

HUTT ROTARY CLUB

THE BRAIN DRAIN

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There are a number of indicators of the long-run performance of an economy – its record of delivering improvements in material living standards to its citizens.

The most familiar is the rate of growth of real gross domestic product (GDP): the increase in the volume of goods and services produced in the economy. Expressed in per capita terms, real GDP is a rough measure of the standard of living.

As is well known, New Zealand's long-term growth performance has been poor. Over the period from 1960 to 1997, real GDP per capita in Organisation for Economic Cooperation and Development (OECD) countries grew, in total, by 139 percent. In comparison, real GDP per capita in New Zealand increased over the same period by just 60 percent.

The record was better for a period in the last decade. Since the end of the recession in the early 1990s, annual growth in real output (not per capita) averaged 4 percent for five years and around 3 percent for the past decade. After the expansion ended in 1997, it has fallen away to a bit over 2 percent.

Another fundamental indicator of economic performance is growth in productivity, which is usually the only basis for sustained growth in living standards. New Zealand's long-term productivity growth rate has been weak. Again, the combined productivity of our capital and labour resources (total factor productivity) increased with better economic policies in the mid-1990s (to around 1.5 percent a year). This increase was not reflected in measured labour productivity growth because many low-skilled people who were not in employment or who were unemployed took up work.

A third indicator of economic performance is the foreign exchange rate. Back in the late 1960s, the New Zealand dollar was worth over US\$1.30. It had fallen to just over US 50 cents by 1992, rose to US 70 cents by late 1996, and has since fallen to around US 40 cents. The trend against the currencies of other well-performing economies has been similar. Like it or not, a weak currency is a vote of no confidence in a country's economic management, particularly in relation to its indebtedness and its ability to maintain international competitiveness.

Another indicator of how well a country is performing, which I want to examine more closely, is migration – the inflows and outflows of people.

The long-term picture here mirrors other economic indicators. Broadly speaking, the 1960s and early 1970s were periods of net inflows of permanent and long-term migrants. There were large net outflows in the late 1970s and throughout the 1980s. In the mid-1990s there was a turnaround: net inflows in the four years to 1997 averaged over 20,000 annually. Since then the pattern has reversed: in the last three years there has been an average outflow of around 10,000, and the total in the March year just ended was 12,600.

Much of the commentary on migration focuses on the net movements of people. It is also relevant to consider the gross statistics. Since 1996, the number of permanent and long-term departures has risen from just over 50,000 to around 79,000 (March years). In the same period, total arrivals have fallen from 80,000 to 66,500. Overall, the more liberal immigration policies of the 1990s have been a good thing, attracting many talented and enterprising people to live and work in New Zealand. However, it would not be a healthy situation for New Zealand to be minimising migration losses simply by lowering entry criteria, or if migrants were coming here merely to gain backdoor entry to Australia. Moreover, the gains from immigration are often long-term as settlement and adaptation to a new country take time. Hence the increase in the total number of New Zealanders departing, regardless of the arrivals pattern, may be a cause for concern.

Taken together with other indicators of a weaker economic performance, I think the recent trends are worrying. This is not just a story of the 18 months since the change of government: in the year to March 1998, net inflows had already fallen to a mere 2,500. Recall that Jim Anderton was referring to this development when he expressed the hope immediately after the election that young New Zealanders who had left the country would return. Movements of people typically reflect the relative attractiveness of a country in terms of earnings and employment opportunities. The net outflows of people in recent years, along with the fall-off in foreign investor interest in New Zealand, tell us that the country has become less attractive.

It is interesting to contrast New Zealand's migration experience with that of another small country, Ireland. For many years up to the 1990s, Ireland typically suffered an exodus of people. When I visited the country a couple of years ago, I was told the Irish used to joke in the 1980s about whether Dublin airport could handle the number of people who wanted to

leave. After Ireland knuckled down and started reforming its economy in the late 1980s very much along New Zealand lines, it saw a dramatic turnaround in migration patterns. Large numbers of returning Irish and other immigrants have been added to the workforce, yet the unemployment rate is now falling towards 3 percent. Ireland's prosperity looks set to continue as, contrary to New Zealand, it has pressed on year by year with market-oriented economic reforms.

At this point is it worth pausing to consider whether New Zealand's recent migration patterns are necessarily a bad thing. Three counter-arguments are sometimes made. I have some sympathy for the first but I think the other two are dubious.

