

SUBMISSION



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To: Inquiry into the Service Sector
New Zealand Productivity Commission
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Submission on: Inquiry into the Service Sector

From: Federated Farmers of New Zealand

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SUBMISSION TO THE NEW ZEALAND PRODUCTIVITY COMMISSION ON ISSUES PAPER: *BOOSTING PRODUCTIVITY IN THE SERVICES SECTOR*

1. INTRODUCTION

- 1.1 Federated Farmers welcomes the opportunity to provide this submission to the New Zealand Productivity Commission on the issues paper *Boosting Productivity in the Services Sector*.
- 1.2 Federated Farmers considers this inquiry to be important because with services making up around 70 percent of GDP, improvements to productivity in the service sector will help New Zealand close the income gap with the OECD. Moreover, services are also widely used by the agricultural sector so any improvements in service sector productivity will also benefit farmers and will further boost the economy through improved agricultural productivity.
- 1.3 In this submission Federated Farmers will make general comments about the services sector, its importance to agriculture, and some of the important issues for the Inquiry to consider.
- 1.4 Federated Farmers looks forward to this inquiry unfolding and delivering recommendations to improve the service sector's productivity.

2. SUMMARY OF RECOMMENDATIONS

- 2.1 Federated Farmers recommends that:
 - (a) 'Electricity, Gas, Water, Water and Waste Services' (ANZSIC D) should be included in the definition of 'service' for the purpose of this inquiry.
 - (b) 'Agriculture, Forestry and Fishing Support Services' (ANZSIC06 A05) should be included in the definition of 'service' for the purpose of this inquiry.
 - (c) The Inquiry should be able to consider issues around public sector productivity, including initiatives to improve it.
 - (d) The Inquiry should consider how regulatory trends are a factor in the growth of the service sector.
 - (e) The Inquiry should look closely at issues around scale and competition in the service sector.
 - (f) The Inquiry should take a broad view of how generic regulations and industry-specific regulations could be improved for the services sector.

3. SCOPE OF THE INQUIRY

- 3.1 Federated Farmers agrees that services are highly diverse and that the boundaries between goods and services can be 'rather fuzzy'. We also agree with the use of ANZSIC06 to define services, although the Federation notes that many would regard 'goods' such as electricity to be a 'service' provided to consumers (in the same way that 'telecommunications' falls within the ANZSIC06 definition of a 'service').
- 3.2 **Recommendation: Federated Farmers recommends that 'Electricity, Gas, Water, and Waste Services' (ANZSIC06 D) should be included in the definition of 'service' for the purpose of this inquiry.**

- 3.3 The Federation also notes that 'Agriculture, Forestry and Fishing Support Services' is a sub-sector within the broader ANZSIC06 sector 'Agriculture, Forestry and Fishing' (i.e., ANZSIC06 code A05). This sub-sector should be considered as one of the service sectors for the purpose of the Inquiry. It is not only important sub-sector in its own right, with almost 6,000 enterprises employing more than 23,000 people¹, but its performance is critical for the performance of the agriculture, forestry, and fishing sectors.
- 3.4 **Recommendation: Federated Farmers recommends that 'Agriculture, Forestry and Fishing Support Services' (ANZSIC06 A05) should be included in the definition of 'service' for the purpose of this inquiry.**
- 3.5 Federated Farmers also notes that the Inquiry's Terms of Reference is confined to 'market-provided services' and that services provided by the public sector would be excluded. The public sector is a large 'chunk' of the service sector and excluding services provided by the public sector from the scope of the Inquiry is in the Federation's view unfortunate and misses an opportunity to learn from experiences (in both directions). We certainly accept that the Government already has a strong programme of initiatives to boost public sector productivity, but it would be useful for the Inquiry to be able to draw on the Government's public sector programme for lessons to apply to the private sector and vice versa.
- 3.6 **Recommendation: Federated Farmers recommends that the Inquiry should be able to consider issues around public sector productivity, including initiatives to improve it.**

4. SERVICES' IMPORTANCE TO AGRICULTURE (AND VICE VERSA)

- 4.1 Services are very important to the agricultural sector and agriculture is very important for the services sector. As discussed above, the 'Agriculture, Forestry, and Fishing Support Services' is significant in its own right, providing a wide range of services such as crop management, shearing, animal health, fertiliser spreading, grazing, fencing, etc. But farms are also extensive users of other more 'general' services, such as finance, energy, transport, insurance, telecommunications, accounting, and legal. Farmers and their families are also important customers for many personal services.
- 4.2 The Ministry for Primary Industries' Pastoral Monitoring Report provides an annual snapshot of farm expenditure. The table below ranks expenditure for dairy and sheep and beef farms.

