NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

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Commentary

Inequality, unions, and wage-led growth

Summary

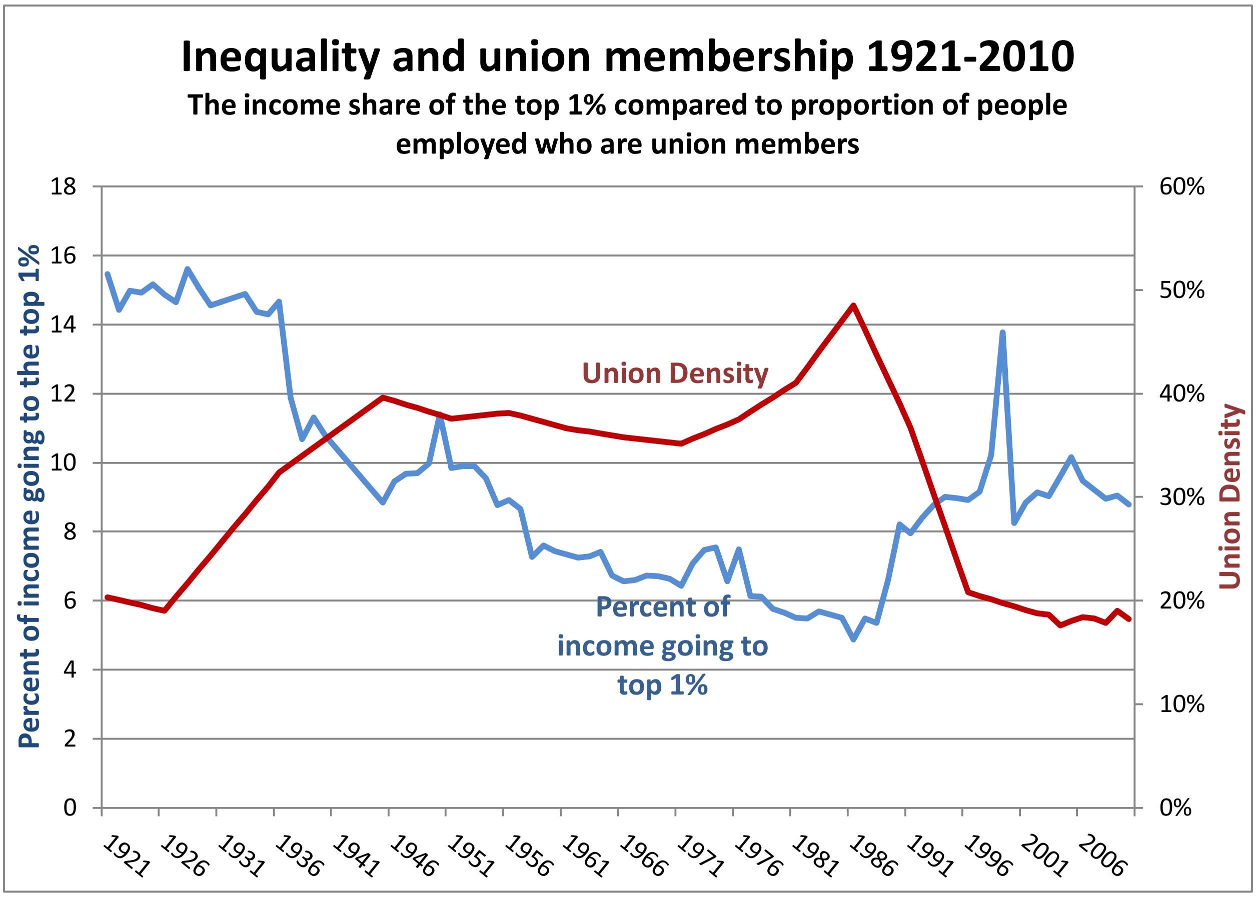
A graph showing the share of income that the richest 1% of people in New Zealand have received over the last 90 years together with union membership over that period gives a clear picture. Income inequality has risen when union membership has been falling, and inequality has fallen when union membership has been strong.

