NZMEA
SUPPORTING THE REAL ECONOMY

2 May 2013

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

Email: info@productivity.govt.nz

Dear Sirs

Submission to Boosting Productivity in the Services Sector

Thank you for the opportunity to comment on the above document.

The New Zealand Manufacturers and Exporters Association (NZMEA) represent the interests of manufacturers and exporters throughout New Zealand.

The Association is New Zealand's only focused and independent voice for manufacturers and exporters. Members make over $2.7 billion in sales per year, with an export value of around $1.3 billion. The Association can trace its beginning back to the early history of New Zealand.

The Association also includes in its membership affiliate organisations such as the Wood Processors Association, the Engineering Printing & Manufacturing Union Inc, the Heavy Engineering Research Association (HERA), and Plastics New Zealand.

The NZMEA is an independent association of manufacturers and exporters. We do not seek or receive funding from local or central government; we have affiliate organisations, we do not affiliate to any other organisation.

We would be happy to meet with the Commission to discuss this submission.

NZMEA Comment

Question 1: Will the Commission's proposed approach to this inquiry deliver the best outcomes for New Zealand? How could it be improved?

We have some comments on the premise of the work the Commission is seeking to do.

- Consideration of the service sector without consideration of what is being serviced is not complete.

- The idea that services, primary and goods producing sectors can be considered independently is flawed.

- Are services a means to an end or an end in themselves? The answer to this question makes statements "70% of GDP" meaningful or meaningless.

- Most of the service sector has a domestic focus, which is not subject to the competitive pressures inherent in the traded sector; witness the difference between the traded and non-traded sector inflation over the long term.

- The quality of services supplied by the public sector does have a significant impact on productivity, from regulation development to the quality of trade agreements – they should not be excluded from consideration of boosting productivity.

Question 2: What relevant publications and data sources should the Commission explore for this inquiry?

Some references worth examining:

- Services economic driver or supporter: http://www.policyinnovations.org/ideas/policy_library/data/engines_of_growth_south_africa/_res/id=sa_File1/growth%20south%20africa.pdf

- Producer Services: http://cber.uky.edu/Downloads/Thompson2-04.pdf and http://papers.tinbergen.nl/07045.pdf

- Interdependences: more on Baumol in Box 3 (Baumol's cost disease of services, Page 12 of the Issues Paper April 2013): http://www4.ncsu.edu/~itkandil/seminar/huang.pdf

- More productive producer services do not lift productivity in goods production. http://ideas.repec.org/p/hst/ghsdps/gd09-076.html

Question 3: Which activities within the following industries are provided in a market (non-government environment): education and training; health care and social assistance; and public administration and safety? To what degree should the market-provided parts of these industries be included within the scope of this inquiry?

Education, training, healthcare, public administration and safety should be included in the review.

Despite what is noted in Box 3, the average service job is low paid; witness the median wage in manufacturing is higher than the average wage in the entire economy including manufacturing. It is clear that most jobs in services are low skill, personal interactions. It is equally clear that a minority of jobs are highly skilled with not too many jobs in the middle.

Question 4: In your experience, do weaknesses and gaps in service industries handicap the performance of other industries? If so, how?

Services are generally available when needed; on occasion they come with a ridiculous price tag as they are not subject to the same competitive pressure as the traded economy. It is probably worth thinking around a more focused set of service definitions, for example – consumer (personal) services, producer services, product services and product distribution – those terms might be more helpful in considering the economic interactions with other sectors.

As manufacturing becomes more elaborate, devices are bundled with different services to form a product. Product services can be informational or support for the products upgrade, use, repair, marketing and sale over the products life and could well involve interactions that support the products on-going development, sale and distribution. Some products have no bundled device, for example software, but need a device to operate. Products, bundles of device and services, increasingly blur the distinction between services and products. Products require distribution.

Producer services are those services in service supply chains consumed by producers. In the absence of producers there would be no demand for producer services in an economy. This interdependence is important to consider avoiding the simple conclusion that producers do not matter, and services will somehow take up the all the slack in the economy. The post-industrial service economy is a fantasy.

Consumer or personal services are, for the most part, supplied and consumed at the same time in the place.

These might be important conceptual distinctions when considering long term economic development and associated policy settings.

Classification is a key matter for the metrics, for example due to differences in ACC levies, many companies have restructured into different entities, a production company plus a sales and marketing company, separating the people employed in an office environment compared to the “factory”. After the change there exists a producer and a producer service provider as opposed to a single manufacturing company – statistics around this trend might misrepresents the true picture of the economy.

Furthermore the trend of outsourcing services, as opposed to employing people in the firm for accounting, marketing and information technology exacerbates this distortion and underlines the difficulty of services as separate from other parts of the economy.

Question 5: What are the causes of the productivity gaps between firms in the same service industry or sub-industry? What can be done to reduce such gaps?

It is hard to reconcile the productivity index numbers with what we observe in the economy. In the goods producing sector productivity growth seems far stronger due to competitive pressure than the productivity growth in the non-traded service sector. Equally, in the non-traded sector without strong cross border competition better tolerates variation in efficiency.

Question 6: What is the potential for improved productivity and growth in service industries that you are familiar with? What are the impediments to improved productivity and growth in those industries?