Table 1: Budgeted Farm Expenditure for 2012/13

Working Expense	National Sheep & Beef		National Dairy	
	2012/13 Budget	Increase on 2011/12	2012/13 Budget	Increase on 2011/12
Permanent Wages	\$21,586	+4.9%	\$94,881	+2.3%
Casual Wages	\$7,395	+0.8%	\$11,067	-12.5%
ACC	\$849	-9.2%	\$3,184	-13.1%
Animal Health	\$19,073	+2.3%	\$36,851	+4.2%
Breeding	\$2,270	+2.3%	\$19,651	-0.4%
Dairy Shed Expenses	0	--	\$11,024	+8.1%

¹ Statistics NZ Business Demography Statistics 2012.

Electricity	\$5,719	+8.9%	\$25,303	+20.8%
Feed (Hay & Silage)	\$8,037	-17.7%	\$64,847	-14.7%
Feed (Feed Crops)	\$3,589	-0.6%	\$2,631	+18.4%
Feed (Grazing)	\$1,505	-2.8%	\$90,545	+6.6%
Feed (Other)	0	--	\$31,054	-21.8%
Fertiliser	\$56,284	+5.6%	\$74,085	-6.7%
Lime	\$5,813	-8.6%	\$3,460	-13.0%
Cash Crop Expenses	\$3,049	+4.0%	0	--
Freight (not elsewhere deducted)	\$5,943	+2.9%	\$5,534	-3.9%
Re-grassing Costs	\$7,417	+0.1%	\$7,278	-3.6%
Shearing Expense	\$21,240	+2.5%	0	--
Weed & Pest Control	\$8,256	-5.4%	\$4,277	-0.4%
Fuel	\$13,128	+4.7%	\$15,673	+13.8%
Vehicle Costs (excluding fuel)	\$10,304	-2.0%	\$17,758	-0.1%
Repairs & Maintenance	\$24,308	-13.1%	\$46,533	-18.1%
Communication Costs	\$2,676	+2.2%	\$3,634	+2.9%
Accountancy	\$4,398	+1.1%	\$5,605	+2.0%
Legal & Consultancy	\$2,594	-1.6%	\$3,983	-3.4%
Other Administration	\$2,722	-4.7%	\$3,012	+1.2%
Water Charges (Irrigation)	\$444	+5.5%	\$4,551	+36.5%
Rates	\$12,165	+5.6%	\$14,738	+3.8%
Insurance	\$8,025	+11.9%	\$11,479	+6.0%
ACC Employer	\$4,430	-0.1%	\$5,019	+7.1%
Other Expenditure	\$3,162	+0.4%	\$7,173	-9.7%
Total Farm Working Expenses	\$269,475	+0.4%	\$624,829	-3.1%
Bank Interest	\$43,023	-5.1%	\$168,589	-9.1%

Source: MPI Farm Monitoring 2012.

