriers to doing business. These issues may be directly trade related, around formal market access. MFAT staff currently spend a lot of time on the regulatory issues around trade barriers, ensuring that New Zealand firms are treated fairly.

But as New Zealand firms increasingly develop a physical presence in offshore markets, a much broader range of issues become relevant to doing business. For example, issues relating to immigration and tax have an impact on the ability of New Zealand firms to do business in foreign markets. As an example, there have been issues around visa clearances for New Zealanders to work in the overseas activities of New Zealand firms in countries like the US.

[10] *The Australian National Food Industry Strategy group is a good example of this approach as is the Korean European Distribution Centre. The Food & Beverage Taskforce recently identified this as a useful idea for the food and beverage sector, which comprises a myriad of small firms.*

This is an area in which government agencies can provide a valuable service to New Zealand firms and make international expansion easier to achieve. These are issues that generally demand government representation, and often at a senior level, and private firms may be unable to access the appropriate people by themselves. There is a need for New Zealand government representatives across a range of agencies to assume responsibility for clearing away this broader set of obstacles that New Zealand firms may find in their way.

Access to local networks

Access to local networks is critical to international business success, allowing New Zealand firms to access local, tacit knowledge and contacts. The impact of ethnic trading networks and business groupings like the keiretsu has been well-documented as having a positive impact on international trade flows (Rauch (2001)). More generally, the evidence is clear that social capital has significant economic effects; for example, contacts matter significantly in terms of finding a new job because informal recommendations can carry a lot of weight.

For New Zealand firms seeking to sell differentiated products in complex markets, having access to networks is likely to be an important driver of success. Being able to talk to people for advice, obtain recommendations for other contacts, and have doors opened on your behalf, is of enormous value.

NZTE should have a high-powered private sector advisory board in each of the countries in which it has a presence to provide guidance on its activities, and also to provide direct advice as appropriate to New Zealand firms. More generally, MFAT and NZTE staff should also be well-networked, and be able to open doors for the New Zealand firms as they arrive in market.

NZTE's newly-established beachheads programme provides a good example of this approach. In this programme, selected New Zealand firms, who are assessed as suitable by a panel of experienced business people, get access to the networks of those involved in the beachheads programme in offshore markets to assist these firms to expand their presence in these markets. These people are a combination of expat New Zealanders and friends of New Zealand.

Although a recent programme, there are some striking success stories already in terms of the rapid international expansion of participating New Zealand firms. The beachheads programme needs to be expanded and given additional funding to allow it to perform at a higher level.

New Zealand can also do more to leverage the networks of the Kiwi diaspora in terms of identifying opportunities for New Zealand firms, and providing assistance as appropriate. Having one of the largest diasporas in the developed world relative to its domestic population should be a source of real competitive advantage to New Zealand firms.

Kea New Zealand has taken the initiative in this regard and has made a substantial contribution over the past few years in establishing chapters of expatriate Kiwis in cities across the world.[11] But this activity could be sped up and expanded if additional resources were made available to supplement the private resources. Additional resources would allow more chapters to be established and for these chapters to be run by paid organisers rather than a network of volunteers.

In addition, establishing deeper relationships with migrant communities in New Zealand may provide opportunities for New Zealand firms to access local networks. Given the size of the migrant community in New Zealand, this ought to be a significant asset for New Zealand.

SHOWCASING NEW ZEALAND

National branding is important to raise the international profile of New Zealand and give people in foreign markets a positive impression of New Zealand. This provides the context for New Zealand firms to access local markets; New Zealand firms should be regarded positively because they are from New Zealand. These activities will support the more directly commercially-oriented activities described above.

There is a lot to build on, and New Zealand is generally regarded in a positive light. But much more is required given the intense competition for scarce attention and New Zealand's small size.

Target firms

Given limited resources, and the objective of generating a material improvement in international performance, the emphasis in providing these services should be on those firms or sectors that are likely to generate a substantial increase in their international economic activity. That is, there should be greater focus on firms or sectors with genuine growth aspirations and those that are assessed to have the capacity to succeed internationally.

These will be medium and large firms, as well as smaller firms who have the potential to expand their international activity substantially. This, for example, will include small New Zealand firms that are 'born global'; firms with no domestic market of any significance but who have substantial international growth potential.

