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Commentary

New Zealand doesn't have to be a low wage country

Summary

The political parties now have most of their employment relations policies out. These policies have great importance for New Zealand's wage levels, and already there are the predictable allegations by business that Labour's policies will lead to unaffordable wage demands. Yet it is inescapable that National's policies which weaken collective bargaining will mean lower wages.

This commentary shows that higher wages are affordable, even with current economic output and growth rates. And of course wages could be higher yet, if productivity increased faster – and the results of that were fairly shared with wage and salary earners.

A sobering place to start is to look at historical average hourly wage statistics which show the real average wage was at its highest in March 1982 when it was $29.97 in June 2011 dollar terms. In June 2011 it was $26.27. The current level of the average wage is about the same as it was in December 1972, yet the output of the economy per person has grown considerably over that time.

Who benefited from the increasing output of the economy if wage and salary earners didn't? This is shown by the share that employees get of the income the economy generates – the "labour share". In New Zealand, it fell by a quarter from 60 percent in the early 1980s to a low of 46 percent in 2002. By comparison, Australia's labour share has been higher than New Zealand's for most of that time. It has thrived with more of its income going to wage and salary earners. In fact New Zealand has one of the lowest labour shares in the OECD.

In theory, wages should rise as fast as labour productivity. New Zealand's wage rises are far behind productivity growth. Measured labour productivity rose 52 percent between 1989 and 2010. The real average hourly wage rose just 16 percent.

This analysis shows that the economy and employers could afford higher wages – and higher superannuation contributions for their employees. Many developed economies are seeing similar trends of falling wages and labour shares, attributed in part to international supply chains, but New Zealand appears to have particularly low wage levels relative to the income available from its economy. An essential ingredient to change this is improving employee bargaining power through collective bargaining. Higher wages would not only have social benefits, but could lead to a high skill, high value economy.

The political parties now have most of their employment relations policies out. These policies have great importance for New Zealand's wage levels, and already there are the predictable allegations by business that Labour's policies will lead to unaffordable wage demands. On the other hand, it is inescapable that National's policies which deliberately weaken collective bargaining will mean lower wages.

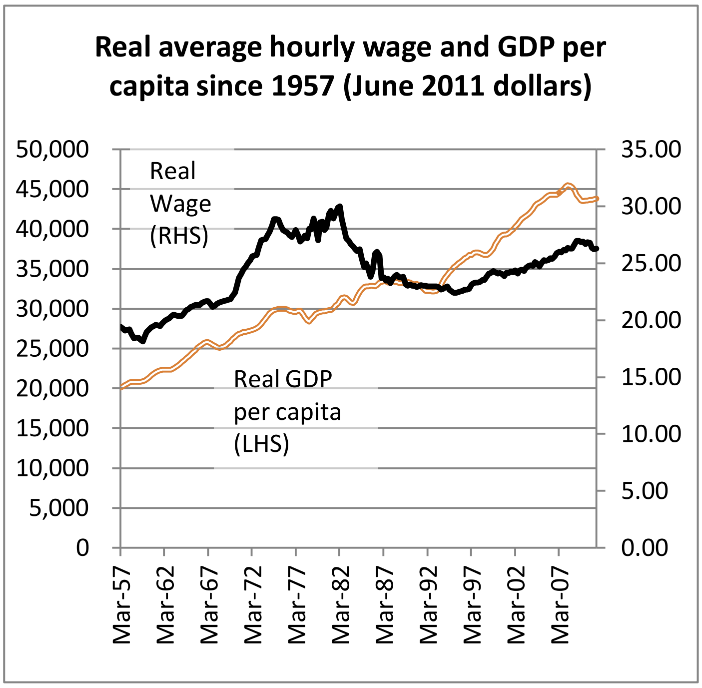
Another election policy affecting wages is retirement saving, and there is also the cost of living. I have heard people say "I don't want higher wages – I just want lower prices". In economic terms, these come to the same thing. We talk about "real wages", which show the buying power of wages, taking account of price rises. Rising prices do affect real wages – they lower the buying power of a given dollar amount.