- 4.3 Although there are some 'fuzzy areas', most of these farm working expenses will have a greater or lesser 'services' component. What Table 1 shows is that farms do not work in isolation and they spend significantly on providers of farm inputs (goods and services) in order to run their businesses. The performance and productivity of the providers will therefore be very important for the performance and productivity of farm businesses.
- 4.4 Overall, farm working expenses were budgeted to be flat (sheep and beef) or down (dairy) for 2012/13 compared to 2011/12. This was more due to decisions by farmers to spend less rather than there being less price pressure. Indeed farm input price inflation is consistently higher than the general CPI. Beef + Lamb New Zealand notes that over the past five years on-farm inflation has run at 22.3 percent, 7.1 points higher than the CPI².
- 4.5 The decision to spend less for 2012/13 was in response to forecasts for a high exchange rate and lower commodity prices meaning lower farmgate revenue (down 6.0 percent for sheep and beef and down 18.2 percent for dairy). Unfortunately, since October 2012 (when the Farm Monitoring Report was released) the higher exchange rate and the drought will have caused many farmers to cut back further on some items, while increasing spending on others (such as feed).
- 4.6 The fortunes of the agricultural sector (good and bad) will impact heavily on the fortunes of the services sector, especially for those services focusing on agriculture. With agricultural incomes being by their nature volatile, swings in farmer spending, sentiment and behaviour will impact more significantly on 'services to agriculture' which tend to operate in the rural and provincial areas than on those services catering to the wider economy which tend to be more 'national' and based in the main centres.

² Beef+Lamb NZ, Movements in Sheep & Beef Farm Input Prices

5. IMPORTANT ISSUES

- 5.1 Federated Farmers agrees that the official productivity data on the services sector (in aggregate) does not make good reading, especially compared to the productivity of agriculture, which has been impressive in recent decades. Table 2 shows the relative productivity performance of sectors since 1978.

Table 2: Multifactor Productivity by Sector 1978-2011

Sector	Multifactor Productivity Growth (Average Annual % Increase)		
	1978-2011	1996-2011	2008-2011
Primary Industries	+1.9%	+0.4%	-0.6%
Agriculture, Forestry & Fishing	+2.3%	+0.8%	+1.9%
Agriculture	+2.5%	+1.1%	+2.8%
Forestry, Fishing, & Services to Agriculture, Forestry & Fishing	+1.7%	-0.8%	-2.5%
Mining	-0.7%	-1.8%	-7.1%
Goods-Producing Industries	+0.2%	+0.3%	-1.0%
Manufacturing	+0.3%	+0.7%	-0.7%
Electricity, Gas, Water & Waste Services	+0.2%	-2.4%	-3.3%
Construction	+0.2%	+0.6%	-0.6%
Services Industries	+0.6%	+0.7%	-0.9%
Wholesale Trade	+0.5%	+1.7%	-0.5%
Retail Trade	+0.2%	+1.1%	-0.3%
Accommodation & Food Services	-1.5%	-1.0%	-0.2%
Transport, Postal & Warehousing	+3.1%	+0.4%	-1.4%
Information Media & Telecommunications	+2.2%	+1.7%	+0.8%
Financial & Insurance Services	+1.1%	+1.6%	-1.4%
Rental, Hiring & Real Estate Services	--	+1.2%	-0.5%
Professional, Scientific & Technical Services	--	-0.7%	-0.9%
Administrative & Support Services	--	-2.5%	-5.9%
Arts & Recreation Services	--	-1.1%	-1.9%
Other Services	--	+2.1%	+1.1%
The Measured Sector	--	+0.6%	-0.9%
The Former Measured Sector	+0.9%	+0.7%	-0.8%

Source: Statistics NZ Industry Productivity Statistics 1978-2011

- 5.2 Agriculture's productivity performance stands out. But although services' productivity growth has been poor in aggregate it has been better than that of the 'goods producing industries' in aggregate. It is also important to acknowledge that some sub-sectors within the broader 'services industries' have also had relatively good productivity performance.
- 5.3 Federated Farmers therefore agrees with the Issues Paper's observation on page 6 that it is not useful to describe the services sector 'as a stagnant sector marked by low productivity', that service jobs are low-waged and low skilled, and services are low growth. However, there are undoubtedly parts of the service sector where these comments are true.
- 5.4 In spite of this the service sector has grown over recent decades, following a wider global trend. We agree with the description of the 'forces at work' described on pages 10-11 of the Issues Paper. However, we would also add the point that increasing regulation of the economy has also had an effect of

increasing the size of the services sector. Surveys of compliance costs have found that increasingly businesses need to use external advice to manage their regulatory obligations³. Examples include accountants for tax planning, and lawyers and various consultants across fields such as employment, workplace health and safety, and the Resource Management Act. Whole industries have grown up around the need for businesses to manage their regulatory risk.