Producer services are likely to be well defined and targeted so efficiency and speed become the focus given functional quality.

Product based services are elaborated to extend the device utility and value, here the trade-off is a value perception created by the seller in the mind of the buyer.

Personal services may be provided at many quality standards above basic utility and depend largely on the natural demand for that “level” of service; essentially a high sensitivity to how well is the rest of the economy doing.

Question 7: To what extent is there insufficient competition in New Zealand’s service industries? In which industries? What are the impediments to competition in these industries?

Competition is limited for services consumed in New Zealand, witness the difference in inflation rates between the trade and non-traded sectors.

Question 8: What are the opportunities for productivity growth in service industries where production and consumption of the service happens in the same location, and demand is geographically spread out?

If production and consumption are co-located and demand is distributed, provided that demand cannot be satisfied in any other way it is likely to be most productive from the producers standpoint. The threat is the demand pattern changes for example, home delivery meets the distributed demand co-locating consumption and demand which is probably less productive from the producer standpoint but more productive from the consumption standpoint, it is hard to generalise in regard to overall productivity.

Question 9: Are there service industries that perform less well than they could due to problems such as low levels of skills; or lack of specialised inputs, scale, appropriate infrastructure or opportunities for agglomeration? What are the impediments to improving productivity and growth in these industries?

There are examples of specialised producer services (technical) not being available in New Zealand.

Question 10: What are the barriers to the export of services? What are the economic impacts of those barriers? What can be done to reduce them?

We would agree that service (in particular service associated with products) is understated in the statistics. Generally the more elaborate the product the greater will be the inherent service content, supporting distribution and market development. There are building issues around tax residency and compliance issues across jurisdictions. If a US resident buys software, sold and supported from New Zealand where does the tax liability stand on revenues flowing from the US? Similar problems exist in many transnational distribution channels.

Question 11: To what extent are there barriers to the efficient import of services? What are the economic impacts of those barriers? What can be done to reduce them?

The nexus of consumption and production proximity has not been broken for producer services; legal services could be sourced offshore by the consumer but are more likely to be sourced offshore by the local legal service provider aiming to lower costs. Generally there is a reluctance to distance these relationships.

Question 12: What barriers exist to the cross-border movement of people that affect international trade in services? How do those barriers affect New Zealand service industries and the economy more generally? Are there opportunities to remove or reduce these barriers?

Moving people around is not generally reported as a problem.

Question 13: What barriers exist to cross-border investment in service industries? How do those barriers affect New Zealand service industries and the economy more generally? Are there opportunities to remove or reduce these barriers?

Problems reported on cross border investment relate to double taxation issue on repatriated profits.

Question 14: How is trade in services affected by New Zealand's current international agreements? What features should negotiators seek or avoid in future agreements, and why?

How trade agreements link to locally supplied services and potentially services supplied by the trade partner can have a major impact on product exports. For example the Mutual Recognition Agreement associated with the China Free Trade Agreement has been a disaster and remains an open question five years since the Agreement was signed. The Agreement references factory inspection services, special product test services and overarching compliance services that are not available in New Zealand.

Question 15: To what extent do New Zealand services businesses invest in, and make effective use of, ICT? What are the barriers to them doing so?

ICT is generally well used in New Zealand. Broadband infrastructure is patchy and does create some problems but these are generally fixed by relocating.

Question 16: What is the scope to raise productivity and wages in service industries that traditionally employ low-skill workers? How would this be best achieved?

For general consumer services low wages are set, in our view, by the average wage levels in the economy, how much will consumers pay for a cup of coffee and how much more productive can the person making the coffee become. Low average wages across the economy will inevitably see low wages for entry level, low skill service employment. Higher earnings in the general economy support demand for higher quality differentiated consumer (personal) service.

Question 17: Are there non-targeted regulations that have a disproportionately negative impact on service industries? How can this situation be improved?

Holiday and opening hour regulations have a disproportionate impact on retail operations.

Question 18: Which service industries are significantly affected by industry-specific regulation? Are there opportunities for improvement?

Holidays and opening hour regulations have a disproportionate impact on retail operations.

Question 19: Are there important issues relating to intangible assets in service industries that the Commission should investigate?

Intangible assets are not peculiar to service industries; financing and valuation in the absence of physical assets does have its challenges but these appear to be dealt with one way or another.

Question 20: What are the most important policy issues relating to management, organisational culture and employee skills in the services sector?

No comments to make.

Question 21: What other policy issues have an important impact on productivity in the services sector?

No comments to make.

Question 22: What topics should be considered for in-depth analysis in Part B of the inquiry? In what ways do they meet the criteria in the Terms of Reference?

- Work on the dependences in the economy. Are services a driver or a supporter of the real economy? Are they both? Should they be seen as separate or integrated? Are some aspects really siloed and others interdependent? Reporting and understanding the difference would be helpful.
- Differentiate the types and characteristics of each type of service – consumer (personal), producer, product (device + service) and distribution?
- Add clarity to the thinking around services by drawing these distinctions.
- What do the numbers behind the headlines mean?
- What should policy be doing as a result?

We appreciate the opportunity to comment on this Issues Paper.

Yours sincerely

John Walley

John Walley
Chief Executive