The first argument is that a concern about migration losses reflects an outdated nationalism, particularly in today's interconnected world. We want New Zealanders to get ahead, to do the best for themselves and their families. Does it matter if Boyd Swinburn, Brad Butterworth, Kiri te Kanawa, Alan Gibbs or the next generation of entrepreneurs can be more productive elsewhere and take their skills and money offshore?

I can relate to that argument. Two of my sons are in Boston and San Francisco embarked on exciting business careers. As parents, many of us want our children to be citizens of the world. With cheap transport and communications it is easy for many families to stay in touch. But there are less attractive features to this scenario. Not everyone will have such opportunities: those who won't will typically be the less skilled, people dependent on welfare, the old and the otherwise immobile. Parents worry about how often they will see their children. Also people are typically tax-receivers when young and old, and taxpayers in between. If people leave in their taxpaying years and stay away for lengthy periods, the position of those dependent on taxpayer support will become tenuous.

A second reason advanced to suggest that the recent outflows aren't a concern is that they are no more than the usual departures of New Zealanders embarking on their overseas experience ('OE'). I believe experience working or spending time overseas is invaluable to residents of a small, isolated country: I learned an enormous amount living in Europe for four years and spending five years on the board of a major Australian company. But I suspect that what we are seeing today in many cases is different from the traditional OE.

Two things in particular stand out. One is that the era of globalisation is leading to many more opportunities for New Zealanders to work abroad. As labour markets have tightened round the world, industries in many countries have become desperate for skills and governments have responded by easing immigration rules and fast-tracking work permits. There are now over a million expatriates in London; Silicon Valley teems with Indian entrepreneurs; and there are vast numbers of British engineers in the German motor vehicle industry. International firms are moving New Zealand personnel around their operations. It is not just information technology staff but nurses, teachers and many others who are being headhunted: New Zealanders have good reputations as workers abroad. Competitor nations will be increasingly seeking working age people as their populations age, and the challenge for New Zealand to attract and retain people is likely to become harder.

In addition, the opportunity gaps between New Zealand and many other countries are widening, accentuated by the currency decline. Average per capita incomes in Australia are now around 40 percent higher than in New Zealand; in the United States they are twice as high. US remuneration packages of US\$100,000 for twenty-something lawyers, computer professionals or MBA graduates are commonplace: at today's exchange rate, that is equivalent to a New Zealand salary of \$250,000. Even allowing for higher costs of living, that difference exerts a powerful pull in earnings terms alone, and in many places lifestyle and cultural attractions rank with those of New Zealand. Also high earners abroad do not have to put up with local attitudes towards those in top pay brackets.

The net result, according to many accounts, is that New Zealanders are leaving, staying away for longer periods, and in many cases are less certain about returning. As they move up the earnings ladder, reach more senior positions that are less plentiful in New Zealand, and settle down and start families, there is a risk that fewer will return than in the past. Some have suggested that there may be ways of harnessing the potential of New Zealanders abroad to the country's benefit; while there are no doubt possibilities, none of significance has been identified so far.

A third argument put forward is that we are not really seeing a 'brain drain' because the outflow is across all skill levels, not concentrated in higher skill managerial, professional and other categories. This appears to be true, at least as far as departures to Australia are concerned; those going further afield tend to be higher skilled. But I suggest there is an element of intellectual snobbery in regarding the brain drain as confined to those with higher

qualifications: a sustained loss of any category of enterprising people with 'get up and go' should be of concern. The act of migrating suggests they may have more initiative, and be more willing to take risks, than counterparts who stay put in their native country. From the point of view of wealth creation, the most serious losses may be of entrepreneurs, who are often not people with advanced qualifications: both Bill Gates and Larry Ellison are college dropouts.

My conclusion is that, at least from a national interest point of view, there is no good reason to be complacent about the current outflows of people. Right now many kinds of skill shortages are being reported even though growth is hardly stellar. A South Island firm is experiencing a serious shortage of truck drivers, for example, and is contemplating advertising in Australia. No doubt there will be variations in the pattern: for example, departures may fall off in the period ahead as activity slows in major economies or increase when New Zealand next goes into recession. However, the trends towards higher sustainable growth and lower unemployment that we have seen around the world in recent years seem likely to resume as countries continue to improve their economic policies. The gravitational pull of mobile capital and labour towards more attractive locations and away from less attractive locations seems likely to remain strong.

There is an irony about these developments. On the one hand, the continuing reductions in the cost of information, transport and communications are reducing the disadvantages of remote locations. Our successful entrepreneurs in industries such as software, fashion and furniture show that it's possible to do business globally from New Zealand.

