NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

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Commentary

Lucky Government, Unlucky Country

Summary

It has been almost the perfect storm for New Zealand over this government's term. From the global financial crisis to the Pike River tragedy, all are beyond our control here in New Zealand – or at least appear to be.

For any government however, a crisis brings opportunity and licence to do what it always wanted to do (but never dared ask). So bad luck for voters may be good luck for a government. By these standards, the Key government has been extraordinarily lucky.

Undoubtedly, much was beyond this government's control, for the better and the worse. But they did have choices in how they reacted. Despite low government debt they talked up its danger. They used it to spin a story of "there is no alternative" to holding, then cutting, government spending when a more generous programme was affordable and could have held down unemployment and prevented its stagnation. An effective economic stimulus could also have reduced the big income gaps in New Zealand.

Delays in rebuilding Christchurch and further turmoil overseas are now looking likely. The government will try to spin the same story: these are beyond its control; the best it can do is keep the government's books in order, and trust that "the market" will pull us through. But as always, it does have choices as to how it responds.

Economic reports in the last few days point to the need for policies to directly address productivity through greater employee and management skills. They show the hollowing out of the economy with higher wage manufacturing jobs replaced by low wage service sector jobs due to international supply chains and changing technology. We need stronger collective bargaining which extends to more of the workforce so that employees do benefit from rising productivity. On its record however, the government if re-elected will focus only on further cuts in government spending and privatisation while talking about an export oriented economy. But a government can continue to rely on its electors' bad luck for only so long in order to avoid addressing the country's future.

It has been almost the perfect storm for New Zealand over this government's term. The worst global financial crisis and recession for decades, crashing local finance companies, leaky homes, devastating earthquakes in Canterbury, the Pike River tragedy, and now another international financial crisis looming. New Zealanders have been hit by falling incomes, loss of assets built up over lifetimes, gut-wrenching emotions – in short, an assault on their well-being in the widest sense. All of these are beyond our control here in New Zealand – or at least appear to be.

For any government however, a crisis that can be convincingly painted as beyond its control brings opportunity. Its biggest threat is its own incompetence in handling it. A crisis gives it licence to do what it always wanted to do (but never dared ask). So bad luck for voters may be good luck for a government. By these standards, the Key government has been extraordinarily lucky. The electorate and the media appears to have accepted the line that bad news was largely beyond the government's control, and good news was of its making.

Undoubtedly, much was beyond this government's control, some for the better, some for the worse. Its most recent stroke of luck was good news on the level of international liabilities. Claim payments owed from earthquake reinsurance and improved coverage of surveys by Statistics New Zealand have pushed down net international liabilities (all still owed privately). They are, for now, around the target 70 percent of GDP that a year ago Treasury and the Savings Working Group said government spending cuts were needed to achieve.

But they did have choices in how they reacted. Despite low government debt (net public debt is going to peak around 30 percent of GDP compared to an OECD average already more than double that) they talked up its danger. They used it to spin a story of "there is no alternative" to holding, then cutting, government spending. They pretended, wrongly, that government finances are just like a household's and that cutting spending was good economics in a recession – something visiting economist Robert Wade described last week as "unlearning the lessons of history". If all governments do it, another world recession is inevitable.

An effective and affordable economic stimulus could have held down unemployment and prevented its current stagnation. It could have reduced the big income gaps in New Zealand through measures like cash grants to low income families, greater increases in the minimum wage, and job-rich programmes such as ramping up the house insulation programme, building state houses, getting more young people into training through greater assistance to employers and trainees, relaxing caps on tertiary student numbers, and job schemes to provide employment in worthwhile green and public infrastructure projects. It could have assisted industry development so that we come out of the recession less reliant on commodity exports, with more high-value products and better paying jobs. Instead, the OECD estimated early in the recession that the government's stimulus was (almost uniquely) virtually all tax cuts. These disproportionately benefited high incomes and even a conservative visiting economist described them as one of the less effective ways to stimulate the economy.