This commentary brings together material on wages which shows that higher wages are affordable, even with current economic output and growth rates[1]. And of course wages could be higher yet, if productivity (how much each hour of work produces) increased faster – and the results of that were fairly shared with the people who actually do the producing.

Wages are very important. Almost three-quarters (74 percent) of average household income in 2011 was from wages and salaries. Wages and salaries are the main way the great majority of New Zealanders get to share the income this country generates. Unfair wages and salaries contribute to the highly unfair levels of income inequality that have grown in this country over the last two to three decades. We have far too many children living in poverty – a quarter of them or 270,000 by one measure – and two in five are from households where at least one adult is in full-time employment. The rest are children of beneficiaries.

How can we tell that our wages are particularly low?

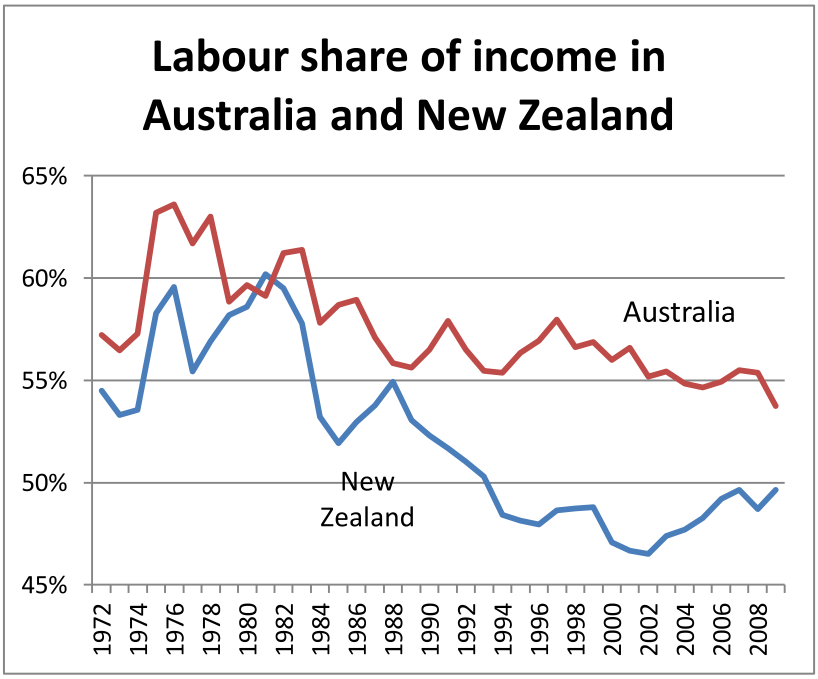
A sobering place to start is to look at average hourly wage statistics going back to 1957. It turns out that the real average wage was at its highest in March 1982 when it was $29.97, using June 2011 dollars (purchasing power). In June 2011 it was $26.27[2]. The current level of the average wage is about the same as it was in December 1972. Yet the output of the economy per person (real GDP/capita) is 41 percent higher than it was in March 1982 and 58 percent higher than it was in December 1972.



The obvious question is: so who benefited from that increase in output if wage and salary earners didn't? This is shown by the share that employees get of the income the economy generates – the "labour share". The rest – the capital share – is mainly interest and dividends going to owners of capital.

