Submission of the
New Zealand Council of Trade Unions
Te Kauae Kaimahi
to the
2025 Taskforce

30 June 2009

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1. Introduction

1.1. This submission should be read in conjunction with the submission that the New Zealand Council of Trade Unions (CTU) made to the 2025 Taskforce in September 2009.

1.2. The CTU is disappointed that the analysis and proposals in the 2025 Taskforce’s November report appear to have learned little from New Zealand’s experience over the last 25 years. Instead the report proposes another round of deregulation and microeconomic reform, with no new evidence to suggest why that would succeed, when it has proven so unsuccessful in the past.

1.3. This submission reviews some of the evidence that has appeared since our previous submission and makes some policy proposals.

2. Key Points

2.1. Since the global financial crisis the gap in wages and economic performance between New Zealand and Australia has grown. A significant reason for that growth has been the better-designed government intervention to stabilise the Australian economy.
2.2. The latest evidence from Statistics New Zealand confirms that the policies of the 1980s and 1990s marked a major divergence in the performance of the New Zealand and Australian economies. For New Zealand, the policies of that era proved unsustainable and did not result in ongoing improvements in productivity and output.

2.3. While New Zealand’s productivity in the measured sector deteriorated somewhat after 1996, it is misleading to say that this was due to an about-turn in policy. Rather than overturning ideas introduced in the mid 80s to mid 90s, many fundamental policies have not been greatly altered. The CTU believes that this lack of change is actually the real problem.

2.4. On that basis this submission puts forward a range of alternative policies in the economic development, monetary, finance, international, fiscal, employment, distributional and social policy areas.

2.5. The CTU also suggests that a much broader forum, including union and other perspectives, will be a fruitful way to gain sustained public support for long term policies.

3. The Comparison with Australia

3.1. Since the global financial crisis the gap in wages and economic performance between the New Zealand and Australia has grown.

3.2. Where Australia went through the crisis without going into recession, New Zealand is just emerging from recession and still shows many signs of weakness in the areas of investment, consumption and wage growth.

3.3. During the crisis Australia’s unemployment rate peaked at 5.8 percent in 2009 (seasonally adjusted) and has now been falling for seven months. This compares with New Zealand’s peak of 7.1 percent unemployment in December 2009. For the first time since 1991 Australia’s unemployment rate is lower than ours.
3.4. Australian average weekly earnings for all employees rose 5.7 percent in the year to February 2010, compared with 2.5 percent in the year to March 2010 in New Zealand (and average hourly earnings rose only 2.1 percent, having fallen for the previous two quarters). Australia’s Wage Price Index rose 3.1 percent in the year to March 2010, while New Zealand’s Labour Cost Index rose 1.5 percent. During that time, the CPI rose by 2.9 percent in Australia and 2.0 percent in New Zealand. By either measure, wages in New Zealand have fallen further behind Australia.

3.5. The relative position of low paid workers in New Zealand has also deteriorated. On 1 April 2010 the New Zealand government increased the minimum wage from $12.50 to $12.75 per hour – a nominal increase of 2 percent, and a zero increase in real terms. Over the two years since 1 April 2008 the New Zealand minimum wage increased by 1.1 percent in real terms. In contrast, on 1 July 2010 the Fair Work Australia specialist Minimum Wages Panel raised the Australian minimum wage to A$15.00 per hour, a nominal increase of 4.7 percent and a real increase of 1.2 percent over the two years since its last increase.

3.6. The Australian minimum wage also included changes that improve wages for approximately 1.45 million workers on minimum award wages, under the Modern Award system. This system provides a centrally-determined underpinning to their entire wages system and continues the Award system that has been in place throughout the period when Australia grew faster than New Zealand.

3.7. Despite falls in trade internationally, Australia has benefited from continued strong international demand for some of its exports. But so has New Zealand – in fact, more so. Australia’s goods exports fell 21 percent in the year to March 2010, with no category experiencing an increase. New Zealand’s goods exports fell only 9 percent in the same period, with some major commodities (forestry, fruit and wine for example) experiencing increases. Overall, Australia’s current

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1 Australian Bureau of Statistics, Balance of Payments and International Investment Position, Table 7 - Goods Credits: Original.
account deficit deteriorated from $40.5 billion to $61.8 billion (a 53 percent deterioration) whereas New Zealand’s improved from $14.6 billion in March 2009 to $4.5 billion (a 69 percent improvement) over this period. While New Zealand’s improvement was partially a symptom of ill-health – low consumer demand for imports, low levels of producer demand for investment and intermediate goods, and low company profits – it would be inaccurate to suggest that Australia’s better performance was because of its mining sector or exports generally.

