What drives Productivity?

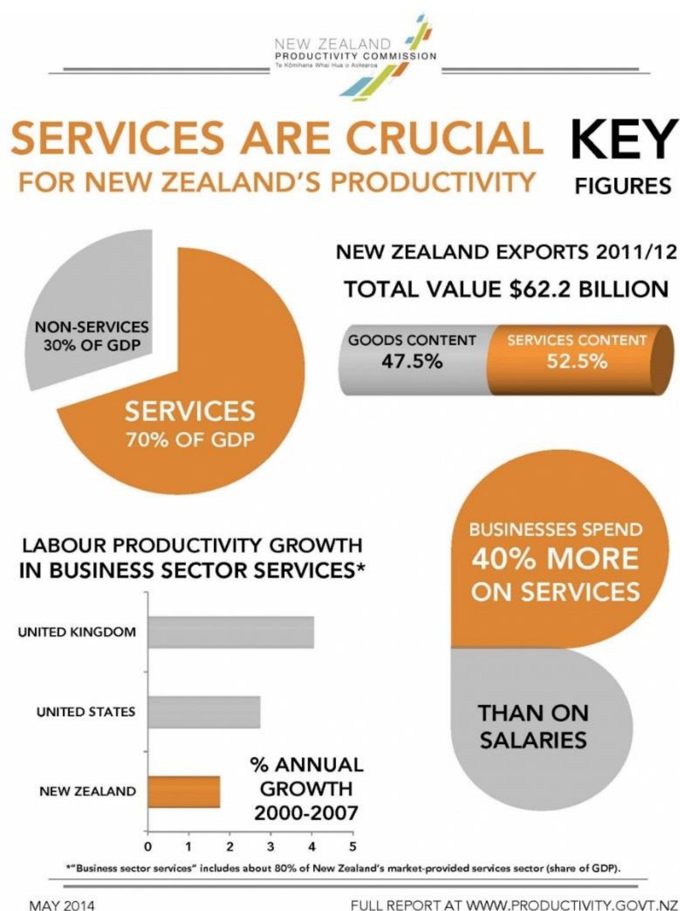
There is a general understanding of the main determinants – or “drivers” – of productivity growth. Certain factors are critical for determining productivity growth. The Office for National Statistics (UK) identifies five drivers that interact to underlie long-term productivity performance: investment, innovation, skills, enterprise and competition.

- *Investment* is in physical capital — machinery, equipment and buildings. The more capital workers have at their disposal, generally the better they are able to do their jobs, producing more and better quality output.
- *Innovation* is the successful exploitation of new ideas. New ideas can take the form of new technologies, new products or new corporate structures and ways of working. Such innovations can boost productivity, for example as better equipment works faster and more efficiently, or better organisation increases motivation at work.
- *Skills* are defined as the quantity and quality of labour of different types available in an economy. Skills complement physical capital, and are needed to take advantage of investment in new technologies and organisational structures.
- *Enterprise* is defined as the seizing of new business opportunities by both start-ups and existing firms. New enterprises compete with existing firms by new ideas and technologies increasing competition. Entrepreneurs are able to combine factors of production and new technologies forcing existing firms to adapt or exit the market.
- *Competition* improves productivity by creating incentives to innovate and ensures that resources are allocated to the most efficient firms. It also forces existing firms to organise work more effectively through imitations of organisational structures and technology.

Other drivers of productivity growth include effective supervision and job satisfaction. Having an effective or knowledgeable supervisor (for example a supervisor who uses the Management by Objectives method) has an easier time motivating their employees to produce more in quantity and quality. An employee who has an effective supervisor, motivating them to be more productive is likely to experience a new level of job satisfaction thereby becoming a driver of productivity itself.

So, why are we so low?

The Productivity Commission recently released a new report focusing on the Service Sector in New Zealand which accounts for 70% of GDP. Murray Sherwin the Commission Chair said:



"What surprised us most about the services sector was its deep and extensive linkages with the rest of the economy. Firms on average spend around 40% more on services than they do on wages and salaries. And services now account for over 50% of the value of New Zealand's exports when you include the value of services, such as transport and finance, that are embedded in goods exports.

"Given the centrality of services to our economy, a high-productivity services sector is a must. But unfortunately the productivity performance of New Zealand's services sector lags behind that of other developed countries and shows little sign of catching up. On the plus side, the scope for improvement is significant.

"A healthy level of competition is an important pre-requisite for lifting productivity. It drives innovation and gives consumers more choice, better products and lower prices. But in some parts of the sector competition is subdued – in part a consequence of New Zealand's small market size and geographic isolation.

Furthermore a recent report by the OECD showed that New Zealand was lagging in other areas such as:

- New Zealand firms face reduced access to large markets and limited participation in global value chains, where the transfer of advanced technologies now often occurs.
- Most of the rest of the gap reflects underinvestment in "knowledge-based capital". In particular, R&D undertaken by the business sector is among the lowest in the OECD, reducing the capacity for "frontier innovation" and the ability of firms to absorb new ideas developed elsewhere ("technological catch-up").
- The quality of management in New Zealand is also low, which lowers the productivity gains from new technology.