Its programme to rebuild Christchurch could have been funded by a progressive earthquake levy targeted to be higher for those with higher incomes. It has announced a welcome $42 million education and training programme but is failing to build the excitement that would attract people to this unique opportunity to get new skills when jobs will be plentiful – in a great project. Too much of the work will go to skilled workers from overseas rather than developing our own skills.

Which takes us to the future. We warned at the time of the large June quake that the government's growth forecasts were fragile – susceptible to delays in rebuilding Christchurch and further turmoil overseas. The Prime Minister denied it. Unfortunately both seem to be coming about. The government will try to spin the same story: these are beyond its control; the best it can do is keep the government's books in order, and trust that "the market" will pull us through.

But as always, it does have choices. Out today is an NZIER study, "Industry productivity and the Australia-New Zealand income gap", which has a few surprises – that relatively low capital per worker is not the biggest reason for us falling behind Australia – but confirms truths that have been evident for some time. Like Australia, our economy has moved over the last two to three decades from higher productivity and value added manufacturing to lower productivity services which now make up about 70 percent of employment and 65 percent of production. Yet where our labour productivity has fallen furthest behind Australia since 1989 is in services: Wholesale, Retail and Finance. Construction has fallen behind too – a problem given the weight given to residential and commercial real estate in our economy. Their solution: "focus much more on the *quality* of management, labour and capital". It is refreshing to see the quality of "management capability and organisational quality" being targeted. There is other evidence to reinforce that. Improving the quality of labour means raising levels of education and skills. We're still suffering from the skills neglect of the 1990s. However the report ignores the elephant in the room: higher productivity doesn't necessarily mean higher wages. Labour productivity rose 48 percent between 1990 and 2010 but the average wage rose only 18 percent after CPI inflation. We need a better wages system or we'll still lose workers to Australia.

This comes shortly after the release of the International Monetary Fund's September *World Economic Outlook*[1]. Once the most diehard of agencies which could have written ACT's economic policies, some of its arms are showing signs of rethinking. International supply chains – the way multinational companies design a product in one country, obtain raw materials in others, assemble them in different countries again, and sell them globally – are intensifying the effect of new technologies, the IMF says, leading to the hollowing out of "advanced" economies. The result is that over the last two to three decades, workers have been moved from medium productivity, middle income jobs (largely manufacturing) to low productivity, low-paid service sector jobs. The result is sluggish productivity growth and increasing income inequality. Their remedy is education, training – and addressing income distribution. So far so good - but they don't address the cause which they have identified as corporate-driven trade patterns enabled by increasingly open economies. Perhaps New Zealand's lower productivity growth is due to the speed with which our economy was opened.

These ideas could give a forward thinking government a clear agenda. Address productivity through programmes to create management which develops and values the skills of its employees and encourages their participation in workplace organisation, and by raising levels of workplace training and education. Find more effective ways to assist industry to develop by recognising that the wide open economy can burn off new firms, including capital for startup companies, support for potential exporters, and management of the exchange rate. Encourage productive investment with a capital gains tax and encourage higher productivity through employment laws that raise wages rather than reward poor management practices. Rethink arrangements like the Transpacific Partnership, under negotiation with the US and others, which is designed to intensify supply chains, and ensure we have policies in place to regulate the international financial flows that could have wrecked our economy as it has others. Address high income inequality so there is fairness in the way the production of our economy is shared. Fixing our wages system to spread the benefits of collective bargaining is an essential part of that.

[1] "World Economic Outlook - September 2011 - Slowing Growth, Rising Risks", IMF, p.41-46.

What choices will the current government make if re-elected? On its record, like the drunk in the dark who searches for his lost keys under the lamppost because he can't see anywhere else, the government will focus on further cuts in government spending and privatisation while talking about an export oriented economy. The result will be even greater dependence on low -value commodity exports, continuing decline in manufacturing, and ever-increasing reliance for jobs on low productivity, low wage service industries. It is not surprising that Fitch has downgraded New Zealand's credit rating citing not public debt, but growing current account deficits and private debt when these problems are not convincingly addressed. The government's nonsensical reaction was to defend its record on government spending rather than acknowledging the private sector problem of too much being paid out to overseas investors, and a low value export sector. It is another sign of where its thinking lies.

