

New Insights on New Zealand's Productivity Performance

In recent years Statistics NZ has done an excellent job of shedding light on the productivity performance of the economy. It made a further contribution with a release last month of productivity statistics at the industry level for the years 1978-2008.

Productivity is about how efficiently a firm or any other organisation can turn its inputs, such as labour and capital, into outputs in the form of goods and services.

Labour productivity, for example, is measured by Statistics NZ on the basis of output per hour of paid work for all employed persons. Working longer hours would not increase labour productivity (although it might increase total output).

Productivity matters because it is the key determinant of the country's material standard of living over the long term. (Other contributing factors could be an increase in workforce participation or improvements in New Zealand's terms of trade.)

Productivity can most reliably be estimated in what Statistics NZ calls the 'measured sector' of the economy. This is essentially the business sector and now accounts for around 74% of GDP.

An economy-wide productivity series is published by the OECD, but this includes industries (such as government administration and defence) in which the growth of outputs is difficult to measure and is sometimes simply proxied by the growth of inputs.

The official New Zealand statistics are also produced on a basis that is similar to that used in Australia, so that comparisons can be made between the two countries.

There are major challenges in measuring productivity, but a clearer picture of trends has been emerging in recent years.

First, productivity in the measured sector improved substantially following the economic reforms of the 1980s and early '90s. Indeed in the 1990s the growth rates of both labour and multifactor productivity (which reflects innovation and technological change) exceeded those in Australia.

With the change in policy directions from 1999, however, productivity growth declined markedly. In the nine years to 2009, labour productivity growth was poor and multifactor productivity did not grow at all. In 2008/09, both were actually negative.

In the latest release there are some new and interesting insights from the industry breakdown. Generally it shows that productivity gains were greatest in industries that were most significantly reformed.

The standout performer was the communications services industry, where labour productivity growth was a staggering 11.0% a year for the 20-year period 1988-2008. This casts doubt on the alleged failings of telecommunications policy in that period.

Substantial productivity gains were achieved in the industries associated with deregulation and the removal of subsidies, such as transport and storage, finance and insurance, and agriculture. The corporatisation and privatisation of state forestry also produced substantial gains. In these industries and in electricity, gas and water supply, New Zealand roughly matched or outperformed Australia for labour productivity growth.

Manufacturing also made a strong contribution to the overall productivity growth of the measured sector because of its size. Despite import liberalisation, manufacturing still accounts for 17.2% of GDP in New Zealand compared with 13.5% in Australia.

The economy-wide data paint a somewhat different picture, however, with labour productivity growing by 1.6% annually in Australia in 1988-2008 compared with 1.3% in New Zealand. Labour productivity growth in the non-measured sector has actually been negative in New Zealand in this period.

Official statisticians have suggested some technical reasons for the disparity between the two series. Other research suggests that productivity performance in parts of the public sector has been poor, although this cannot be inferred from the Statistics NZ data. The department is undertaking work to include 'education' and 'health' in the measured sector.

The general conclusions to be drawn from this analysis have important implications for the government's goal of catching up to Australian income levels by 2025.

The most obvious is that New Zealand needs to re-establish a superior productivity performance to Australia, and maintain it consistently for a decade and a half. This is not an impossible task, as the experience of high-income countries like Hong Kong and Singapore demonstrates.

Another is that economic reform is a never-ending process. The gains from one-off reforms fall away over time. New Zealand outstripped Australia's productivity performance for a time but the momentum of reform was lost from the mid-1990s (not helped by the advent of MMP).

A third implication is that productivity gains are needed in all sectors if aggregate performance is to be significantly improved. The announced changes in employment law, though modest, will help. But if parts of the public sector (like ACC) are sheltered from reforms, or policy changes in areas such as privatisation, superannuation or mining are ruled out, the goal will be very difficult to achieve.

Currently the income gap with Australia looks set to widen rather than narrow. Major improvements in productivity must be front and centre on the government's agenda.

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