Inequality was very high in the 1920s in the lead up to the Great Depression when around 15 percent of all income went to the richest 1% of the population. It peaked at 15.6 percent in 1928, the year before the Wall Street Crash and then fell rapidly from 1936 after the first Labour Government instituted compulsory unionism, allowed national unions, restored compulsory arbitration, and greatly expanded the welfare state and other advances which gave working people increased bargaining power. Inequality fell until the early 1980s, reaching a low in 1986 when the top 1% received just 4.9 percent of all income – less than a third of what they were pocketing in the 1920s. The radical restructuring programme of the 1984-1990 Labour government, followed by National’s Employment Contracts Act 1991 led to a steep fall in union membership and a rapid rise in inequality. The top 1% more than doubled their portion of available income by 1998, reaching a peak of 13.8 percent in 1999. Since then inequality and deunionisation have largely flattened out – helped recently by low investment returns for the top 1% as a result of the global crisis.

Our experience is not unique: all OECD countries have had rising inequality and falling unionisation. There is also a growing number of academic studies that tell the same story. One estimates that the decline of organised labour explains a fifth to a third of the growth in inequality in the US. Another shows how increased inequality could have been the underlying cause of the financial crisis, and can only be fixed by increasing the bargaining power of workers. In Europe, research indicates that globalisation in production and finance and changes in bargaining power between working people and employers have been the drivers of increasing inequality. Higher wages can both generate the demand for goods and services which is necessary for a healthy economy and stimulate higher productivity.

New year greetings. I hope you had the opportunity to take a decent break. I did some reading over my break. Here are a few thoughts from it.

The graph below shows how inequality has changed over the past 90 years, compared to changes in union membership. Here, inequality is measured by the share of all taxable income that goes to the highest income 1% of the population. Union membership is measured by union density – the proportion of employed people who are in unions. With long term series like this there are lots of health warnings about the data (see the box at the end of this commentary), but the picture is stark and unlikely to be changed by better quality data.



Inequality was very high in the 1920s in the lead up to the Great Depression when around 15 percent of all income went to the richest 1% of the population. It peaked at 15.6 percent in 1928, the year before the Wall Street Crash. It fell rapidly from 1936. The first Labour Government, elected in 1935, instituted compulsory unionism, allowed national unions, restored compulsory arbitration, and greatly expanded the welfare state, progressive taxes and social advances, all of which gave working people increased bargaining power to argue for better pay and working conditions. Inequality fell until the early 1980s, reaching a low in 1986 when the top 1% received just 4.9 percent of all income – less than a third of what they were pocketing in the 1920s.

The radical programme of restructuring, privatisation and opening the economy to imports and finance by the 1984-1990 Labour government, followed by National's Employment Contracts Act 1991, which was designed to gut working people's bargaining power, led to a steep fall in union membership (despite state unions being included in the count from 1987) and a steep rise in inequality. The slashing of welfare benefits in the 1990s further reduced working people's welfare, ability to sustain loss of work and their bargaining power. By 1991, the top 1% had increased their portion of available income to 8%, and had more than doubled the 1986 level by 1998, reaching 10.2 percent that year and a peak of 13.8 percent in 1999.

Inequality and union membership both flattened out in the 2000s with a change in employment legislation and some measures to restore after-tax income. Since 2008 the global financial crisis has hit the incomes of many high income people by cutting the returns on investment, slightly reducing the income share of the top 1%. That is not a structural change however, and as the world economy begins to expand the position will reverse again unless other measures are taken. The top 1% are still getting about 9 percent of total income, a level not seen since the 1950s when it was on the way down.

The graph and the way I have told this disturbing story suggest that unionisation and the bargaining power of working people are closely related to the distribution of income in society. A graph doesn't necessarily prove that one causes the other. But there is good reason to believe that relative bargaining power is a major underlying cause of the income distribution we end up with.

First, our experience isn't unique. See here for a similar graph for the U.K.[1], or here for a speech earlier in January by Alan Krueger, the chairman of Obama's Council of Economic Advisors (in the slideshow, slide 6 has a graph on the income share of the 1% in the US – though New Zealander Robert Wade has been talking about this for several years; in his speech, Krueger mentions the problems of falling union membership)[2] and here for a graph of union membership in the US since 1947[3].

Second, there is an increasing number of academic studies that tell the same story and explain it. For example one by Bruce Western of Harvard University and Jake Rosenfeld of the University of Washington looked at the decline in private sector union membership in the US from 1973 to 2007 and the growing inequality in hourly wages. It concluded that "the decline of organized labour explains a fifth to a third of the growth in inequality"[4]. I have previously mentioned the International Monetary Fund (IMF) researchers, Michael Kumhof and Romain Rancière[5], who have created economic models showing how increased inequality with stagnating low and middle incomes could lead to the debt crisis in the US, and the international debt problems of open economies like New Zealand. Their principal solution is to increase workers' bargaining power to raise their share of income.

