# Productivity Hub Workshop Closing Address

## Speech delivered by Bryan Chapple on behalf of Gabriel Makhlouf, Secretary to the Treasury

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Good afternoon everyone. Thank you for inviting me to provide a few closing remarks at the end of this workshop.

I would first like to thank the Productivity Commission and all the members of the Productivity Hub for putting on this event. A special thanks is also due to today's speakers for sharing their insights and stimulating our thinking. In particular I want to acknowledge OECD Chief Economist Catherine L Mann for joining us. Bringing together experts with a common interest in productivity is a valuable way to provoke discussion, increase knowledge, and – most importantly – generate action.

Productivity, as we know, has been a persistent challenge. Indeed the OECD has flagged it as the most important medium term challenge for New Zealand.

Of course New Zealand has much to be proud of when you look at how we measure up against the majority of OECD wellbeing indicators. We rank highly in employment, health, air quality, social network support and overall life satisfaction. These are things we care a lot about, and rightly so.

But it's a different story when you look at our productivity. We are middle of the OECD pack at best in the amount of income we derive per hour worked, and we have made little or no headway on lifting our productivity performance rankings over the past 15 years. That's why cooperative efforts like the Productivity Hub and today's workshop are so important.

Our understanding of New Zealand's productivity performance is improving, thanks to a wealth of information that has recently been released including as a result of the Productivity Commission's report Achieving New Zealand's Productivity Potential, the OECD's

New Zealand Country Study and Going for Growth, and the Treasury's He Tirohanga Mokopuna. (That last one is a cracking read, by the way.)

I'm also pleased that we are making progress in our understanding of issues at the firm level, for example on technology diffusion and resource allocation. It's also evident that we are growing our understanding of how productivity enhances, but also depends on, other aspects of New Zealand's wellbeing. Aspects like Māori and regional economic development, skills and education.

Our challenge now is to keep building the momentum of progress and turning our growing understanding into action that lifts our productivity performance. Underpinning this is the use of data to inform policy, which is the essence of the investment approach.

The productivity challenge applies to the public sector as much as it does to the private sector. With core Crown expenses nearly 30 percent of the total economy, public sector productivity really matters. If we look wider to include the activities of organisations where the Crown has an ownership interest such as Crown Financial Institutions, State-Owned Enterprises, Mixed Ownership Model companies and Crown Entities, the significance of productivity becomes even more apparent. And perhaps most importantly, it's also the public sector – central and local government – that helps shape the rules and conditions in which the private sector operates. I am really looking forward to seeing the work from the Productivity Commission's new inquiry into State sector productivity.

As I mentioned, we have seen little improvement on where we rank among OECD countries for productivity, yet we have been told that we have world-leading settings.

This raises a few questions for me. The most obvious is whether what we've been told is right. And if it is right, does that mean that our very good settings will always be undermined by our size and distance – a case where plate tectonics overrides great economics? Or could it in fact be that New Zealand's world leading economic and policy settings aren't so world-leading anymore?

It's clear that the centre of global economic activity has been shifting towards Asia at a rapid pace. This can only benefit us as a trading nation. Countries like Indonesia, Malaysia, Viet Nam, The Philippines and, of course, India and China have millions of people and growing wealth. One estimate is for the Chinese, Indian and Southeast Asian middle classes to be almost 2 billion people by 2020. That is a vast group of markets for us. Part of our challenge is to position ourselves as a key part of the value chain. And, increasingly, trade within value chains happens within regions, so we need to not only focus on our immediate export markets, but also understand the ultimate destination of our exports. Promoting good regional trade within Asia will be an important complement to our own bilateral trade deals.

'World-leading' is always evolving. Looking back through history, Rome, China, India and the United Kingdom have all at times been world leading economies, just as the United States is today. So while some things will continue to hold for productivity and incomes, we need to make sure we are not working towards something that used to be world-leading, but is no longer so. It's also likely that what's world-leading will vary by country so it's not a recipe that we can simply copy.

So what matters for productivity? I'd like to cover five factors that the Treasury believes always matter: skills, connections, markets, resources and rules. To improve productivity we will have to be more effective in the utilisation of these factors and the interactions between them. But we will also have to make sure we keep evaluating what works, and keep asking whether something needs to change or whether there are other avenues to explore or whether there's anything missing that could make a difference. You can never declare victory and stop looking to improve.