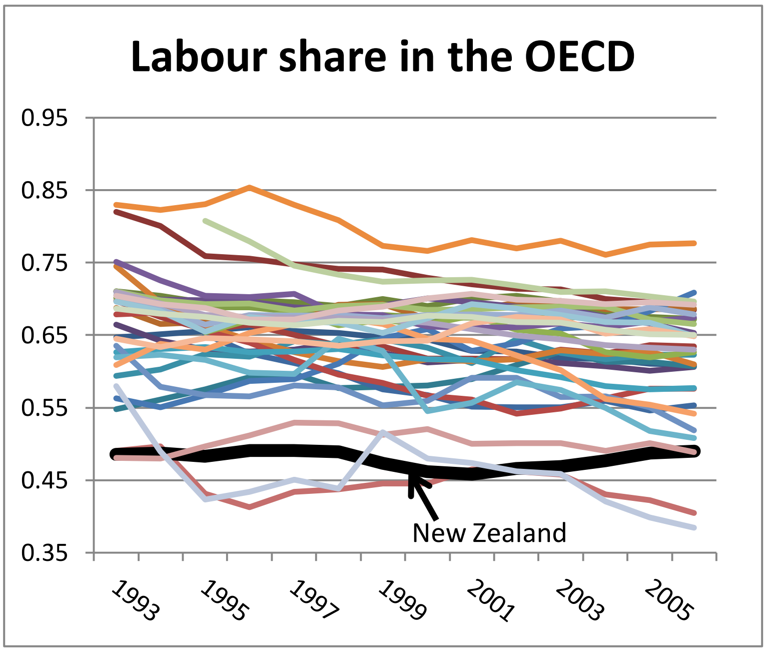
[1] Some of this was published in a *Dominion Post* opinion piece on 21 October 2011.
[2] Mike Treen of Unite has already pointed this out, but NZIER economists, Ralph Lattimore and Shamubeel Eaqub recently published a book "The New Zealand Economy: An Introduction" and some long term data series with it, which are used here. See http://sites.google.com/site/eaqubs/.

In New Zealand, the labour share fell from 60 percent in the early 1980s to a low of 46 percent in 2002, having fallen through most of the 1980s and 1990s. In other words, wage and salary earners lost about a quarter of their share of the income the economy generated over that period. It began to rise again but by 2010 was only 51 percent – still well below thirty years earlier. The labour share can fall if production becomes more capital intensive – if employers have invested in plant and machinery to make their firms more productive. In fact that kind of investment was weak in New Zealand.



By comparison, Australia's labour share has been higher than New Zealand's for virtually all of this period. Its labour share did fall from 64 percent in 1976, but bottomed out around 56 percent in 1989 and stayed around that level while New Zealand's continued to fall. Yet if anything, Australia's capital intensity is higher than New Zealand's.

Australia has thrived with more of its income going to wage and salary earners than New Zealand. That was likely helped by its award system which sets scales of rates that underpin the country's wages. Though the award rates are lower than most actual rates, research has shown that around 80 percent of wages are influenced by award increases[3].

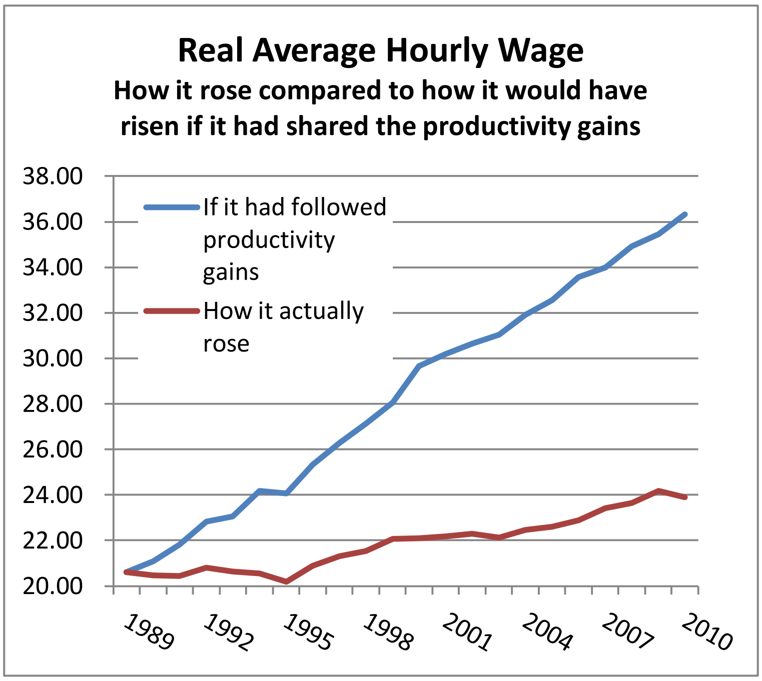


And in fact, New Zealand has one of the lowest labour shares in the OECD. While the individual countries in the graph to the right are difficult to make out, it is clear where New Zealand lies: it is the black line near the bottom. Only Turkey and Mexico trail lower[4].