This IMF work suggests that economic systems cannot be sustainable – or at least cannot avoid hugely destructive crises – unless they maintain a reasonable level of income equality, which requires a much better balance of bargaining power between working people and employers. A recent issue of the International Labour Organisation's *International Journal of Labour Research*[6], took this a step further. It was devoted to the theme "Towards a sustainable recovery: The case for wage-led policies". Two papers in it are particularly interesting.

One, by Engelbert Stockhammer of Kingston University, summarises research he has carried out over several years. He looks at another indicator of growing inequality, the falling labour (or wage) share of income in all OECD countries (for New Zealand's case, see the October Economic Bulletin). He finds that globalisation (openness in international trade and finance) and union density consistently have significant effects. Globalisation increases inequality and union density reduces it. He concludes that

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[1] http://www.guardian.co.uk/commentisfree/2011/nov/28/public-service-workers-strike

[2] http://www.whitehouse.gov/blog/2012/01/12/chairman-alan-krueger-discusses-rise-and-consequences-inequality-center-american-pro

[3] http://stateofworkingamerica.org/charts/union-membership-1947-2010

[4] "Unions, Norms, and the Rise in American Wage Inequality", by Bruce Western, Harvard University and Jake Rosenfeld, University of Washington, Seattle, March 2011, *American Sociological Review*, Vol 76, 4, p.513-537.

[5] E.g. "Inequality, Leverage and Crises", by Michael Kumhof and Romain Rancière, IMF Working Paper WP/10/268, November 2010. A non-technical version is reprinted in the *International Journal of Labour Research* mentioned below.

[6] International Journal of Labour Research, 2011, Vol.3, no.2, available at http://www.ilo.org/actrav/what/pubs/WCMS_168753/lang--en/index.htm.

globalisation in production and finance and changes in bargaining power between working people and employers, rather than technological change, have been the drivers behind increasing inequality. He then looks at why countries following neoliberal economic policies which emphasise wage suppression have failed to produce the same growth rates as the Keynesian policies of the three decades following the Second World War. He concludes that for relatively export-intensive economies, wage-suppression may lead to higher growth rates for that individual country. But for most countries – and the world as a whole (which of course has zero exports) – higher wages generate the demand for goods and services which is necessary for a healthy economy. The countries which compete on the basis of wage suppression are therefore undermining the health of the world's economy in a race to the bottom.

For those who say that you can't have higher wages without first raising productivity, Servaas Storm and C.W.M. Naastepad have an answer. It is that wage increases, in the right circumstances, stimulate higher productivity rather than the other way round. They cite 15 studies showing a positive effect of either wage growth or improved labour rights on productivity growth. Locally, Professor Morris Altman at Victoria University, has similar findings, based on behavioural economics, which looks at how people actually behave rather than how many economists have always assumed (or hoped) they did.

These findings all lead to the conclusion that stronger bargaining power for working people is essential for a balanced and healthy economy. Of course we still have to think about how limits to resources mean that economies may have to cope without endless growth. But creating stagnation by not paying people enough to buy the goods and services they create hardly seems a sensible way to go about it.

Have a good year.

Bill Rosenberg

Techie bits about the graph

The graph uses several sources of data. Union membership until 2003, with the exception of a few years from 1986 to 1990 comes from a long term series on the Statistics New Zealand web site. The remaining data comes from the OECD and (most recent data) the Department of Labour. Until 1987, most state unions were not registered unions, so their members are not counted. To calculate union density, another long term series of "people employed" is used until 2001. It is based on census figures and only available for about every 5-6 years so union density is only calculated at those points. It includes employers and the self-employed who are unlikely ever to have been prospective union members, lowering the union density figure. However the pattern of change is likely to be little different if only employees were used. Since 2001, the number of employees plus self-employed from the Household Labour Force Survey is used. This gives rough continuity for the series though it does not include employers. The percentage of income going to the top 1% up to 2000 comes from "The Distribution of Top Incomes in New Zealand", by A.B. Atkinson and Andrew Leigh, November 2005, then my own calculations from IRD data. Note that this data is taxable income declared by individuals and is subject to significant changes in the treatment of taxation through the decades. It is also subject to under-declaration, especially by people on higher incomes. Atkinson and Leigh warn that figures for individual years should be treated with care, but that the overall picture is a reasonably accurate one.

