

## Book Review

(Reviewed by Les Rudd – April 2007)

Culture and Prosperity: the truth about markets – why some nations are rich but most remain poor , John Kay, 2003, Harper Business

I was given this book by a co-director in a consulting business I support. I found it to be a good read because of my interest in 'complex adaptive systems' in relation to organisation design and development. However, it seemed a double whammy in terms of the learning because it's main focus is economics, and working for NZMEA you cannot fail to be interested in this subject. It became a triple whammy when I found that John Kay cites and analyses New Zealand as one of the few countries that was once in the rich list but is now in the intermediate-rich list, (not far off being considered poor!) We all know New Zealand has slipped down the OECD rankings and the NZMEA comments frequently about the Government's inadequate attempts to rectify this. However, this book is likely to become a seminal text and New Zealand is included as a case study on how not to remain a rich country! So it was hard to put down, as comparing John Kay's analysis and what we know is happening in and around New Zealand, it just strengthened my deep concern that we may never reverse the trend and his work might be as prophetic as it is philosophical.

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John Kay is a professor of economics with London School of Economics and Oxford University, and writes columns for The Financial Times. He earned my respect because he thinks economists should practice their craft in the same way that dentists practice theirs. Meaning economists should only be relied on to provide relief with appropriate interventions, not as architects of wealth creation, because in reality, economics is not so much a science as we'd all really like to believe. Therefore the answer to the question, "why some nations are rich but most remain poor," is by no means simple, because, quoting from the very last paragraph in the book:

"There is no grand narrative, only little stories. But the need for grand narrative [Marxism, free trade theory, Chicago's 'American Business Model'] is so firmly ingrained in human thinking that the fruitless search for it will never end. This book is dedicated to those for whom a partial understanding of complex reality is better than the reassurance of false universal explanations."

**New Zealand; one of the few countries that was once in the rich list but is now in the intermediate-rich list.**

This all might sound boringly academic and philosophical, and the kind of thing I wrote at the back of my PhD thesis – that is, a nice big caveat against any stuff-up's that others would find coming after me. (Well it was in my case! And don't bother reading my PhD, it really is boring.) However, John Kay means it, and getting around the Nobel'ist philosophy and broad ranging treatment of the central question, it was the insights related to the "little stories" which John Kay shared that proved interesting, in particular his comments on New Zealand. I'll try to outline some of the comment on New Zealand here, but if you are also interested in things like globalisation and the question the book is focused on, it is a compelling read and has an excellent website that gives a much more comprehensive review that is, [www.cultureandprosperity.com](http://www.cultureandprosperity.com).

New Zealand's first significant mention comes when John Kay makes the point that the wealth of a nation is not well correlated with access to natural resources and it is shown that by value of natural resources per head, New Zealand is second only to Saudi Arabia. While this comparison falls apart in many ways in trying to explain New Zealand's loss of wealth, the nub of his argument is quickly illustrated by making the stark comparison between the development of East and West Germany after World War II.

Essentially, generation and maintenance of a nation's wealth is more dependent on the quality of and inter-relation between the social, political and cultural institutions of a nation's markets, and the central role of pluralism in economic advancement. Pluralism is about allowing opportunity for alternatives, or put another way, choice. Out of this comes a refinement of ideas/products/service, that ever more effectively meet (adapt to) market need. Mercedes or Trabant – go figure!

The richest, intermediate and poorest countries by GNI are listed and it shows that rich countries have tended to stay rich and some are moving up the ladder. New Zealand and Argentina are the only ones clearly moving down and it is noted that until the 1980's, New Zealand would have been grouped in with Australia, USA and the more prosperous countries in Europe. Everyone in New Zealand knows the story and how this was accelerated, if not initiated.

However, maybe the UK finding a more logical place in the world post-Empire and now supporting Europe, has meant we've only had to worry about the Middle East being the starting grid of World War III and not Hitler's old stomping ground.

John Kay goes on to suggest that a nation's wealth does indeed have something to do with geography, but it is not the logistical challenge that we often hear about as a reason (excuse?) here in New Zealand. After all, New Zealand got rich by sending ship-loads of animal products half-way around the world, so distance and proximity to markets may not be the excuse many claim, certainly not with the technology we have today. The issue with geography is the proximity to appropriate thinking and behaviours exhibited by rich countries that practice pluralism and have good quality, well related social, political and cultural institutions supporting their markets and how this effect rubs off onto neighbours that trade with them. Our closest neighbour is Australia, they are defined as rich (which is why many New Zealanders keep moving over there I guess) and while they might be our largest trading partner, few could deny that our attitudes to business are different, and maybe deliberately so?

John Kay argues that one cause of New Zealand's slide to poverty has been the opportunity to follow approaches that, given greater proximity to rich countries (and a desire to emulate them) may not have been considered.

