Submission by

ExportNZ

A DIVISION OF BUSINESSNZ

BusinessNZ

GROWING PROSPERITY AND POTENTIAL

to the

**Productivity Commission**

on the

**New Zealand firms: reaching for the frontier**

**February 2021**

## GENERAL DISCUSSION

1. BusinessNZ/ExportNZ is generally supportive of the Productivity Commission's findings and recommendations in the draft report "New Zealand firms: Reaching for the frontier".

2. BusinessNZ/ExportNZ consulted with a range of businesses to get an understanding of barriers to high productivity within their businesses. Similar themes emerged through these consultations, some of which are also addressed through the Productivity Commission's recommendations.

2.1. A high-quality education system that provides opportunities to young people and supplies the business community with the skills and talents necessary to grow and prosper is critical. A robust foundational education is crucial to increase the productivity of industry. The Draft Report states that *"New Zealand has a well-educated workforce, and workers continue to undertake further education and training at high rates (NZPC, 2020b)".* However, a report by the Tertiary Education Commission (TEC) found that about 40 percent of people in the workforce do not have sufficient literacy and numeracy skills to function well in a knowledge society and information economy. Workforce Literacy and numeracy urgently need to be improved as over a million people don't have the skills needed to participate fully in working life. Poor literacy and numeracy skills are reflected in risks, errors, and accidents in the workplace, and contribute to low productivity. The feedback we get from businesses is that they can often not find the talent and skills needed to fill specialized roles.

Covid-19 has highlighted this challenge given talent cannot easily enter New Zealand at present.

Comparatively high qualification attainment rates do not necessarily relate to levels of skill or educational attainment. NCEA is undergoing literacy and numeracy reform following the research (noted above) demonstrating that 40% of those that achieve level 2 do not have literacy and numeracy skills at a desirable level.

Further, the Productivity Commission's education section on technological change and the future of work noted that "*There is consistent evidence that the [education] system is not performing well in developing core skills for learners or in addressing the persistent long tail of underachievement between the highest and lowest performing students"* and "*there is evidence of declining achievement in core skills areas of reading, mathematics and science over the last decade".*

The significant reform programme currently being undertaken in vocational education also signals that major improvements are needed in the way New Zealand upskills the workforce, particularly those in work.

2.2. BusinessNZ/ExportNZ agrees with the Commission's F7.1 finding that concludes: "*The performance of the New Zealand innovation ecosystem is notably weaker than in comparator small-advanced economies on some measures".* New Zealand's expenditure on Research and Development (R&D) is well below the OECD average. However, in 2019 Business R&D expenditure reached $2.4 billion, twice that spent in 2012 and the number of businesses engaging in R&D increased by 17 percent from 2012. This is promising for increasing innovation in New Zealand. Almost threequarters of the funding for business R&D came from businesses themselves. BusinessNZ/ExportNZ advocates for more support from government to incentivise R&D investment ensuring high-value jobs are created.

As noted in our previous submission, CRIs and universities are not easy for the business community to work with. For example, the funding model for Universities incentivises research and publication in academic journals. Academics are rewarded for publishing, but publishing can be at odds with the protection of intellectual property which needs to be kept secret until properly protected. Furthermore, businesses can find working with academics difficult because the latter are primarily focused on teaching and publishing, so the work cannot always be done promptly. Academics are not incentivised or rewarded for working with businesses and cannot easily move between academia and industry. BusinessNZ/ExportNZ recommends that policy should be implemented to provide career pathways and latitude for academics to go between industry and academia more fluidly, as happens in Europe. Furthermore, there should be incentives, other than publishing, for academics to be rewarded for contributions to R&D that are more conducive to the needs of industry. BusinessNZ/ExportNZ also agrees with the Commission's finding F7.7 which states that "*The Government should review the suite of programmes designed directly to assist firms with innovation and exporting. The review should identify and implement ways to:*

- *reduce and consolidate the number of programmes;*
- *simplify the process for firms to apply for assistance; and*
- *make it easier for firms to identify and access relevant programmes, including by providing a common platform and "front door" across programmes.*"

BusinessNZ/ExportNZ’s feedback from businesses indicates that the new R&D tax incentive is not currently fit for purpose and that both the IRD and Callaghan Innovation are interpreting what qualifies as R&D very narrowly, even for some of our biggest investors in R&D. All the emphasis has gone on research that is ”new to the world” and development is given little support. The transaction cost of accessing the tax incentive is high, and most firms have to engage the ‘big four’ consultants to apply for tax relief. This situation needs urgent attention from the Government, as those firms with overseas investment will simply move their R&D function to other parts of the world where the R&D incentives are stronger.

