BusinessNZ
The voice of business

Lumley House
3-11 Hunter Street
PO Box 1925
Wellington 6001
New Zealand

Tel: 04 496-6555
Fax: 04 496-6550
www.businessnz.org.nz

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Inquiry into the Service Sector
New Zealand Productivity Commission
PO Box 8036
The Terrace
Wellington 6143

Email to: info@productivity.govt.nz

Dear Sir/Madam

Re: Boosting Productivity in the Service Sector Issues Paper

1. Background

I am writing to you regarding the New Zealand Productivity Commission's (NZPC) recently released issues paper entitled *Boosting Productivity in the Services Sector* (referred to as 'the Paper').

We very much welcome this focus by the NZPC on the services sector. As the Paper states, the total services sector (private + public sector contribution) accounts for around 70% of New Zealand's GDP. However, it represents roughly 25% of our exports. To deliver on the Government's goal of growing the proportion of exports to GDP from 30% to 40% by 2025, there will have to be substantial growth in services exports. Improving productivity in the sector will be a crucial contributor to this growth.

The economic importance of the services sector is not often well understood by policy makers, and this is at times reflected in prioritisation across a wide range of policy areas. As recently as 2005, the New Zealand Government was prepared to sign a Free Trade Agreement (FTA) which excluded services (Thailand). In trade policy, it has been seen as a poor cousin to goods. In New Zealand's case, the pecking order has often been agriculture, manufactures and only then services.

2. BusinessNZ's Membership & Consultation

The structure of BusinessNZ's membership means that a significant proportion is either directly or indirectly involved in the services sector.

Therefore, in addition to BusinessNZ's submission, various members of BusinessNZ's regional associations, affiliated industries group and major companies group[1] will also be submitting on this document. We expect that much of the information provided by our members will typically be industry specific, while our views cover the services sector as a whole.

To further assist the NZPC with its inquiry, we note that a meeting of interested services sector companies and organisations has been set up and hosted by BusinessNZ for 6 May, so that direct discussions could be had in terms of information provided to the NZPC to assist in the development of future reports.

As we point out subsequently in this submission, taking into account the views of industry associations/organisations will be key to ensuring the final report provides the most relevant recommendations.

3. Specific Points of the Paper

The Paper asks whether the Commission's proposed approach to the inquiry would deliver the best outcomes for New Zealand, and how the approach could be improved. First, we believe that, in general, the NZPC is taking the correct approach to the inquiry, particularly the splitting up of the inquiry into:

Part A: A broad assessment of the services sector; and

Part B: Detailed analysis of topics that are 'critical for lifting productivity in the relevant parts of the services sector'.

We note that the paper asks 23 specific questions. BusinessNZ does not intend to answer each one. Instead, we wish to provide comments on certain questions that we believe will assist in maximising the effectiveness of the inquiry through interim reports and the final report to be published over the next ten months.

3a. Additional Data Sources

Question 2 of the Paper also asks what relevant publications and data sources the Commission should explore for this inquiry.

Domestic Statistics

First, it goes without saying that official data produced by StatsiticsNZ involving areas such as GDP, employment and productivity must be included in the interim and final report so that an accurate picture of the sector can be established.

However, a symptom of the generally poor understanding of the services sector is the poor quality of services statistics. For instance, the monthly trade statistics

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[1] Encompassing four regional business organisations (Employers' & Manufacturers' Association, Employers Chamber of Commerce Central, Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), its 81 member Major Companies Group comprising New Zealand's largest businesses, and its 76-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, BusinessNZ is New Zealand's largest business advocacy body.

exclude services (even though they are 25% of the total), and likewise when the Prime Minister and others give speeches quoting trade levels they almost always are referring to goods trade. For some markets – e.g. Australia and China, the services component of our trade is extremely important and cannot be ignored by policy makers. New Zealand Trade and Enterprise (NZTE) have traditionally found it very difficult both to understand and to support services trade. As a consequence, work previously done by NZTE has been transferred to Education New Zealand and Film New Zealand.

Recommendation: That the NZPC examine ways in which regular trade statistics could incorporate activity from the services sector.