[11] *www.keanewzealand.com*

"These days, individuals, firms, cities, regions, countries and continents all market themselves professionally, often through aggressive sales techniques. Indeed, having a bad reputation or none at all is a serious handicap for a state seeking to remain competitive in the international arena. The unbranded state has a difficult time attracting economic and political attention. Image and reputation are thus becoming essential parts of the state's strategic equity".

Peter van Ham, Foreign Affairs, 2001

Some national branding occurs at the moment, but almost entirely in the context of promoting tourism. This tends to focus on New Zealand's landscape and other physical attractions. But national branding needs to be considered much more broadly in order to ensure that New Zealand firms can fully realise the commercial opportunities in the offshore market. Various projects have been undertaken around New Zealand's broader national branding over the years, but this has not yet resulted in a strong, integrated national branding campaign for New Zealand.

A national branding campaign may include a New Zealand trade campaign run in international markets. This could involve high-profile advertising, as well as other promotional activities such as events, trade shows, direct marketing, website promotion, and so on. Again, aspects of this approach occur at the moment, but the overall sense is that the New Zealand effort lacks materiality, aggression, and focus.

Other actions that can be taken to raise New Zealand's profile include establishing a more meaningful physical presence in key markets. Points of physical presence matter significantly for how a country is viewed. This will be both in terms of official New Zealand space, like embassies and high commissions, as well as in terms of a more commercial presence – a New Zealand shop-front to the world. This means that the office space, showroom facilities, and so on, which were described above, should be distinctively New Zealand rather than generic space.

There are some examples of this beginning to happen, in terms of facilities to showcase New Zealand firms in cities like Hong Kong and New York, but much greater ambition is required. Increasingly countries are seeing their official physical presence as a platform to showcase themselves in a distinctive manner. New Zealand needs to be visible and distinctive to a much greater extent in key markets than is the case at the moment.

Broader forms of engagement should also be stepped up. Given the importance of Asia, New Zealand has not done as much to strengthen its engagement with the region as is needed. This is both in terms of the frequency and profile of official business and government delegations, and also in terms of private sector engagement. For example, TVNZ has closed down its Asian news bureau and there is no other permanent New Zealand media presence in the region. In the other direction, there is very little coverage in Asia of New Zealand news. Together, this adds up to a low profile for New Zealand and gives a sense that New Zealand is not taking these relationships as seriously as could be the case.

Arms race on Embassy Row

“Everywhere you turn on Washington’s fashionable Embassy Row, a new palace-sized building is under construction, a testament to the frenzied competition to gain attention in the capital of the last remaining superpower… From these castle-bastions, foreign diplomats conduct what they call the new Washington diplomacy, an explosion of events geared to reaching the broadest possible audience in hopes of being heard above the din of other countries competing for the same elusive prize of influence”.

Source: New York Times, 17 August 2002

Recent analysis by World Television of the two major global media distributors, Reuters and APTN, showed that there is little international coverage of New Zealand news. With an average of less than 35 stories per quarter out of APTN and Reuter’s combined total of about 23,000 stories each quarter, New Zealand captures just 0.1% of the news market. “From 2004-2006, overseas TV news viewers saw no stories on Kiwi business or trade. They saw various ‘bizarre/human interest’ stories such as ‘Whipper the Budgerigar’, Shrek, and the damage done to a roof by a grapefruit-sized meteor. They saw four election stories, two on the successful election of Helen Clark, one focusing on an incident on election night with a light plane and one featuring Toby, a Jack Russell terrier in Wanaka that was registered to vote" (Dover (2006)).

This influences the way in which New Zealand is perceived and indeed whether New Zealand is thought about at all. New Zealand needs to take some strategic decisions around what sort of image it wishes to project to the world, and then take the actions required to deliver those images and materials to global media agents. Proposals to generate a New Zealand News Service have been estimated to cost less than $5 million for an initial two year pilot to provide new stories on New Zealand for an international audience.

Ministerial delegations and integrated missions around particular events to raise New Zealand's profile are also important. The various events that were organised in Shanghai in November to coincide with the launch of the new Air New Zealand direct service is the type of activity that New Zealand needs to be doing more of. There is also scope to be much more creative around other ways of raising New Zealand's profile in countries like China, in terms of a systematic programme of artistic and cultural visits.

In sum, New Zealand ought to be investing in raising its national profile abroad. New Zealand is a small country and needs to be much more creative and deliberate to succeed in attracting attention.

TRADE NEGOTIATIONS

The WTO remains a key priority for New Zealand, as it will deliver significant gains to New Zealand particularly as a consequence of improving returns for the primary sector. New Zealand should do what it can to assist in moving the Doha Round to a successful conclusion and ensuring that the multilateral system is not eroded. However, although New Zealand can make a contribution, ultimately these decisions will be made by other, larger countries.