[3] "The significance of minimum wages for the broader wage-setting environment: understanding the role and reach of Australian awards", by John Buchanan and Gillian Considine, in: "2008 Minimum Wage Research Forum Proceedings, Volume 1", October 2008, Australian Fair Pay Commission.

[4] This graphs a slightly different measure of labour share, which includes the labour income of self-employed people (called real unit labour cost).

That's one way to see that wage earners have been dealt a bad deal in New Zealand. Another is to look at how wages fared against productivity increases. Dominant (neoclassical) economic theory says that real wages should rise at the same rate as the growth in labour productivity. Treasury bases its economic models on this assumption. Employers regularly use it as a reason not to give wage and salary rises ("the only way you are going to get a wage rise of *that* size is if productivity rises"). One of the founders of welfare economics, Arthur Pigou, called a situation where wages fell behind productivity "exploitation". It is therefore a useful benchmark for wages.



New Zealand's wage rises have fallen far behind productivity growth. In the part of the economy where productivity can be reliably measured (the private sector give or take some subsectors), productivity rose 52 percent between 1989 and 2010. The real average hourly wage rose just 16 percent. It was somewhat better over the period of the Employment Relations Act, but the gap was still large: labour productivity rose 13 percent but real wages rose only 9 percent.

The wage-productivity gap shows that employers can afford to increase their Kiwisaver contributions as Labour has proposed. It doesn't need to come out of wage increases. The affordability is shown by relating wages to the prices firms receive for their products rather than the prices we pay for day to day living[5].That shows an even bigger gap. Over the 10 years to March 2010, labour productivity rose by 1.25 percent a year, but real wages in employers' terms rose by only 0.3 percent a year – a difference of over 0.9 percent a year. Part of Labour's Kiwisaver proposal is to lift the employer contribution from 3 percent to 7 percent by 0.5 per cent a year between 2014 and 2022. Since 0.5 percent is considerably less than 0.9 percent, employers should be able to afford it and still give wage and salary earners a bigger share of productivity increases than they have over the last decade. Of course that doesn't mean employers will actually concede it is affordable. That will come down to bargaining.

Why have wages fallen so far behind? In part, this has been a trend occurring throughout the developed world. The "Occupy Wall Street" movement should come as no surprise. After years of denying it, in September the conservative International Monetary Fund (IMF) came up with an answer[6]: international supply chains – the way multinational companies design a product in one country, obtain raw materials

[5] The prices firms receive for their products are given by the Producer Price Index for Outputs; the prices we experience in day to day living are given by the familiar Consumer Price Index.
[6] "World Economic Outlook", September 2011, International Monetary Fund, p.41-46.

in others, assemble them in different countries again, and sell them globally – are intensifying the effect of new technologies, leading to the hollowing out of "advanced" economies. As a result, 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, they say, is sluggish productivity growth and increasing income inequality. This loss of higher value-added production since the opening of the economy in the 1980s has been documented in New Zealand. So has the growing income inequality.

This doesn't fully explain though why New Zealand wages are particularly low, nor why employees have a reduced share of the country's income. A large part of the explanation must be that the bargaining power of employers has greatly outstripped that of their employees. The rapid opening of the economy encouraged employers to move jobs to low income countries, or threaten to. That was reinforced by the 1991 Employment Contracts Act which made the most effective form of wage bargaining, union-backed collective bargaining, extremely difficult. The most effective collective bargaining to raise general wage levels, national industry bargaining, was impossible. At the same time, the minimum wage was allowed to fall well below current wage levels. The Employment Relations Act which replaced it in 2000 was an improvement, but only a small one. Collective bargaining is still very difficult, and over 90 percent of private sector employees are not directly covered by it.