International Statistics

It is similarly important that internationally comparable data, such as that outlined on pages 21-22 of the Paper, are included so that similarities and differences can be assessed.

We would like to point out an additional data source as a way in which to back up the need for this inquiry. BusinessNZ, in association with the Bank of New Zealand, produces a monthly activity index on the private sector of the service industry in New Zealand, the BNZ BusinessNZ Performance of Services Index (PSI). Like its sister survey that examines the manufacturing sector, the PSI provides a regular update on the overall health of the services sector.

Figure 1

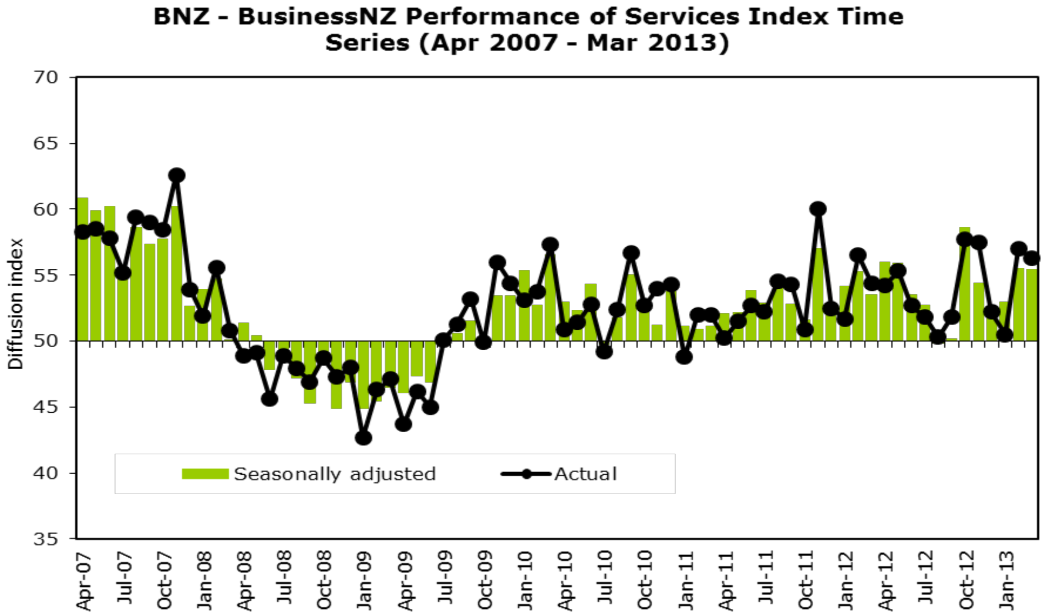

Figure 2: JPMorgan Global Performance of Services Index (2005-2013)