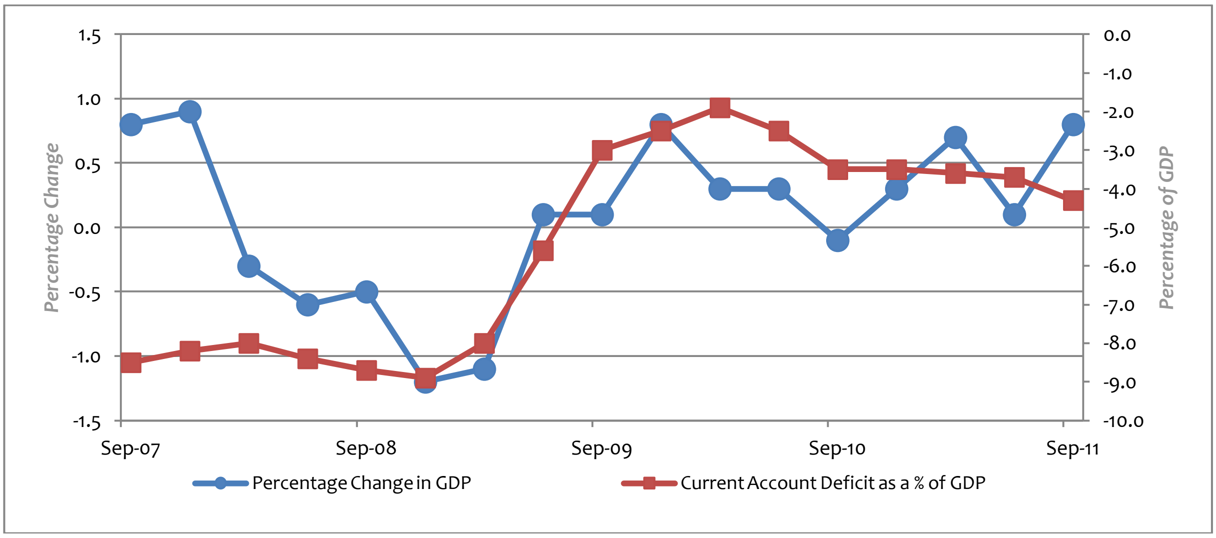
Forecast

★ This [NZIER consensus forecast] was published on 12 December 2011.

Annual Percentage Change (March Year)	**2011-12**	**2012-13**	**2013-14**
GDP	2.1	3.0	3.0
CPI	2.3	2.4	2.5
Private Sector Wages	3.3	3.3	3.6
Employment	1.0	1.9	1.8
Unemployment	6.3	5.8	5.1

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

Economy



★ Gross Domestic Product was up 0.8 percent in the September 2011 quarter, but GDP growth for the year to September 2011 was only 1.3 percent. The largest contributor was manufacturing which rose 2.3 percent in the quarter, mainly in food, beverage and tobacco manufacturing, and 4.9 percent in the year. However construction was down 2.2 percent in the quarter and 9.3 percent in the year, taking it to its lowest level since the June 2002 quarter.