On the other hand, there are powerful forces at work which are leading activity and people to concentrate in fewer, denser places closer to larger consumer markets. Recent economic research suggests that productivity and wages are higher in big cities, labour markets offer improved matching and greater security for workers because of the pool of employment opportunities, and there is more innovation and opportunities for specialisation with attendant efficiency gains.

To understand the challenges New Zealand is facing, it is worth watching developments in Australia. Writing recently in the *Australian Financial Review*, the highly respected business commentator Alan Kohler said:

Australia's place is increasingly peripheral: no replacement has been found for its leadership in basic commodities; very few Australian companies have successfully built global businesses ... [After News Corporation, Rio Tinto and National Australia Bank, the list of Australian corporations either moving abroad or thinking about it] is beginning to look like a list of the ASX Top 20: AMP, Amcor, AXA Asia, BHP, Brambles, Cochlear, CSL, CSR, Foster's, James Hardie, Lend Lease ... Globalisation is without doubt the number one issue for Australian businesses as the new century begins and the difficulty of running a global business from Australia is the number one problem associated with it ... The rest of the world is just too far away and our own consumer and capital markets are too small.

These challenges are magnified for smaller peripheral economies, such as South Australia, Tasmania and, of course, New Zealand. Since 1972 Tasmania has had net migration losses to the rest of Australia in all but six years. It is now actually losing population and is projected to continue to do so. On top of its natural disadvantages of distance it has compounded its problems with over-government, heavy taxes on business, and excessive environmental and industry regulation.

There is nothing New Zealand can do about its location, international technological innovations, or the advantages of major centres of population. To offset these factors it has to strive to be superior in the skills and effort of its workforce, the quality of its business management and, above all, in its public policies. Modern economic growth is mainly about brain power and sound policy. Investment capital and entrepreneurial talent will flow toward economies with low taxes, secure property rights, sound money and sensible regulatory policies. In contrast, when these factors are absent, people will find more attractive environments elsewhere. The quality of public policies is the key factor within the control of governments and the electorate, and it decisively influences whether countries prosper or languish.

A very strong case can be made that developments in public policy in recent years have not helped New Zealand meet the challenges and opportunities of globalisation. After the 1990-93 parliamentary term, the momentum of economic reform fell away, and the current government has changed the direction of economic policy ("reset the compass"), as it promised it would. While most OECD countries and many others are continuing with market-oriented economic reforms, New Zealand is on another path.

It is difficult, however, to detect in the government's programme a strategy that will improve the long-term indicators of economic performance that I mentioned at the outset, including the migration outflows. On the government's own projections, the economy is set to grow by only 2-3 percent in the years ahead, and the risks of a worse performance are significant. That signals continuing relative decline. In respect of migration, the increase in the top tax rate has increased the incentive for talented people to leave: in addition to making it more costly for firms to retain them, it is an unfortunate psychological signal that effort and risk taking are not highly valued. In respect of hopes for 'new economy' developments, the changes to employment law are a step backwards. They have made it more difficult and costly to lay off workers, which discourages firms from hiring in the first place. A key feature of Silicon Valley is the ease of hiring and firing, which makes innovative start-up ventures much less risky.

I doubt that any single factor is decisive in generating or arresting a brain drain. Attributing recent trends to student loans, for example, strikes me as implausible: the costs of university tuition and levels of student borrowing are often much higher in the United States than New Zealand, yet the United States stands out as a country that is not suffering a loss of internationally sought-after talent. Rather, I suspect people make decisions to migrate on the basis of push and pull factors, rewards and opportunities, in which an overall judgment of whether a country is going in the right direction is an important element. They give weight to economic factors, but also to cultural attitudes (including to entrepreneurship and wealth creation), the quality of political life, and whether policies affecting today's multi-ethnic societies are promoting harmony or divisiveness.

It is a matter of democratic choice whether New Zealand pursues policies that result in strong economic growth and attractive living and working conditions. As the turnaround in net migration in New Zealand in the 1990s and the experience of countries like Ireland shows, there is no reason why a small economy cannot transform its outlook by 'wising up' with its public policies. Equally, however, as the experience of Tasmania shows, natural disadvantages coupled with persistent mismanagement can make a brain drain endemic. Tasmanians are not going on a traditional OE.

New Zealanders may choose to vote for the quiet life, to avoid the continuing adjustments needed to cope with globalisation, and to reject the lessons of international economic success. A majority may decide to opt for redistributive rather than wealth-creating policies, and seek to tax the enterprising and those with money to invest. But if they do, in the face of all the

evidence about how today's economic world works, they should not complain when the most productive vote with their money and their feet, reducing the tax base for those who remain. Actions have consequences, some of which can be unfortunate.