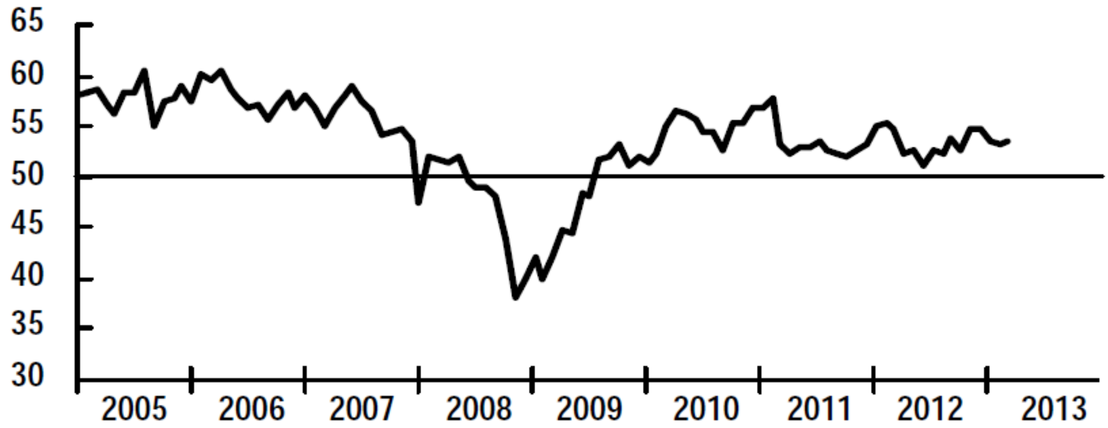

Figure 1 shows the main unadjusted and seasonally adjusted results for the history of the New Zealand PSI, which began in 2007. A PSI reading above 50 points indicates services activity is expanding; below 50 indicates it is contracting. Figure 2 shows the global PSI result, which New Zealand is part of, and takes into account an estimated 78% of activity in the global services sector.

As other data indicates, post the Global Financial Crisis the services sector has struggled to find its feet again compared with the level of activity seen in pre-2008. While current results for both measures are now back in positive territory, the fact that five years have passed where activity has been middling to stagnant, indicates that an inquiry to examine ways in which to boost productivity are clearly required.

Recommendation: That the internationally recognised Performance of Services Index is taken into account in the following reports when providing a background to comparing New Zealand's services sector activity in a global setting.

3b. Exclusion of the Public Sector in the Terms of Reference

We note that point 14 of the terms of reference for the inquiry stipulates that *"consideration of productivity in the services sector should be limited to market-provided services and therefor exclude study of services provided directly by the public sector"*. The reasoning for this is that *"the Government has a wide programme underway to improve public sector productivity, detailed consideration of this sector is not possible within the time available to the Commission, and measurement issues in this sector also make analysis difficult"*.

Nevertheless, the exclusion of services within the public sector represents close to a quarter (23.9%) of all service industries in New Zealand, as outlined in figure 1 of the Paper. In terms of boosting productivity, this means a substantial section of the services sector will not be examined.

Much of our international trade occurs with the involvement of public sector entities. Universities, Polytechnics and Schools are all engaged in international trade. The Metservice, Airways Corporation and Learning Media are all examples of state owned entities that trade internationally. There is no reason why our hospitals could not be as active in international trade as our universities. It is our belief that international education is the second largest service export industry, taking $2,7 billion in foreign exchange in 2011. Much of this trade is carried on by publicly owned entities, so excluding these entities means excluding an important part of the sector.

We also note that the Paper states that *'a decision to exclude an industry or service would not mean that the Commission considers it to be unimportant, nor would it exclude that topic from being the subject of a future inquiry'*. While we accept that the Government currently has a wide programme underway for boosting public sector productivity, we believe a future inquiry into the success or otherwise of any changes made by the Commission should take place.

Recommendation: That the NZPC conduct an inquiry in the near future regarding ways in which to boost public sector productivity.

3c. Public Perception of the Services Sector

We agree with the point raised on page 6 of the Paper that while many 20th century assessments of the service sector were disparaging, describing service industries as *'sources of low-skill, low-wage jobs' that are 'part of a stagnant sector marked by low productivity growth and only limited opportunities for innovation' ... This characterisation is no longer useful'*. We concur with the Commission that while this description of the service sector for certain industries was once probably true, the service sector of the 21st century is highly diverse, with certain sub-industries being prime drivers of growth.

Unfortunately, the public perception of the services sector is often still coloured by those 20th century assessments. Therefore, it is important that such perceptions are not intentionally or unintentionally continued through to younger generations who are assessing options for post-secondary study that will eventually lead to employment positions in certain industries. In short, clear and accurate information needs to be provided to students to show how various elements of the services sector involve high-skill, high wages employment opportunities.

Recommendation: That the inquiry takes into account the need for clear and accurate information to students to show how various elements of the services sector involve high-skill and high wage employment opportunities.

3d. Services Sector Role in the Economy

Overall, we agree that services sector productivity can affect the performance of other sectors. Question 4 of the Paper asks whether weaknesses and gaps in service industries handicap the performance of other industries, and if so, how. While this is an important issue, from BusinessNZ's perspective we believe it is equally important that the Commission turns this question around and also asks whether weaknesses and gaps in the primary and goods producing industries handicap the performance of the service sector.

