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Fair deal? The cost of living, productivity and wages

What's a fair way to set increases in wages? There are many factors, but two that always come up in bargaining are the cost of living (inflation, usually measured by the CPI), and productivity. Workers have an expectation that they will at least be compensated for price increases (inflation) in order to maintain their spending power – their "real wage". That expectation is not always met and the perennial counterargument is "the company can't afford it – wage increases need to reflect productivity". The implication is that if productivity rises, we can expect higher wages. Unions are rightly suspicious of an explicit linkage between productivity and bonuses as a substitute for a decent wage increase, but certainly productivity must be an important consideration. So what is the actual record?

There are many technical issues that can make this a confusing area to navigate. I can provide details to those interested. But the story is as follows.

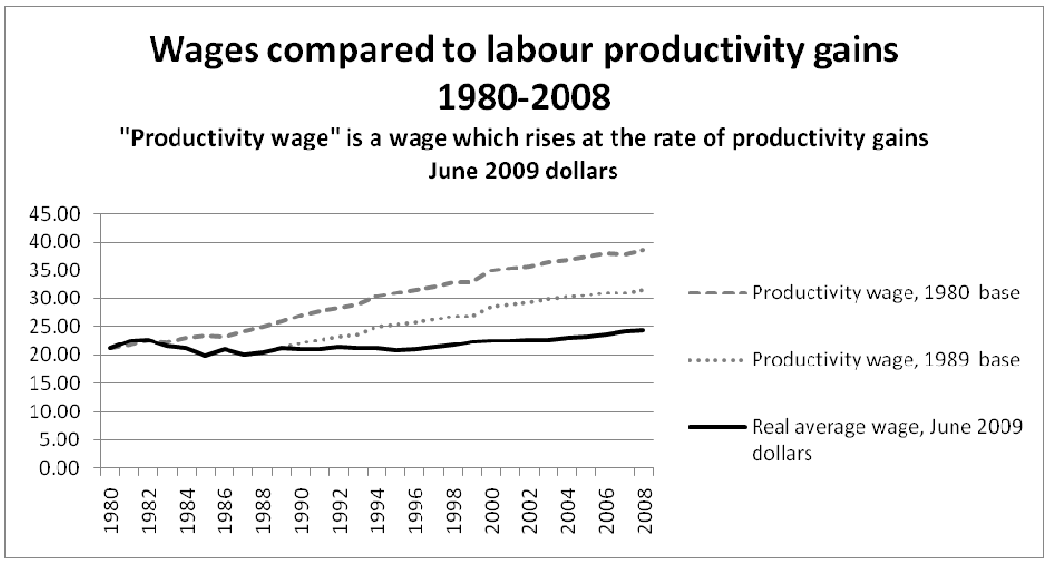
For this analysis, the most appropriate statistics available to use are the average ordinary time wage and the salary and ordinary time wage rates part of the Labour Cost Index (LCI). The LCI is the most relevant but only goes back to 1992.

First – real wages. The real average ordinary time wage has increased, but only just, since 1980: by 18 percent or a rate of about 0.6 percent per year. Looking in terms of governments of the period, it *fell* by 6 percent between 1980 and 1984 (1.6 percent per year), rose by only 4 percent over the remaining six years of that decade to 1990 (0.7 percent per year), and then by just 8 percent from 1990-1999 (an average of 0.8 percent per year, though falling between 1990 and 1996). From 1999 to 2008 it rose 10 percent, by a small margin the fastest growth of the three decades at 1.1 percent.

That's the good news. The LCI shows that between 1992 and the present, ordinary time hourly wages and salaries fell by 1 percent. They just broke even from 1992 to 1999, but fell by 1 percent from 1999 to 2008. It appears that it was just recognition of individual employees and perhaps compositional effects in the workforce that gave rise to the small real increase that did occur in paid hourly wages.

