

This article was first published in *The Dominion Post* on 24 March 2008

### **New Zealand's Productivity Crisis**

Ten days ago, arguably the most important statistical data of the year, on the economy's productivity performance, were released by Statistics New Zealand.

Extraordinarily, there was minimal media coverage and no immediate political reactions.

This for an economic indicator which signals the potential – or lack of it – for any sustainable increase in wages and material living standards.

The news was bad. In the measured sector, covering approximately 73% of the economy, labour productivity grew by only 0.5% in the year to March 2007 while capital productivity growth (-2.1%) and multifactor productivity growth (-0.6%) were negative for a second successive year.

For the Clark/Cullen years 2000-2007, annual labour productivity growth has averaged only 1.1%, much less than half the rate of labour productivity growth in the 1990s, as the attached chart shows.

The chart also shows the even steeper fall in the growth of multifactor productivity, which reflects things such as improvements in knowledge, technology and innovation. At just 0.4% a year in 2000-2007, the slump in multifactor productivity growth shows there has been no substance to the government's 'knowledge wave' and 'economic transformation' talk.

Also noteworthy is that with annual labour productivity growth averaging only 1.1% this decade, New Zealand has fallen back to below the rate recorded in the last economic cycle in the Muldoon years.

The productivity data cover essentially the business sector of the economy. As ANZ National Bank economists noted, "We shudder to think what those

numbers would look like if the government sector were to be included in the measurement.”

In his 2004 budget, finance minister Michael Cullen acknowledged that productivity growth was “a key factor placing a ceiling on our ability to grow faster”, but claimed “there are signs of longer term increases in labour productivity growth.”

Unfortunately there are no such signs. On present trends there is no prospect that the government’s former ‘top priority’ goal of getting New Zealand back into the top half of the OECD income range will be achieved. Annual productivity growth rates of 3% or more on average would be needed to achieve fast economic growth.

Besides its depressing effect on economic growth (the Reserve Bank is forecasting growth in GDP of only 2% on average over the next three years, indicating little or no likely pick-up in productivity growth), the weak productivity performance is contributing to inflationary pressures and the need for the Bank to maintain high interest rates.

The contrast between the productivity debate in Australia and its absence in New Zealand is striking. In last year’s federal election campaign, Labor leader Kevin Rudd made much of Australia’s labour productivity performance having slipped because the Howard government became lazy about economic reform.

Yet Australia’s productivity performance in the current decade has significantly outstripped New Zealand’s, unlike in the 1990s when we kept pace.

Nevertheless, business organisations and commentators in Australia are concerned that labour productivity growth may fall short of 2% a year and real GDP growth may only average 3% a year in the next decade, and are calling for more vigorous economic reform. The new Labor government is cutting government spending and has established a ministerial portfolio for deregulation.

New Zealand's flagging productivity record cannot be put down to weak investment (capital input growth has exceeded output growth). Nor are the latest poor figures due to the entry of low-skilled people into the labour force (this was occurring at a fast rate in the 1990s).

Moreover, productivity is not mainly about business management, work effort and skills, as the government seems to think. If anything, changes in these areas have been positive rather than negative and cannot explain the deteriorating trend.

Fundamentally, productivity reflects the quality of institutions and policies that affect the overall economic environment, especially ones that restrict or enhance economic freedom.

For example, a cut in high marginal tax rates in the forthcoming budget, rather than a tax package focused on further income redistribution, would help increase productivity. Research indicates that high taxes are an important reason for the sluggish productivity growth of European economies compared with the United States.

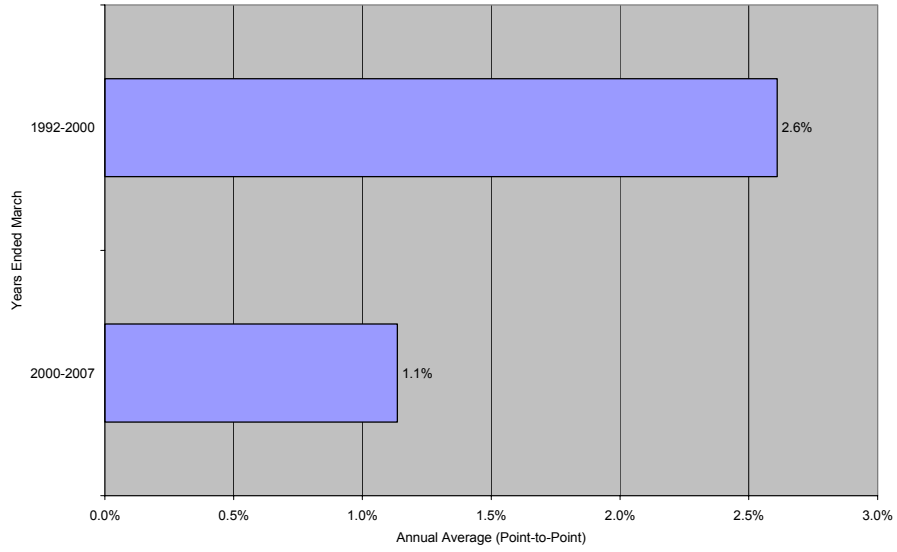
It is beyond doubt that the government's policies of high and wasteful government spending, excessive taxation and over-regulation have reduced institutional quality and economic freedom. Lower productivity growth has been the inevitable result.

The government should be changing its policy directions if it wants to reduce the gap between standards of living in New Zealand and Australia. The focus should be on making it easier for New Zealanders to create wealth, not harder.

Prosperity ultimately depends on productivity. It should be a major issue in this year's election debate. All parties should be putting forward credible policies to reverse New Zealand's productivity growth decline.

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**Labour Productivity Growth**  
Measured Sector



**Multifactor Productivity Growth**  
Measured Sector

