New Zealand's Low Value Economy

Bill Rosenberg
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An Analysis of New Zealand's Productivity Paradox

Prepared for Ann Pettifor of Prime Economics and The Policy Observatory, Auckland University of Technology

About this report

This report is one in a series prepared for Ann Pettifor's visit to New Zealand in September 2016. The reports provide background information on challenges facing the New Zealand economy and society, and are available on The Policy Observatory website.

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The Policy Observatory
Auckland University of Technology
Private Bag 92006
Auckland 1142

policyobservatory@aut.ac.nz
+64 9 921 9999 extn. 7531
https://thepolicyobservatory.aut.ac.nz/

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New Zealand's Low Value Economy

By Bill Rosenberg

While counted among the high income countries of the world, and currently going through a rare period where its GDP growth rates appear high compared to the rest of the OECD (due more to the state of many of its members than New Zealand's high performance), New Zealand's problems are in large part due to a model which has it running along a track of low value, low wages and poor productivity growth. In this paper I sketch some of the indicators and reasons for this, particularly in areas that affect incomes and productivity.

They in turn suggest some of the policies needed to create progressive change. We cannot avoid the bigger picture: that New Zealand's current state was designed this way in the neoliberal counter-revolution starting in 1984 which deliberately created a coherent set of policies which were made difficult to reverse. It was not intended to be low-value; but that was an evitable outcome because the faith in the 'free market' providing all solutions was recklessly misplaced. It produced a result that failed in its purpose of increasing the economic growth rate, but instead succeeded in increasing inequality – it redistributed to the rich and wealthy much more effectively than it changed economic performance.

Since the embedding of neoliberalism in the 1980s and 1990s there have been numerous changes, many of them to respond to the problems the model has created which range from absurdities to catastrophes. But its underlying principles remain intact. Only an equally coherent response can switch us to a higher value, fairer track. We start from what the OECD has called New Zealand's 'Productivity Paradox' and consider some possible explanations.

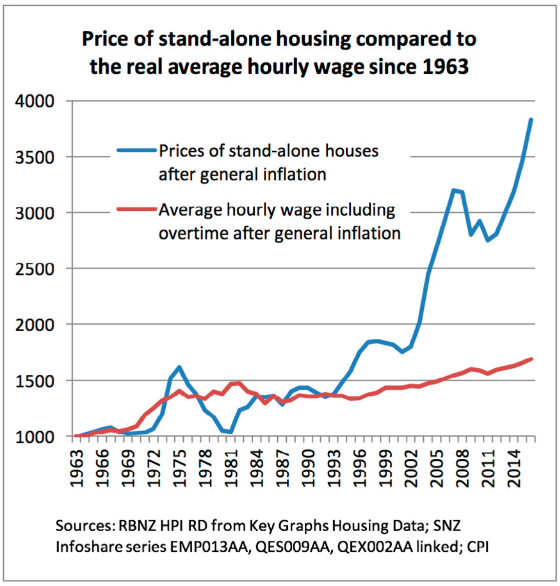
The Productivity Paradox

In its 2003 annual survey of New Zealand, the OECD commented: "The mystery is why a country that seems close to best practice in most of the policies that are regarded as the key drivers of growth is nevertheless just an average performer" (OECD, 2004). Even 'average' is overstating the case. The New Zealand Productivity Commission sums up the position as follows: "New Zealand has both low productivity levels and growth rates in aggregate and at the industry level and, as such, shows no sign of 'catching up' towards higher productivity countries" (Conway & Meehan, 2013, p. 33). At a symposium on the Productivity Paradox run by the Commission in 2013, the OECD (de Serres, Yashiro, & Boulhol, 2014) found that "the gap in labour productivity has continued to widen somewhat relative to most advanced OECD countries throughout the 1990s and, to a lesser extent, during the 2000s". Regardless, it stuck to its policy prescription. It also noted that New Zealand is "far below what would be expected in terms of trade intensity given its size" (p.24). The largest single reason that it could find to account for New Zealand's poor performance was our distance from markets. It should not need stating that New Zealand has not moved any further from markets since the 1950s, when it had a standard of living among the highest in the world. Indeed it is now closer to markets due to improved transport and telecommunications and the huge income growth in East Asia compared to Europe and the US since then. The OECD's primary recommendation was to further reduce barriers to international competition by yet more deregulation of products and professions (in one of the most open, deregulated economies in the world) and more research and development. It also comments on poor quality management (judged against US management practices), the need for better access to venture capital and "the labour market integration of low-skilled workers" (p.34). We shall return to some of these.

