Submission by

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 Commissions 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 Commissions 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 in New Zealand as over a million people don't have the skill needed to participate fully in working life. Poor literacy and numeracy skills are reflected in risks, errors, and accidents in the workplace, and contributes 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 in New Zealand. Covid-19 had highlighted this challenge given the talent cannot easily enter New Zealand at present.

Comparatively high qualification attainment rates in New Zealand does not necessarily relate to the level of skill or educational attainment. NCEA is undergoing literacy and numeracy reform following research 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 commissions F7.1 finding that concludes that "*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 performing R&D increased by 17 percent from 2012. This is promising for increasing innovation in New Zealand. Almost three-quarters of the funding for business R&D came from within the business itself.

BusinessNZ/ExportNZ advocates that more support from Government to incentivise R&D investment would ensure that high-value jobs are created.
As noted in our previous submission, CRI's 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. 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 their primary motivations are teaching and publishing, so working with industry cannot always be done promptly. Academics are not incentivised or rewarded for working with businesses and it is not easy for them to move jobs between academia and industry very easily. 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 their contribution to R&D that are more conducive to the needs of Industry. BusinessNZ/ExportNZ also agrees with the commissions 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 has had feedback from business that the new R&D tax incentive is not currently fit for purpose. Feedback is that the IRD and Callaghan Innovation are taking a very narrow interpretation on what qualifies as R&D, 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 has 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 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 to support 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 to set policy that acts as a magnet for multinationals and to develop attraction programmes to directly attract MNCs. These policy settings also need to make New Zealand attractive to investors by ensuring that the innovation ecosystem is world-class. These policy settings would need to be carefully and strategically set to ensure their success. Given New Zealand's distance from markets and customers, attraction policy should be focused on areas where New Zealand has a natural competitive advantage, such as the future of food or for weightless exports, such as R&D and IP creation, or for investment in high tech areas which are suited to having a large land mass and a small population, e.g., autonomous vehicle testing and rocket launching.

2.4. To attract more multinationals BusinessNZ/ExportNZ believes that the government should look at removing barriers to foreign direct investment. New Zealand is currently ranked 34/34 in the OECD Product Market Regulation Indicators for Regulation of FDI. As noted in our previous submission, 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 have facilitated the growth of more productive firms. New Zealand's Covid-free status has made New Zealand more attractive to overseas investors. New Zealand should be supporting the opportunity for more FDI, which may also help to improve New Zealand's productivity by deepening the availability of capital, as well as diffusion of knowledge and skills. The 2019 analysis of the Deloitte top 200 companies show that overseas-owned firms outperform both NZ owned, NZX listed state-owned entities and council-owned entities by a significant margin. BusinessNZ/ExportNZ recommends that barriers to overseas investment, particularly concerning the to the purchase or lease of "sensitive land" should be made more permissive, e.g., the current definition is anything over 5 ha, which is small enough to include many manufacturing campuses. The more barriers to investment that are put in place, the harder it is for businesses to grow. The risks of leasing or selling sensitive land to an overseas investor are no greater to leasing or selling the land to a domestic investor, given they are both subject to the same regulatory safeguards. The policy should reflect this position. What is important is that the investment results in highly paid jobs being created in New Zealand.

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 captures the reality of New Zealand's immigration, which is a necessity due to poor skills matching between education and labour market demand, variable educational outcomes, and a lack of understanding about the nature of the industries. 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 underfunding from Government to deliver services. While aged care is an essential public service in ensuring that older vulnerable people receive a suitable standard of care, and the sector is forecast to grow given New Zealand's demographics, there is still no skills pathway in to the industry from tertiary for caregivers (the qualification provides a broad social services for social work, aged care and disability care); no Apprenticeship type model for caregivers to be able to work their way up to nurses without quitting their jobs to re-enrol in tertiary education. This type of 'low skilled migration' as referred to in the report was the first sector to be given emergency immigration provisions recognising the criticality of their work during 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 is problematic and not fit for purpose. With the exception of working holiday visas, migrants on work visas must be paid equivalent to the median wage. While this is causing distortion in the labour market and risks driving down wages for New Zealanders, it is because employers must pay migrant workers a premium rather than competing on ‘cheap labour’ as the Commission suggests.