But what about recognition for productivity gains[1]? Despite national gnashing of teeth over our productivity record compared to Australia and other high income nations, productivity did grow. Between 1980 and 2008 (the latest data available) labour productivity grew by no less than 82 percent – while the average ordinary time real wage grew by just 18 percent. Between 1980 and 1984 productivity growth was 9 percent compared to a 6 percent fall in wages. From 1984 to 1990, productivity rose 17 percent while wages rose only 4 percent. From 1990 to 1999, productivity gained 22 percent, but wages only 8 percent. And from 1999 to 2008, productivity rose 17 percent and wages only 10 percent.

So if we look at the average ordinary time wage (the story would be even more compelling using the LCI), if wages had reflected the increase in productivity we would be looking at an average ordinary time wage of around $38.60 in 2008 if it had received its share of the productivity gains since 1980, and $31.60 if it was only since 1989. Instead it was $24.47. See the accompanying graph.



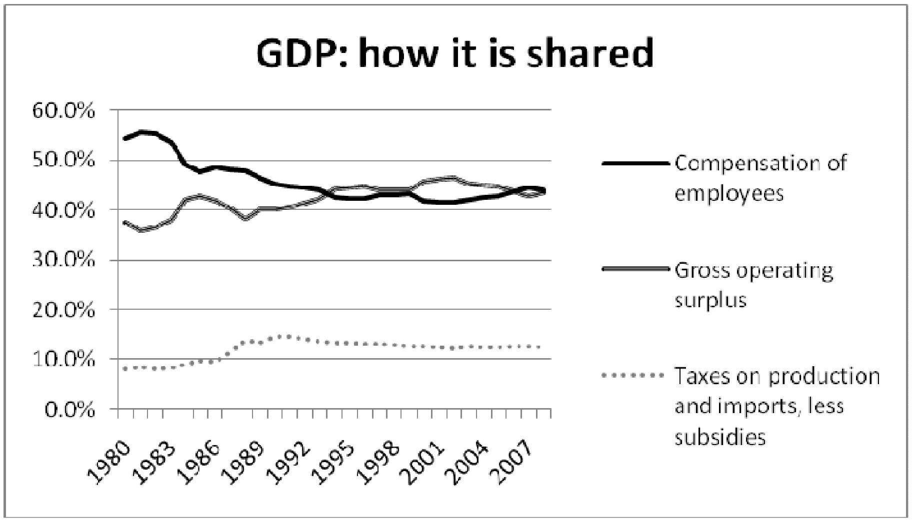
Is there any reason workers should not have benefitted in their pay from the productivity increases? What they don't get, their employer does. Perhaps if the proceeds had been reinvested in more jobs and higher productivity, it would have been justified. As we know though, the record of New Zealand business has been of relatively low capital intensity, and poor productivity growth. Much of the difference has in fact gone into profits and interest payments: a Treasury paper in 2008[2] found that New Zealand has a higher cost of capital (in other words, higher return to capital or profits) than other

[1] There are some technical issues to be noted here. Productivity is measured over only part of the economy (the "measured sector") due to measurement difficulties in areas like health and education. We are assuming that productivity if it could be measured would be similar across the whole economy. But even if this were not true, the story is not that different for the measured sector of the economy.

[2] "Investment, Productivity and the Cost of Capital: Understanding New Zealand's 'Capital Shallowness'", New Zealand Treasury Productivity Paper 08/03, April 2008.

OECD countries, and that has been rising over most of the period we have looked at. It is well known that our interest rates are comparatively high.

The second graph indicates that there has been a long term trend which has changed the balance in the economy between income to employees and returns to capital – “Gross operating surplus” or profits and interest. Until 1993, employees received a greater (though rapidly falling) share of the economy’s output than capital did. From 1994 until 2006 the position was reversed.



The imbalance in how the growing production of the economy is shared (which also shows up in New Zealand’s high levels of income inequality) is clearly a systemic issue which got steeply worse until about 2002 when capital received a record 46.4 percent of GDP (roughly a sixth of which goes overseas). Since then, the imbalance has moderated but has a long way to go to return to historical levels.

The period was, until the last decade, also a time of deliberate weakening of unionism. Although ours is a common experience in the OECD (US workers’ average real wage rose just 6 percent in real terms in the 30 years since 1979), it does not seem coincidental that this huge change in distributional patterns and the lack of pass-on of the fruits of increased productivity happened over this time. Unions in the CTU have in the last decade made raising productivity a central part of their work, in the expectation that there will be a return to workers. The expectation is yet to be met. Unions accept that productivity needs to rise for many reasons, including closing the wage gap with Australia and coping with a more resource-limited world. But the wage gap won’t be closed unless productivity increases are passed on to workers.