An increasingly important priority in terms of trade negotiations is through ongoing investments in obtaining regional and bilateral FTAs. As noted earlier, this is in order to secure the upside from reduced trade protection on New Zealand's exports and also to ensure that other countries do not steal a competitive march on New Zealand firms by obtaining preferential trade access to important markets.

Bilateral and regional trade negotiations are increasingly couched in a broader diplomatic and political context. Accordingly, it is likely that the success of New Zealand in securing trade deals will rest on the health of the overall relationship. And so the government needs to be focused on investing political capital in support of trade negotiations. The New Zealand/US FTA, for example, is not just an economic issue.

This means that New Zealand's attempts to secure FTAs will likely require a greater investment over the coming years. There needs to be broad government engagement with other countries on a range of fronts, from immigration, to education, to research, to culture and the arts. Accordingly, a wide range of government agencies should have a focus on international engagement and making a contribution to developing New Zealand's relationships with other countries. This is not just about MFAT and NZTE. There should be an integrated whole of government approach to New Zealand's international engagement.

In addition, New Zealand needs a deliberate, offensive FTA strategy that is focused on securing FTAs with New Zealand's priority markets. Aside from the prospective deal with China, many of the FTAs signed to date have been small with limited economic upside. New Zealand needs to be focused on progressing deals with major markets, such as Japan and Korea, and making the investments in both the economic and political relationship that will support this. Indeed, making significant on-the-ground investments to help New Zealand firms engage in the market should also assist with the FTA discussions as it gives a signal that New Zealand is serious about the economic relationship.

In addition to bilateral FTAs, New Zealand needs to be actively engaged with regional groupings in the Asia Pacific to ensure that it is on the inside of as many of these emerging groupings as possible. The groupings include ASEAN, the East Asian summit, and APEC. New Zealand is engaged with all of

Alphabet Soup

ASEAN: Current members are Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam

ASEAN + 3: ASEAN + Japan, Korea, China

East Asia Summit: ASEAN + Japan, Korea, China, India, Australia, and New Zealand [ASEAN + 6]

APEC: Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taiwan, Thailand, US, Vietnam

these groups at the moment, which is positive, but investments need to be made to ensure New Zealand's ongoing visibility and presence.

One problem facing New Zealand in progressing FTA discussions with priority markets like the US, Japan, and Korea, is New Zealand's small economic size. Other countries do not perceive a major upside from negotiating an FTA with New Zealand. But this should not be fatal to New Zealand's chances. Other relatively small countries like Chile have made much more progress than New Zealand, signing FTAs with the US, the EU, China, Korea, and others.

The lesson from this experience for New Zealand is two-fold. First, there is a need to deploy more resource in developing the relationships to make an FTA more likely. A greater degree of aggression is required if New Zealand is to compete with countries like Australia as they also seek to pursue FTAs in the Asia Pacific. New Zealand's FTA strategy should be more ambitious than its current reactive flavour, in which New Zealand focuses on those countries that indicate an interest in negotiating. A more proactive approach is appropriate.

And second, it is timely to consider whether New Zealand's historical 'principled' approach to FTA negotiations remains fully appropriate going forward. New Zealand has a position in which its FTA negotiations need to be comprehensive, covering all sectors. This can be defended as a good negotiating stance, and certainly it leads to better quality FTAs where these deals are signed.

However, this position, combined with the fact that New Zealand offers limited economic benefits, makes it less likely that other countries will want to negotiate with New Zealand in the first place. Many of the sectors that matter to New Zealand, such as primary, are politically sensitive in other countries and make passage of the FTA in the other country more difficult. If countries see significant political difficulties and relatively small economic upside, they will be less inclined to commence discussions with New Zealand about an FTA. That is, New Zealand's approach may exacerbate the disincentive to negotiate with New Zealand.

This suggests it is appropriate to consider whether a more pragmatic approach may be appropriate, which excludes some sectors for the sake of making some progress in terms of securing FTAs – even if they are more modest agreements.

SUMMARY

Obtaining increased international market access for New Zealand firms is increasingly about providing in-market services as well as negotiating trade liberalisation agreements. Although New Zealand should continue to pursue trade agreements, both through the WTO and FTAs, the policy and resource emphasis should be shifted towards helping high potential New Zealand firms obtain market access through providing access to detailed in-market knowledge and networks and strengthening New Zealand's offshore presence.