3.8. It is therefore likely that the Australian government’s reaction has played a strong role in it riding out the crisis considerably more successfully than New Zealand, and indeed most of the OECD. In its June 2009 Economic Outlook the OECD estimated the size of the New Zealand government’s stimulus package at 3.7 percent of 2008 GDP. This was below both the 3.9 percent weighted average for all OECD countries or the 4.3 percent weighted average for just those applying a positive stimulus. It was significantly less than Australia's 5.4 percent.

3.9. Australia’s stimulus was also quite differently constructed: 4.1 percent was through additional government spending on investment and transfers to households, leaving only 1.3 percent through tax reductions. In contrast, New Zealand’s was negative 0.3 percent in net reductions in government spending, and 4.1 percent in tax reductions. Australia was able to target its stimulus much more directly than a simple tax reduction, which favours those on higher incomes. The New Zealand pattern has continued with tight constraints on government spending accompanied by income tax cuts which are mildly expansionary in the first year (by $460 million) but forecast to be fiscally neutral to contractionary from then on, in a context of government spending reducing as a proportion of GDP.

3.10. We conclude that the widening gap is in substantial part due to the inadequate response of the New Zealand government to the crisis, including its reliance on
tax cuts rather than better-targeted interventions, and its failure to provide more support to low income New Zealanders who had greater need and would have been more likely to spend any additional or replacement income, assisting in the economy’s recovery.

4. **Productivity**

4.1. The latest Statistics New Zealand report on productivity, which includes a section comparing New Zealand with Australia, provides additional information supporting the CTU’s explanation of the divergence between the two countries.

4.2. However, this and other productivity measurements do need to be read with caution. The measurement of labour productivity involves a number of assumptions, including the existence of competitive markets with all participants being price takers. This is never absolutely true, but in some industries in particular, there is a high degree of concentration with prices which have in recent times been demonstrably higher than they would be in a perfectly competitive market. These industries include communication services, finance and insurance, and the electricity, gas and water supply sectors which appear in the new statistics to have particularly rapid productivity growth, both in New Zealand and Australia. The apparent increase, which is measured by value-added (at constant price), may in part be due to increases in rates of profits (economic rents). Higher productivity in one country may be due to higher industry concentration rather than more efficient use of inputs.

4.3. Similarly, wages are not set with all participants “price takers”. This is recognised by international conventions and the need for special employment legislation to recognise (in the words of the Employment Relations Act 2000) “the inherent inequality of power in employment relationships”. It is reflected in the fact that the real average hourly wage in New Zealand has risen significantly slower than labour productivity. For the measured sector the real average total hourly wage rose by 12 percent between 1989 and 2008 while labour productivity rose 47

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percent. This in turn means that assumptions underpinning growth accounting may not hold, and the relative shares of output growth may not be correct.

4.4. Statistics New Zealand = new report confirms tentative information provided to the Taskforce which shows that in the measured sector (the part of the two economies which is both comparable and for which productivity measurement can be validly carried out), New Zealand has in fact outperformed Australia in labour productivity since 1986.

4.5. The growth story told by the earlier report\(^3\) confirms our own:

“The two countries followed similar growth paths from the 1960s to the mid-1980s. New Zealand’s economic performance stalled in the mid-1980s while Australia continued to grow. Between 1985 and 1993, Australia grew by 27 percent while New Zealand grew by only 4 percent. Since 1993, both countries have grown at a similar pace; Australia growing by 75 percent compared with 68 percent growth for New Zealand.”

4.6. The publication divides the period into two: 1986-1996 and 1996-2008. While labour productivity in the measured sector grew faster in New Zealand than in Australia from 1986 to 1996, output grew more slowly (at an annual rate of 2.6 per cent to Australia’s 3.4 percent). This was because “for much of this period, labour was shed in the New Zealand economy”. Labour utilisation dropped steeply between 1987 and 1992 and has only recently returned to the 1987 levels. Capital input was also weaker in New Zealand than Australia, and capital productivity fell by 0.5 percent per year over the period. In other words, productivity increases were bought at the cost of high unemployment and relatively low input, and inefficient use, of capital.