In other words, once the umbilical with New Zealand's main market (UK) was cut, New Zealand could be different, because it could. In particular, with no second house and the associated checks, balances and damping in policy making, it appears on reflection that illegitimate decisions have been made with great loss. We still suffer from these it seems and the decisions were probably never properly debated and contested as they may have been in countries with a bicameral legislature.

It would appear with 20/20 hindsight the approaches that New Zealand has followed simply have not worked. First up was Robert Muldoon's "think big" centrally planned interventions, most of which were written off with massive losses, and then Roger Douglas' copying of the American Business Model and shoe-horning in-vogue free-market policies and thinking into New Zealand, with little regard for context difference. (For example, monetary and fiscal policy linkage differences, something we still struggle with.) Neither approach has worked, and so GDP per capita fell from 125% of the average of the richest countries in 1960 to 60% in 2000.

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Little wonder that John Kay should comment that, "this freedom to be different was exploited to dismal effect." He noted the decline was bleakly symbolised in 1998 with a seven week black-out of Auckland's CBD as the supply cables of the unregulated Mercury Energy failed. (Deja vu?? See NZMEA's 2006 report, "Will it take more Blackouts before we see the light?")

So New Zealand, tired of the economic experiments and being run by ideologically committed treasury officials (economists), returned a more conventional Government in 1999, he said. He also said, "If ever a country was run by economists, it was New Zealand," and given he wrote this book in 2003, one wonders whether in 2007, with the OECD slide still a problem, along with power-cuts and a lurch back to centrally planned intervention, he might not have much to edit in this sorry story except for a few dates and the location of the new home of those "ideologically committed treasury officials" MED, NZTE, MFAT, New Zealand Institute perhaps? In other words, what has changed since 1999? Not a lot, we don't see any evidence of positive change in the numbers do we?

I said in the opening paragraph that reading this book strengthened my deep concern New Zealand will ever reverse the trend and how (I hope not) this work might be prophetic. Therefore his comparison between pluralism and central planning, and the follies of the UK nuclear power industry seemed chilling. Essentially the Advanced Gas Cooled Reactor (AGR) project was a failure, not because of the design per se, but because of the dictate that only "a single voice" should be heard from the industry. According to John Kay, Ford used to have the same problem and still suffer the consequences, and Wang Computers the same. Critique, alternatives (pluralism) and debate of such were not welcomed and positively discouraged in these environments. NZMEA has criticised Government for apparent 'Emperors Clothes' type attitudes on a variety of issues linked to this problem. So combined with centrally planned interventions like:

- ManufacturingPlus: We call it OneMillionPlus now, as that's how much they wasted on it.
- Export Year 2007: Blink, it's \$33Million extra in grants – a political sop.
- Growth Innovation Framework: They mean the sectors who get favoured with grants are ICT, bio-tech and creatives – pluralism, what pluralism?
- Hi-Growth Project: Pick and develop 100 ICT companies to do \$100M t/o – yeah right!

And then to see increasing evidence of a strong desire to stifle alternate lobby voices, plus also hear that the Government wants exporters (ExportNZ - funded by Government) and the ICT sector (ICT-NZ - funded by Government) to "speak with one voice" - was what caused the frightening chill - never mind that most of my wealth is now in New Zealand dollars! New Zealand simply is not getting any better and cannot afford more of the same thinking and styles of thinking seen before 1999. What we need to recognise is that a country's economy is a complex adaptive system, and pluralism, and the benefits of it, will not be seen if policy structures do not allow the adaptive behaviour that leads to growth enabling pluralism, consider:

- Grants: Instead use tax incentives that encourage people, market focused product and plant development – markets are better at providing the pull that firms adapt to – officials can't make this adaptive behaviour work.
- Supporting only exporters: Ditto above, we compete on supply-chain capability, end to end, not just the end user product attributes.

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- Supporting just ICT, bio-tech, the creatives: Ditto above, for all sectors – while economies may specialise, it is difficult to believe they can be grown from a deliberate silo-like approach. They do seem to grow out of capable supply-chains and naturally occurring 'clusters' of firms who respond to market-pull with appropriate, efficient ideas in a pluralistic way. A silo approach (anti-pluralism) is simply blinkered to the opportunities that may prevail.