A government can continue to rely on its electors' bad luck for only so long in order to avoid addressing the country's future.

Bill Rosenberg

Inflation forecasts

I was asked whether I could give a summary of inflation forecasts to help in bargaining. The NZIER consensus forecast (see the Bulletin's data section below) gathers together a range of forecasts, and so is really doing the job, but it is mainly for March years.

I have put it alongside the more detailed Reserve Bank (RBNZ) and Treasury forecasts that do have quarterly estimates. The RBNZ one is from its September Monetary Policy Statement. It is more recent than the Treasury one which was compiled for the May Budget, and so is several months old. Bear in mind that the further out the estimates go, the less accurate they will be.

CPI Forecasts (% annual change)			
	RBNZ	Treasury	Consensus
Sep-11	4.9	4.8	4.9
Dec-11	2.6	3.1	
Mar-12	2.1	3.1	2.8
Jun-12	2.0	2.7	
Sep-12	1.7	2.6	
Dec-12	1.8	2.5	
Mar-13	2.0	2.4	2.6
Jun-13	2.0	2.5	
Sep-13	2.2	2.6	
Dec-13	2.3	2.7	
Mar-14	2.2	2.5	2.7

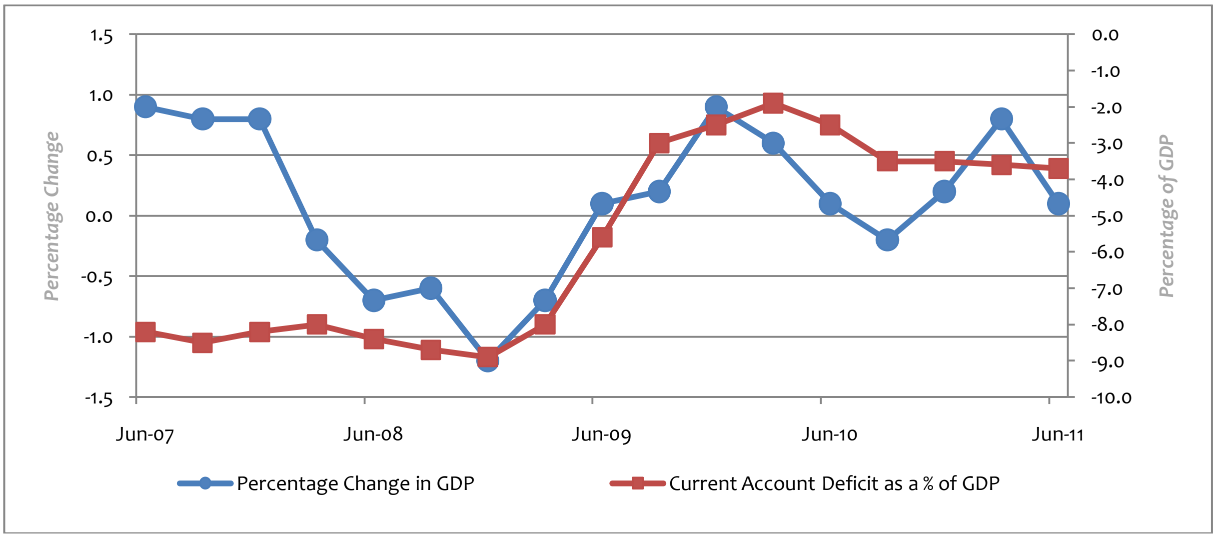
Forecast

★ This NZIER consensus forecast was published on 19 September 2011.

Annual Percentage Change (March Year)	**2011-12**	**2012-13**	**2013-14**
GDP	2.6	3.7	2.9
CPI	2.8	2.6	2.7
Private Sector Wages	3.2	3.5	3.8
Employment	1.7	2.5	1.7
Unemployment	6.0	5.2	4.8

A ★ indicates information that has been updated since the last bulletin.