4.7. For workers during this period, real average hourly ordinary time wages did not rise despite the high productivity growth. In June 2009 dollars, the wage was

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$21.01 in March 1986, $21.04 in March 1990, and $20.93 in March 1996. In addition there were substantial cuts in payments to beneficiaries, rapid growth in poverty (particularly in families with children) and the most rapid rise in income inequality in the OECD.

4.8. This was clearly an unsustainable situation and it would be irresponsible to attempt to go back to the policies of that period that produced those outcomes.

4.9. Growth was stronger for both Australia and New Zealand in the second part of the period (1996-2008) although growth in labour productivity slowed to 1.9 percent per year, compared to Australia’s 2.3 percent. New Zealand’s improving labour utilisation, including lower unemployment rates and higher labour force participation rates assisted output growth during this period. We should also note that some of the difference in labour utilisation is a measurement issue: New Zealand data includes holidays and leave in its calculation of productivity, where Australia does not. This will have affected apparent productivity in New Zealand following the 1 April 2007 introduction of a fourth week of annual leave. Though Australia has a stronger record over this period for both productivity and output growth, the difference accounts for only a small part of the very large difference between the countries’ wage levels and GDP per capita.

5. **Policy implications**

5.1. In our view, the lower productivity and output growth rates of the period 1996-2008 are due more to a continuation of many of the policies of the earlier period, rather than a radical change in the fundamentals. While the 1999-2008 government took a more active and strategic view of economic development, new companies still found it difficult to survive in an open economy with high interest rates and volatile exchange rates which were often much higher than would be appropriate for the real economy. Speculative rather than productive investment was encouraged by high interest rates and the absence of a capital gains tax. The economy was opened further through preferential trade and investment agreements.
5.2. There were some improvements in employment law which have been insufficient to rebuild unions and the coverage of collective employment agreements, or see significant real increases in wage levels, and leave employment relationships in New Zealand among the most “flexible” in the OECD. Tax changes, including the Working for Families package stopped the growth in inequality and child poverty but did not reverse it. New Zealand had a personal tax wedge among the lowest in the OECD and total company taxes (not just the headline company income tax rate) were seventh lowest in the OECD according to a World Bank, PricewaterhouseCoopers report\(^4\). Core Crown revenue in 2008 at 33.9 percent of GDP was little different from its level in 1998 (33.3 percent) and Core Crown expenses at 31.2 percent were lower (32.1 percent in 1998)\(^5\). These are marginal changes to the fundamentals of the 1980s and 1990s.

5.3. It is simplistic and dangerous to arbitrarily set a cap on government spending as the Taskforce has suggested, and in the light of the above, has little point. First, it ignores the lessons of the current global crisis. The world is in the deepest financial crisis since the catastrophic depression of the 1930s, an economic disaster that led to millions losing their jobs, contributed to the forces that led to the Second World War, and left deep scars on the memories of the generations who lived through it. The world has largely escaped the depth of that depression this time because governments heeded its lessons. They increased government spending to maintain activity in the economy and give sufficient confidence to the private sector that individual firms did not feel they had to cut employment and output for their own survival. Without that confidence the irresistible logic of each individual firm would have ensured a downward spiral of entire economies into depression. In addition, governments were faced with the collapse of entire banking systems.


\(^5\) 2010 Budget Economic and Fiscal Update, p.159.
5.4. As a result, Governments have increased their spending in unprecedented proportions. The OECD, estimates that its members increased their total government expenditure from around 40 percent of GDP in the years to 2007 before the crisis hit to over 45 percent in 2009 and 46 percent this year. Without that huge increase in government spending, firms in large sections of the world economy would face bankruptcy. Unemployment would have surged far past the 8.8 percent peak in the OECD. Banking systems would likely have collapsed.

5.5. How would rules setting an arbitrary cap on government spending cope with such crises? For a small open economy like New Zealand’s they occur with all too great a frequency to ignore and leave to the free market to resolve. The lesson of history is that the market cannot avoid such crises and only recovers after grave damage to the economy and the people who rely on it.