It is long past the time we should have accepted that what OECD economists label 'best practice' – little different from the standard neoliberal prescription, the now discredited 'Washington Consensus' – is not working, certainly for New Zealand.

A better set of policies must come from a diagnosis of what New Zealand's real problems are. As a contribution towards this, I sketch some features that largely escape investigation in official circles, and then focus on those to do with wages. While environmental and resource limitation issues are an increasingly important part of New Zealand's problems, I leave these to someone better qualified.

Excessive Finance



With growing evidence even from former citadels of neoliberalism, the IMF and the Bank of International Settlements (BIS), that there can be "too much finance" (Arcand, Berkes, & Panizza, 2012; Cecchetti & Kharroubi, 2012, 2015; Sahay et al., 2015), New Zealand needs to re-examine the regulation and institutions of its financial sector. BIS researchers estimated that for New Zealand, the growth in the size of the financial sector since the early 1990s "created a drag of nearly one half of 1 percentage point on trend productivity growth". This is a huge drag given annual productivity growth as they measured it (GDP per worker) averaged just 1.1% over the period. The Finance sector doubled its proportion of GDP from 1972 to 2013 from 3.0% to 5.8%. Its share of profits – gross operating surplus – tripled from 2.0% to 6.1%.[1]

The finance sector is therefore not much smaller in proportion to the economy than the bloated sectors in the US (6.9%) and the U.K. (7.6%) in 2013.[2] Household debt has reached a new peak of 165% of disposable household income, including debt on investment properties.[3] As the accompanying graph suggests, this reflects the origins of rampant house price inflation in New Zealand in the deregulation of finance and housing from 1984, and particularly from the early 1990s, disconnecting house prices from household incomes and sucking investment away from the productive sector. The swollen financial sector is not supplying the needs of productive business investment and innovation with the government stepping into venture capital provision (the New Zealand Venture Investment Fund) as well as retail bank and insurance provision. The lack of a capital gains tax encourages the imbalance towards property speculation and property investment.

The size and stability of the financial sector is difficult to control with open capital markets. Monetary policy both is severely weakened by the ready availability of international finance (the 'impossible trilemma' of the open economy) and has driven its increased use. The New Zealand dollar is the eleventh most traded currency in the world according to the BIS, contributing to a chronically overvalued exchange rate penalising exporters of goods and services.

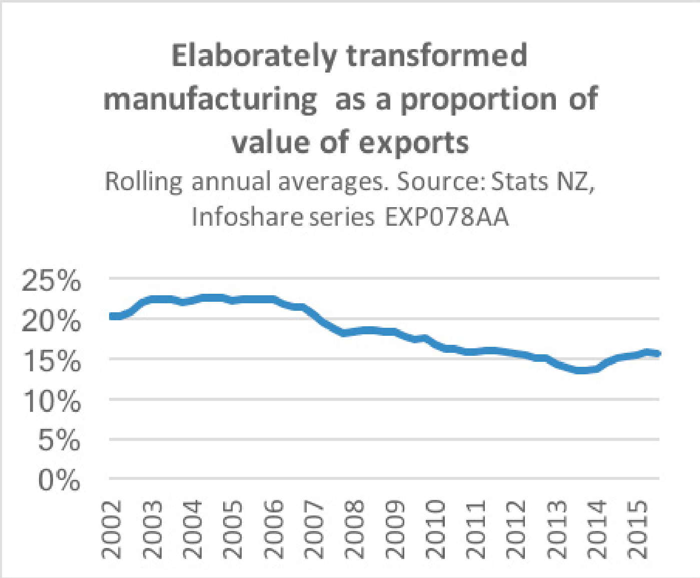
The situation demands tighter regulation of domestic and international financial markets.[4]

