

Report to:
Wellington Regional Council

**“ECONOMIC WEALTH IN THE GREATER WELLINGTON REGION
AND THE OLYMPICS OPPORTUNITY”
- REVIEW OF PROPOSAL TO WRC**

This report has been prepared in response to the questions posed¹ about the proposal to the Council from the Wider Wellington Olympic Trade Focus Group (WWOTFG).

In preparing this report we have spoken with Trade New Zealand in Sydney; Australian economic forecasting agencies; and Ms Suzanne Snively, Chair of the WWOTFG.

The latter discussion suggested that the essential emphasis of the proposal is rather different from our initial reading of it (and probably that of other people). Moreover, in seeking to answer the questions, we have in some instances found that this has simply generated another set. However, while this report may not provide the definitive response sought by the Council, we hope that it will focus the response to the proposal.

1 Outlook for the Wellington Economy

We concur with the overall assessment that

- the traditional “drivers” of the Wellington economy - government departments, banks and other corporates - are reducing their input into the region through downsizing, decentralization and relocation. This in turn affects servicing industries such as business services (legal/ accounting/ consulting etc) and some types of computing
- overseas investment tends to go to either Auckland (servicing the domestic market) or regions close to resources (primary processing)
- so far as export manufacturing is concerned, the region has never had a significant primary processing capacity, and (like many other secondary manufacturing centres) much of its other manufacturing has been lost with the consolidation to Auckland and Christchurch in the 1980s
- it is still only moderately important as a tourist destination

¹ Letter of 27 September 1999 from Mr G Schollum. WRC

Overall, Wellington's economic focus is the domestic economy rather than international trade. While the current economic base provides a level of stability and insulation from the downside of international trade (eg as experienced by many traditional agricultural regions), this offers little upside.

However, Wellington does have a strong base in the knowledge industries (in part through the contracting out of professional jobs from large organizations), and a major fillip to its tourism through Te Papa. These offer the region a significant growth potential. The major uncertainty is whether these can expand sufficiently to take over from the traditional sources of growth, especially as they require an entrepreneurial culture which is quite different from the political/ bureaucratic one which has traditionally prevailed in Wellington.

2 Olympic Trade Opportunities with NSW

If asked three years ago, we would have expected there to have been significant business opportunities around the Olympic Games and a number of related major projects (infrastructure, tourism), because of their sheer scale.

However, these opportunities for local businesses are likely to be limited by now, given that the event is less than a year away, and

- most construction has already been completed or is fully contracted
- contracts for most services will have already been let (although we understand there are still a number of uncommitted contracts for supply of food and beverages).

Therefore any Olympic-related trade is likely to be small-scale and opportunist. This may or may not provide the platform for sustainable exporting to NSW or Australia by individual firms, and is likely to have a very limited effect, if any, on Wellington businesses.

3 Private Sector Involvement

While there may be significant business opportunities in Sydney and NSW, one question is immediately obvious: why would Wellington businesses not take advantage of these opportunities if they are profitable, unless there is some public sector input such as what is proposed? This is not addressed at all in the proposal.

The general policy rationale given for promotional activities of this nature is to lower the “transaction costs” of exporting, through providing market information, contacts with overseas customers, promoting mutual support amongst exporters, providing a national or regional “brand identity” etc. Generally the focus is on activities which are best provided collectively, and paid for (at least in part) by the firms which benefit; but where individual firms might not be able to join together effectively without some neutral party to provide organization and possibly some financial support.

The corollary of this approach is that public agencies must absolutely avoid providing support for the provision of the actual goods and services being sold – if exporting is not attractive for the firms without subsidy, it is almost certainly uneconomic and unsustainable in the long-term.

Typically such interventions are aimed primarily at first-time or inexperienced exporters to enable them to “take the plunge” – assuming established exporters have sufficient market information, networks etc to operate effectively in foreign markets. Another way to look at this is that the goal is to get first-time and inexperienced firms to a given level of successful exporting faster than would be the case otherwise.

(This is particularly pertinent in that New Zealand exporting is dominated by a few dozen large firms. The vast majority of small firms export infrequently, at low levels, or not at all.)

Therefore, the essence of such approaches is to keep the intervention small and at the start of the process; the private sector must take ownership of the process, put its own money into it and accept and manage the risks, if the intervention is to lead to sustainable exporting.

These arguments for public support need to be acknowledged with a certain degree of caution. Many of these are marketing activities which are a normal, indeed essential, component of business costs wherever the trade occurs. Firms can and do get together to

organize joint information and promotional activities. The payoffs from marketing activities can be uncertain and long-term, but so are many other types of investment.

Note also that a considerable proportion of the effects of any intervention is “deadweight”, ie assisting the private sector to do what it would do anyway - although how much and which parts are deadweight is impossible to assess (not dissimilar to the general perception of advertising). There may also be some “displacement” – where a local firm engages in external trade, it may give up some local trade to do so, which is filled by an external firm.