5.6. Setting a cap also assumes that the current rate of government spending is either ideal or too high. What if we find that there are services more efficiently provided by government, or the private sector fails to provide services in sufficient quantity or to provide for people’s needs? An arbitrary cap would have stopped the previous government ensuring we had a functioning railway system, or the current government from creating high speed internet infrastructure, both of which the private sector has failed to provide on its own or has provided at such a low level of coverage or quality that the future of other parts of the economy are put at risk.

5.7. A cap would also stop a government increasing spending on public services like education and health despite obvious underfunding. Granted these are services which can always find good reasons to ask for more money, but the level of funding should still be based on democratic mandated and not arbitrary technocratic limits that are only a boon for private health and education providers by forcing citizens to pay them for services the state is no longer funded to provide.
5.8. There are many nations of about New Zealand’s size which spend a considerably higher proportion of their national output through government services and, at the same time, have considerably higher standards of living. It is quality of government spending, not quantity, that counts.

5.9. Health is just one example that demonstrates the value of quality over quantity. According to the OECD, the US with a largely private health system spent 16 percent of its GDP on health in 2007. New Zealand spent just 9.2 percent, overwhelmingly through government funding. Indeed, in most of the OECD, most health is publicly provided. The average spending was similar to New Zealand’s – 8.9 percent of GDP. Per person, the comparison is even worse: Americans spent almost two-and-a-half times the OECD average, and this difference is not accounted for by the fact that it is a richer economy. Yet the US has inferior health outcomes in many respects to New Zealand and the rest of the OECD. It has lower life expectancy for example, and (prior to the reforms forced through by the Obama administration in the last month) significant parts of the population were without insurance coverage.

5.10. So comparing government spending in the US and New Zealand not only ignores the fact that government in the US doesn’t provide nearly as much health care as New Zealand – and the economy and population get vastly inferior results from it. We are demonstrably better off with that higher government spending.

5.11. In focusing on retrograde microeconomic policies, the Taskforce has overlooked other possible improvements in efficiency and productivity, and other policy options.

5.12. The government says it has six main policy drivers: regulatory reform; investment in infrastructure; better public services; education and skills; innovation and business assistance; and a world-class tax system.
5.13. We have expressed our concern that regulatory reform in the forms proposed has not only more than run its course but fails to learn from our history and is destructive of economic development and a decent society.

5.14. We support greater investment in infrastructure, but in the light of New Zealand and international experience, reject any notion that public infrastructure is always better owned, operated or managed by the private sector. It adds both transaction costs and the requirement to fund a private agent’s profits, and frequently confers a monopoly status from which New Zealand has repeatedly suffered. It also frequently implies a loss of public control.

5.15. We support better public services, and are keen to engage in their improvement, as long as this is not a euphemism for reducing services to cut costs.

5.16. Education and skills are of fundamental importance for both economic and social development, and we are greatly disappointed at the reduction in funding for quality early childhood education, the reduction in places in tertiary education, and the loss of emphasis on skills (including literacy, language and numeracy) in the workplace.

5.17. We have supported innovation in practical ways and advocate appropriate business assistance.

5.18. Our view is that a world-class tax system must prioritise distributional considerations at least as highly as efficiency.

5.19. We provide some suggestions for alternative policies in these areas below.

6. Alternatives

6.1. As we noted briefly in our previous submission, researchers Richard Wilkinson and Kate Pickett in their book “The Spirit Level: Why More Equal Societies Almost Always Do Better” (Allen Lane, 2009) provide broad and carefully analysed evidence that inequality in society leads to poorer outcomes in societies in a range of health and social problems. The authors are health
researchers who discovered these results in a surprising number of areas of health. They find that the same applies in many other areas of society: "we became aware that almost all problems which are more common at the bottom of the social ladder are more common in more unequal societies". They describe such problems as having a "social gradient".