Income inequality

New Zealand's income equality rose rapidly between the mid-1980s and mid-1990s, one of the fastest rises in the OECD. Though it then largely stabilised at the new high level, the rise in inequality in most other OECD countries now places New Zealand in a cluster above the OECD median (Perry, 2016, p. 178ff). There are indications it is rising again (e.g. Perry, 2016, p. 84, Table D.8), particularly after housing costs. It is now widely accepted, including by the IMF and the OECD, that growing inequality is a brake on economic growth and productivity (e.g. Cingano, 2014; Ostry, Berg, & Charalambos G., 2014). Reducing New Zealand's high levels of inequality and poverty is therefore vital in its own right but is also important for productivity growth. Both 'pre-distribution' – a fairer wage system – and restoring the distributive strength of the taxation system are vital ingredients.

[1]Calculated from Statistics New Zealand, Infoshare series SNE089AA.
[2]US Bureau of Economic Analysis, table "Value Added by Industry as a Percentage of Gross Domestic Product", and U.K. Official of National Statistics, U.K. table "GDP(O) low level aggregates".
[3]At June 2016, Reserve Bank of New Zealand, Table C21 Key household financial and housing statistics, available at http://rbnz.govt.nz/statistics/c21.
[4]See Kelsey (2015) for a fuller description.

Industry

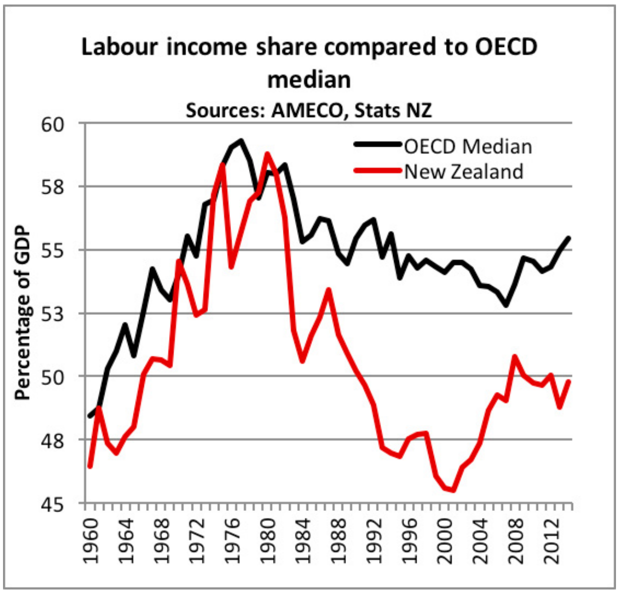


New Zealand's exports are excessively dependent on a relatively narrow range of land-based commodities and tourism. All have little value added and are subject to large cyclical price and volume swings. This is the result of destruction of productive (but internationally uncompetitive) manufacturers in the 1980s and 1990s, neglecting the need for policies to replace them with ones as good or better. Our low-value exports produce not only increasing environmental problems but also a "Dutch disease" effect, raising the exchange rate when their export values are high, pricing out higher valued exports such as manufactured goods. Combined with the effects of the financial system described above, this is toxic to trade in higher value goods and the export share of elaborately transformed manufactured goods has fallen in the last decade from over 22% of exports to 15%.

Our main exports – dairy, meat, forestry, horticulture, tourism – all pay near minimum wages with notoriously poor working conditions and increased reliance on low-skilled immigration. An exception is provision of education to international students, though many students are attending low quality private English language schools, doubtless often attracted by generous entitlements to work which add to the supply of low-skilled labour, and the possibility of New Zealand residence.