It is not just a union economist saying this: the IMF and the International Labour Organisation agree that loss of employee bargaining power is a cause of growing inequality internationally. Strengthened collective bargaining is recognised in international conventions as the most effective way to address it.

Can New Zealand afford higher wages and salaries? The above analysis suggests that this is not an issue of affordability – it is one of fairer distribution of income. But there would also be wider benefits across the whole economy as well as better social outcomes from a commitment to a high wage, high skill, high value society. The integration of innovation, higher wages and more investment in skills and technology are a sound underpinning for development that is sustainable both economically and socially. This is a stark contrast to the low wage pathway that competes on the basis of cost alone.

Bill Rosenberg

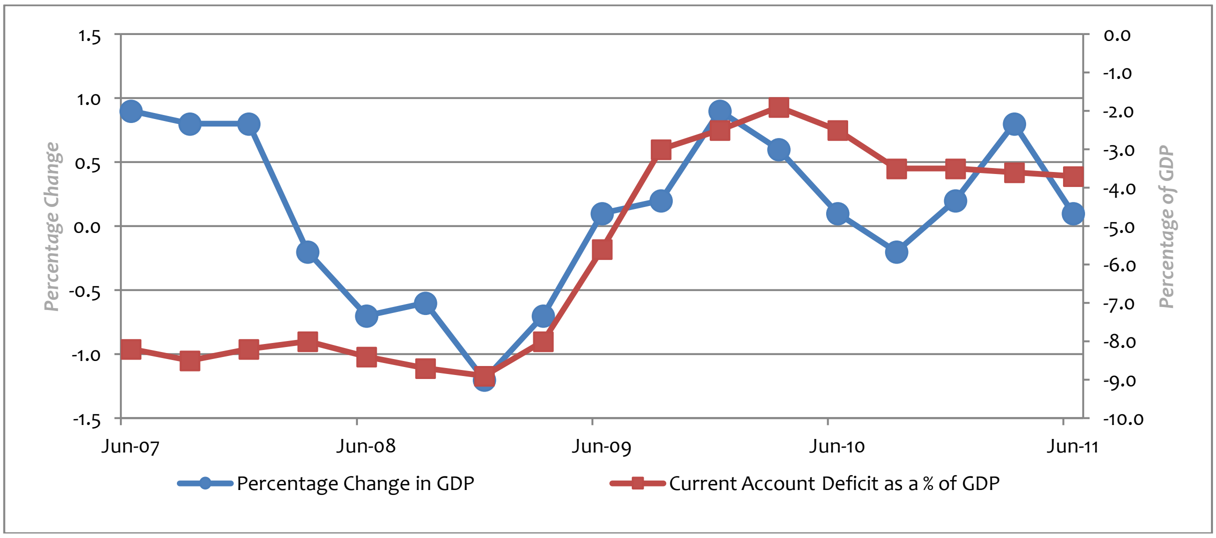
Forecast

★ 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

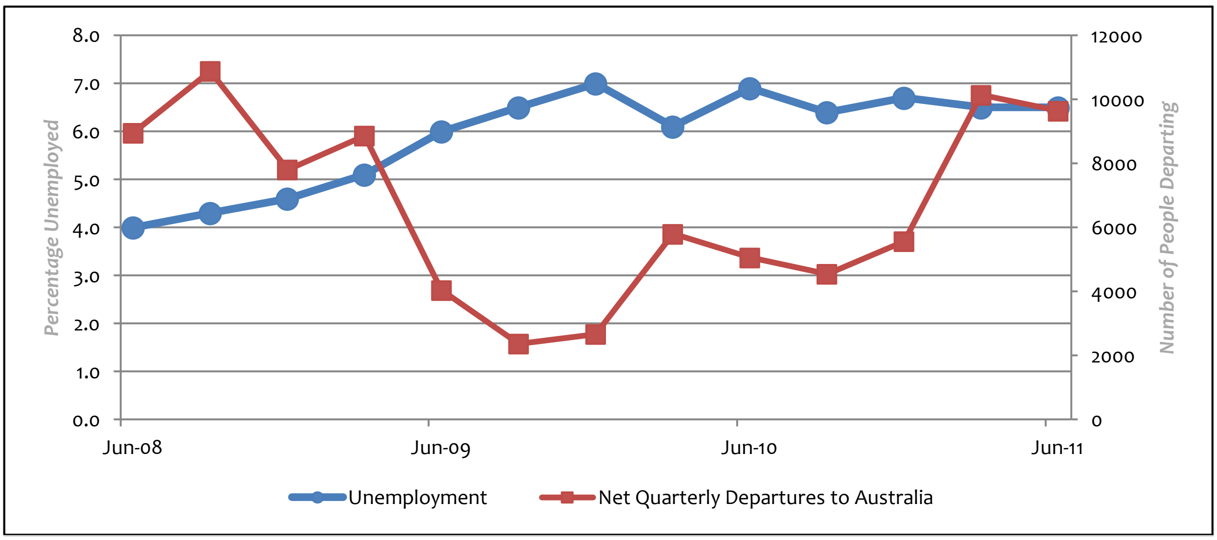


- Gross Domestic Product was up 0.1 percent in the June 2011 quarter, leaving GDP growth for the year to June 2011 at 1.5 percent.
- New Zealand recorded a Current Account deficit of $2.0bn for the June 2011 quarter and a deficit for the year to June of $7.5bn (3.7 percent of GDP). This compares with 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.

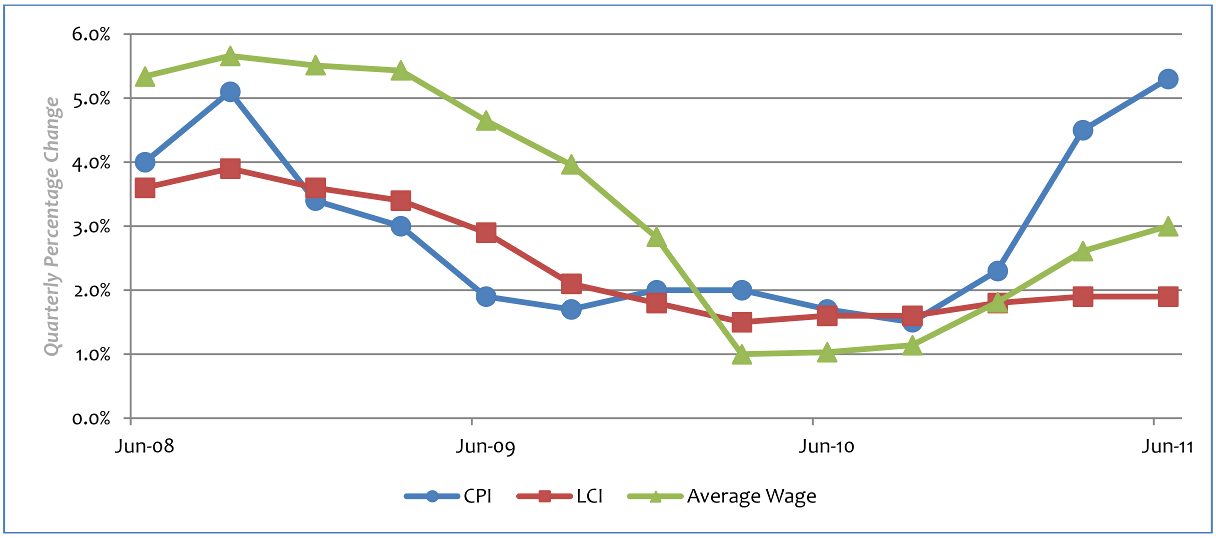