6.2. It is important to be clear what they are asserting. Very unequal societies do have more people in poverty, so we would expect such societies to have more low income people afflicted by these problems. But it is not just people in poverty who suffer more from these problems in more unequal societies. Almost everyone does, right up the income and status ladder. For example, comparing rates of diabetes, hypertension, cancer, lung disease and heart disease between the US (the most unequal society in their study) and England (also very unequal, but less so than the US) shows US people are worse off whether we compare people at low, medium or high educational levels. Finland, Belgium, the UK and the US are in order of decreasing equality. The literacy levels of adults in the four societies also decrease in that order - across all levels of educational achievement of their parents. Wilkinson and Pickett give many other examples, all statistically tested, both between countries and between states of the US.

6.3. Problems with a “social gradient” include infant mortality, life expectancy, mental illness, drug abuse, teenage births, obesity, the proportion of the population in prison, educational performance of school children, levels of trust and strength of community life, and social mobility.

6.4. If Wilkinson and Pickett are correct, there is an economic efficiency argument (as well as a social one) for reducing the inequality in society. We suggest that the Taskforce recommend further research on Wilkinson and Pickett’s findings.

6.5. The 2010 Budget worsened inequalities through tax changes (increased GST, and reduced personal income tax rates largely benefiting high income earners) in the name of economic efficiency and encouraging work and investment. We see little evidence of that working from similar policies in the 1980s and 1990s.
But even if there were increases in efficiency from the tax cuts, it could well be that its marginal improvements are more than negated by the increased inequality.

6.6. There is also international evidence from the World Health Organisation (WHO) that better health services reduce future health costs\(^6\). For example the increased health spending over the last decade in New Zealand has been associated with an improved “healthy life expectancy”. Between 2000 and 2007 there was an almost three year increase in healthy life expectancy, while life expectancy at birth increased by two years, according to the WHO. Ministry of Health data shows a similar trend, though at lower rates. Increased spending on appropriate health services can therefore lead to future saving and should be seen as an investment. A healthy population and accident prevention both increase productivity by reducing absences or incapacity at work, and so are worth investing in for that reason as well as the wellbeing of people for its own sake. The costs of an ageing population lie largely in deteriorating health outcomes. If those can be delayed or significantly reduced, increasing people’s healthy life expectancy, the looming (often exaggerated) rising fiscal costs of an ageing population become less a threat.

6.7. In terms of economic development, the CTU advocates a more strategic approach, providing support to firms meeting appropriate criteria whose objective is to encourage new exporters which also act responsibly in developing their workplace, workers’ skills and conditions of work.

6.8. Manufacturing is struggling in the current environment. Its output peaked in 2006 having fallen through the early 1990s, and this output is a considerably smaller proportion of the economy than it was in 1983 (15.1 percent in 2007 compared to 23.4 percent in 1983). Yet its output still exceeds that of agriculture, forestry and mining while adding to the value of all of them. It was particularly hard hit by

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the global financial crisis, as was manufacturing internationally, and is only recently beginning a recovery assisted for a few months by a favourable exchange rate for its exports to Australia. Prior to the crisis it provided over a third of New Zealand’s goods exports (34.2 percent in 2007) but dropped to 28.3 percent in 2009. It provides reasonably paid jobs and is capable of producing the high value-add exports that New Zealand needs, but start-ups and small companies struggle in the open economy. It is an important part of our economy and should be supported to grow and improve its productivity and export and import substitution contributions.

6.9. New Zealand industry suffers from a lack of suitable finance for development. Funding could come from a government owned development finance agency raising funds from direct government contributions, investment from other government investment funds (such as ACC and the New Zealand Superannuation Fund) and privately subscribed bonds. This would provide both development funding (including venture capital and “patient funding” during further development phases) and an investment vehicle to increase local equity in New Zealand firms. Long term Kiwi bonds for infrastructure may also be attractive for superannuation purposes, and we could encourage a greater proportion of the New Zealand Superannuation Fund to be invested locally by use of partial government guarantees to the Fund on investment consistent with the economic development strategy. Encouragement could also be given to private superannuation funds to invest in New Zealand.

6.10. To provide a supportive environment for developing producers of tradeable goods, the reliance of monetary authorities on interest rates to control the price level should be greatly reduced through the use of other instruments, for example by direct control of the money supply, capitalisation ratios, liquidity regulations, and considering other mechanisms such as empowering the Reserve Bank to increase or reduce a small slice of compulsory superannuation contributions.
6.11. The objectives of monetary policy should be broadened to include employment, living standards, the exchange rate and other matters.