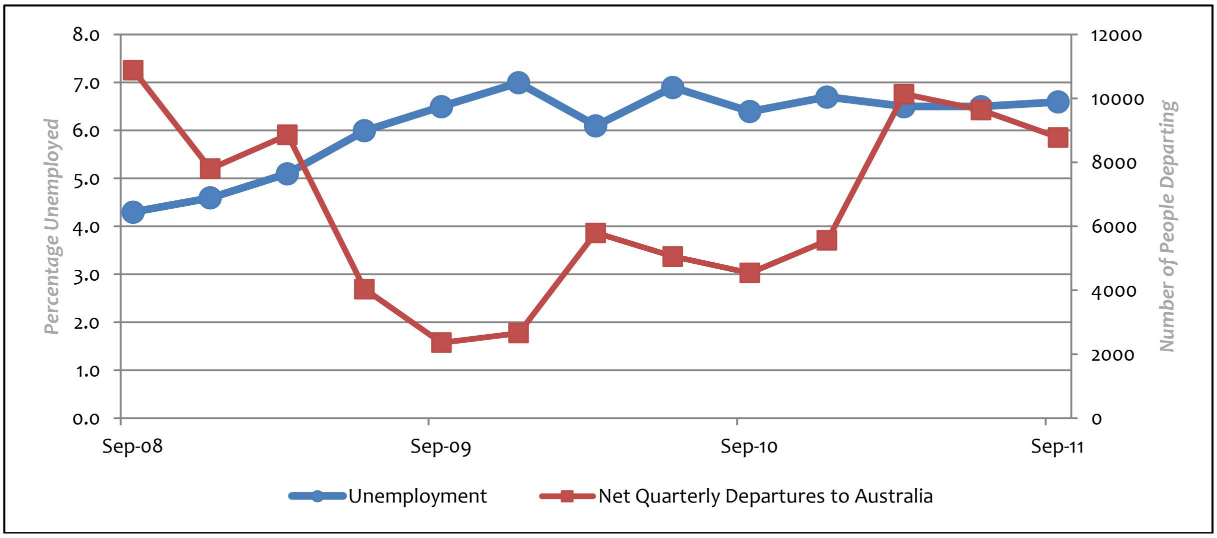
★ New Zealand recorded a Current Account deficit of $4.6bn for the September 2011 quarter ($2.7bn seasonally adjusted) and a deficit for the year to September of $8.7bn (4.3 percent of GDP; $8.8 bn seasonally adjusted). This compares with a current account deficit of $6.6bn (3.5 percent of GDP) for the year ended September 2010. The annual deficit is mainly due to profits and interest going to overseas investors ($10.3bn deficit) plus a deficit in services trade ($1.1bn) partially offset by a positive balance on goods trade ($3.0bn), all of which worsened during the quarter. The investment income deficit during the quarter was driven by bank profits.

★ The country's Net International Liabilities were $148.2bn at the end of September 2011 – 72.9 percent of GDP compared with $138.4bn or 69.0 percent of GDP in June and $148.3bn in September 2010. Reinsurance claims owed but not yet paid for the Canterbury earthquakes totalled $12.7bn at 30 September. Without them, international liabilities would be $160.9bn or

79.1 percent of GDP. In September, the government was still not a contributor to the net international liabilities, though it had only $0.4bn more overseas assets than liabilities. Liabilities increased in the quarter mainly as a result of bank borrowing (reversing a reduction in the previous three quarters) but also a reduction in the values of overseas shares owned by New Zealanders as a result of falling sharemarkets. The banks borrowed a net $5.3bn from overseas during the quarter, and the government borrowed $2.8bn.

