RESEARCH NOTE

Response to CTU "Fact check" 10 July 2019

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Overview and background

On Tuesday 9 July, The New Zealand Initiative published a report, *Work in Progress: Why Fair Pay Agreements would be bad for labour*. It assessed the Fair Pay Agreement Working Group's case for imposing collective pay agreement structures on New Zealanders.

The working group's report sought to justify these proposals in good part on the claim that labour's income share had fallen following the *Employment Contracts Act 1991*.

Our report demonstrated that Statistics New Zealand's national income account statistics showed employees' income share has trended up overall, not down, since 1991. It is disappointing that the working group's report did not draw readers' attention to this easily replicable fact. It contradicts the report's assertion, failing any argument to the contrary.[1]

Our report also found that other statistical justifications the working group put forward in support of its recommendations were similarly far too partial and unbalanced to justify its recommendations. Many of New Zealand's labour market outcomes since 1991 compare very favourably internationally (high labour market participation, exceptionally high jobs growth, comparatively low unemployment, rising real wages in all wage deciles, and so on).

In short, the government and the public deserve to be given a much more convincing case before any further consideration is given to the working group's recommendations.

Shortly after our report was published, we learned that the New Zealand Council of Trade Unions (CTU) had circulated a six-page note[2] that engaged in the statistical debate. We welcome such engagement.

Below are four points in our report that the CTU's note purports to rebut:

1. Employees' income share has trended up overall, not down, since 1991;
2. On the basis of the most authoritative research estimates available, income inequality trended down, not up, between 1991 and 2013;
3. Real hourly wage rates have risen significantly faster than inflation since 1991 across all industry groups, contrary to the 'race to the bottom' mantra; and
4. There is no evidence linking low productivity growth over the last decade or two to our wage setting arrangements.

This note finds that the CTU's response has implicitly conceded all four points. This finding reinforces our earlier conclusion that the statistics being put forward by the advocates of the proposed changes are too one-sided and flimsy to justify their case.

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This note also responds to claims made by the CTU, but not by the working group, about New Zealand's poor labour productivity growth rate relative to the Organisation for Economic Co-operation and Development (OECD) member-country average.

Despite the CTU's claims, the OECD's statistics disclose that New Zealand's relative productivity performance has been much improved since 1991.

Nor do the OECD's economy-wide official statistics for New Zealand indicate that wage rate increases have lagged productivity growth since 1991.

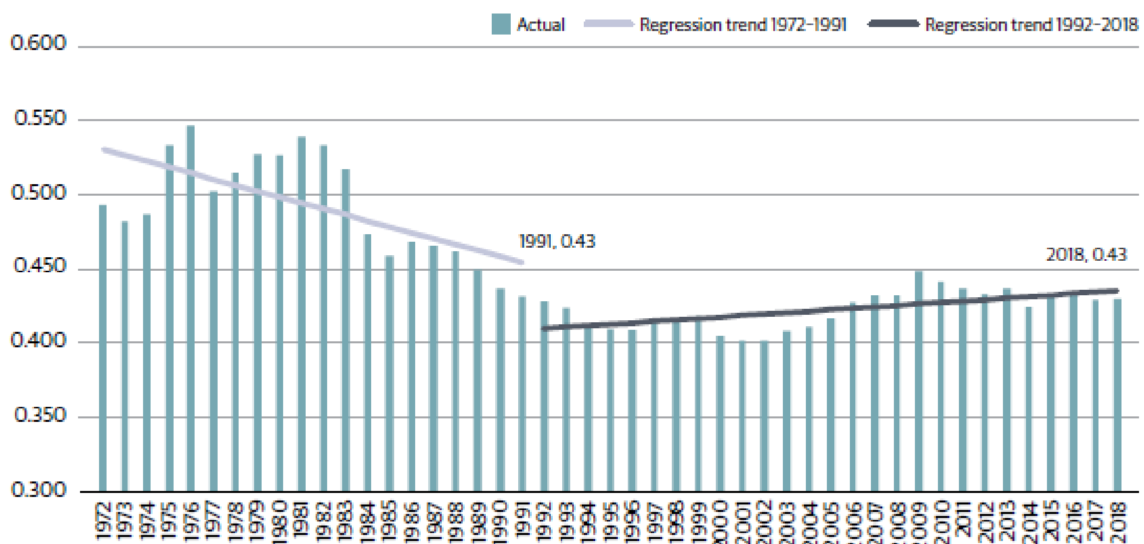
It is a concern that neither the working group report nor the CTU addressed the broad range of official statistics that were relevant to their case.