2.3. BusinessNZ/ExportNZ agrees with the Commission’s findings supporting more businesses to export specialised products at scale. Government policy should be focussed on attracting high value-adding export-oriented multinationals that can support and build scale through networks. Government policy should proactively target multinationals that will lift the capability of other firms and increase innovation diffusion. BusinessNZ/ExportNZ agrees with the report’s recommendations around setting policy that acts as a magnet for multinationals and developing attraction programmes to directly attract MNCs. These policy settings also need to make New Zealand attractive to investors by ensuring its innovation ecosystem is world-class. But to ensure their success, they must be carefully and strategically set Given New Zealand’s distance from markets and customers, attraction policy should focus on areas where the country has a natural competitive advantage, - the future of food, weightless exports, such as R&D and IP creation, or investment in high tech areas compatible with a large land mass and small population, e.g., autonomous vehicle testing and rocket launching.

2.4. To attract more multinationals, BusinessNZ/ExportNZ believes government should look at removing barriers to good foreign direct investment. Every country should be concerned about the quality of foreign investment. This should be managed by foreign investors having to abide by the same regulations as domestic investors. New Zealand is currently ranked 34/34 in the OECD Product Market Regulation Indicators for Regulation of FDI. As noted in our previous submission, good Foreign Direct Investment (FDI) and international connections play a critical role in the growth of exports. Access to parent company knowledge and resources, technology and international networks has facilitated the growth of more productive firms. New Zealand's Covid-free status has made New Zealand more attractive to overseas investors. The country should be taking the opportunity to encourage more FDI, which may also help to improve productivity by deepening the availability of capital, as well as the diffusion of knowledge and skills. The 2019 analysis of the Deloitte top 200 companies shows that overseas-owned firms outperform both NZ- owned, NZX listed state-owned and council-owned entities by a significant margin. BusinessNZ/ExportNZ recommends making the barriers to overseas investment, particularly concerning the to the purchase or lease of "sensitive land", more permissive, e.g., the current definition is anything over 5 ha, which is small enough to include many manufacturing campuses. The more barriers there are to investment, the harder it is for businesses to grow. The risks of leasing or selling sensitive land to an overseas investor are no greater than leasing or selling the land to a domestic investor, given both are subject to the same regulatory safeguards; policy should reflect this position. What is important is that the investment should result in the creation of highly paid jobs.

2.5. BusinessNZ/ExportNZ strongly rejects the assertion that *New Zealand's immigration policy settings are encouraging reliance on low-cost migrant labour. This is inhibiting capital investment and innovation.* Section 8.3 poorly describes the reality of New Zealand immigration, which is a necessity due to poor skills matching between education and labour market demand, variable educational outcomes, and a lack of understanding of the nature of the industries requiring migrant labour. While horticulture is noted as an example, a study of the aged care and health sectors would be more relevant. In aged care, the sector is bound by pay equity rates and chronic government underfunding for the delivery services. While aged care is an essential public service ensuring older, vulnerable people receive a suitable standard of care - with the sector forecast to grow exponentially given New Zealand's demographics - there is still no skills pathway from tertiary into the industry (the qualification provides a broad social services approach to r social work, aged care and disability care). Nor is there an apprenticeship- type model enabling caregivers to work their way up to becoming nurses without quitting their jobs and -enrolling in tertiary education. The type of" low skilled migration" referred to in the report was the first to be given emergency status, recognising the critical importance of aged care workers to the Covid response. The Commission's view of immigration settings clearly references rhetoric rather than reality.

The skills' classification for immigration is being phased out and replaced with remuneration rates as a proxy because the skills' taxonomy and language are problematic and not fit for purpose. With the exception of working holiday visas, migrants on work visas must be paid an amount equivalent to the median wage. This is causing distortion in the labour market and risks driving down wages for New Zealanders, but employers are required to pay migrant workers a premium in order not to compete on” cheap labour” as the Commission believes is happening.

Further, the Commission ignores the realities of the New Zealand labour market – the demographics’ profile and work undertaken by Professor Paul Spoonley show New Zealand as now below the population replacement rate – without immigration, New Zealand would be significantly disadvantaged both in terms of meeting current labour market demand and in future years. With the skills and tertiary sectors lacking any incentive to supply the skills New Zealanders need and with no accountability, immigration becomes the last resort if firms are to continue to operate, let alone innovate to be more productive. Robust economic fundamentals, primarily labour based, and a tight labour market with unemployment figures tracking well below forecast and industries signalling skill shortages, will hamper productivity further.

BusinessNZ/ExportNZ agrees that to create enduring polices, immigration settings need to be reviewed in tandem with the poor performance of the education system and the ineffectiveness of the Ministry of Social Development in making successful job placements, so their role in labour market and skills supply can be properly understood.