- ★ For September 2011, Overseas Merchandise Trade recorded a $751 million deficit – 22 percent of the value of exports for the month. For the year to September 2011, New Zealand recorded a surplus of $0.7bn (1.5 percent of exports). Exports were up $268 million (8.4 percent) to $3.4bn and imports up $564 million (15.6 percent) to $4.1bn. Import increases for the month were led by petroleum products (up 83 percent), gold coins, vehicles, mechanical machinery and equipment, and railway wagons, and export increases by meat, logs and wood, iron and steel, and mechanical machinery and equipment. The greatest increase in imports was from China, followed by the US, Canada and Germany. The greatest increases in exports were to China and Australia with India in third place.
- ★ The Performance of Manufacturing Index for September 2011 fell to 50.8[1], down from 52.7 in July. The employment sub-index rose however to 51.2, from 49.4 in August, partially reversing its fall last month. It is still lower than the 52.2 it reached in July.
- ★ The Performance of Services Index for September 2011 was 53.2[1], down from 53.8 in August. The employment sub-index rose sharply from 49.4 to 53.5.
- ○ 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 27 October 2011 the Reserve Bank left the Official Cash Rate unchanged at 2.50 percent. The next review will be on 8 December 2011 and will include a Monetary Policy Statement.
- ★ The REINZ Housing Price Index recorded a 0.2 percent rise in house prices for the month of September 2011, but the median house price was down $5,000 to $350,000. The House Price Index was up 2.7 percent for the year to September.