Our report and this note aim to inform policymakers and the wider public about the statistical evidence that has been overlooked or ignored. The burden of proof for making a robust case for radical changes to New Zealand's wage-fixing arrangements remains with those advocating those changes. That case has not been made.

1. The CTU implicitly concedes the upward trend in employee's income share since 1991

First up on the CTU's list for rebuttal is our observation that: "[s]ince the 1991 reforms, the decline in employee's share of GDP has been arrested and is now trending upwards".[3] Figure 1 below reproduces Figure 2 in our report.[4] It presents our evidence (the regression lines can be easily replicated using Excel). A long decline from the 1970s and early 1980s continued for some time after 1991 but was eventually arrested and turned around to such a degree that the slope of the overall trend line is significantly positive since 1991.

Figure 1: Replica of Figure 2 in our report



The CTU's response side-steps the issue in three ways. First, it replicates our chart, but without the trend lines. Second, it points out what Figure 1 shows - that the decline in labour's income share

continued after 1991. That does not rebut our point. Third, the CTU asserts that labour's income share is "now" below its 1991 level. That would not rebut our point either, even if it were true, which it is not to two significant figures as the figure shows.

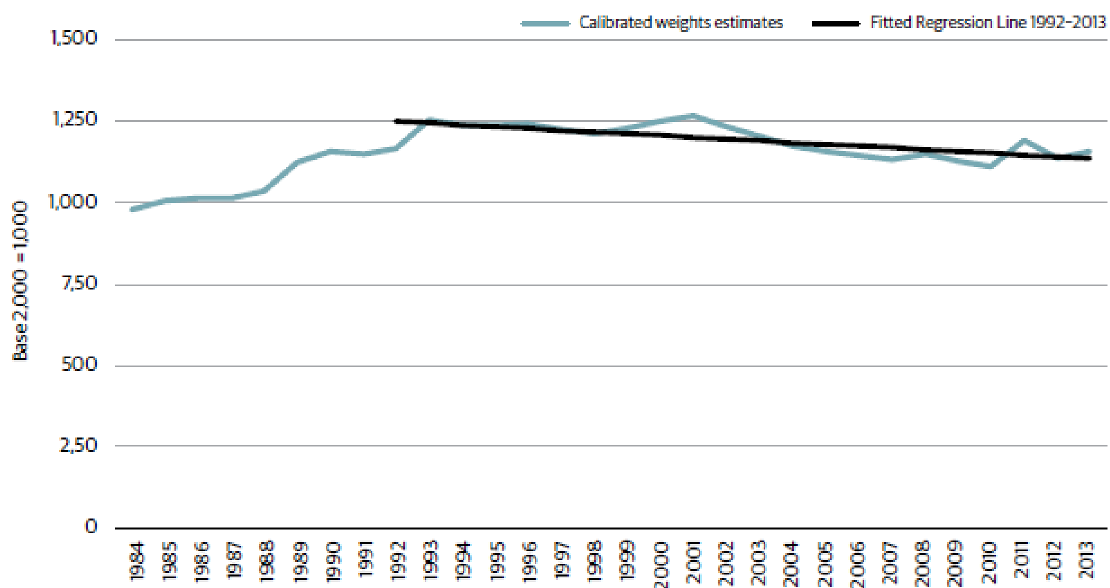
Consequently, the CTU has implicitly conceded that the post-1991 trend in the employees' income share has been up, not down.

2. The CTU does not dispute the downward trend in market income inequality

The CTU's second fact check purports to rebut our point that income inequality before taxes and transfers has trended down, not up, since 1991. Figure 2 below replicates Figure 6 in our report showing that downwards trend.