We understand that the emphasis in the proposal is really on building long-term commercial relationships between businesses in Wellington and Sydney, by alerting local firms to the possibilities and helping them make connections. The “Olympic opportunity” is only relevant in so far as it attracts attention to the Sydney/ NSW markets in the long term - there is no real expectation that much business would be generated directly from the Games.

The arguments in favour of trade promotion might have relevance to Wellington to the extent that its export manufacturing, service and tourism industries are relatively undeveloped compared to those in other regions, so would benefit most by such “front-end” support. They are also relevant to the extent that Wellington firms which might engage in trade are generally small – there is a big gap in size between the big players in Wellington (in the public sector or branches of multi-national firms) most of whom are unlikely to be significant traders, and the rest. The weakness of the region’s “entrepreneurial culture” is also a barrier to be overcome.

However, we must observe that there seem to be a large number of organizations and initiatives in the business development field, for example:

- Trade New Zealand
- the NZ Tourism Board
- the “Biz” programme
- economic development agencies supported by all territorial local authorities
- the Five Cities of Wellington “Invest Wellington” initiative
- Tourism Wellington

and it is not really clear what gap this initiative is filling

The participation of the various public sector agencies in WWOTFG does not demonstrate the merits of the initiative. Willingness by the private sector would. This has not been

forthcoming to date, although in fairness the small scale of activities to date means that the group has not been able to build up a track record.

4 Ongoing Opportunities in NSW

The Australian economy is always the most significant for New Zealand exports, not only because it is the largest export destination (accounting for 20%+ of total exports) but also because the typical pattern of New Zealand exporting is for companies to move firstly into Australia (the market most similar to NZ), and if successful, to look to wider markets.

Sydney alone has a population the same size as New Zealand's, with larger markets again in New South Wales and other states.

We expect trends over the last decade, where Australia has consistently generated higher incomes and growth than this country, to continue. NSW is the largest of the State economies, to the extent that its performance usually looks very similar to that of Australia as a whole.

In the post-Olympic period, the NSW economy is likely to slow significantly because of the dissipation of the Olympic construction boom, along with other construction spending tailing off (repairs after the Sydney hailstorms, bringing forward spending before the introduction of GST on 1 July 2000). Construction activity in Sydney may have already passed its peak, and while some commentators expect a rapid rebound, it may be in the doldrums for at least 2-3 years.'

Tourism will also fall back after the Olympics. However, tourism into Australia is generally growing strongly regardless of the Games, and may or may not receive an additional boost from the Olympics (as a result of international publicity) - so will continue to be significant

Sydney also continues to be the main destination for inward investment into Australia, especially for commercial and service businesses.

We note one commentator (*Westpac op.cit*) has suggested that Victoria (with a larger manufacturing base) is expected to grow more strongly than NSW, as manufactured exports are likely to play a large role in Australian growth.

² **Westpac Market Insights** September 1999 www.westpac.com.au : **BIS Shrapnel Building Industry Set for Slump** News Release, September 1999

The picture which emerges is that economic growth in NSW will be moderate over the next few years – neither continuing at the pace of recent years leading up to the Olympics, but nor in an economic slump. On this basis we would expect there to be significant export opportunities in NSW in the next decade.

5 Successful Economic Initiatives

This is a very broad topic, considerably more so than can be addressed adequately in this note! not least because of the breadth of initiatives taken throughout the world. The common features of the various initiatives are only at a very general level. They frequently seem to be driven by a need to “do something” in the face of unpalatable economic prospects, rather than any focussed problem definition which we would normally expect in the process of public policy formulation.

Such schemes almost invariably have a sponsor or sponsors outspoken in the benefits claimed for their initiative, and why it will work (and others will not). The range of initiatives, the variety of arguments for each, and nuances in the differences between each, are quite bewildering.

The emphasis in economic development programmes in the last decade has been in strengthening business competencies, especially in small and start-up firms and in marketing and financial management (where they are usually weakest). This is true for national, regional and local initiatives, especially in this country. There are some “market failure” arguments for interventions at this level – arguments which are not overwhelming and which at best justify small-scale intervention.

Evaluation studies of the effectiveness of local economic development initiatives have been inconclusive, partly because of the diversity of initiatives and also because of the difficulty in demonstrating any causal relationships between the initiatives and economic outcomes.

However, certain key points are generally accepted:

- economic initiatives must be based upon existing strengths – ie initiatives must build on a solid platform in firms/ industries/ product lines/ productive competencies where the region has already demonstrated its competitiveness – not “sowing seeds in the desert”

(But the concept of “existing strengths” can be interpreted broadly – businesses can apply existing strengths in innovative ways to get into apparently unrelated

lines of business, often with great success. A certain amount of opportunism in moving to “related” products, however defined, is one way in which firms test markets, indeed can be a strength in its own right.)