Bill Rosenberg.

NZIER Consensus Forecasts[3]

These consensus forecasts were published on 22 September 2009.

March Year Percent Change	**2009/2010**	**2010/2011**	**2011/2012**
GDP	-1.3	2.7	3.4
CPI	1.9	1.8	1.9
Private Sector Wages (QES)	2.7	1.7	2.2
Employment	-1.8	0.8	2.2
Unemployment	7.1	7.3	6.7

Since the previous release of NZIER's quarterly predictions in June, there have been substantial revisions in a number of areas. Predictions for private sector wage increases for the 2009/2010 March year dropped from 5.2 percent to only 2.7 percent, with CPI also being revised down from 3.0 percent to 1.9 percent. In addition, unemployment predictions were revised up to 7.1 percent for March 2010 year, from the 5.0 percent predicted back in June. Employment growth is now expected to be negative this year, with a predicted fall of 1.8 percent, as opposed to 0.8 percent growth that was previously predicted. Economic growth predictions are more pessimistic this year, falling from negative 1.0 percent to negative 1.3 percent, but a huge swing towards optimism for 2010/11, with previous predictions of negative 1.6 percent being revised to a positive 2.7 percent, and even stronger growth forecasted for 2011/12.

Economic Snapshot

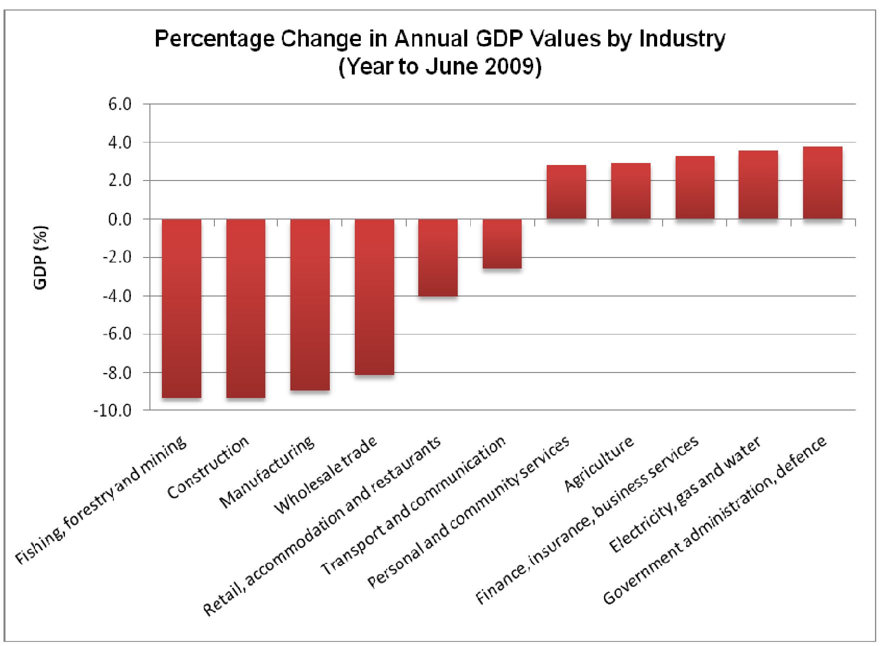
- After five previous quarters of negative growth, **GDP** has increased by 0.1 percent for the June 2009 quarter. In annual terms GDP has declined 1.8 percent.
- The **Consumer Price Index** rose by 1.9 percent for the year to June.
- **Food prices** rose 4.6 percent over the year to August.
- **Unemployment** is sitting at 6.0 percent. Maori unemployment is 12.6 percent, Pacific people's unemployment is at 12.8 percent, Asian unemployment is at 7.8 percent, and European/Pakeha unemployment is at 4.0 percent. Youth unemployment (15-19 year olds) is 22.9 percent and the unemployment rate for those aged 20 to 24 is at 11.5 percent. In June 2009, 50,855 people were on unemployment benefits.
- The number of people in **employment** decreased in the year to June by 0.9 percent to a total of 2,169,000.
- The **minimum wage** is $12.50 an hour and $10.00 an hour for new entrants aged 16 or 17 in their first 3 months or 200 hours, whichever ends first.