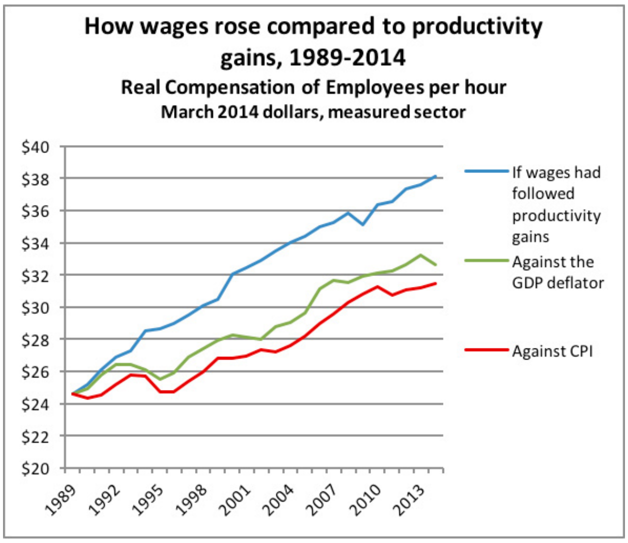
New Zealand needs industry policy that steers the economy towards higher value, more diversified domestic and tradeable production. It must encompass a strong government role in research, product development and strategic support of higher value manufacturing and services. It also requires redirecting the finance sector to provide the patient investment required and away from property, to review monetary policy, and to manage the exchange rate.

Employment and Wages



New Zealand's labour market was almost completely deregulated in the 1991 Employment Contracts Act. This led to the halving of union membership, among the lowest collective bargaining rates in the OECD and several years of falling real wages. Between 1981 and 2002 wage and salary earners lost almost one quarter of their share of national income (the Labour Share), which is among the lowest in the OECD. It recovered partially to 2009 under the influence of new employment laws (the Employment Relations Act) and strong rises in the minimum wage but now has resumed a downward trend. This reflects the fact that real compensation of employees fell well behind even the weak productivity growth over this period.

Both union membership and collective bargaining densities continue to decline. Current employment law provides very weak support for collective bargaining compared to most of Europe. New Zealand wages are therefore low both compared to the rest of the OECD and to what the economy could afford.



While the common New Zealand 'wage narrative' is that 'wages can only rise when productivity rises' (following neoclassical economic theory), not only has that frequently failed to happen but there is also a reverse causality that is ignored: rising real wages can stimulate productivity growth. Higher incomes increase demand for products which encourage employers to invest in new technology and production methods. Rising real wages – like any cost or competitive pressure – also provide an incentive to employers to improve their management skills, raise capital/labour ratios and productivity.

They also encourage employee commitment and effort. New Zealand's employment laws are designed to weaken employee bargaining power which suits employers in agriculture, tourism and other industries whose business model depends on low wages. New Zealand's low wages and the enfeebled bargaining power of employees is therefore a contributor to (and victim of) the low value economy.

Recent IMF research (Jaumotte & Buitron, 2015) confirms studies from the ILO, OECD and independent researchers showing the major part which deunionisation has played in driving increased income inequality. They identify New Zealand as being at the extreme among the OECD countries studied. As noted above, the increased inequality also reduces productivity.

Low wages are enforced in other ways. New Zealand has among the lowest income replacement rates and quality of support in the OECD for people who lose their jobs. For example a two-earner couple with two children in New Zealand in 2013 received 59 percent of the average wage (30th out of 33 countries) according to OECD data comparing benefits during the first years of unemployment for families qualifying for additional assistance, whereas the OECD median is 77 percent, Germany paid 88 percent and Canada 81 percent.[5]

The State provides little in the way of training, guidance or relocation assistance for laid off workers unless they are entitled to an unemployment ('jobseeker') benefit, but this is tightly means tested. Under these conditions, many are forced to take inadequate jobs, often at lower pay and with damaged employment prospects. This not only impoverishes their families but wastes the value of their skills and experience to the economy.