Let me start with skills, because they, and in particular the people that have them, are at the heart of productivity. The Treasury believes that opportunities remain to lift skills and resilience in the workforce, and it's important that those opportunities are pursued. Jobs growth has been strongest in those industries that have a greater concentration of workers with post-school qualifications. And labour market skill requirements are likely to keep increasing, especially as competition intensifies both domestically and in our export markets, and as the adoption of new technology – not least artificial intelligence – accelerates across most sectors of the economy. We also need to explore how we can better utilise the skills in our workforce, because there is increasing evidence internationally that under-utilisation of skills in the workplace inhibits productivity. One study by the OECD has suggested that reducing New Zealand's skills mismatch to best practice would increase productivity by 7.2 percent, compared with an OECD average of 6 percent.

Of course as the world changes, so too will the types of skills we need change. The need for people to develop more relevant and higher skills over time will require businesses and their employees to think hard about skill development and retraining. A key question for all of us is whether systems and incentives are supportive of lifelong learning.

The next factor is connections. Connections matter, in particular people-to-people connections. And as Asia continues to dominate economic activity, perhaps those types of connections – i.e., relationships – matter more than ever. Improving connections can help to improve the flow of people, capital, trade and ideas that contribute to productivity. Strong people-to-people relationships build confidence and understanding and promote learning. They help our businesses to identify capabilities that will help them improve their productivity and ultimately compete and succeed in both domestic and global markets.

And markets is in fact the third factor I want to cover. In the Treasury's view we need to continue to lift the competitive intensity of the New Zealand economy. The pressure of competition pushes firms to be more productive, for example by innovation to improve quality or cut costs. We need to ensure our markets are as competitive as possible by reducing the barriers to entry, including for imports (whether in goods or services), or by regulating the price and quality of goods and services in markets where there is little or no competition, such as in our telecommunications and electricity markets. And we need to maintain the effectiveness of competition laws and institutions. If we want competitive markets and the productivity gains they bring, we have to ask ourselves: what are the regulatory barriers preventing competition and what can we do about them? How bold do we want to be to invite competition?

These aren't just questions for the tradable sector. Having a high-performing, productive, efficient and competitive non-tradables sector makes a big difference to the cost base for exporters, and it's great for our domestic economy too.

Our natural and physical resources are next. One of the most high profile issues we're examining in New Zealand – housing – illustrates how these resources are a significant factor in productivity. We are all aware of issues in house price growth in Auckland and the inefficiencies in our use of land which are proving to be a bottleneck in New Zealand's growth and productivity. The Productivity Commission has published a number of excellent reports on the issues here.

At the heart of the matter is the allocation and development of our natural and physical resources. At the moment, it can be argued that too much of our natural resource use is determined by incumbency rather than most efficient use. Better rules around use and around pricing externalities such as pollution are critical to making best use of resources and are likely to be key to promoting significant diversification of the economy and contributing to an improvement in productivity.

To use water as an example, the 'first-in first-served' approach to water allocation means it may not always be allocated to the highest value use, and the current system lacks sufficient incentives for use to move to a higher value one. The Freshwater Allocation Work Programme is considering options that could be more appropriate to ensure that we are getting the best use of our water resources.

And to briefly cite housing again, the degree of its affordability or unaffordability is a product of our entire urban development chain and of multiple interacting areas of policy. We're considering these issues holistically, as well as particularly how land owners capture the economic rents and potentially magnify the problems. We see the concept of competitive land markets as an important part of the way forward.

Finally, I want to talk about rules. The making of rules and regulations – whether by central or local government or even by self-regulated occupational groups – has an impact on productivity. All rule-makers help shape the environment in which investment, enterprise, and job creation is either promoted or limited. Rule-makers in the public sphere have a double responsibility: to ensure effectiveness in public spending and decision-making, and to provide the best possible regulatory and policy settings.

I believe the investment approach to policy-making can be an important driver to greater productivity, especially – but not only – in the public sector. Better data and powerful analytics can make a big impact in our understanding of the economic system, measuring the effectiveness of regulation and policy, and feeding evidence of performance back into decision-making. The Treasury is a fan of feedback loops.

We need to continue to test our assumptions about what does and doesn't work, and to apply new things were they make sense. I know there's a lot of willpower and brain power here to ask questions, find solutions and take actions to raise New Zealand's productivity.