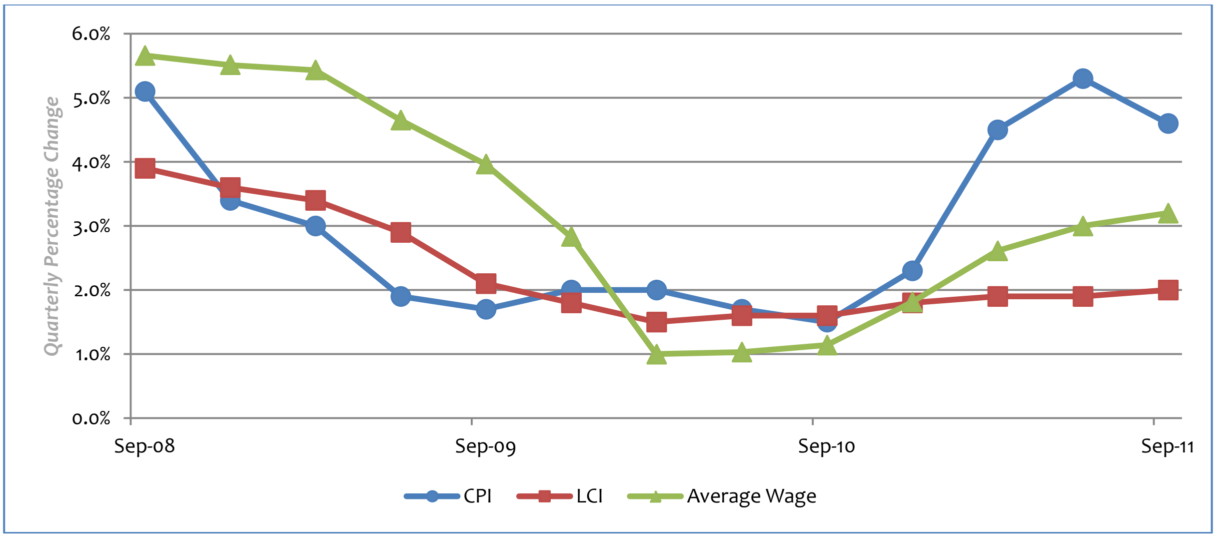
- ★ For the December 2011 quarter, Overseas Merchandise Trade recorded a seasonally adjusted $698m surplus – 5.7 percent of the value of exports for the quarter. For the year to December 2011, New Zealand recorded a trade surplus of $1.1bn (2.3 percent of exports).
- ★ The Performance of Manufacturing Index for December 2011 rose sharply to 51.9[1] from 46.0 in November which was the lowest level since June 2009. The employment sub-index also rose: to 52.7 from 50.1 in November.
- ★ The Performance of Services Index for December 2011 was 50.6[1], a sharp fall from 56.2 in November and close to its value of 50.8 in October. The employment sub-index fell slightly to 52.7 from 53.1 in November.
- ○ The Retail Trade Survey for September 2011 found retail sales were up 2.2 percent by volume and 2.1 percent by value between the June and September 2011 quarters, the largest quarterly increase since December 2006, largely due to the Rugby World Cup. They were up 3.9 percent by volume and 6.3 percent by value compared to the September quarter in 2010.
- ★ On 8 December 2011 and 26 January 2012 the Reserve Bank left the Official Cash Rate unchanged at 2.50 percent. The next review will be on 8 March 2012 and will include a Monetary Policy Statement.
- ★ The REINZ Housing Price Index recorded a 0.1 percent fall in house prices for the month of December 2011 after a 1.1 percent rise in November, and the median house price was down $12,000 from November to $355,000, $4,000 lower than in October. The House Price Index was up 3.1 percent for the year to December.

Employment



- According to the Household Labour Force Survey the unemployment rate in the September 2011 quarter was 6.6 percent, up slightly from 6.5 percent in the June quarter. The participation rate was 68.4 percent – up 0.1 percentage points on June. There are 157,000 people unemployed. Māori unemployment was 15.1 percent, Pacific unemployment was 13.8 percent, Asian unemployment was 7.8 percent and European/Pakeha unemployment was 4.3 percent. Youth unemployment (15-19 year olds) was 23.4 percent.
- ★ At the end of December 2011 there were 59,964 working age people on an Unemployment Benefit, an increase of 5,481, or 10.1 percent, from 54,483 in November 2011. (Quarterly figures on Unemployment Benefit numbers are available from the MSD website.)
- ★ In December 2011, Job Vacancies Online fell by 1.8 percent for all vacancies and 0.9 percent for skilled jobs in seasonally adjusted terms.
- ★ International Travel and Migration figures show 7,027 permanent and long-term arrivals to New Zealand in November 2011 and 6,082 departures. There was a net loss of 568 migrants in the year to November 2011, the largest annual net loss since the September 2001 year. Net migration to Australia in the year to November was 35,758 departures. The 6,500 departures from Christchurch between the 22 February earthquake and November was 2,300 higher than the same period last year, though the number moving overseas in November (500) was the same as in November 2010. However there was an increase of 13,842 permanent and long-term departures from New Zealand nationally for the year to November 2011 compared to the year to November 2010.