This isn't about party politics or changing the Government, it is about having government (notice the small g) change the way they think and understand the type of problem they are dealing with. So while we should be drawing on what we have seen work in other jurisdictions, we should be applying that knowledge with thinking and approaches that are more likely to deliver solutions in a complex adaptive system. We should not simply be trying to shoe-horn what others have done into the New Zealand's context en bloc. On review, some of originators never got what we copied to work too well anyway. For instance, free-market approaches applied in public service monopolies, and particularly when, as we might expect, we don't really understand our context fully and it's difference with others – because they are both complex. Clearly Muldoon and Douglas didn't understand, will Clarke and Cullen, or Key and English? Will the post-99'ers prove any different before we slide further down the ladder? Let's not forget:

“Madness is defined as continuing to do the same thing, and expecting change”  
and  
“There is no grand narrative, only little stories”

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(Reviewed by Les Rudd – December 2007)

The Origin of Wealth - Evolution, Complexity, and the Radical Remaking of Economics - Eric D. Beinhocker, 2006, Harvard Business School Press

If this title doesn't grab you what will?

This book is a good read for NZMEA members, because like the one I reviewed in April this year, 'Culture and Prosperity: the truth about markets – why some nations are rich but most remain poor' by John Kay, it too lends support to our policy position.

Beinhocker's work is perhaps not as poignant as John Kay's book, which used New Zealand as an example of a nation once rich but now becoming poor, while arguing his case that national wealth and prosperity is dependent on the quality and inter-relation between the social, political and cultural institutions of a nation's markets and the central role of pluralism in economic advancement. Instead, Beinhocker fundamentally challenges the generally accepted world view of traditional economic theory, upon which much economic development policy in New Zealand seems to be based - because like traditional economic theory, it does not appear to be working that well in the real world in which we live.

I came across this book because of an interest in so called complex adaptive system theory in relation to organisational design and development. Complex adaptive systems are complex in that they are diverse and made up of multiple interconnected elements with the capacity to change and learn from experience. (Sound familiar? You probably own and/or run one!) Whereas Kay levered some of his arguments from a characterisation of national economies as complex adaptive systems, the whole point of Beinhocker's work is that we need to re-think much of present economic theory based on this approach, in contrast to the present theoretical substrate of a closed equilibrium system. An economy is not like a closed equilibrium system which is characterised by predictable cause and effect relations tending toward stability/equilibrium, because, if on a micro scale your firm was, wouldn't life be easy. However, it is not like this at the micro level of your firm, so why do 'them up in Wellington' (or in many other world governments) continue to believe it will be any different at the macro-economic level, given the national economy is after all the sum of a plethora of micro-parts – your firms?

Beinhocker is a practical thinking McKinsey man. His work, published in 2006, is copiously referenced and John Kay endorses the work on the front cover of his book as, 'Unquestionably the most important business book of the year.' Before outlining the synergy of thinking with our policy position and what you know needs to be done to improve growth prospects in New Zealand, I'll recount some key areas. However, as this book was 500 pages at 8 point font, you would need to read it to get the full insights available, many of which would equally help with firm level performance, hence a more direct benefit if you can spare the time.

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Beinhocker recounts that in developing Traditional Economics, to aid their understanding, the founding thinkers and philosophers utilised many metaphors and analogies from the developing physical sciences of the day, circa 1680 to 1930. However, whereas those sciences continued to develop along many new horizons; quite exponentially in some areas since that time, economics seemed to spend more effort on justifying/rationalising various equilibrium focused arguments and principles.

This was assisted with more sophisticated mathematics and analytical technique became available, all in an attempt to improve correlation between theory, practice and policy. This contrast was captured nicely in an exchange between physicists and economists taking part in a cross-disciplinary workshop sponsored by Citicorp in 1987 that initiated various areas of research focused on applying complexity theory into economics via the Santa Fe Institute; a not-for-profit set up with the goal of addressing some of the more awkward problems in science characterised as complex systems. The physical scientists had challenged the economists for continuing to use models that so clearly did not represent reality and were shocked at the magnitude of assumptions made. It appeared as if the focus was not on matching reality, but rather ensuring the currency of assumptions was common across the sub-theories and approaches being used in main-stream economics. Quoting from the book:

"The economists backed into a corner would reply, "Yeah, but this allows us to solve these problems. If you don't make these assumptions, then you can't do anything.

And the physicists would come right back, "Yeah, but where does that get you – you're solving the wrong problem if that's not reality."

This all sounds similar to conversations between NZMEA and some government officials, and now you have another reason for their behaviour – it's not their fault they probably just don't know any better and simply hold Traditional Economic theory too tightly. Beinhocker clinically, elegantly; but very respectfully, challenges many areas of Traditional Economic theory and replaces some with complex adaptive approaches. I'll pick out a couple of areas of interest to us on the policy front.

A characteristic of complex adaptive systems is that they run on an evolutionary algorithm, from the bottom up, in essence it goes:

differentiation – creating a range of options (pluralism) within a scheme – the adapting agent does this, that is, your firm, the economy, in response to it's environment.

selection – the environment does this, that is, the market.

amplification – the adapting agent does this, that is, seeing what's working, do more of the same.

replicate – the adapting agent does this and starts differentiating again, maybe on a different scheme, eg. Nokia – they didn't stick to what they were traditionally good at (forestry) and survived – the point of evolution!