- the emphasis on the public input should be in promoting and supporting activities by private firms, such as facilitation, brokerage, organising joint activities etc, which those firms cannot or cannot easily undertake themselves
- public funds must be small relative to the total value of trade supported – partly to ensure that they are not at a level which makes uneconomic trade viable, at least short-term – but equally, to ensure that private sector “buy-in” to any initiative is demonstrated by a willingness to commit its own money to make it work. That buy-in, based upon profitable business, is the only real test of whether the trade is sustainable and the activities worthwhile.
- ideally, the public sector should withdraw from the activities sooner or later, and the initiatives should be taken over by the private sector if they are worthwhile, or closed down if they are not (admittedly, much easier said than done).

6 Potential Benefits in WWOTFG Business Plan

We consider that the benefits claimed in the business plan are totally implausible

The plan claims direct economic benefits – ie additional revenues to Wellington businesses - of \$35m effects for \$350,000 public money, ie 100: 1 for every dollar of public spending. This implies huge leverage. However, there is no supporting evidence provided for calculations such as *x companies doing \$y00,000 per year*, and frankly, any claims of such enormous returns should have something more robust than this if they are to be taken seriously.

Nor are the returns claimed linked to the activities under the business plan in any way which would enable us to feel more confident of them, and perhaps provide a basis for evaluation of outcomes.

We would also highlight two technical flaws in the claims:

- revenues are not the same as benefits, as costs also have to be taken into account (and these will be high for foreign trade). A more accurate measure would be value added, which would on average be around 40-45% of sales and possibly less.

- deadweight and displacement effects need to be taken into account. as these will offset the claimed returns. These are, respectively, the revenues which would have been earned by firms which would have gone into export anyway; and where products are diverted from Wellington to export markets, the costs of Wellington customers having to obtain alternative sources.

The plan then claims multiplier effects of IO: 1 - ie for every dollar of direct benefits (per above), there are ten dollars across the region as a whole, allowing for the flow-on of purchases of exporters from suppliers, consumption spending by employees etc. In our experience multipliers are usually in the order of 1.5 - 2: 1 for a region (and 2 - 2.5: 1 for the nation) - we know of no instance of such high multipliers, and consider these to lack any credibility.

There may well be positive benefits from the initiative – we do not deny the possibility. However they would be considerably less than is claimed in the proposal. The notion that the benefits of this initiative are a thousand times the cost to the public purse (ie that if WWOTFG could fund and operate its activities to the tune of \$ 1 m per annum, this would result in \$1 billion worth of economic benefits to the region) is so excessive that it would undermine the plausibility of the entire proposal

7 Overview of Proposal

We have had considerable difficulties in answering your questions in a focussed way, not least because the information provided in the proposal has not always been helpful in getting to the heart of the issues. We would highlight the following:

- [1] the focus on the “Olympic opportunities” is actually not the key element in this proposal – business arising directly from this is likely to be short-term and small scale. Rather it is about promoting exporting by Wellington businesses, initially into the most accessible target market, using the publicity generated by the Games as a catalyst.
- [2] In so doing the proposal is generally focussed on broadly appropriate goals:
- the Sydney market, while not the fastest growing in Australia over the next few years, is still healthy, large and has a mix of industries (commercial and service) consistent with Wellington’s business strengths
 - the proposed activities are focussed on the front-end of the export process, helping Wellington firms take the first step and supporting commercial

contacts with Australian customers, but relying on the firms themselves to turn these contacts into actual business

- [3] However, this proposal is still at too great a level of generality. The proposal as written does not articulate the precise reason “why” an intervention is required, ie identifying the barriers to the private sector seeking and securing business in NSW and how it would overcome these. Nor does it identify what tangible outcomes it is intended to achieve (especially alongside the multitude of other business support activities from central and local government).
- [4] The question of targeting of support – ie what types of local firms would be encouraged to participate – has not been spelt out.
- [5] The claimed regional economic benefits, 1000 times the level of public funding, are so high (and with some technical errors on their calculation) that they are unbelievable. There may certainly be benefits, but they would not be remotely close to this level.
- [6] The willingness of firms to support the initiative is critical to the success of the initiative, and this appears limited to date – admittedly, in part because what has been done previously is on a significantly smaller scale than what is proposed. However, support and demonstration of support needs to be central to the initiative in future.

As we noted previously, it is possible in the area of local economic promotion, to observe a vast variety of initiatives, each with outspoken sponsors claiming a wonderful range of benefits, and each with plausible arguments in support of the initiatives. However, the available evidence about the benefits of such initiatives is largely anecdotal and at best suggests modest benefits. Nor (in spite of the vast number of local initiatives internationally) is there a body of “best practice” suggesting approaches which work best in different circumstances – other than obvious things to avoid like large-scale production subsidies.

Overall, we consider that this proposal may have some merits, but also considerable uncertainties. These uncertainties may be because the WWOTFG has not considered certain issues, or has not articulated how it would address them. But regardless, that level of uncertainty may affect confidence in the success of the initiative. The uncertainty would also present the Council with difficulties in specifying and monitoring outcomes, in terms of accountability for a considerable sum of public money.

For this reason, if the Council wished to pursue this matter further, we would recommend the issues set out in this section would need to be raised with the WWOTFG and resolved to its satisfaction.