FIGURE 2: REPLICA OF FIGURE 6 IN OUR REPORT

Figure 6: Market income inequality in New Zealand (1983/84 to 2012/13)



Source: Christopher Ball and John Creedy, "Inequality in New Zealand 1983/84 to 2012/13," *New Zealand Economic Papers* 50:3 (2016), 323–342.

The CTU's response does not address our point. Instead it responds by observing that average hourly wage rates are unequal across deciles, and, on the data, became more unequal between 1998 and 2015. Neither factual point is in dispute and neither point rebuts our case.

On the first aspect, it is inconceivable that wage rates could ever be equal regardless of skill, experience, risk, responsibility or public demand. People with skills in greater demand *do* tend to get higher rates of pay. Witness the differential earnings of top professional rugby or golf players, rock stars and IT specialists.

The CTU does not explain how that would, or should be, different under collective bargaining. Surely it is desirable for workers to be rewarded for learning the skills that are most in demand. If so, we must accept wage rate differentials.

The CTU's second point is that the percentage increases in wage rates across deciles between 1998 and 2015 were unequal in the direction of rising absolute differentials. (The percentage increases

rose progressively from the fourth-highest decile to the highest decile.) The CTU says this shows "that inequality among wage and salary earners has risen over that period".[5]

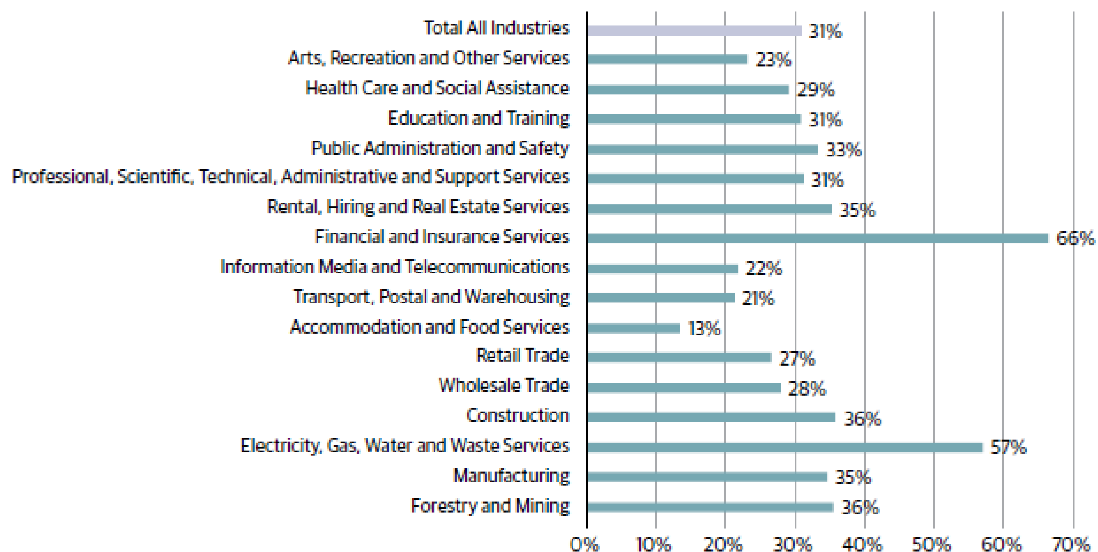
However, these statistics show hourly wage rate inequality, not income inequality. Moreover, the rise in wage differentials at the top has been a global phenomenon – despite the marked differences across countries in wage setting arrangements. The CTU makes no case that New Zealand could have resisted these competitive pressures with different wage setting arrangements.

The CTU also gives the impression that it is bad if our labour market is flexible enough to cater for people who need to work longer hours and/or hold down multiple jobs because of low pay. Of course, it would be better if their productivity was high enough to allow them to find higher-paying work. However, it would not be welfare enhancing for those who are least employable to be priced out of the job market.

3. The CTU implicitly confirms no race to the bottom is evident in its data

The CTU's third fact check responds to our observation that the CTU's own statistics show substantial real average hourly wage rate increases across its deciles. Our report substantiated this observation with the cross-industry statistics replicated in Figure 3 below. The increases in average real wage rates since 1991 have been substantial across all 16 industries in Statistics New Zealand's industry breakdown.