The priorities for trade negotiations and the type of in-market activities should be coordinated to a much greater extent than is currently the case. Signing FTAs without significant investments being made to assist New Zealand firms to access market opportunities will likely mean that New Zealand does not realise the full potential of the FTA. Similarly, making substantial investments in the market should also enhance New Zealand's positioning in terms of achieving more favourable treatment from other governments in terms of FTAs.

Much of this proposed activity can be resourced through reducing the funding currently directed to NZTE's domestic activities and by adopting a tighter regional focus. Indeed, most of the proposals detailed above aim to make New Zealand's existing spend more effective by increasing the strategic focus of New Zealand's efforts and reducing fragmentation.

But in addition to reallocating existing resources towards more valuable activities, it may be appropriate to consider New Zealand's overall level of resourcing of these activities. Other countries invest substantially in these activities, but it is even more of a priority for New Zealand given the importance of international engagement for New Zealand's economic performance and New Zealand's current poor performance.

8 CONCLUDING REMARKS

The combination of formal barriers to trade, such as import tariffs, and the less formal obstacles that confront New Zealand firms going global from a small remote market, make international expansion from New Zealand a demanding process. Assisting New Zealand firms to overcome these barriers and access foreign markets is a vitally important part of creating a global New Zealand economy.

This process of achieving market access has been made more difficult by developments in the international economic environment, such as the suspension of the Doha Round and the increasingly consumer-driven nature of market access. These changes mean that New Zealand's current approach to enhancing international market access, which has been based on historical priorities, needs to be reviewed.

The need to consider doing things differently is also evident from an examination of the outcomes that New Zealand has been generating in terms of exporting, outward FDI, and other forms of international economic engagement. New Zealand has not been participating actively in the globalisation process compared to other countries.

This report has proposed three key changes. First, New Zealand's external strategy should include a much more explicit regional focus on the Asia Pacific, with particular priority on developing New Zealand's economic relationships with Australia, the US, and China.

Second, New Zealand should adopt a clear focus on outcomes as the success metric for New Zealand's external strategy. Specific outcomes-based targets and formal accountability mechanisms are proposed with respect to the three key economic relationships.

Third, there should be a significantly increased focus on making in-market investments to assist New Zealand firms to enter and expand into these markets. This will involve a range of activities from providing a platform for New Zealand firms to access market research, shared infrastructure, and networks, as well as a national branding campaign, and a more pragmatic FTA strategy.

New Zealand undertakes some of this activity at the moment, but not in sufficient measure. New Zealand needs to be considerably more ambitious, adopt a clear strategy with specific outcomes, and be much more deliberate and strategic in execution.

Ultimately, of course, the extent of New Zealand's international economic engagement rests on the capacity and aspiration of New Zealand firms. External strategy can only shape the environment in which these firms operate; it is not a substitute for good corporate strategy, as was discussed in the Institute's last report. As Ong Keng

Yong, the Secretary General of ASEAN, said on a recent visit to New Zealand, achieving an FTA with the ASEAN countries will do New Zealand little good unless New Zealand firms significantly improve their ability to compete in these markets.

Nevertheless, New Zealand's external strategy does matter, and it can be made significantly more conducive to international success by New Zealand firms. To grow new areas of international strength in the New Zealand economy, and assist a new generation of New Zealand firms to expand into international markets, a new approach to external strategy is required.

In sum, New Zealand business and government organisations need to make more aggressive and deliberate efforts in order to achieve much higher levels of international engagement. Although New Zealand is a small country, and the world is in many senses becoming more challenging, there is much that is within New Zealand's control. New Zealand can act to shape the environment that it faces, and has real choices available to it that can lead to much improved outcomes. New Zealand needs to choose to compete in international markets and then do what it takes to win.

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Danielle is a researcher at the New Zealand Institute. Danielle was previously a consultant at The Boston Consulting Group, where she advised a wide range of leading companies in New Zealand, Australia, the US, and Asia. Danielle has a Masters of Management from Northwestern University's J.L. Kellogg Graduate School of Management in Chicago and a Bachelor of Arts with majors in Economics, Accounting, and Government from Claremont McKenna College in California.

