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IV. Improving labour market outcomes for marginal groups

New Zealand's overall labour market performance is good by OECD standards and has been particularly impressive in the past few years. Employment legislation and the industrial relations framework both contribute to a labour market that has been able to painlessly absorb a significant influx of working-age migrants over the 1990s. The flexibility of the framework has made it easier to cope with significant changes in working practices, including greater use of part-time and temporary work and a shift towards higher skills. It has also given more scope to small firms to tailor employment conditions to their specific needs. In terms of basic outcomes, this framework has delivered above-average employment rates for men and women, and an unemployment rate below 4½ per cent of the labour force. The incidence of long-term unemployment, as measured by the labour force survey, is also low in comparison with other countries. However, a broader measure of joblessness that includes people only marginally attached to the labour force – *e.g.* those without a job but who want one – is considerably higher (Table 15). Thus, there is still a significant number of able-bodied people who are permanently or frequently out of work and who may be able to be brought into the labour force if particular blockages are removed. This Chapter reviews the labour market position of such people and focuses on social assistance reforms that may help the jobless move from welfare to work while minimising any negative impacts on poverty or social outcomes more generally. It also discusses the importance of maintaining labour market flexibility.

Who are the long-term jobless?

Since 1999, most of the reduction in joblessness has come from a reduction in the ILO-consistent survey measure. The number of people available for but not actively seeking work, or looking but temporarily unavailable, has not fallen by anywhere near as much, while the fall in the number of people receiving the unemployment benefit has lagged the general improvement in employment conditions. The share of the population receiving other benefits, especially single parents and the disabled, has been broadly stable or rising over the 1990s (Figure 32).

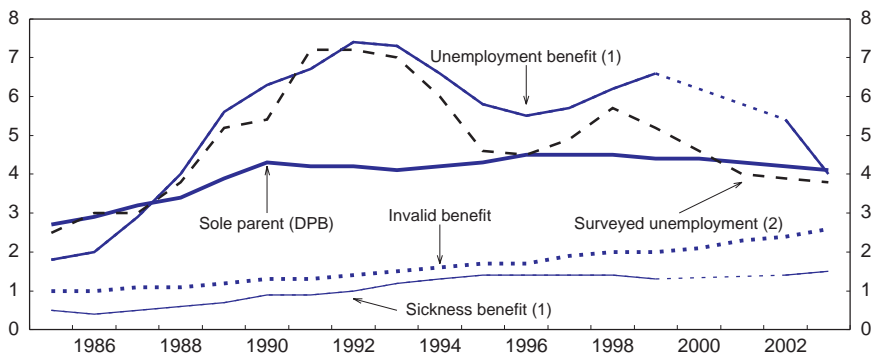
Table 15. **The jobless and job-search methods**
Per cent of the working-age population

Year ended March	Officially unemployed (ILO measure)	Available for but not actively seeking work ¹			Actively seeking but not available for work ³	Total jobless
		Seeking through a newspaper only	Discouraged ²	Other or not specified		
1987	3.0	0.2	0.4	1.2	0.5	5.3
1991	5.9	0.5	0.6	1.5	0.7	9.3
1995	5.4	0.5	0.5	1.6	0.6	8.6
1999	5.6	0.5	0.5	1.6	0.8	8.9
2003 ⁴	3.7	0.4	0.3	1.4	0.7	6.4

1. Refers to people who answered "yes" to the question "If you had been offered a job would you have started last week?".
2. Refers to people who were not actively seeking work because they believed they lacked skills, or were the wrong age, or the right work was not available in their area.
3. Someone may be temporarily unable to start work because of sickness, personal or family responsibilities or because they are attending an educational institution.
4. Year to September.

Source: Statistics New Zealand.

Figure 32. **Benefit recipients**
Per cent of working age population



1. From October 1998 to June 2001, the unemployment and sickness benefits were combined into a single benefit (the Community Wage).
2. Unemployment rate from the Household Labour Force Survey. Note that this is measured as the percentage of the working-age population rather than the labour force.

Source: Ministry of Social Development.