Figure 3: Replica of Figure 7 in our report



Substantial, widespread real wage increases are not evidence of any "race to the bottom".

The CTU is also concerned, as are we, about real wage rate levels. It defines a "'good' wage to be one that New Zealanders can live on decently".[6]

It is not clear what this might mean in practice. Is a student holding down a holiday job to have the same "good" wage as someone doing the same work who is the head of a household with a non-working partner and two dependant children? Whether someone can live decently on a given wage

rate surely depends on many other factors, including the number of hours worked, the number of dependants in the household, and any special needs.

Separately, the CTU asserts that real wage rates have not kept up with productivity growth. Even if that were true, it would not be evidence of a "race to the bottom".

In its "fact check" note #3, the CTU defines a fair distribution of income growth to be one where wage rate growth has matched productivity.[7] Yet, its case for a "good wage" is unrelated to productivity.

The risk for the least skilled is that the CTU's push for higher wage rates unrelated to productivity is that it could see more of them priced out of paid employment. The unemployed have no one to represent them in the proposed wage setting processes. That looks neither fair nor caring.

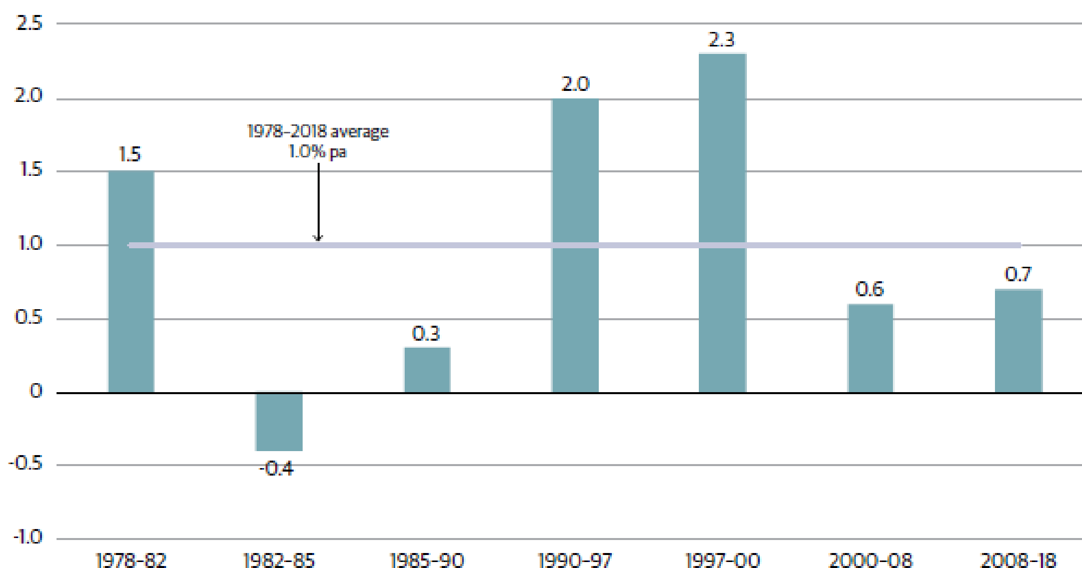
4. There is no evidence linking low productivity growth over the last decade or two to our wage setting arrangements

The CTU's fourth fact check point responds to our observation that there is no evidence linking New Zealand's low productivity growth over the past decade or two with our current labour market settings.

Without any evidence, the CTU asserts that the policy changes of the 1980s and 1990s "led to weak productivity growth, continuing to fall behind the rest of the OECD".

Figure 4 below replicates Figure 10 in our report. It shows Statistics New Zealand's estimated growth cycles since 1978 for the productivity of labour and capital combined for its former measured sector[8] Contrary to the CTU's assertion that the reforms "led to weak productivity growth", Figure 4 shows the fastest rates of growth occurred in the 1990s.

