Submission on Frontier Firms discussion document

Author

I currently work as the Economic Policy Advisor of Palmerston North City Council but this submission has been prepared on a personal basis rather than through my role at the city council. Previous work experience includes five years at the Department of Trade and Industry (trade policy, regional development and import licensing), 17 years at the New Zealand Manufacturers Federation/ Business New Zealand (working for a range of industry groups and in policy roles) and five years for Crown Financial Ministries New Zealand.

Challenges with measuring productivity

A key challenge with measuring productivity is the extent to which the government invests adequately in updating the GDP deflators and Producers Price Index. In the early 1990s, when I was working at the Manufacturers Federation, I became concerned that the PPI Outputs index was overstating the rate of change in manufacturing output prices. This view was also shared by The Treasury and Reserve Bank and they jointly funded the updating of the GDP deflators and PPI. When the update was completed, Statistics New Zealand produced an undated index with an overlap between the old manufacturing sector PPI Outputs series and the new series. The difference between the new and old series was around 100 percentage points, which meant productivity growth had been higher than was initially indicated. During the remainder of the 90s, after the update to the deflators and in the early 2000s there was a decline in productivity growth, which may be explained by insufficient resources to keep the deflators up-to-date. I have been working for the city council since 2007 and have not needed to regularly refer to the PPI, so I am unsure what the Statistics New Zealand programme is for keeping the GDP deflators up-to-date.

A further challenge with assessing productivity is the very limited production data collected by Statistics New Zealand, Again, I am out-of-date to the department's approach to assessing production volumes for GDP, but for some sectors output has been estimated using employment data. The employment data is robust, because it is sourced from PAYE returns from all employers. However, this means productivity change cannot be measured.

How important is productivity in a New Zealand context?

During the 1990s I had the opportunity to participate in two large studies on manufacturing best practice. The study was a joint project between the New Zealand Manufacturing Advisory Group (managed by the Ministry of Economic Development) and the Australian Manufacturing Council. University academics participating included Lawrie Corbett (Victoria University) and Claire Massey (Massey University). A large survey of manufacturers was developed and coordinated by Statistics New Zealand. Once the initial analysis of the results was completed, site visits were organised to some of the highest performing and lowest performing businesses. The survey results and what I heard during the site visits helped to reinforce what I had seen and heard during site visits or meetings with companies from the industry groups I had been servicing.

Companies talked about the improvements they were making through greater automation of manufacturing processes but many were not reducing their total staff numbers. That was due to increased investment in R&D, product enhancements (which often can't be classified as R&D), short-run quick-response manufacturing or customisation of product for individual customers, and increase after-sales service and product set up for customers. Most companies were small in global terms but were competing with major international companies.

There were some interesting stories from the two surveys and from discussions with individual members of the Manufacturers Federation. Two stories help to explain why productivity improvement wasn't the only factor in their success as a business.

1. An Auckland screw manufacturer received a large order early in the morning from a Taiwanese furniture manufacturer, with the key proviso that the product had to be on the plane to Taiwan that night. The company owner stopped production and called a staff meeting, explaining the order that had been received. Staff immediately began to set up the tools to make the screws ordered, having to stop the machines multiple times during the day to set up the tools for the different types and sizes of screws ordered. Staff volunteered to work late in the evening to complete the order. The company wasn't told why the screws were needed urgently but assumed screws ordered from a large screw manufacturer had not arrived or were faulty. The New Zealand company was able to charge a premium for the product delivered but its productivity that day was lower than normal due to the need to change the tools so often.

2. A company I spoke to was a direct competitor with Fonterra, producing a food ingredient product for food manufactures in New Zealand and overseas. Fonterra only offered a narrow range of products while the other manufacturer was willing to customise its product for each customer. That meant it was not able to achieve the same productivity as Fonterra but it was able to charge a premium for the product it supplied because it met the requirements of its individual customers.

It is important to recognise how small most global New Zealand companies are compared with their overseas counterparts. In the early 2000's the government consulted on new financial reporting rules for small businesses. The membership of Business New Zealand was critical of the proposal rules because they did not seem appropriate to small businesses. We were advised by the Ministry of Economic Development that the rules were based on OECD financial reporting guidelines for small businesses. However, when we checked the OECD definition of small business it was based on business with up to 500 employees, which covered a very high percentage of all businesses operating in New Zealand.