Table 16. Employment rates
Per cent of people aged 15-64

	1990	1995	2000	2003 (first half)
By ethnicity				
Pakeha	70.4	74.0	75.2	77.3
Maori	49.4	53.0	57.6	61.5
Pacific Islanders	50.2	51.7	57.3	60.0
By education level				
Less than upper secondary	57.6	58.5	59.4	62.0
Upper secondary	67.3	70.8	68.6	68.4
Tertiary	79.1	81.7	80.8	81.6
By age				
15-24	58.3	59.4	54.7	56.1 ¹
25-54	76.3	77.6	78.6	79.8 ¹
55-64	41.8	50.4	57.2	64.0 ¹
New Zealand Total	67.2	70.0	70.6	72.2
OECD average	64.5	63.7	66.0	–

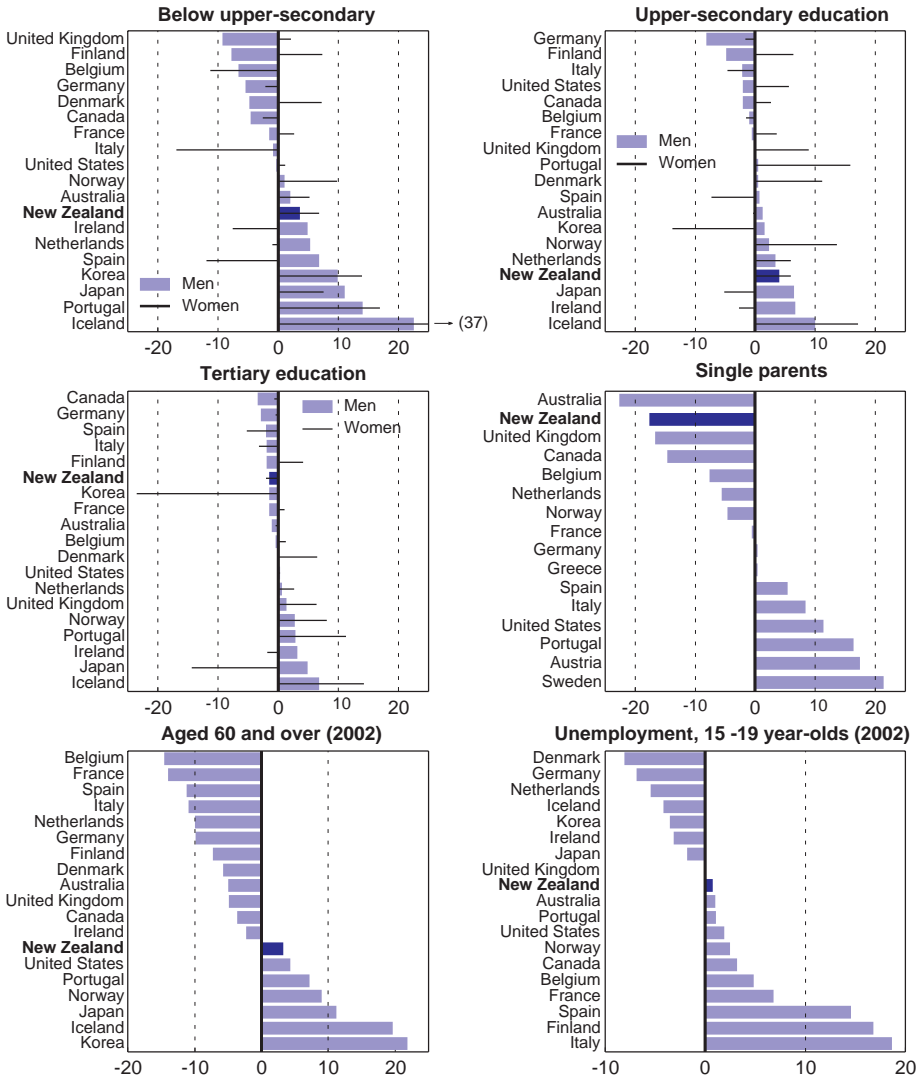
1. First three quarters of 2003.

Source: Statistics New Zealand and OECD.

The better-than-average labour market performance is concentrated among those with upper-secondary qualifications (Figure 33). Employment rates are around the OECD average for the low-skilled, and are a little below average for people with tertiary qualifications. With lower average education, Maori and Pacific Islanders have significantly worse employment rates, although these groups have shown the biggest improvement over the past decade (Table 16).