Note, the environment/market pick the winners – not government officials. However, you can pick winning behaviour sets, (see above). This is why the NZMEA policy position is similarly about encouraging winning behaviour sets, at the firm level, which is about letting it happen (emerge) from the bottom up. That is:

differentiation – tax incentives for people development (the right kind of development) and more for R&D - we've a long way to catch up. So that we get ..

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selection – accuracy in meeting market needs. This is achieved by capable people able to innovate and lead connection between products and services, and market demands. From an exporting point of view it'd really also help if the Kiwi was less volatile, and that could be achieved, see our work on monetary and fiscal policy.

amplification – faster depreciation of plant, patents and tax exempt retained earnings for SMEs – see what Singapore is now doing on tax exempting start-ups.

replicate – supported by more of the above and with full deductibility on start-up investment as it would facilitate emergence of capable market focused supply-chains = the 'clusters' of value creation New Zealand desperately needs and that NZTE's 'picked winners' cluster programme had no hope of ever achieving. (I think that's why they cancelled it!)

It's not about trying to pick winning firms, technologies or sectors. As tempting as that might be, the evidence is to the contrary, let alone Complexity Economic theory.

Given the logic involved, Beinhocker rounds off the work with a final chapter called, 'Politics and Policy – The End of Left versus Right' that includes a very interesting section entitled 'Left-wing Utopias and Free Market Fantasies'. It's far from a promotion of Tony Blair's 'The Third Way' and therefore not simply about gravitation toward centre politics in the first world. From a complexity point of view, the critique of the left is quite obvious – you cannot centrally plan evolution. (Unless your name is God perhaps!) For the right, free markets are not as free, fair and efficient as theory predicts and so dogmatic assertions of 'leave it to the markets' are as flawed as central planning. Rather the role of the state is to create an institutional framework that supports the evolutionary mechanisms that underpin markets, striking a balance between cooperation and competition while best shaping their character to serve the needs of society. The state is also obliged to ensure citizens have equal opportunity to participate (good for all) with relevant support should they fail in taking risks that could benefit the whole, but consistent with the norms of legitimacy and strong reciprocity - "I trust you will do the same unto me as I'll do unto you." The key words here are legitimacy and trust, demonstrated at all levels, as this promotes engagement. At the highest level, government, and therefore legitimate governing processes. At the societal level, work for your advantage, don't bend the system to get it – you freeload on us, we off-load you. (Perhaps something akin to a 'strict Aunty' rather than 'Nanny state'.) The role of markets is to provide incentives for the discovery and differentiation of business plans (read products and services), facilitate selection against the needs of society and their legitimate representation, and channel resources to selections for amplification – but government can enhance amplification via tax incentives; see our policy position.

So, measuring up against this kind of thinking, where is New Zealand now and where would we be if government adopted more of the kind of policy shape NZMEA advocate?

More support - at least one other outside of NZMEA here in New Zealand is recognising this issue. On 15 November 2007, The Royal Society began running its Distinguished Speaker series around the country and this year selected a home-grown candidate, Professor Paul Callaghan, of Victoria University. His lecture was called, 'Beyond the Farm and Theme Park'. ([http://www.hotscience.co.nz/video\\_detail.php?videoid=169](http://www.hotscience.co.nz/video_detail.php?videoid=169)) Paul argued that for a first world future we cannot simply rely on doing more of what we have traditionally been good at. Instead, we must invest yet more effort in science and technology, (the 'what') but in a pluralistic way across all sectors (nearer to the 'how' we advocate), not just the three hot/sexy sectors that the New Zealand Government has decided (in classic centralist style) are prime in NZTE's grant focused Growth Innovation Framework (GIF). These are ICT, biotechnology and the creative sectors - and we cannot assume we will win in biotechnology just because we are winners in agriculture.

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Hearing Paul relate his argument to principles of complexity and question the wisdom of the GIF strategy on this basis in a radio interview on 13 November, got me interested enough to attend his first lecture with the Royal Society in Christchurch. Paul directs the MacDiarmid Institute for advanced materials and nanotechnology and given his research interests, described as: "methodologies for the study of molecular dynamics and molecular organization in complex fluids, soft matter and porous material" - it was not difficult to see why he would be taking a similar view on Government economic policy as others of us with an appreciation of complex adaptive systems.

On a final note, another characteristic of complex adaptive systems is that of fractal self-similarity, but this is only really useful in understanding stock and currency market behaviour, so I won't bore you with that here!

**We recommend viewing "beyond the farm and themepark" by Professor Paul Callaghan**