Economy



- ★ Gross Domestic Product was up 0.1 percent in the June 2011 quarter, leaving GDP growth for the year to June 2011 at 1.5 percent.
- ★ New Zealand recorded a Current Account deficit of \$2.0bn for the June 2011 quarter and a deficit for the year to June of \$7.5bn (3.7 percent of GDP). This compares with a current account deficit of \$4.7bn (2.5 percent of GDP) for the year ended June 2010. The annual deficit is mainly due to profits and interest going to overseas investors (\$9.7bn deficit) plus a deficit in services trade (\$0.9bn) partially offset by a positive balance on goods trade (\$3.5bn).
- ★ The country's Net International Liabilities were \$140.2bn at the end of June 2011 – 70.0 percent of GDP and \$4.1bn more than at the end of March 2011. In June, the government was still not a contributor to the net international liabilities – it had \$4.0 billion more overseas assets than liabilities. International assets have been significantly revised (with revisions going back to 2000) by including an estimate for prevous under coverage of New Zealand portfolio investment in Australian companies, assets held overseas by small fund managers, and student loans owed by non-residents. This has resulted in a reduction in recorded Net International Liabilities by an average of \$9bn over the decade and \$12.2bn in March 2011 – an improvement of 8.2 percent. Along with the \$12.0bn due for outstanding reinsurance claims from the Canterbury

earthquakes, net international liabilities appear to have undergone a miraculous improvement from a peak of 90.2 percent of GDP in March 2009 to 70.0 percent in June, 15 months later, but this is not due to any change in the balance of the economy. The peak has now been revised to 84.6 percent of GDP, and the reinsurance from the intervening earthquake completes most of the improvement.

★ For August 2011 Overseas Merchandise Trade recorded a $641 million deficit – 19 percent of the value of exports for the month. For the year to August 2011, New Zealand recorded a surplus of $1.1bn (2.3 percent of exports). Exports were up $313 million (10 percent) to $3.4bn and imports up $523 million (15 percent) to $4.1bn. Import increases were led by petroleum products and industrial supplies, and export increases by meat, crude oil, and dairy commodities.

★ The Performance of Manufacturing Index for August 2011 fell to 52.9[1], down from 53.2 in July. The employment sub-index also fell to 49.2 from 52.1 in July, its first fall since April.

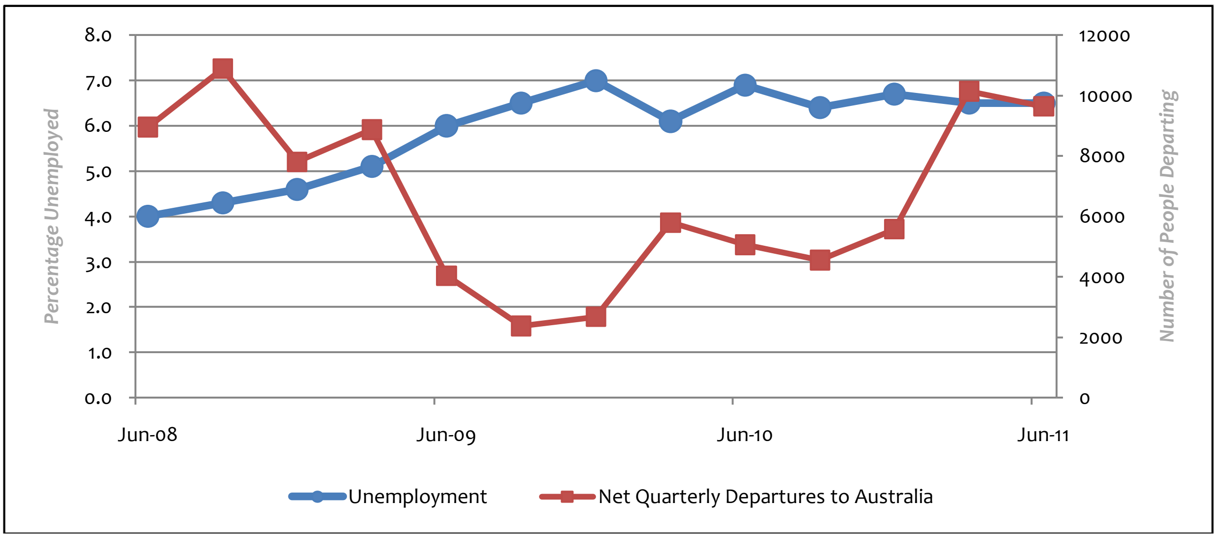
★ The Performance of Services Index for August 2011 was 53.9[1], down from 54.5 in July. The employment sub-index rose from 48.8 to 49.2.