Dixon and Maré (2013) found for example that even under somewhat less stringent benefit levels and lower unemployment rates during the 2000s, displaced workers experienced severely reduced employment rates, and for those who found work, the average wage was "12 percent lower 0–1 years after displacement, 11 percent lower 1–2 years after and 7 percent lower 2–3 years after" compared to matched workers who had not lost their jobs.

There are other symptoms of a system that encourages low value. Qualifications, particularly vocational ones, are poorly rewarded in higher wages (Crichton, 2009; Crichton & Dixon, 2011; Zuccollo, Maani, Kaye-Blake, & Zeng, 2013), contrary to the rhetoric that education is the way out of poverty and inequality. During the 1990s, control of industry training was handed to employers and led to the near-death of apprenticeships. While there has been a partial recovery of work-based training, it is still far from adequate.

[5]See http://www.oecd.org/els/soc/NRR_Initial_EN.xlsx linked from http://www.oecd.org/els/benefits-and-wages-statistics.htm

Job tenure in New Zealand is among the shortest in the OECD. In 2012, almost twice as many people had been less than a year in their job in New Zealand compared to the Netherlands. Only Denmark, Australia, Mexico, Turkey and Korea had more people in jobs for less than a year (New Zealand Council of Trade Unions Te Kauae Kaimahi, 2013, p. 12). This can be viewed in two ways: it is a mark of flexibility in the job market, indicating better job matching to employer skill requirements, raising productivity and encouraging innovative change. Alternatively it can be observed that earnings rise with job tenure so short tenure indicates loss in productivity (and loss in lifetime earnings to workers). The facts outlined above give more credence to the latter interpretation. Short job tenure is an aspect of the insecure, temporary, often highly exploited work many working people in New Zealand experience. In 2012 at least 30% of the workforce (other than employers) were in temporary employment, in a permanent job with a medium to high chance of job loss in the next year, or were unemployed, and in addition an unknown but significant number of self-employed people lived with high levels of insecurity.

Record high net immigration levels (adding around 1.5% per year to New Zealand's working age population) are currently exposing the faults in New Zealand's employment systems: they are enabling employers to avoid raising wages and improving employment conditions because of labour shortages, and to avoid training New Zealanders for jobs they are well capable of.

New Zealand's recent employment policies have not served New Zealand well. They are outliers in the OECD where high levels of collective bargaining are standard: the median proportion of employees covered is 48% (2013) compared to 15% in New Zealand[6]. A higher level of collective bargaining would help to turn around many of the above negative trends. This in turn requires strengthening of union organisation, which as Jaumotte and Buitron (2015) confirmed, also has other benefits in terms of progressive social legislation and reduced inequality.

These policies must be accompanied by improvements in industry training and the reconnection of qualifications to wages, immigration policies that match skill needs, a restoration of liveable income replacement levels for benefits, and serious active labour market policies to assist working people in transition and ensure they do not, as they do now, bear the brunt of rapid change in the economy which they cannot control.

These steps would contribute to both social progress and switching New Zealand jobs and production onto a high value, high wage track.

[6]ICTWSS database, Version 5, November 2015, available at http://www.uva-aias.net/en/ictwss

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About The Author

Bill Rosenberg was appointed Economist and Director of Policy at the Council of Trade Unions in May 2009. He holds a B.Com in Economics, a BSc in Mathematics and a PhD in mathematical Psychology. Bill was previously Deputy Director, University Centre for Teaching and Learning at the University of Canterbury, a member of the Institute of Directors, a Commissioner on the Tertiary Education Commission, and a member of the Regional Transport Committee of Environment Canterbury. Dr. Rosenberg is widely published on labour, welfare, the New Zealand economy, globalisation and trade and has been an active trade unionist for 35 years including in the Tramways Union and the Association of University Staff where he was National President for several years.

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