2.6. There is significant evidence showing that good cluster policy and high productivity coincide. In Europe, particularly in the Nordic countries, public agencies take a proactive role in facilitating the growth of clusters. The European Commission has identified 2,500 clusters in Europe, accounting for one third of employment and half Europe’s wages. BusinessNZ/ExportNZ is pleased that government is taking a new approach to industry policy through *Industry Transformation Plans for* key sectors. These plans have been designed to transform industries to lift aggregate productivity and enable the scaling up of highly productive and internationally competitive clusters in areas of comparative advantage. This intervention is a good start, however, BusinessNZ/ExportNZ recommends that specific, proactive geographic cluster development policy should be set up as a deliberate, long-term strategy to improve productivity performance amongst New Zealand firms. BusinessNZ/ExportNZ is aware of the submission to the Productivity Commission on the initial inquiry by Ifor Ffowcs-Williams CEO, Cluster Navigators Limited, and agrees with the table of recommendations in his submission. This table is attached as appendix 1.

## 3. To Summarize

3.1. Increasing productivity will require a strategic and balanced policy that approaches New Zealand's barriers to high productivity holistically.

3.2. BusinessNZ/ExportNZ advocates for a high-quality education system that provides opportunities for young people and supplies the business community with the skills and talents necessary to grow and prosper. A robust foundational education is crucial to supporting a highly productive workforce. Literacy and numeracy urgently need to be improved as over a million people don't have the skills necessary to participate fully in working life. If these people are not productive members of the workforce now, they will be completely left behind as new technology affects the future of work. PISA data shows that New Zealand is going backwards, so urgent intervention is essential, or a generation of young people will be left behind.

3.3. BusinessNZ/ExportNZ advocates for a review of the innovation ecosystem, particularly the barriers to business engagement with the CRIs and universities and the implementation of the R&D tax scheme. 3.4 BusinessNZ/ExportNZ agrees with the Commission's recommendation (R5.1) that the Government should take a more proactive and deliberate approach to attracting multinational corporations (MNCs) that are knowledge-intensive, oriented to exporting and a source of spill over benefits. The approach should develop programmes of attraction similar to those used successfully in some small, advanced economies (SAEs). In practice, creating the conditions that act as a magnet for MNCs will require upgrading the innovation ecosystem and building deep networks between industry, researchers, and government. In SAEs, this has been best achieved by focusing efforts on a few target areas of existing domestic strength. Such a programme requires careful monitoring, evaluation, and adaptation to New Zealand circumstances to ensure it is in the national interest.

3.5. Given New Zealand has a shallow capital base, overseas investment plays a vital role in transforming New Zealand businesses into successful international businesses. International investment in exporting businesses not only gives them vital capital but often involves opening channels to markets, overseas, market knowledge and relationships. BusinessNZ/ExportNZ believes that removing barriers to good Foreign Direct Investment (FDI) is necessary for growing New Zealand's productivity.

3.5 BusinessNZ/Export New Zealand rejects the Commission's assertions that present immigration settings contribute to the lack of innovation and ability for companies to become frontier firms, and strongly encourages the Commission to undertake further due diligence on the current wage, skill, and demand settings for immigration to ensure it puts forward a better informed and evidence-based view of what is driving the demand for immigration.

3.6. BusinessNZ/ExportNZ is supportive of the policy recommendations regarding proactive cluster development which are attached as appendix 1 *(Ifor Ffowcs-Williams CEO, Cluster Navigators Limited).*

## ABOUT BUSINESSNZ

BusinessNZ is New Zealand's largest business advocacy body, representing:

- Regional business groups EMA, Business Central, Canterbury Employers' Chamber of Commerce, and Employers Otago Southland
- Major Companies Group of New Zealand's largest businesses
- Gold Group of medium sized businesses
- Affiliated Industries Group of national industry associations
- ExportNZ representing New Zealand exporting enterprises
- ManufacturingNZ representing New Zealand manufacturing enterprises
- Sustainable Business Council of enterprises leading sustainable business practice
- BusinessNZ Energy Council of enterprises leading sustainable energy production and use
- Buy NZ Made representing producers, retailers and consumers of New Zealand-made goods

BusinessNZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy and services for enterprise, BusinessNZ contributes to Government, tripartite working parties and international bodies including the International Labour Organisation (ILO), the International Organisation of Employers (IOE) and the Business and Industry Advisory Council (BIAC) to the Organisation for Economic Cooperation and Development (OECD).