Most benefit recipients have only a weak attachment to the labour market, being unemployed for long periods or cycling between short spells of work and joblessness. Around one in 11 people of working age has been receiving a benefit for a year or more (Table 17). However, duration measures understate the problem because many of the long-term beneficiaries who find a job are back on a benefit less than a year later.⁸⁹ Adding together multiple spells of unemployment, one study that followed a cohort of unemployed over four years in the mid-1990s found that 44 per cent were unemployed for at least one out of the four years, and 20 per cent were without a job for at least half of that period, despite a decline in the unemployment rate from 10 to 6 per cent (Gobbi and Rea, 2002). Unsurprisingly, the probability of being out of work for long periods is higher for the young, the low-skilled, for Maori and Pacific Islanders, and for those in remote regions (although differences across regions are not particularly large). These factors are obviously inter-related, but there have been no studies that look at labour

Figure 33. **Employment rate indicators**
 Percentage point difference relative to OECD average, 2001¹



1. The education-related panels refer to employment rates of the population aged 25-64.
 Source: OECD.

Table 17. **Benefits by duration**

Proportion of beneficiaries by duration on each benefit (excluding pensions), June 2003, per cent

	0-6 months	6-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Per cent of all beneficiaries ¹	Per cent of long term ² beneficiaries ¹
Unemployment	36.7	18.0	17.0	22.1	5.6	0.6	27.2	19.6
Sole parent (DPB)	13.8	10.8	16.3	27.5	21.0	10.7	28.0	33.5
Invalids	6.3	7.3	12.7	23.7	21.8	28.3	17.8	24.4
Sickness	33.3	16.9	18.7	19.0	10.1	2.0	10.4	8.2
All benefits	23.3	13.6	16.1	23.0	14.3	9.7	100.0	100.0
Per cent of working-age population	3.4	2.0	2.3	3.3	2.1	1.4	–	–

1. Does not add to 100 as the table excludes other categories such as veterans and widows benefits.

2. Longer than one year.

Source: Ministry of Social Development.

market performance in a multi-variable framework that controls for all these factors at the same time. This lack of knowledge of the underlying causes of labour market outcomes makes it harder to design the best solution.

Single parents account for a third of long-term working-age benefit recipients, and a third of them have been receiving the sole-parent benefit for at least five years. Fewer than half of single parents work, which is especially striking given that other mothers have relatively high employment rates as a result of liberal social attitudes, flexible working arrangements and relatively easy availability of part-time and temporary work. This sort of employment gap is much smaller in welfare systems that have work requirements for single parents, such as Denmark, Sweden and the post-reform United States (OECD, 2003g). Another fifth of long-term jobless receive the unemployment benefit; the majority of these people are young (half are under 35), and most have no dependent children.⁹⁰

Features of the income support system

New Zealand has a social assistance system in which most benefits for working-age people are income tested (based on family income) and available for an unlimited time. The phase-out profile of benefits means that income support does not extend much beyond the average household income. The main social security benefits are the *Domestic Purposes Benefit* (DPB) for single parents, the *Unemployment Benefit* (for those aged 18 and over), the *Sickness Benefit* (for those who temporarily cannot work) and the *Invalids Benefit* (for those who are severely and permanently disabled). A second-tier of assistance is available for specific purposes, such as the *Accommodation Supplement* and *Childcare Subsidy*. A third tier is available for people facing particular hardship such as an ongoing deficiency of income relative to outgoings,

although expenditure on this tier is relatively small. Most of the assistance for low-to-medium income families in employment is delivered through the tax system.

Major benefit reforms in 1991 led to a tightening in eligibility criteria and a cut in benefit rates. Cuts differed across demographic groups and benefit types: young adults without children saw their benefit fall by around 25 per cent, but couples with children saw a cut of just 3 per cent. Further reforms in 1998 were aimed at reducing benefit dependency and halting the rise in disability benefits (which succeeded temporarily). A work test was introduced for spouses of disability beneficiaries and was extended for single parents (the test depending on the age of the youngest child), rates for sickness and unemployment benefits were aligned, and mandatory community work or training was extended to a greater share of unemployment beneficiaries, but still only applied to a small minority (around 6 per cent). Most of these latter reforms were reversed in 2000 by the incoming government who felt that all the obligations were on the individual, with insufficient help to overcome barriers to employability. It was replaced with a system of case management with relatively light-handed obligations and sanctions.