[3] The consensus is made up of the average of forecasts from NZIER, Berl, ANZ- National Bank, ASB Bank, BNZ Bank, First New Zealand Capital, Deutsche Bank, UBS, Westpac, Reserve Bank of New Zealand and Treasury. Because the consensus forecasts are done only every 3 months, some of the more recent forecasts will be more accurate.

- **Ordinary time hourly wages**, as measured by the Quarterly Employment Survey (QES) for June 2009, were up annually by 4.5 percent (5.8 percent in the private sector and 3.8 percent in the public sector) and down from the 5.3 percent recorded in the March 2009 year. The average hourly wage is now $25.06 ($23.25 in the private sector and $31.85 in the public sector). The female rate of pay is $23.31 which is 87.9 percent of the male wage of $26.51. The Labour Cost Index (LCI) shows that ordinary time wages went up by 2.9 percent in the June 2009 year (2.6 percent in the private sector and 3.6 percent in the public sector). For those workers who received a pay rise in the year, the median increase was 4.0 percent and the average increase was 5.2 percent.
- On 16 September the Reserve Bank of NZ left the **official cash rate** unchanged at 2.5 percent for the third consecutive review.

Economic Growth

After 5 quarters of negative GDP growth, the June quarter recorded a slight increase of 0.1 percent, but Statistics NZ did say that this seasonally adjusted figure was too close to zero to be able to pronounce a recovery. Primary industries (up 1.5 percent) led this increase, with fishing, forestry and mining posting 4.0 percent growth after a run of negative results in 2008. Production continued to contract in the goods producing industries (down 0.5 percent), after recording -4.5 percent in the March quarter and -3.6 percent in the December quarter. Growth in the service industries remained at zero for the second quarter in a row. In annual terms GDP has declined by 1.8 percent in the year to June 2009 compared to 2.5 percent growth in the June 2008 year. According to Statistics NZ this is "the largest annual contraction in economic activity since the series began in June 1987". Some industries have fared much worst than others over the year (see graph below).



Food Prices

Food prices dropped by 0.9 percent in August, the largest monthly fall in three and a half years. The 4.6 percent change in food prices compared to August 2008 is the lowest annual figure since the beginning of 2008, and is down considerably from the 8.4 percent recorded in July 2009. Compared to the previous month, grocery foods were down 1.3 percent, fruit and vegetables were down 3.3 percent, and meat and poultry was down 0.4 percent. Non-alcoholic beverages increased 1.0 percent for the month and restaurant meals increased by 0.3 percent.

Balance of Payments

There was an improvement in the Balance of Payments to June 2009 with the current account deficit falling $1,508 million since the March 2009 quarter, to $612 million when adjusted for seasonal patterns. For the year to June 2009 the deficit fell from 8.1 percent of GDP to 5.9 percent, the lowest figure since September 2004. This was due mainly to a fall in income on foreign investment in New Zealand, largely a result of falling company profits. New Zealand's investment income deficit now stands at $1,600 million for the quarter, down considerably from the deficit of $2,781 million in the previous quarter. The current account balance is a $124 million surplus, although if a company tax transaction by BNZ due to the court ruling against it is excluded then current account would have a deficit of $537 million. That tax payment was balanced by a withdrawal of overseas investment from New Zealand because it was paid from the BNZ's retained earnings. Banks were responsible for a rise in New Zealand's net overseas debt, increasing their indebtedness by $8.2 billion. Their debt is now equivalent to 77.0 percent of New Zealand's net international debt. The net international liabilities position improved from $173 billion or 96.4 percent of GDP at March 2009 to $171 billion or 95.2 percent of GDP and gross international liabilities stand at $306 billion; both gross and net levels are significantly higher than in June 2008. The seasonally adjusted value of exports and imports of goods dropped equally during the 3 months to June by $771 million and $772 million respectively. See below for more information on trade.