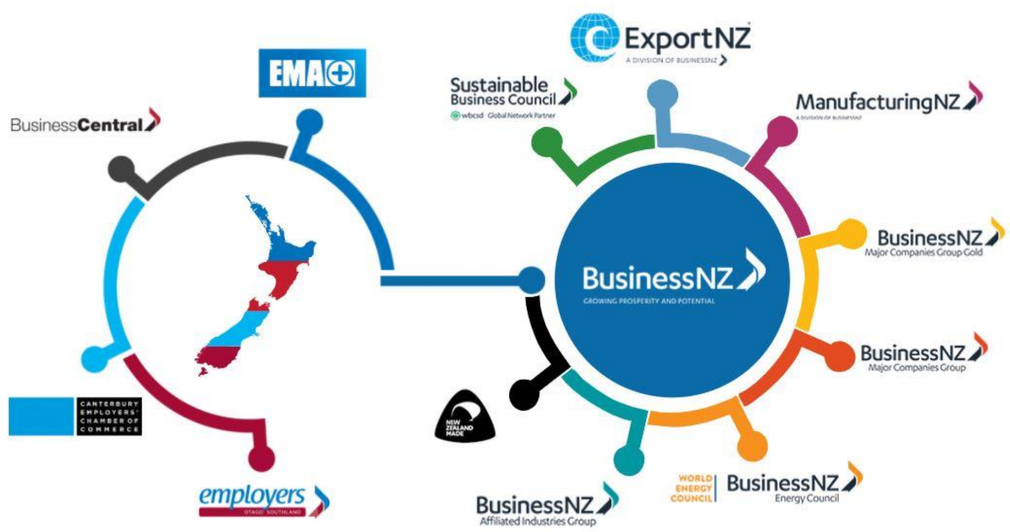
## **ABOUT EXPORTNZ**

ExportNZ is a national industry association representing a diverse range of exporters throughout New Zealand. ExportNZ is a division of BusinessNZ, New Zealand's peak business advocacy body.

We are a membership organisation and across our two brands have approximately 2,000 export members. We also have four regional partners: Employers Manufacturers Association (Upper North Island), Business Central (Lower North Island), Canterbury Employers Chamber of Commerce (Upper South Island) and Otago Southland Employers Association (Lower South Island) which between them represents the bulk of manufacturers in New Zealand.

Our value proposition for members is a mixture of policy and advocacy, education and training, networking, trade missions and inspiration through awards events and conferences. Notably, we run a BusinessNZ Chief Technology Officers Group, incorporating the largest innovation-driven companies in New Zealand, many of which export.

Division Brands



**APPENDIX 1.**

## Designing a Cluster Development Intervention

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| **Ten Principles for New Zealand** | |
| **1.** | Using national competitions to select the best proposals for public co-funding … not Wellington determining the clusters that merit support.<br>Cluster development is **not** a Top Down process.<br>It is about *'backing winners'*, as Skilling refers. |
| **2.** | Using public competitions to emphasise the importance of behaviour changes, i.e. much more than funding a few cluster projects.<br>This includes:<br>• Encouraging regions to prioritise their competitive strengths;<br>• Building triple helix alignment around those specialisations;<br>• Emphasis on needs-driven, collaborative/pre-competitive R&D;<br>• Partnerships between training providers and cluster firms;<br>• Facilitating business co-opetition, co-specialisation. |
| **3.** | The primary application of cluster funding is for a small cluster management team that acts as the cluster's development catalyst & connector, and identifies collaborative projects.<br>This key role is relationship building and learning-by-doing, exploring at the cluster's edges, **not** paralysis-by-analysis and yet another report.<br>Funding is also required for small scale, immediate projects that assist with early cluster mobilisation. |
| **4.** | Accepting that as relationship building and behaviour changes take time, co-funding is in place for a minimum of 5 years. |
| **5.** | Accepting that the functional region of a cluster will not necessarily align with political boundaries, and clusters often stretch over sectors. |
| **6.** | Accepting the importance of garnering the difficult, but super critical, public-private collaboration around a cluster's development agenda. |
| **7.** | While public agencies take the lead in introducing a cluster approach, sustainable clustering initiatives are firmly business led, with relevant public agencies (national & regional) and academia as partners. |
| **8.** | National agencies provide, alongside financial support, training to cluster managers and cluster boards, and proactive in connecting related clusters within NZ, and globally. No cluster is an island. |
| **9.** | Resources & funding for the larger, cluster specific projects … pre-competitive R&D; an export mission; an inward-buyers visit; a cluster- specific incubator; business mentoring; vocational training; student, migrant & FDI attraction; seed funding etc. … are accessible through established NZ programmes. |

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| **10.** | An indicative level of funding to support a national cluster programme:<br>**$20 - 25 million a year, for five years.**<br>A relatively small investment for a centre-stage programme to lift NZ's regions, stimulating the growth of high value jobs and frontier firms. |