Recommendation: That the inquiry examines whether weaknesses and gaps in the primary and goods producing industries handicap the performance of the services sector.

3e. Increased Blurring of Boundaries between Services & Manufacturing

In addition to the point above, we believe it is important that the NZPC takes into account the increasing blurring of boundaries between the services, goods producing and primary sectors.

For instance, international evidence, thinking and research over recent years shows that many manufacturers now have a services based element to their business. This has led to the rise of 'manu-service' businesses, which are said to have replaced high-tech industry as the key source of potential comparative advantage for economies engaged in advanced manufacturing. Many businesses, both in New Zealand and offshore, now sell a complementary range of services around their main product. This ensures that they can meet the needs of their customers, while at the same time providing an additional stream of revenue.

Therefore, BusinessNZ believes the Commission needs to take this issue into account in their interim reports.

Recommendation: That the inquiry takes into account the increasing blurring of lines between the primary, goods producing and services sectors.

3f. Industry-by-Industry Analysis

We agree with the view taken in the Paper that the overall picture of services sector productivity is mixed, and that evidence of poor productivity levels and low growth rates of some service industries is concerning. To rectify this, the Paper states that *"the Commission intends to present an industry-by-industry analysis of the sector in its report on Part A of the inquiry"*, and BusinessNZ believes that is an important step in better understanding the similarities and differences across the wider services sector.

However, we believe a full and frank assessment of each services industry needs to include consultation with the main private sector associations/organisations in each of the sub-industries. This should provide the Commission with both an in-depth sector view on productivity related issues, as well as an idea of the previous and current regulatory paths certain services sectors are heading down. This would assist the NZPC in outlining potential productivity roadblocks, and would also be consistent with point 16 in the terms of reference which states that the Commission should consult with key interest groups and affected parties.

Recommendation: That the NZPC consult the major private sector association/organisation associated with each major services sector identified for analysis.

3g. Productivity Gaps Between Firms

Question 5 of the paper asks what are the causes of the productivity gaps between firms in the same service industry or sub-industry, and what can be done to reduce such gaps?

The Paper points out that firms providing differentiated services, or serving different market segments will have different productivity levels. Therefore, such variability suggests that there is significant scope for the lower performers to improve.

We agree that identifying productivity gaps between firms in the same service industry or sub-industry is important. However, we would probably go back one step and ask what is the greater goal of the inquiry from a New Zealand economy perspective? While point 7 in the terms of reference state *that the purpose of the inquiry is two-fold: to provide an overview of the role of services in the New Zealand economy and to provide policy options to lift productivity in the services sector*, lifting productivity can come from either examining ways in which to raise the bar for those displaying low productivity, or further turbo charging the productivity of those already experiencing high productivity.

Obviously, the inquiry does not need to take a mutually exclusive approach to these two courses of action. However, with finite time and resources for this inquiry, we believe the NZPC needs to be conscious of the pathway for policy options that will provide the greatest outcome for the New Zealand economy.

Recommendation: That the NZPC ensure Part B of the inquiry examines options that have the greatest chance of lifting overall economic growth, as opposed to options that have the greatest chance of lifting productivity in a particular services sector.

3h. International Trade in Services

The Paper states that a common myth is that services are unable to be traded internationally. While this may be true for certain services, it does not hold for all, with particular services providing substantial income for New Zealand's economy.

Barriers to the Export of Services

Question 10 asks what are the barriers to the export of service, while question 11 asks to what extent are there barriers to the efficient import of services?

From BusinessNZ's perspective, there are numerous barriers to the export of services, but they are often more complex and less transparent than barriers to trade in goods. Often, the barrier is not at the border, but behind the border in laws and regulation. There is also a big cross over between services and investment barriers

(Mode 3) and immigration policy (Mode 4). The barriers are well understood and are explained in OECD and World Trade Organisation (WTO) studies.

New Zealand is relatively open, but there are still barriers here. We would argue that the medical profession is a good example of a profession that it still heavily protected (note it is excluded from the Trans-Tasman Mutual Recognition Arrangement). Everyone else is generally open to, at least, competition from Australia because of TTMRA.