- The Retail Trade Survey for June 2011 found retail sales were up 0.9 percent by volume and 1.7 percent by value between the March and June 2011 quarters. They were up 1.1 percent by volume and 4.1 percent by value compared to the June quarter in 2010.

★ On 15 September 2011 the Reserve Bank left the Official Cash Rate unchanged at 2.50 percent. The next review will be on 27 October 2011.

★ The REINZ Housing Price Index recorded a 0.5 percent rise in house prices for the month of August 2011, with the median house price up $10,000 to $355,000. House prices were up 0.6 percent for the year to August.

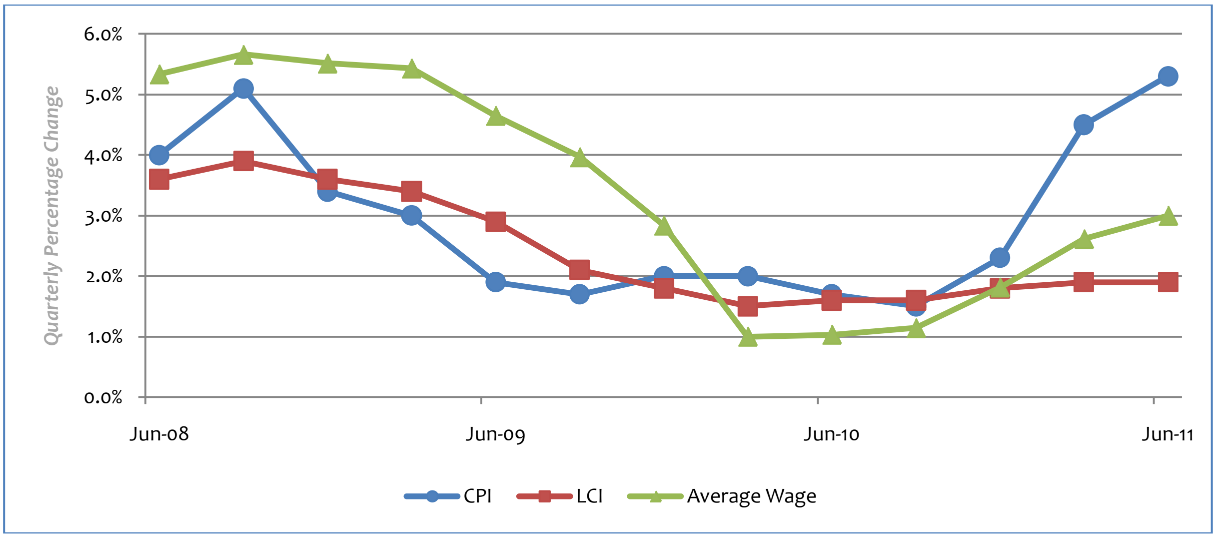
Employment



- According to the Household Labour Force Survey the unemployment rate in the June quarter was 6.5 percent, unchanged from a revised figure in the March quarter. The participation rate was 68.4 percent – down 0.2 percentage points on March. There are 154,000 people unemployed. Māori unemployment was 13.7 percent, Pacific unemployment was 13.1 percent, Asian unemployment was 6.1 percent and European/Pakeha unemployment was 4.7 percent. Youth unemployment (15-19 year olds) was 27.6 percent.