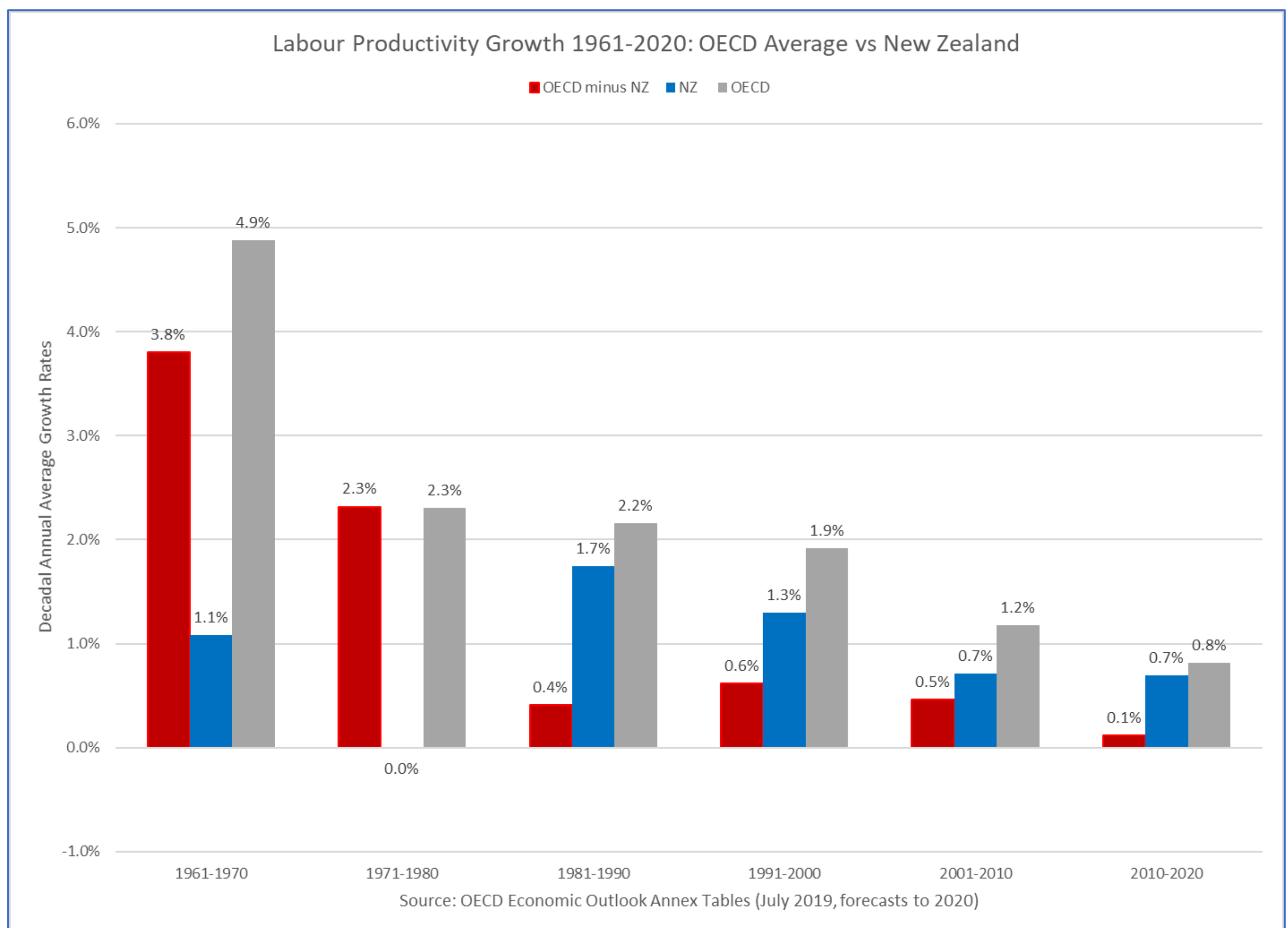
FIGURE 4: REPLICA OF FIGURE 10 IN OUR REPORT



To enhance debate and analysis, Figure 5 below compares decadal average labour productivity growth rates for New Zealand since 1961 with the average for member countries of the OECD. It demonstrates a very substantial increase in New Zealand's labour productivity growth relative to the OECD average during the reform period and subsequently.

(The red bars in Figure 5 show by how much the OECD average growth rate in each decade exceeded the corresponding New Zealand average. For example, between 1961 and 1970, labour productivity grew at an annual average rate of 4.9% for the OECD average, but only by 1.1% per annum for New Zealand. The red bar shows the extent of New Zealand's shortfall – 3.8% per annum.)