The key features of the current system include:

- *Income replacement rates are relatively high for families with children.* Unlike countries that have an unemployment insurance system, benefit rates are the same regardless how long someone has been unemployed. This flat rate is relatively low for single people in the initial period of their spell but is higher than average for the long-term unemployed.⁹¹
- *The benefit system is relatively passive.* Although the heart of the government's approach is to put more emphasis on active case management, the benefit system is still relatively passive, with the "active" share of expenditure on labour market programmes being lower than in most countries (Table A2). While inflows to active labour market programmes (ALMPs) have increased since 1999, expenditure per person has fallen. The imbalance between active and passive measures is important given the evidence that passive social spending can be a drag on growth but active social spending can promote it (Arjona *et al.*, 2001).
- *The earnings disregard or abatement-free zone is small.* All benefits except the Accommodation Supplement have a small abatement-free zone equivalent to approximately 10 per cent of the average wage (or around 9½ hours work per week at the minimum wage). This is relatively low; countries with gradual abatement (*i.e.* less than 100 per cent) typically have earnings disregard zones equal to 20-40 per cent of the average wage, while Ireland and the Netherlands base theirs on hours worked rather than income (OECD, 2002f). Relatively few NZ beneficiaries take advantage of the earnings disregard (Nolan, 2003), possibly because the

fixed costs of working a small number of hours outweigh the financial return.

- *Marginal effective tax rates are high for some groups.* The reduction in benefit income as earned income rises can create disincentives to increase hours of work, or to move into work in the first place, especially for families with children. Beyond the abatement-free zone, benefits are reduced by 70 cents for each extra dollar earned (except for sole parents, invalids and widows, which have a 30 per cent phase-out rate for part-time work). After taking childcare and transport costs into account, lone parents for example would be little or no better off by moving into work. For those already working part time, there is little incentive to increase hours of work: moving from 15 to 40 hours at the minimum wage would bring in just NZ\$ 30 a week, and childcare costs would eat away much of this (Table 18). In sum, families with children are better off staying on a benefit unless they can move into a full-time job paying at least the average wage.
- *The minimum wage is slightly above average.* The adult minimum wage is approximately half the median wage, a proportion that is slightly above

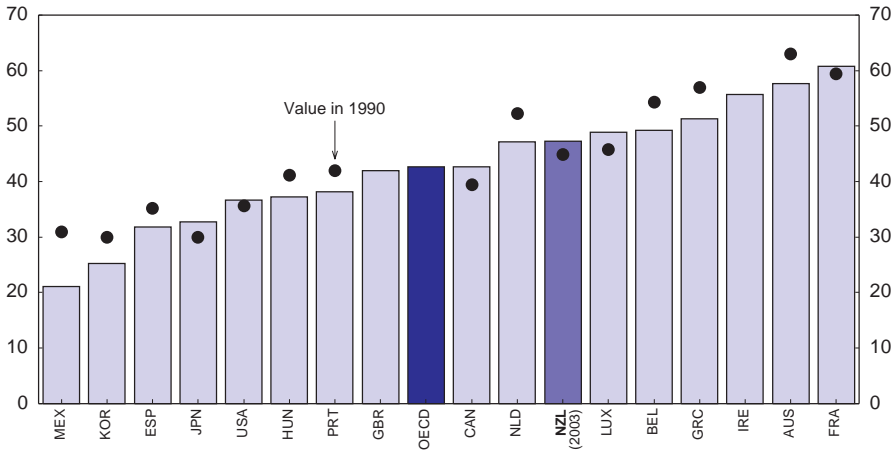
Table 18. **Benefit replacement rates for single parents**
Disposable income including housing benefits,¹ ignoring transport and childcare costs

	One child		Two children	
	Disposable income NZ\$ per week	Replacement rate Per cent	Disposable income NZ\$ per week	Replacement rate Per cent
At minimum wage				
Hours of work				
0 (benefit only)	348	–	397	–
15	412	84	456	87
20	427	81	472	84
40	444	78	487	82
At average full-time wage				
Hours of work				
0 (benefit only)	348	–	397	–
15	437	80	481	83
20	446	78	490	81
40	579	60	600	66

1. Accommodation Supplement based on rent of NZ\$ 8 750 per year in Auckland.

Source: OECD; New Zealand Treasury.

Figure 34. **The adult minimum wage**
Per cent of median wage, 2000



Source: OECD.

the OECD average (Figure 34). However, the wage distribution is wide, implying the minimum wage will be quite high relative to a typical low-paid job. It has also been increasing faster than other wages (by 21 per cent for adults since 1999, by 62 per cent for 16-17 year-olds and by 100 per cent for 18-19 year-olds who now receive the adult rate). This may be one reason why the unemployment rate of 15-19 year-olds is slightly above average despite the low adult unemployment rate.