In terms of how to rectify this situation, domestic barriers should be eliminated by unilateral government action, while foreign barriers should be addressed through Free Trade Agreement (FTA) negotiations that actually achieve liberalisation and through the re-launch of WTO negotiations. Again, these negotiations should be seeking real liberalisation as opposed to the codification of existing regulation.

Trade in Services & International Agreements
Question 14 asks how trade in services is affected by New Zealand's current international agreements.

From our point of view, TTMRA and the Closer Economic Relations (CER) Services Protocol are crucial to maintaining strong competition across our domestic services economy. Other negotiations have less impact, but the Trans Pacific Partnership Agreement (TPP) may make a real difference if the United States pushes hard for the removal of remaining barriers.

We believe that our negotiators must insist that future negotiations include all four modes of services supply and achieve to the extent possible, a liberalisation of barriers in all areas. Past negotiations have at times excluded services or had outcomes that have achieved minimal liberalisation.

3i. Relationship between Productivity & Wages
Question 16 of the Paper asks what is the scope to raise productivity and wages in service industries that traditionally employ low-skill workers, and how could this best be achieved.

The Paper points out some current schools of thought on this, such as where the productivity of low wage/skill requirement industries could be improved by raising wage levels – the so called theory of 'efficiency wages'. Another argues that a market-driven or mandated rise in wages incentivises firms to lift productivity by, for example, investing in more, and more modern, capital equipment. Those unable to do so will be forced to close down.

While we appreciate that the NZPC is taking an open approach to views on the matter, we would like to point out that any regulatory attempt to force employers to pay more and hence eradicate low paid 'unproductive' jobs is fraught with danger for the wider economy.

Low paid employment may well reflect the productivity of the individual employed. Artificially increasing wages, through such mechanisms as a higher minimum wage or a ‘living’ wage, assuming these can be successfully policed, may result in increased wages for people who keep their jobs. However, by and large, the result will be fewer such jobs than would otherwise be the case. The fact that some low paying jobs are lost does not necessarily mean people will simply move into other paying jobs, particularly if their skill levels are low.

In reality, internationally mobile industries can now tap into highly competitive and increasingly skilled labour in other countries. Many firms will simply not use domestic labour at wage rates which underwrite higher standards of living unless productivity increases proportionately.

For these reasons, BusinessNZ believes it is preferable for the NZPC to examine the issue of productivity and wages for the services sector by way of mechanisms that do not encompass government-driven setting of wages, but rather industry-led opportunities.

Recommendation: That an examination of productivity and low wages in the services sector do not encompass government driven setting of wages, but rather industry-led opportunities.

3j. Regulating Service Industries

Question 18 asks which service industries are significantly affected by industry-specific regulation, and whether there are opportunities for improvement.

As outlined above, we have taken the opportunity to discuss aspects of regulation in relation to service industries. In addition, we have previously pointed out to the Commission via our proposals for the third tranche of inquiries that while most occupational licensing can be justified on public safety and/or consumer protection grounds, it is also important for it not to restrict entry into occupations on grounds that are clearly not justified. Unjustified controls simply reduce the number of practitioners in the field and raise costs.

BusinessNZ believes there are three aspects that need to be examined to properly address this question. First, it is important to analyse the common regulatory environment affecting all services sector groups (i.e. the employment legislative landscape). This would help identify common areas across the sector that could be changed to boost productivity across a major part of the economy.

Second, as alluded to in the Paper, there will be certain generic legislation that will have particular adverse impacts on certain sectors of the economy, such as the Holidays Act 2003 and its effect on certain service industries.

Last, the examination of industry specific regulation, with the assistance of the industry associations/organisations, would identify specific areas such as those in training, health & safety and standards where there is need for improvement.

Recommendation: That the NZPC take a broad view in terms of how generic regulations and industry specific regulations affect the services sector.

Thank you for the opportunity to comment, and we look forward to further discussions and the release of the interim reports.

Kind regards,

Phil O’Reilly
Chief Executive
BusinessNZ