Trade

New Zealand's merchandise terms of trade index experienced its largest quarterly fall in 20 years with a 9 percent decline in the June 2009 quarter. The index, which indicates our ability to pay the cost of imports from the returns made on exports (it reflects for example how many computers or television sets can be imported from the proceeds of an exported tonne of dairy produce or lamb), was also down 13.1 percent for the year to June 2009, the largest annual fall since 1980. The NZ dollar rose throughout the quarter leading to an exchange rate appreciation of 8.7 percent against the Trade Weighted Index (TWI – a composite of the main currencies in which New Zealand trades), which is bad news for the export sector. Export prices were down 11.6 percent for the quarter and fell considerably more than import prices, which dropped 2.9 percent. There was a 14.8 percent decline in food and beverage prices, (within which dairy prices declined by a record 24.1 percent and meat fell 7.0 percent) and manufactured goods (excluding food) were down 9.4 percent (within which aluminum prices decreased by 15.4). Note however that dairy prices have risen sharply since June.

The decline in export prices was partly offset by a 7.0 percent increase in export volumes in the three months to June, with dairy (up 23.7 percent), petroleum (mainly crude oil, up 62.7 percent), and forestry products (up 14.6 percent) all contributing to this rise. Import volumes fell 1.9 percent decline, the fourth consecutive decline. Intermediate goods (goods used or transformed in industrial production) declined by 8.1 percent and led the fall, a symptom of the low levels of production in the domestic economy. Import volumes for consumption goods fell by 0.7 percent, and although capital goods increased by 41.0 percent due to imported aircraft for Jetstar, capital machinery and plant imports fell 9.7 percent.

Trade figures have also been released for the month of August, which show export values are down to $2.7 billion, a decrease of $830 million or 23.2 percent since the same period of 2008, but similar to 2007 figures. Import values stand at $3.5 billion, down $953 million or 21.6 percent from the peak recorded in August 2008. The trade deficit for the month is $725 million, which is 26.4 percent of exports. This sits below the 5 year average deficit for August of 34.1 percent of exports.

Manufacturing Sector

The Economic Survey of Manufacturing for the June 2009 quarter showed that sales volumes increased by 1.8 percent after 5 quarters of decline. This figure was propped up by a 7.8 percent increase in meat and dairy manufactured product sales (driven up by an increase in dairy exports). The remainder of the manufacturing sector recorded a 2.8 percent decline in sales. Increases came from unadjusted paper products (up 8.8 percent) and other food manufacturing (up 3.3 percent), whilst machinery and equipment manufacturing (down 7.3 percent) and non-metallic mineral products (down 9.1 percent) had the largest falls. Sales values were negative with a 4.8 percent decline ($986 million), with meat and dairy creating the greatest downward pressure with an 8.9 percent decline in prices ($633 million). Other sectors that experienced falls were machinery and equipment manufacturing, down 8.0 percent ($144 million) and basic metal manufacturing, down 10.9 percent (not seasonally adjusted, worth $72 million). However, there were increases in sales values recorded in print and media, up 2.4 percent ($20 million) and food manufacturing, up 2.1 percent ($45 million).

The Performance of Manufacturing Index (PMI) for August 2009 was 48.7[4], dipping slightly from last month's result of 49.7. This means that manufacturing activity has been contracting for 16 consecutive months. The employment index was still contracting at 46.9, but this is the best result it has posted since May 2008. Food manufacturing improved markedly, up to 56.3,

[4] A figure under 50 shows the manufacturing industry is contracting; above 50 shows that the industry is growing. The index is an early indicator of business activity

but results for all other sectors were down compared to the previous month. Elsewhere, Australia recorded its first expansion in manufacturing activity in 14 months (51.7) and the US recorded its best result in over two years (52.9).

Service Sector

The Performance of Services Index (PSI) for August 2009 expanded for the second month in a row with an index of 51.3; the best PSI result for 18 months. New orders were up to 57.6 and employment, while still contracting, also seems to be steadily improving, up to 49.3 from 47.9 last month. All regions recorded expansion apart from Northland, which dropped slightly. As for the different sectors, the best result came from accommodation, cafes and restaurants (61.8), followed by cultural, recreational and personal services (57.4), property and business services (54.1), and wholesale trade (51.0). The retail sector was the only one to slip slightly at 47.7.