- At the end of August 2011 there were 55,463 people on the Unemployment Benefit, a decline of 1,116, or 1.9 percent, from July 2011. (Quarterly figures on Unemployment Benefit numbers are available from the MSD website.)
- In August 2011 Job Vacancies Online rose by 6.3 percent for all vacancies and 3.9 percent for skilled jobs in seasonally adjusted terms.
- International Travel and Migration figures show 7,129 permanent and long-term arrivals to New Zealand in August 2011 and 6,834 departures. Net migration in the year to August 2011 was 2,257 arrivals. Net migration to Australia in the year to August was 32,727 departures.

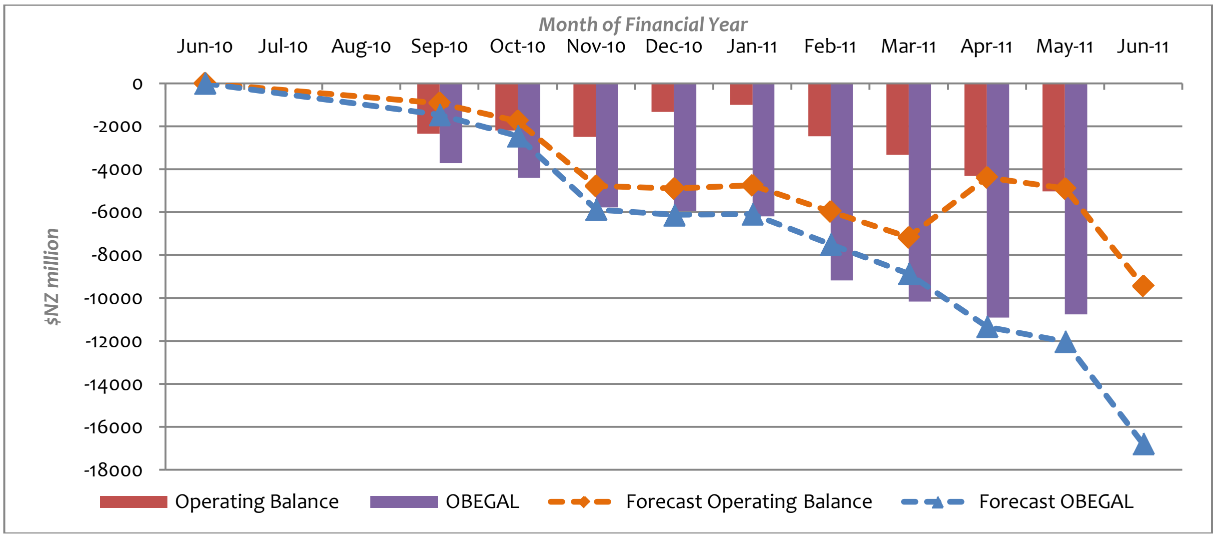
Wages

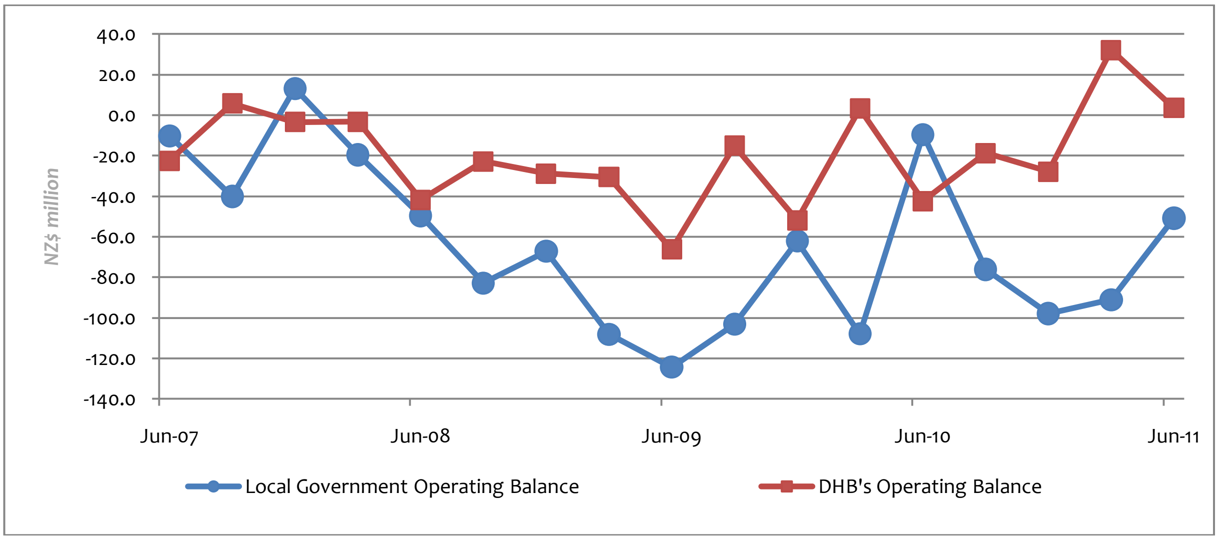


- The Labour Cost Index (Wage and Salary Rates) (LCI) rose 1.9 percent for the year to June 2011 and 0.5 percent for the June quarter for salary and ordinary time rates. It rose 1.5 percent in the public sector and 2.1 percent in the private sector for the year. For the 58 percent of those surveyed who received an increase in their salary or wage rate during the year, the median increase was 2.9 percent.
- The June 2011 Quarterly Employment Survey found the average hourly earnings for ordinary-time work was $26.21, up 1.1 percent on the March quarter. The average ordinary-time wage was $24.21 in the private sector (up 1.2 percent in the quarter and 3.1 percent in the year) and $33.23 in the public sector (down 0.7 percent in the quarter and up 2.2 percent in the year). Female workers (at $24.31) earned 87.3 percent of what male workers earned (at $27.86) for average ordinary time hourly earnings.
- The Consumer Price Index for the June 2011 quarter rose 1.0 percent, and 5.3 percent for the year to June. For the quarter transport costs were up 2.7 percent, food costs 1.1 percent and utility costs 0.9 percent.