6.12. The Reserve Bank should also be given sufficient powers to take an active role in stabilising the exchange rate including management of international capital flows and currency controls, seeking cooperation and agreements with other nations.

6.13. We should make much more active use of government procurement and the activities of State Owned Enterprises to support and build New Zealand’s productive capacity. For example the study by BERL\(^7\) earlier this year on the feasibility of building passenger trains and locomotives in New Zealand indicated a strong business case for such an industry. Such developments could be assisted to sufficient scale (and scope) to be economically viable through the support of an SOE (in this case KiwiRail).

6.14. This could be broadened to an investment approach to economic development in which employers, workers and unions work on increasing value added content, tap into experienced and skilled workers ability to innovate, and thus build sustainable high-value industries with a strong New Zealand brand.

6.15. As we described in our previous submission, the CTU and affiliates have been involved for several years, on many occasions alongside Business New Zealand, in developing workplace productivity in both the private and public sector. We see this as a concrete and positive approach to increasing productivity which can also assist in building workplace relationships.

6.16. This is also part of our commitment to skill development and higher educational attainment for New Zealanders. There needs to be a well resourced campaign to raise the literacy, language and numeracy levels of our existing workforce (40 percent of whom have insufficient of those skills) as well as ensuring the school

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system does not produce more leavers without such skills. We should not be capping tertiary education so tightly as to deny many school leavers and adult students access to a tertiary education.

6.17. Research and development by firms needs support, which could be by funding through buying shares in the firm or part public ownership of intellectual property created, or through tax credits. Research and development funds for technology and services which assist national priorities and themes also have a place. Support could also be provided through Crown Research Institutes, with encouragement for collaborative clustering of firms sharing development and commercialisation. Intellectual property laws and rules in public institutions should be reviewed to encourage new forms of intellectual property ownership similar to open source software, creative commons licensing, and the practical application of publicly funded research by our universities and CRIs. This would enable sharing by firms and extraction of the widest benefit from new developments rather than conferring limited monopolies. Application of research would be encouraged by sharing proceeds with the researchers who create new concepts. The utilisation of our public research capability could be improved by moving most government funding of research to centres of excellence (formal or part of existing institutions) and capability funds such as PBRF and CRI core funding, away from contestable funds. Centres of excellence should have a requirement to collaborate with all New Zealand experts and users in the field.

6.18. We have already provided evidence that workers are not being adequately recognised for their increased productivity in their wages. That situation will only increase the attractiveness of working in other countries and lead to cynicism about the value of increasing productivity. We need a government focus on wages, including an immediate rise in the minimum wage to $15, and an employment relations environment with strong support for unions and collective bargaining in order to encourage the development of an economy that is based on high wages and high value rather than low wages and commodity exports.
6.19. Both the employment relations environment and the tax system should support reductions in inequality. The tax system should be more progressive, include a capital gains tax or equivalent and support strong, quality public services. GST should be reduced, replacing it with other taxes which broaden the tax base.

6.20. Our international economic relationships should support these policies rather than deregulation of the economy. They currently reduce our ability to support developing firms and to shape the social environment New Zealanders wish to have.

7. Conclusion

7.1. We have considered the existing evidence on the comparison between New Zealand and Australia, pointing out how government actions during the economic crisis appear to have been a significant contributor to further widening of the gap.

7.2. We have discussed the evidence on productivity and growth, which confirm our previously stated view that the policies of the 1980s and 1990s marked a major divergence the performance of the New Zealand and Australian economies. The policies of that era were unsustainable and do not provide evidence that they led to ongoing improvements in productivity and output.

7.3. While New Zealand’s productivity in the measured sector deteriorated somewhat after 1996, it is misleading to say that this was due to an about-turn in policy. In fact many fundamental policies did not change greatly. The CTU believes that this lack of change is actually the real problem.

7.4. We have put forward some alternatives including economic development, monetary, finance, international, fiscal, employment, distributional and social policies.
7.5. We once again encourage the Taskforce to be broad-minded, open to the full range of discussions around productivity, and be willing to consider a wide range of policy options.

7.6. We suggest that a much broader forum that includes union and other perspectives may be a fruitful way to gain sustained public support for long term policies.

7.7. We look forward to further opportunities to engage.