Migration

There was a net gain of 1,600 permanent and long-term (PLT) migrants in August 2009, down from the 2,400 recorded in the last month. In August 2008 the net gain stood at just 500 migrants. Net migration for the year to August 2009 was 15,600, which is the highest figure in nearly five years, and up substantially on the 4,900 recorded in the year to August 2008. The number of PLT departures from New Zealand has dropped by 12 percent since last year (to 71,900), whereas arrivals have increased by 1 percent (to 87,500). The net outflow for the year to Australia continues to fall, standing at 700 for the month and 24,800 for the year, which compares to 33,300 in the year to August 2008. The strong migration figures are adding to the population growth and are bolstering the housing market (see below).

Housing and Property

The Real Estate Institute of New Zealand's (REINZ) new Monthly Housing Price Index showed that median house prices increased from $340,000 in July 2009 to $346,750 in August 2009, a 2.0 percent rise. This represents a gain of 5.1 percent compared to August 2008.[5] REINZ report that the median time it took to sell reduced to 33 days, compared to 54 days the same time last year.

There were 1,165 residential building consents, excluding apartments, in the month of August, the highest number since September 2008. In seasonally adjusted terms this is a 2.8 percent increase on top of the 11.4 increase reported in July. However, Statistics NZ say that consent numbers are still low and that values for residential consents are down by 27 percent for the August 2009 year compared to the August 2008 year.

[5] This figure is calculated by stratifying the data to prevent any distortions that may come from exceptionally high property sales.

Retail Sales

After an increase in retail sales in June (up 1.1 percent), the July retail sales return to negative numbers, decreasing by 0.5 percent (worth $25 million). Fuel (down 2.9 percent), department stores (down 2.2 percent), and other retailing (down 2.4 percent) had the biggest falls over the month, whilst recreational goods and accommodation retailing (both up by 3.3 percent) and motor vehicle retailing (up 2.1 percent) had the biggest increases. According to BNZ, the year on year figure for retail sales is -1.7 percent, but if automotive retailing is excluded, retail sales have increased by 1.9 percent.

Vulnerability to Long Term Unemployment; OECD Unemployment

The Department of Labour has released a report assessing “resilience”: the ability of workers in different industries to find new employment if they lose their job. Key factors that affect vulnerability include: low qualifications, low skills, or highly specific skills, being a younger or older worker, being of Māori or Pacific ethnicity, and having worked in the same job for a long time. Manufacturing workers appeared the most vulnerable. This is accentuated by current weak job growth in the industry as well as predictions this will continue into the future. Transport, postal and warehousing workers were also at higher risk of becoming unemployed for longer, although job growth in the industry was classed as medium. Construction workers were seen as more resilient, but future job growth in this industry looks weak. A number of sectors, such as retail, media, finance, and power, water and waste services were highlighted as having poor recent job growth trends, largely as a result of the recession, but their future growth prospects are more optimistic. Sectors that are expected to have strong job growth in the next five years include: professional, scientific and technical services; finance and insurance; health care and social assistance; and information media and telecommunications.

The OECD recently released its 2009 Employment Outlook. Unemployment across the OECD countries has reached a post-World War II high of 8.5 percent, but that could increase to 10 percent (equivalent to 57 million people) with the current recovery considered weak. Most disadvantaged by the crisis are youth, low-skilled, immigrants, ethnic minorities and people on temporary contracts. Long term unemployment is a real risk for many workers. The OECD is encouraging governments to spend more on temporary and targeted active labour market strategies, foster training initiatives, increase job-search programmes, and ensure proper social safety nets are in place.

Small and Medium Enterprises (SMEs)

The 2009 "SMEs in New Zealand: Structure and Dynamics" report was released this month. It shows that 97 percent of enterprises employ 19 or fewer people, and account for 31 percent of all employees. Self-employed people comprise 11 percent of the labour force.

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