BNZ Insights

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This is the third paper in this series of BNZ Insights in which we examine international economic ranking studies to try and determine in what areas our economy appears to be lacking. The second paper looked at the World Economic Forum's Global Competitiveness Index and from it we gleaned the following.

"…the areas of high competitiveness disadvantage for New Zealand are poor savings, poor infrastructure, poor domestic competition, poor finance availability and cost, lack of scientists and engineers, and over-dependence upon a primary sector export base."(1)

Also, when asked directly what they consider to be the main constraints for their businesses the 44 NZ respondents in the Executive Opinion Survey noted

1. Inadequate supply of infrastructure
2. Access to financing
3. Tax rates
4. Inadequately educated workforce.

In our second paper we examined the other major annual global competitiveness survey from IMD and found the following potentially causative factors behind New Zealand's poor productivity growth.

- High youth unemployment
- Low capital gains taxes
- High cost of capital to businesses
- Labour market regulations, unemployment benefit regime
- Insufficient skilled labour
- Brain drain
- Poor management, especially international experience
- Small poorly trusted sharemarket
- Lack of venture capital
- Inadequate roading, electricity, and telecommunications infrastructure
- Lack of engineers, scientists, and technicians
- Insufficient public/private technology cooperation
- Low business R&D spending

In this paper we examine a range of smaller studies.

KOF Index of Globalisation

In this paper we examine the 2010 KOF Index of Globalisation and the Heritage Foundation's Economic Freedom Index . First the KOF material. The index has been produced since 2002 and in their words"…covers the economic, social and political dimensions of globalization. It defines globalization to be the process of creating networks of connections among actors at multi-continental distances, mediated through a variety of flows including people, information and ideas, capital and goods.

More specifically, the three dimensions of the KOF index are defined as:
- economic globalization, characterized as long distance flows of goods, capital and services as well as information and perceptions that accompany market exchanges;
- political globalization, characterized by a diffusion of government policies; and
- social globalization, expressed as the spread of ideas, information, images and people."(1)

There is no formal report as such with commentary – only a detailed database giving index readings for the 208 countries covered. New Zealand ranked 25. The detailed rankings were as follow.

Overall Index of globalisation	24
Economic globalisation	23
Actual flows	48
Restrictions	9
Social globalisation	28
Data on personal contact	30
Data on information flows	19
Data on cultural proximity	27
Political globalisation	56

In terms of what goes into each index we have the following.

Economic globalisation – actual flows = data on trade, FDI, portfolio investment.
Economic globalisation – restrictions = tariffs, taxes, hidden barriers, capital controls.
Social globalisation – data on personal contact = international telecom traffic, extent of tourism, transfers offshore received and paid, foreign population present, international letters.

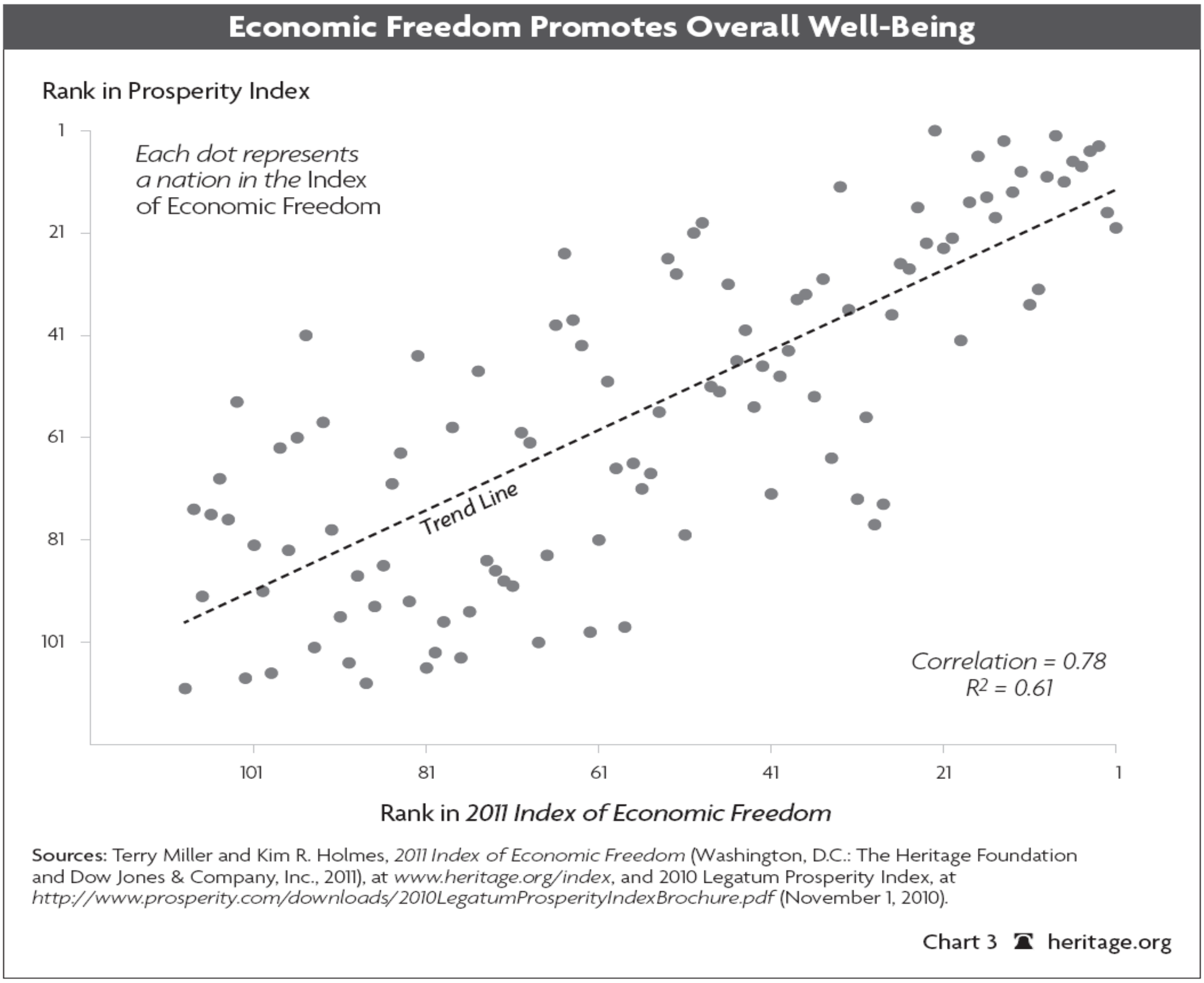
Social globalisation – data on information flows = per capita number of internet users, per capita number of televisions, international newspapers traded.
Social globalisation – data on cultural proximity = imported and exported books relative to GDP, number of McDonalds restaurants.
Political globalisation = number of embassies and high commissions in a country, number of international organisations the country belongs to, number of UN peace keeping missions participated in, number of treaties signed with other states.