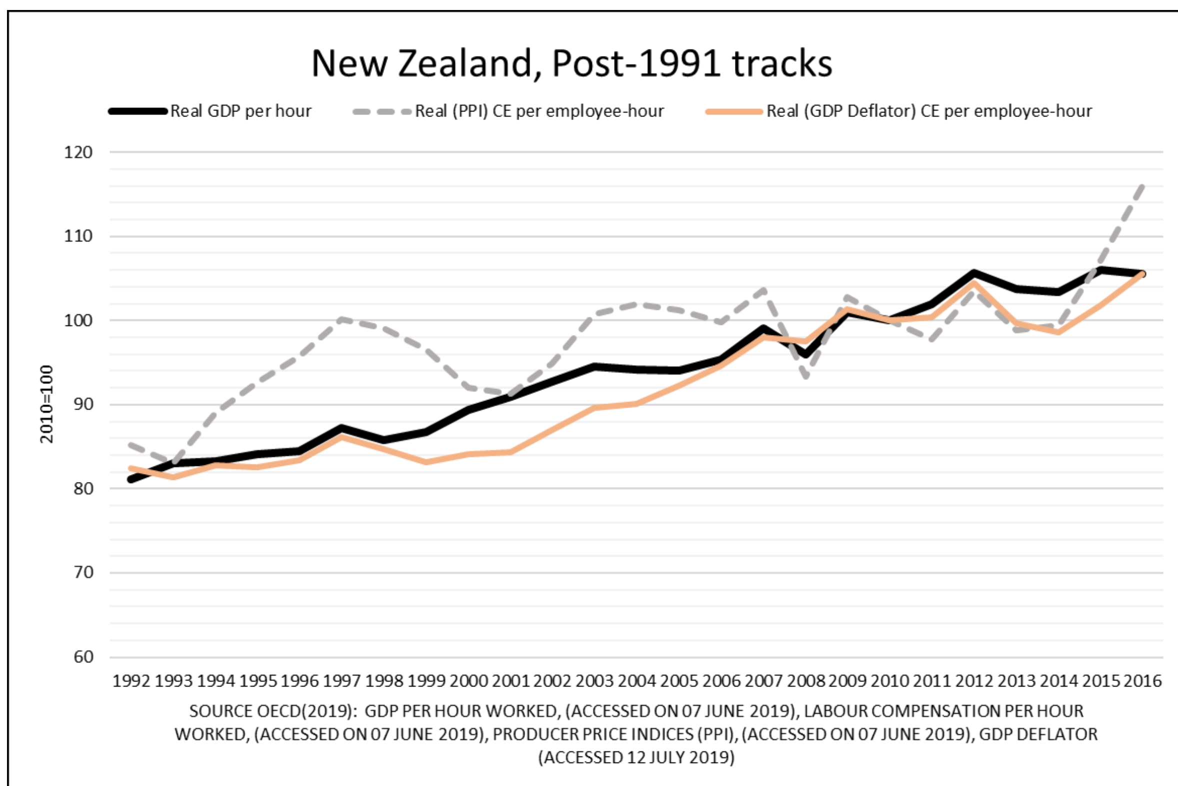
FIGURE 5: NEW ZEALAND'S IMPROVED LABOUR PRODUCTIVITY PERFORMANCE AGAINST THE OECD AVERAGE



The CTU's assertion of "continuing to fall behind the rest of the OECD" is misleading because it ignores the major gain in *relative* performance.

Likewise, the CTU's claim that "real wages have not even kept up-with that growth"[9] is not supported by economy-wide statistics published by the OECD. Figure 6 below uses the OECD's database to compare real compensation of employees per employee hour worked with real GDP per hour worked since 1991. It uses two OECD price indexes to calculate real compensation of employees per hour, the GDP deflator and its producer price Index. (CE = compensation of employees.)

FIGURE 6: REAL GDP PER HOUR AND TWO MEASURES OF REAL EARNINGS PER EMPLOYEE HOUR



The plotted lines for the two real wage rate series show considerable annual volatility in their relative movements, but no overall diverging gap with the black line that tracks the OECD's estimates of real GDP per hour for New Zealand.

