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presents

"PRODUCTIVITY POVERTY"

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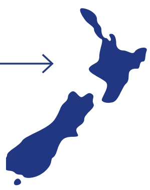
We have been described as "rock stars" by HSBC, and told by our politicians the record high migration rates and house prices in New Zealand are just problems of success. This may be true but the chart below highlights that we as a nation have been in denial about the most important factor that contributes toward long-term economic success - our productivity (or lack of it) - for most of the last two decades.

So what is productivity growth and why does it matter so much?

Productivity growth refers to the extra production we are able to extract from each hour worked. Without productivity there is no ground to increase wages. It is, or should be, the holy grail of economic performance. An economy can get by for a short while by increasing the number of workers or working more hours in the week, but ultimately there will be little wage growth after inflation without growing productivity. Productivity growth is therefore the best measure of our ability to increase wages and generate wealth, and also investment power and spending power over the long run.

To quote Howard Marks, Chairman of Oaktree Capital and one of the most successful investors behind Warren Buffett - "*Central bankers can't create economic progress; they can only stimulate activity temporarily. GDP, or national output, can be seen roughly as the amount of labor employed times (multiplied by) productivity, or the amount of output per unit of labor. In the long term, these things are independent of the amount of money in circulation or the rate of interest. The level of economic activity is determined by the nation's productiveness.*"

GROWTH IN PRODUCTIVITY SINCE 1970



+0.46% — *Productivity Growth from 2004 - 2014*

+1.30% — *Productivity Growth From 1996 - 2004*

+1.43% — *Productivity Growth From 1970 - 1996*

	2004 - 2014	1996 - 2004	1970 - 1996
Korea	3.58%	5.19%	6.95%
Chile	2.62%	2.67%	4.04%
Ireland	2.01%	4.56%	4.21%
Australia	1.34%	2.05%	1.54%
United States	1.12%	2.50%	1.52%
Canada	1.05%	1.64%	1.37%
Japan	0.87%	1.94%	3.33%
Germany	0.86%	1.68%	2.90%
Central Europe	0.82%	1.66%	2.71%
Southern Europe	0.81%	-0.22%	1.82%
France	0.71%	2.02%	3.09%
New Zealand	0.46%	1.30%	1.43%
Nordic Countries	0.46%	2.34%	2.79%
United Kingdom	0.45%	2.45%	2.56%
Italy	0.04%	0.64%	2.65%

HIGHER PRODUCTIVITY GROWTH RATES

LOWER PRODUCTIVITY GROWTH RATES

Source: OECD Compendium of Productivity Indicators
http://www.oecd.org/std/productivity-stats/oecd-compendium-of-productivity-indicators-22252126.htm

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New Zealand's productivity growth has been the third worst in the OECD in the last 20 years. We are underperforming a number of countries like France (with a 35 hour work week) and Japan (with a rapidly aging population).

New Zealand is now seeing the fruits of a long period of very low productivity growth. Wage growth has been much weaker than expected since 2011 and we are becoming increasingly reliant on migration and debt, rather than using our resources more efficiently.

The Productivity Commission (http://www.productivity.govt.nz) has found a variety of reasons why our performance has been so poor. It states that the countries with the fastest productivity growth for the longest periods tend to have highly competitive, internationally connected businesses and invest heavily in education, health and new technologies. Companies in these countries continually invest in systems and machines that increase the skill level and output of their workers -- essentially they worship high wages rather than low wages.

New Zealand unfortunately has missed the mark under successive governments and we are in denial about addressing some basic truths around mis-allocation of resources:

i) our tax system incentivises investment in land and property rather than investment in productive businesses and job-creation;

ii) our relatively small domestic savings base has led to local property investment being fueled by heavy borrowing from foreign lenders; subsequently inflating our currency for at least a decade and stunting growth within our export sector. This has robbed a large chunk of our economy of the sort of competitive intensity and international connection that makes everyone richer. Instead of building globally minded companies which create and sell innovative products and services, we have been happy to employ more real estate agents and mortgage brokers; and

iii) our very high migration rate over the last 20 years (and currently the largest single immigration programme in the developed world) has further driven our currency and interest rates higher than is/was desirable for the export sector, while the relatively low skilled nature of much of the migration* has had little effect in raising worker skill levels or ultimately the productivity of the economy at large. We are mostly importing low skilled workers for jobs within aged care facilities, construction, and dairy farms, rather than software design and food technology. The Treasury is now concerned this strategy is dragging on wage growth. After all, why develop a new machine or management system that would allow higher wages for fewer staff when you can simply employ more people on the same old low wages?

New Zealand has to realise it has become dependent on a concoction of: financial leverage, tax-free capital gains, and migration-fueled - low-quality economic growth.

As Nobel Economist Paul Krugman wrote in 1994 - *"Productivity isn't everything but in the long run it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker"*.

** Top 20 Work Visa Jobs (Year to June 30 2016): 1. Tour guide 2. Chef 3. Dairy-cattle farmer 4. Retail Manager (general) 5. Cafe/restaurant manager 6. Carpenter 7. Retail Supervisor 8. Student 9. Aged or disabled care 10. Deck hand 11. Dairy cattle farm worker 12. Software engineer** 13. University lecturer** 14. Cook 15. Registered nurse (aged care) 16. ICT support technicians** 17. Developer/programmer** 18. Entertainment or variety artist 19. Office manager 20. Waiter*
***Higher-skilled category* *Source: New Zealand Herald - Too many visas, not enough pay by Bernard Hickey - 21/08/2016*

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We understand New Zealand is an economic bright spot in a global context, but that does not exclude us from some intellectual honesty. There are no short-term solutions to long-term issues like productivity, and voting cycles do not naturally lend themselves to the political class acting with our long-term interests (as a nation) at heart. To again quote Howard Marks - *"Remember, governments and regulators don't create wealth, they only redistribute it. Their impact is largely a zero-sum game except in the longest-term sense... Intelligent changes in investment incentives, the tax system or infrastructure, for example – can increase the slope of the growth curve and provide substantial net long-term benefits for a society".*

Notwithstanding, one sure fire way to address a long-term issue like productivity is to cease encouraging one form of investment versus others. E.g., investing for capital gains versus investing for dividends.

Any brave politicians/bureaucrats out there who can lead the change rather than just manage the status quo?

This article was co-authored by Christopher Swasbrook (chris.swasbrook@elevationcapital.co.nz) and Bernard Hickey (bernard@hivenews.co.nz). Bernard Hickey received remuneration from Elevation Capital Management Limited for his services in constructing this article.

Mail: PO Box 911145, Victoria Street West, Auckland 1142, New Zealand;
Email: info@elevationcapital.co.nz
Phone: +64 9 307 6741