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 September 2011 there were 55,721 people on an Unemployment Benefit, a decline of 318, or 0.6 percent, from August 2011. (Quarterly figures on Unemployment Benefit numbers are available from the MSD website.)
- ★ In September 2011 Job Vacancies Online fell by 1.2 percent for all vacancies and 1.2 percent for skilled jobs in seasonally adjusted terms.
- ★ International Travel and Migration figures show 7,162 permanent and long-term arrivals to New Zealand in September 2011 and 6,132 departures. Net migration in the year to September 2011 was 1,030 arrivals. Net migration to Australia in the year to September was 34,151 departures.

Wages

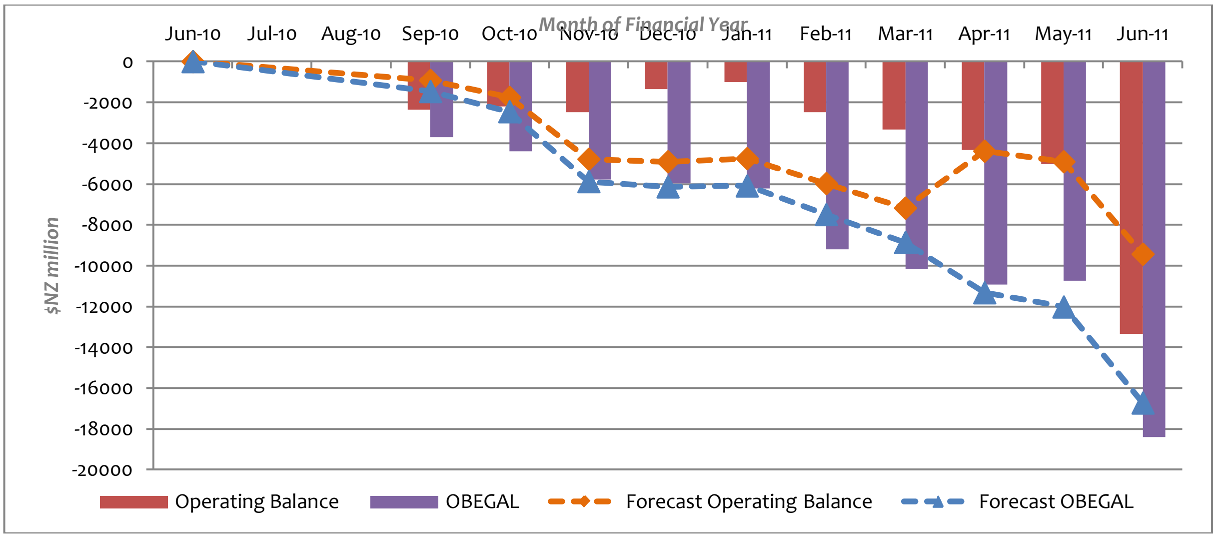


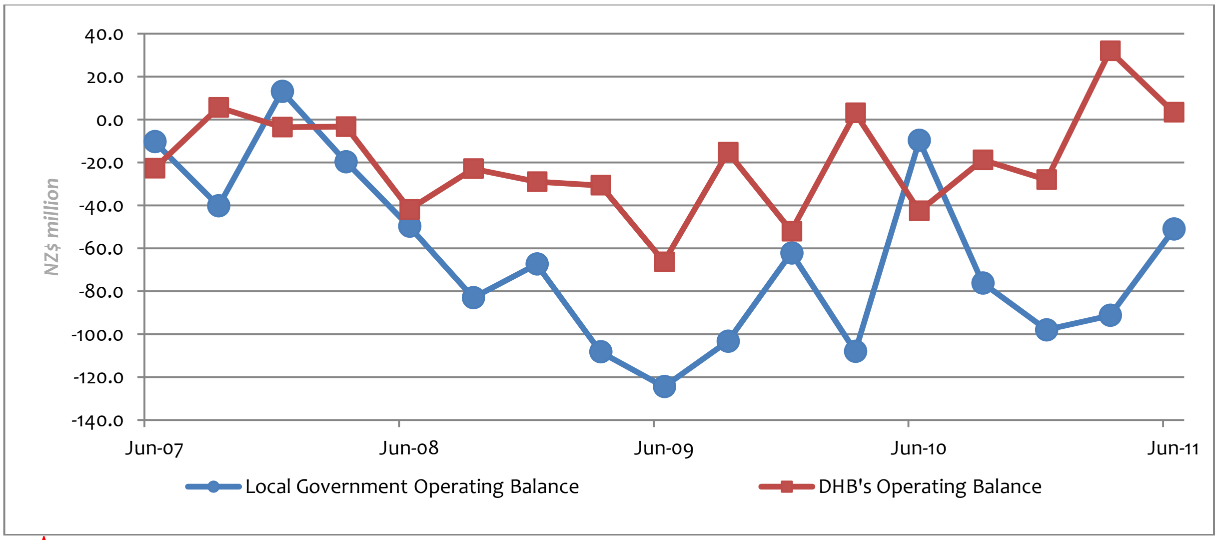
- The Labour Cost Index (Wage and Salary Rates) (LCI) rose 1.9 percent for the year to June 2011 and 0.5 percent for the June quarter for salary and ordinary time rates. It rose 1.5 percent in the public sector and 2.1 percent in the private sector for the year. For the 58 percent of those surveyed who 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 September 2011 quarter rose 0.4 percent, and 4.6 percent for the year to June. For the quarter, food costs were up 1.7 percent, insurance and credit services

were up 2.4 and 2.3 percent respectively, transport costs were down 1.0 percent and communications down 3.6 percent.

- The Food Price Index fell 1.0 percent in the month of September, leaving a 4.7 percent increase in food prices between September 2010 and September 2011. Between August and September, Fruit and Vegetable prices fell 8.6 percent, Grocery Food fell 0.2 percent, Meat, Poultry and Fish rose 0.3 percent, Non-alcoholic Beverages rose 1.3 percent, and Restaurant Meals and Ready-to-eat Food prices rose 0.2 percent.

Public Sector





- According to Treasury's Financial Statements of the Government of New Zealand for the Year Ended 30 June 2011, government revenue was up $600m (1.1 percent) on the forecast in the 2011 Budget Economic and Fiscal Update (BEFU) (helped by tax revenue up $368m) and expenditure was down $2,344m (3.2 percent). The operating deficit before gains and losses (OBEGAL) was $18.4bn, $1.7bn worse than forecast. The operating deficit was $13.4bn, $3.9b worse than forecast. The Government's net debt is 20.0 percent of GDP, 0.8 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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For further information contact Bill Rosenberg.