Further, the Commission ignores the realities of the New Zealand labour market – the demographics profile and work undertaken by Professor Paul Spoonley shows that New Zealand is now below replacement rate for the population – without immigration, New Zealand would be significantly disadvantaged both in terms of meeting current labour market demand and in future years. With no incentives or accountability for the skills and tertiary sector to supply the skills that New Zealanders need, immigration becomes the last resort to ensure that firms can operate, let alone look to innovate to be more productive. The robust economic fundamentals which are primarily labour based, and tight labour market has been proven with the unemployment figures tracking well below forecast and industries signalling skill shortages will hamper productivity further.

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

2.5. There is significant evidence that shows that good cluster policy and high productivity coincide. In Europe, particularly 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. These clusters account for one third of employment and half of Europe’s wages. BusinessNZ/ExportNZ is pleased that Government is taking a new approach to industry policy through *Industry Transformation Plans for* key sectors which 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 within his submission. This table is attached as appendix 1.

3. To Summarize

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

3.1. BusinessNZ/ExportNZ advocates for 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. A robust foundational education is crucial to supporting a highly productive workforce. Literacy and numeracy urgently need to be improved in New Zealand as over a million people don't have the skills needed 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 changes the future of work. PISA data shows that New Zealand is going backwards, so urgent intervention is necessary, or a generation of young people will be left behind.

3.2. BusinessNZ/ExportNZ advocates for a review of the innovation ecosystem, particularly the barriers to business engagement with the CRI's and universities and the implementation of the R&D tax scheme.

3.3 BusinessNZ/ExportNZ agrees with the commission's recommendation (R5.1), The Government should take a more proactive and deliberate approach to attract 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.

3.4. 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 the market, overseas market knowledge and relationships. BusinessNZ/ExportNZ believes that removing barriers to Foreign Direct Investment (FDI) is necessary for growing New Zealand's productivity.

3.4 BusinessNZ/Export New Zealand rejects the Commission's assertions that 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 demand for immigration.

3.5 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).

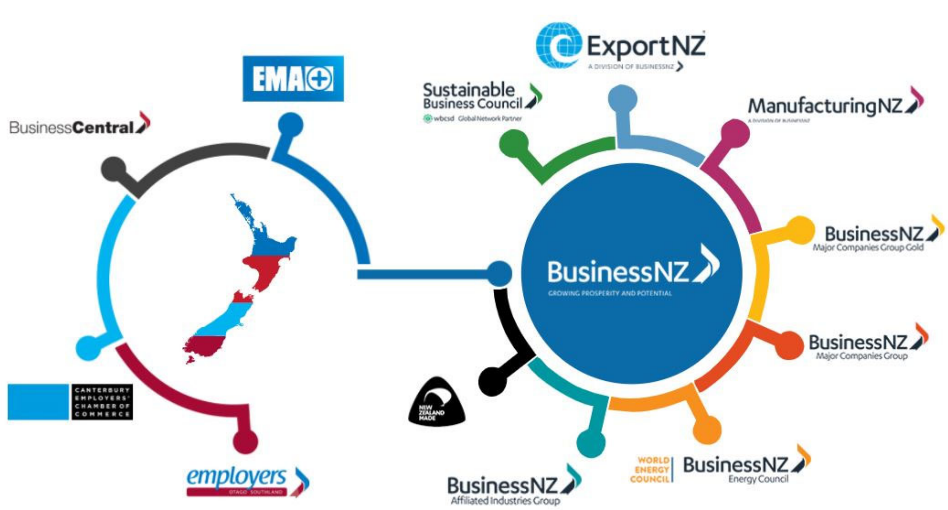
ABOUT EXPORTNZ

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

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. Cluster development is **not** a Top Down process. 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. This includes: • Encouraging regions to prioritise their competitive strengths; • Building triple helix alignment around those specialisations; • Emphasis on needs-driven, collaborative/pre-competitive R&D; • Partnerships between training providers and cluster firms; • 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. This key role is relationship building and learning-by-doing, exploring at the cluster's edges, **not** paralysis-by-analysis and yet another report. 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.
10.	An indicative level of funding to support a national cluster programme: **$20 - 25 million a year, for five years.** A relatively small investment for a centre-stage programme to lift NZ's regions, stimulating the growth of high value jobs and frontier firms.