Given the CTU's definition above of a fair distribution of income growth, these statistics indicate that New Zealand's distribution of the benefits of income growth has been fair overall since 1991.

It needs to be acknowledged that there are unresolved difficulties in reconciling the differences between different official measures of labour productivity growth and real wage rates. There are differences in coverage, time periods and definitions. [10]

It also needs to be said that departures between the two (in either direction) during any given period may be necessary and desirable. New Zealanders depend on foreign trade for their standard of living. The need to maintain a cost structure that is internationally competitive is inexorable. Fluctuations in international competitiveness due to overseas or domestic events can necessitate periods of painful adjustments for workers and investors. Context is everything in assessing whether any observed change in labour's income share of the gap between real wage rates and labour productivity is necessary and desirable.

Concluding comment – we need a more civil dialogue

Our purpose in this statistical debate is a narrow one. It is simply to point out that the statistics used by the CTU, the Minister and the Working Group do not suffice to justify their claims, let alone wholesale changes to New Zealand's wage-fixing arrangements.

The Initiative's report concluded that the government's working group and the Minister of Labour's Cabinet paper had failed to find flaws in current arrangements that justified the radical changes being proposed. The CTU's response reinforces that conclusion.

Regardless, the CTU's response creates doubts about how constructive high-level collective wage-setting negotiations would be in New Zealand. OECD cross-country research shows that countries with the most enduring forms of high-level collective bargaining have a high level of trust between the negotiating parties. Indeed, the OECD sees trust as a pre-condition for adopting such arrangements.

Such trust surely includes a willingness to collaborate in sustaining international competitiveness and trying to grow the cake rather than sparring over current income shares.

The CTU's focus on income share, an alleged imbalance of power, and the so-called "race to the bottom" all lend themselves to the perception that it does not see common cause with the business community in building prosperity in a mutually beneficial way.

Particularly jarring is the assertion in the CTU's paper that "each percentage fall in labour's share represents a $1,000 less on average per wage or salary earner in their average pay". First, it signals an antagonistic zero-sum game mentality. Second, it suggests a failure to understand that if real wages had been higher, investment and employment decisions would have been different. Higher real wages relative to productivity mean higher unit labour costs. That means a less competitive traded goods sector and greater net international debt.

Related to this is the issue of tone. The CTU disparages reasoned professional debate with gratuitous political slogans and terms like 'outdated thinking'. This is unhelpful. Fundamentally, employees and employers have common cause in being part of successful and prospering businesses. Firms cannot expect to be successful for long without willing and motivated workers. If this is outdated thinking, the prospect for mutually beneficial collective pay agreements are slim.

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Endnotes

1. Nor did the working group's report make any case that the higher levels for employees' share in the mid-1970s and early 1980s were economically sustainable in the face of mounting external and fiscal indebtedness. Wage rates cannot be expected to move lock-step with average labour productivity throughout economic cycles and regardless of international competitiveness. But in the longer run, productivity growth is nearly everything for real wage rate growth.
2. CTU, "Fact check – Fair Pay Agreements and the 'New Zealand Initiative'" (2019).
3. CTU Fact Check #1. Ibid. 1.
4. Roger Partridge and Bryce Wilkinson, "Work in Progress: Why Fair Pay Agreements would be bad for labour" (Wellington: The New Zealand Initiative, 2019), 19.
5. CTU Fact Check #2. op. cit. 2.
6. CTU Fact Check #3. Ibid. 3.
7. "Real wages have not kept up with (the weak) labour productivity growth New Zealand has experienced. In other words they have not fairly shared in the growth of income in the economy." CTU, "Fact check," op. cit. 3.
8. The industries covered in this sector contribute around 60% to measured gross domestic product.
9. CTU Fact Check #4. op. cit. 4.
10. See the New Zealand Productivity Commission's many reports and papers for in depth assessments of the productivity measurement issues.

ABOUT THE INITIATIVE

The New Zealand Initiative is an independent public policy think tank supported by chief executives of major New Zealand businesses. We believe in evidence-based policy and are committed to developing policies that work for all New Zealanders.

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