Sadly, many of the businesses that were operating in the electrical and electronic industries when I worked for them in the second half of the 1980s are no longer in business. The lack of international anti-competition laws has meant it has been easy for a large overseas competitor to offer a ridiculous amount of money to the owner of the New Zealand business, and in almost every case then close it down. Some has been reinvested back in business by people such as Neville Jordan, who started Marine Air Systems (MAS) Technology in the mid-80s. There were sometimes other genuine reasons for selling to an international company,

such as lack of access to capital (options on the New Zealand Stock Exchange were much more limited then) and accessing finance from New Zealand banks is difficult, or to partner with a major global player.

There is a strong bias in bank landing towards physical assets, such as land. For example, in November 2020 total borrowing by the agriculture sector was slightly under $63 billion, while borrowing by the rest of the business sector was just over $116 billion. Agricultural production accounts for just under 5.1% of total GDP but accounts for 35% of lending to the business sector. That means it can be difficult for companies to access finance for investment in technology that would assist productivity improvement. Lending for housing at the end of November was $296 billion, while personal consumer lending was a further $15 billion.

New Zealand continues to have a significant number of companies operating in transport equipment manufacturing and machinery and equipment manufacturing, with 5,853 enterprises identified in February 2020[1]. I don't have access to the latest information on how many of these companies are involved in exporting or how many of these businesses employ staff because that information isn't included in the standard tables published by Statistics New Zealand. There were a total of 38,900 employees in the 5,833 businesses classified under these two ANZSIC codes, but some have no employees.

The role of monetary policy

From the late 1980's until recently real (inflation adjusted) interest rates have been high in New Zealand compared with other major OECD countries. There have been a range of factors contributing to this, with high growth in housing debt in New Zealand an important factor. High interest rates are a barrier to investment when competitors in other countries can access finance on more favourable terms.

Early monetary policy focussed on the exchange rate to reduce inflation, but in the 90's the Official Cash Rate (OCR) was introduced. While this reduced the role of the exchange rate in controlling inflation, an increase in interest rate will usually put some pressure on the exchange rate, reducing the competitiveness of New Zealand exporters. Some exporters are able to operate as price makers, so are not influenced by increases in the value of the New Zealand dollar, but many companies are price takers and can lose significant business when there is a significant increase in the dollar. Our small domestic market, therefore creates risk for companies highly dependent on export returns, and this is a factor in some companies moving production overseas when their export activity accounts for a significant share of total business turnover.

More recent moves to focus monetary policy more tightly on the housing sector, particularly through minimum deposit requirements have allowed real interest rates to reduce, so is positive for exporting businesses.

Migration Policy

[1] Statistics New Zealand Business Demography, ANZSIC C23 and C24

I strongly support recommendations 8.2 and 8.3, but have some additional observations and suggestions.

Tourism and horticulture labour demand is highly seasonal and has attracted significant media attention because of the difficulty businesses have attracting staff. I believe there are opportunities for sectors to be more strategic about how they address their short-term peaks in labour demand and consider ways where employment can be provided on a more sustainable basis. For example, several years ago a group of Horowhenua horticultural companies discussed how their peak labour demand occurred at different times of the year. They identified some good workers from their existing labour force and I understand were able to provide them employment in the Horowhenua area for nine months of the year.

I also believe there needs to be a greater incentive for businesses to take on new employees, particularly those who are qualified but struggle to find work because they have no experience. This has been a significant gap since the corporatisation of the government sector in the 80s and 90s. Many of the major government departments used to take on significant numbers of young people, offering training and work experience. Many then moved on to the business sector, which was willing to offer higher pay rates for skilled employees, but businesses lacked their own programmes for training new employees. Few companies have addressed this gap in workforce development.

Migration has been seen as the easy solution by businesses because New Zealand is seen as an attractive destination by migrants. Businesses often see training and staff development as a cost, but the two best practice surveys identified that companies that invested in the development of their workforce grew more strongly and were more profitable than those companies that did not invest in this area. So rather than a cost, spending on training and employee development should be seen as an investment. This links with finding number 8.4 which notes that *Evidence suggests that many New Zealand firms lack the leadership capabilities needed to lift their productivity.* I strongly endorse this conclusion.

Conclusions

This is a very brief overview of the challenges with measuring GDP and productivity growth, the relevance of productivity change as a key measure in the New Zealand economy and some observations about management skills in New Zealand. I am happy to provide more information if there are any issues you would like to follow up on.