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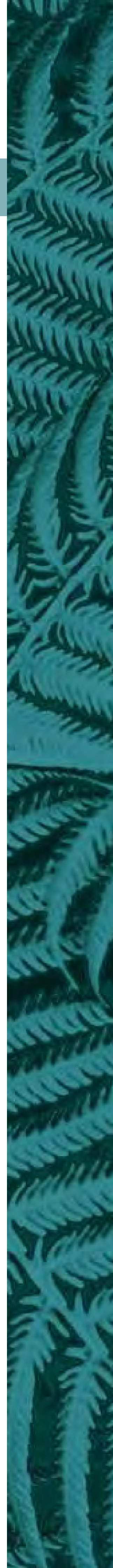

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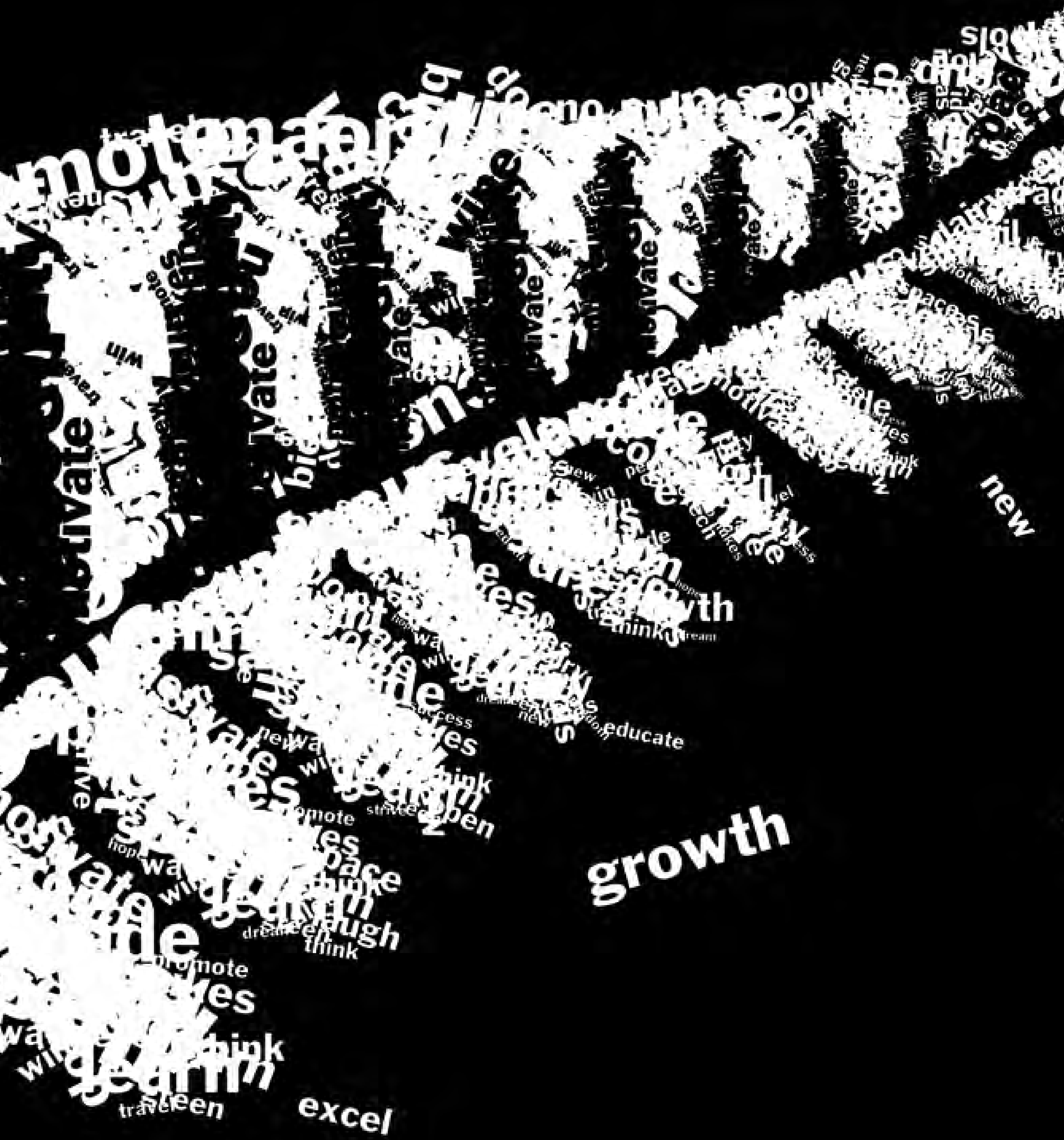

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