New Zealand is placed 24th in the overall Index of Globalisation and this low ranking results from a high ranking on lack of restrictions on trade and capital flows being offset by all other measures but in particular low exports and imports as proportions of GDP, and low political globalisation. Given that what we are searching for are reasons to explain lack of strong export sector growth over the past four decades the low Globalisation Index reading largely encapsulates what we already know to be a problem. In that regard there is little which we can take from this index to guide us toward clear areas of deficiency in the NZ economy which government policy changes can directly affect for the better. So on to the next one.

Economic Freedom Index 2010

In the latest Heritage Foundation's annual Economic Freedom Index we achieved a rank of fourth out of 183 so on the face of it an examination of the index may not reveal much in terms of potential areas for improvement. However indexes such as this are generally made up of various sub-indexes so we shall examine the survey to see if any of those component indexes can provide some insight into areas in which our economy appears deficient.

The following graphic from the report shows the general relationship between the Heritage measure of economic freedom and ranking in the Legatum Prosperity Index in which we rank 5th.



The index values achieved by New Zealand in the 2010 report are as follows.

	Index	Ranking
Business freedom	99.9	1
Trade freedom	86.6	25
Fiscal freedom	64.7	28
Government spending	49.3	26
Monetary freedom	84.8	7
Investment freedom	80.0	14
Financial freedom	80.0	14
Property rights	95.0	1
Freedom from corruption	94.0	1
Labour freedom	89.2	7

There are three areas of weakness, fiscal freedom, government spending, and trade freedom. The fiscal freedom rating commentary provided in the report notes the 38% top personal tax rate which now has been cut to 33% and starts at a higher income level. The 30% corporate tax rate they record has also been cut to 28%. Presumably the next report which should capture this change will see this rating improve.

The commentary on Government freedom notes the government's significant stakes in the industries of transport, electricity, and telecommunications, and recent increases in the ratio of total government spending to GDP. Recently we have seen the Prime Minister announce plans to move toward reduced government holdings in the electricity sector and Air New Zealand. However if the sales go ahead the government will remain a majority shareholder in the four state owned enterprises and company concerned, ownership of Kiwirail is expected to continue, and it will take some time for spending reductions to cut the ratio of government spending to GDP. The Government freedom measure is unlikely to improve in the next survey but may in the one after that.

The Trade freedom commentary notes "Ten points were deducted from New Zealand's trade freedom score to account for non-tariff barriers." These are noted as services market access barriers, import fees, restrictive biotechnology, sanitary, pharmaceutical, and phytosanitary regulations.

Given the vulnerability of our primary sector based export sector to pests and diseases it is unlikely that this rating will shift much in the future. Note however that with an index value of 86.6 this is of far lesser concern than the two indexes noted above which are slowly being addressed.

In summary the Heritage Foundation Economic Freedom Index identifies high state sector asset ownership and perhaps after the change in the top personal income tax rate the relatively low level at which it cuts in as impediments to greater economic freedom for the economy.

After four reports, in summary the factors we have identified so far as impeding New Zealand's competitiveness include the following.

- Inadequate roading, electricity and telecommunications infrastructure
- Low savings
- Poor domestic market competition
- Access to finance
- Tax rates, incl. low capital gains taxes.
- Lack of scientists, engineers and technicians
- High dependence upon a primary sector export base
- Government asset ownership.
- Government spending relative to GDP.
- Restrictions (necessary) on imports which threaten the agricultural economic base.
- High youth unemployment
- High cost of capital to businesses
- Labour market regulations, unemployment benefit regime
- Insufficient skilled labour
- Brain drain
- Poor management, especially international experience
- Small poorly trusted sharemarket
- Lack of venture capital
- Insufficient public/private technology cooperation
- Low business R&D spending

References

(1) A write-up of the construction of the KOF Index.
http://globalization.kof.ethz.ch/static/pdf/method_2010.pdf
http://globalization.kof.ethz.ch/
http://www.heritage.org/index/download

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