5.5 Recommendation: Federated Farmers recommends that the Inquiry should consider how regulatory trends are a factor in the growth of the service sector.

5.6 Federated Farmers agrees that scale and competition will be important for productivity in the services sector. It is also true in other sectors. It is likely that agriculture's good productivity performance is a reflection of its exposure to international market forces and the competition from millions of competitors overseas which impacts on farm-gate prices received. Because of this exposure farming is required to continually improve its productivity and as part of this response we have seen a trend towards fewer and larger farms. For example, the since 1980 the number of dairy herds has fallen from around 16,000 to less than 12,000 while the average dairy herd size has increased from around 120 cows to nearly 400⁴.

5.7 New Zealand's small market size and its large number of relatively small businesses are likely to be a reason why there is low productivity in some service sectors. Geographic isolation also makes for less potential for overseas competition in the 'non-tradable' service sectors, although Internet commerce is and will in the future erode this isolation and open up more of the service sector to competition, to the benefit of consumers.

5.8 Issues around scale and competition are also true for 'services to agriculture', and the relatively high rate of on-farm inflation might reflect this (although price fluctuations of goods such as feed, fuel and fertiliser will also be an important factor). Putting aside the big national service providers in areas such as finance, insurance, electricity, telecommunications, etc., many of the businesses servicing the agricultural sector are small and localised and geography can be a constraint to getting large numbers of businesses competing for the business of farmers.

5.9 Farmers themselves are often keen to stick with providers they know and in many cases they are members of rural service cooperatives. That said, farmers are generally 'savvy' at getting the best price from their service providers (national or local) and are not afraid to negotiate for the best deals.

5.10 Recommendation: Federated Farmers recommends that the Inquiry should look closely at issues around scale and competition in the service sector.

5.11 Federated Farmers also agrees that issues around international trade in services are important. Given New Zealand's expertise in agriculture it would

³ For example, refer to Business NZ's Compliance Cost Surveys (undertaken from 2003-2008) which provide data on the use of external advice to comply with regulation and the costs of that advice.

⁴ NZ Dairy Statistics, Dairy NZ and LIC

seem obvious that services to agriculture should be a potentially lucrative services export.

- 5.12 Given the productivity benefits likely from greater use of information and communications technology (ICT), it would be useful for the Inquiry to look into the use of ICT. Statistics New Zealand's recently released Business Operations Survey contains (among other things) a wealth of information on business investment in and use of ICT by sector.
- 5.13 Federated Farmers is cautious about simply raising the wages in the 'low wage service industries'. Wages are likely to be low due to low productivity and an inability for employers in those industries to pay more. To raise wages without thought to these factors is likely to harm those businesses, add to inflationary pressures, and result in job losses.
- 5.14 Federated Farmers believes there is good potential to look into the regulation of service industries. This should be one of the main topics for the Inquiry. The experience of agriculture is that exposure to market forces and competition was a major driver for its high rate of productivity growth but it took far-reaching reforms (both industry-specific and generic) in the 1980s and 1990s to get that exposure. Many of the issues of concern about regulation are generic across all businesses but there are likely to be aspects of industry-specific regulation that could be looked at. The Business Operations Survey contains very useful information on sectoral perceptions of regulation.
- 5.15 Recommendation: Federated Farmers recommends that the Inquiry should take a broad view of how generic regulations and industry-specific regulations could be improved for the services sector.**

6. ABOUT FEDERATED FARMERS

- 6.1 Federated Farmers of New Zealand is a member-based organisation representing farming and other rural businesses. Federated Farmers has a long and proud history of representing the needs and interests of New Zealand farmers.
- 6.2 The Federation aims to add value to its members' farming business. Our key strategic outcomes include the need for New Zealand to provide an economic and social environment within which:
- Our members may operate their business in a fair and flexible commercial environment;
 - Our members' families and their staff have access to services essential to the needs of the rural community; and
 - Our members adopt responsible management and environmental practices.