- The Food Price Index fell 1.3 percent in the month of August, leaving a 6.6 percent increase in food prices between August 2010 and August 2011. Between July and August, Fruit and Vegetable prices fell 5.9 percent, Meat, Poultry and Fish fell 0.9 percent, Grocery Food fell 0.3

percent, Non-alcoholic Beverages fell 1.3 percent, and Restaurant Meals and Ready-to-eat Food prices were unchanged.

Public Sector





- According to Treasury's Month End Financial Statement for the eleven months to the end of May 2011, government revenue was down $295m (0.6 percent) on the forecast in the Budget Economic and Fiscal Update (BEFU) (though tax revenue was up $214m) and expenditure was down $770m (1.2 percent). The operating deficit before gains and losses (OBEGAL) was $10.8bn, $1.3bn better than forecast. The operating deficit was $5bn, $113m worse than forecast. The Government's net debt is 20.4 percent of GDP, 0.1 percentage points better than budgeted in the BEFU.
- ★ District Health Boards recorded an operating deficit of $3.5m for the June 2011 quarter compared to a surplus in the March 2011 quarter of $32.1m. Employment costs were $1.24bn, up 4.0 percent for the quarter, compared to total expenses of $3.33bn, up 4.8 percent.
- ★ Local Government recorded a 2.3 percent increase in operating income and a 0.1 percent increase in operating expenditure for the June 2011 quarter compared to March, resulting in an operating deficit for the quarter of $51.0m, all in seasonally adjusted terms.

Notes

1 For the Performance of Manufacturing Index (PMI) and Performance of Services Index (PSI) a figure under 50 shows the sector is contracting; above 50 shows that it is growing. Previous month's figures are often revised and may differ from those published in a previous Bulletin.

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