Wages

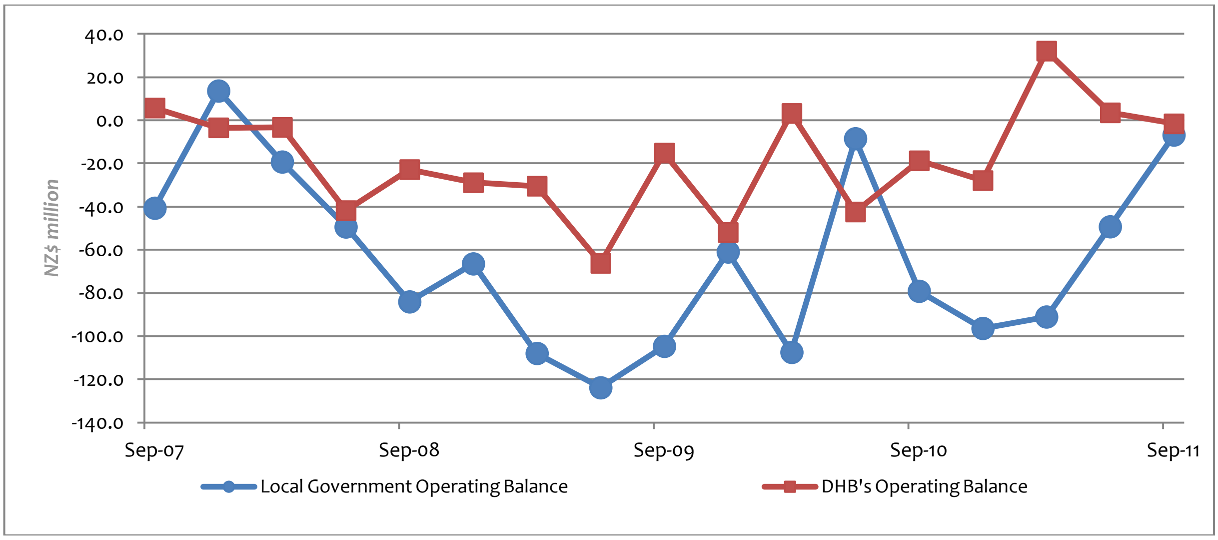


- The Labour Cost Index (Wage and Salary Rates) (LCI) rose 2.0 percent for the year to September 2011 and 0.6 percent for the September quarter for salary and ordinary time rates. It rose 1.8 percent in the public sector and 2.0 percent in the private sector for the year. For the 56 percent of those surveyed who received an increase in their salary or wage rate during the year, the median increase was 3.0 percent.
- The September 2011 Quarterly Employment Survey found the average hourly earnings for ordinary-time work was $26.53, up 1.2 percent on the June quarter and 3.2 percent over the

year. The average ordinary-time wage was $24.52 in the private sector (up 1.3 percent in the quarter and 3.4 percent in the year) and $33.52 in the public sector (up 0.9 percent in the quarter and 2.8 percent in the year). Female workers (at $24.63) earned 87.4 percent of what male workers earned (at $28.17) for average ordinary time hourly earnings.

- The Consumer Price Index for the December 2011 quarter fell 0.3 percent, but rose 1.8 percent for the year to December. This is the first quarter since September 2010 which has not been affected by the October 2010 GST increase. For the quarter, food costs were down 2.2 percent, communication prices fell 3.5 percent, while transport costs rose 1.4 percent.
- The Food Price Index rose 0.2 percent in the month of December, and there was a 2.9 percent increase in food prices between December 2010 and December 2011. Between November and December, Fruit and Vegetable prices rose 2.5 percent, Grocery food fell 0.2 percent, Meat, Poultry and Fish rose 1.2 percent, Non-alcoholic Beverages fell 2.5 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 five months ended November 2011, government revenue was down $696m (2.9 percent) on the forecast in the 2011 Pre-Election Economic and Fiscal Update (PREFU), mainly due to tax revenue being down $498m, and expenditure was down $399m (1.4 percent) on forecast. The operating deficit before gains and losses (OBEGAL) was $4.5bn, $0.3bn worse than forecast. The operating deficit was $9.9bn, $2.8bn worse than forecast due to a fall in valuations of investments held by ACC, the New Zealand Superannuation fund and EQC, a change in the discount rate used by ACC to calculate its future liabilities, and government (GSF) superannuitants living longer. The Government's net debt is 23.4 percent of GDP, 0.1 percentage points worse than budgeted in the PREFU.
- District Health Boards recorded an operating deficit of $1.6m for the September 2011 quarter compared to a deficit in the June 2011 quarter of $3.5m. Employment costs were $1.23bn, down 1.2 percent for the September quarter, compared to total expenses of $3.35bn, up 0.6 percent.

- ★ Local Government recorded a 4.6 percent increase in operating income and a 2.3 percent increase in operating expenditure for the September 2011 quarter compared to June, resulting in an operating deficit for the quarter of $7m, all in seasonally adjusted terms. Without seasonal adjustment, their deficit for the September 2011 quarter was $34m, compared to a $81m deficit in the September 2010 quarter.

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.

This bulletin is available online at http://www.union.org.nz/economicbulletin131.
For further information contact Bill Rosenberg.