- *Employment conditional benefits are small.* There are three employment conditional tax credits, the biggest by far being a *Child Tax Credit* (costing NZ\$ 159 million in 2002-03) which is a per-child payment available to families that are independent of state assistance. A *Family Tax Credit* (NZ\$ 12 million) provides a guaranteed minimum family income, but few families qualify because there is a very small income range over which it can be received. Finally, a *Parental Tax Credit* (NZ\$ 17 million) is paid for the first eight weeks after the birth of a child to parents who are not on welfare. All three are refundable (non-wastable) and income tested, but together amount to less than 3 per cent of welfare spending on people of working age (Nolan, 2002).

Shifting towards in-work benefits

In a nutshell, the problem of long-term joblessness is concentrated among sole parents, who account for a third of long-term benefit recipients, and those receiving the unemployment benefit, who account for another 20 per cent. The government has signalled that, if it has the fiscal room next year, it will modify the income support system with the aims of increasing the level of family support to low- and middle-income families and improving the incentives to move from benefits into employment. Benefit replacement rates for families with children are above the OECD average, but the government does not regard them as generous or excessive relative to what is needed to provide a minimum acceptable standard of living. It believes that further reductions in benefit rates would lead to an unacceptable increase in poverty. Yet at these levels, the small gap between benefit and employment income provides little financial incentive to work unless in a full-time job paying a good wage. That is not an option for the majority of the long-term jobless because they are relatively low skilled or they cannot find or afford childcare.

In similar circumstances, several countries have moved towards employment-conditional benefits as a way of increasing work incentives without increasing poverty (see Table A3). These “making work pay” policies are likely to be most appropriate where payroll and income taxes are not high, where the minimum wage is moderate, and where the unemployment problem is more concentrated on particular groups. In some countries, reducing payroll taxes may be the first priority, while countries with high income tax rates may find that effective marginal tax rates become too high over the income range in which an in-work benefit is phased out. Countries with high minimum wages may also find such benefits ineffective because it is pointless to encourage labour supply if the constraint is on the demand side of the market. With low income taxes, a minimal payroll tax and a minimum wage that is not excessive, the main conditions are in place in New Zealand for making-work-pay policies to be potentially effective. However, they would need to be carefully designed, for otherwise they could be expensive or have unintended consequences for other groups. The following section discusses what has been learned from international experience about the best way to design an in-work benefit if the main goal is to improve work incentives.⁹²

Best practice at making work pay

Untargeted benefits can be expensive

Welfare reform packages have the twin objectives of supporting incomes and boosting work incentives. But in the presence of a budget constraint, a trade-off must often be made between these two goals. If more weight is placed on income support, then the benefit should be income tested and perhaps restricted

to certain household types such as families with children. But inevitably, the more widely the money is spread the lower the impact will be on each individual or household. Hence, if the primary goal is to boost work incentives then the benefit should be more closely targeted at the groups with the biggest labour market problems, such as sole parents and the long-term jobless. This would allow a larger financial incentive to be given to those groups. This trade-off is especially sharp in New Zealand's case because the high employment rates of non-disadvantaged groups means that an across-the-board benefit is likely to be very expensive per job created, as the bulk of the money would go to people who would be working anyway.

Some policymakers are wary of targeting benefits at only some groups because it may change welfare-claiming behaviour. For example, a benefit that is only for the long-term unemployed may encourage people to stay on welfare longer in order to qualify. A time-limited benefit may also encourage people to cycle between welfare and work to become eligible again – the so-called “revolving door” effect. However, these theoretical concerns may be exaggerated. There is not a great deal of evidence on this point, but Canada's making-work-pay experiment for sole parents looked for yet found little evidence that people altered their behaviour in this way.

Benefits must be generous to be effective

While at least nine OECD countries have employment-conditional benefits, most are tiny and have a trivial impact on work incentives (Table A3). The only substantial benefits are the UK's Working Family Tax Credit (WFTC) and the US's Earned Income Tax Credit (EITC), although Canada conducted a temporary experiment with a back-to-work benefit for single parents who had been out of work for at least a year (the Self Sufficiency Project, or SSP). The financial incentive must be large enough to create a sizeable wedge between welfare and work, and the optimal level will therefore depend on factors such as levels of income support relative to wage rates of the less skilled, the minimum wage, and the availability of affordable childcare services for single parents and dual-income families. New Zealand's existing employment-conditional benefits are much smaller than the EITC, WFTC or SSP (Figure 35).

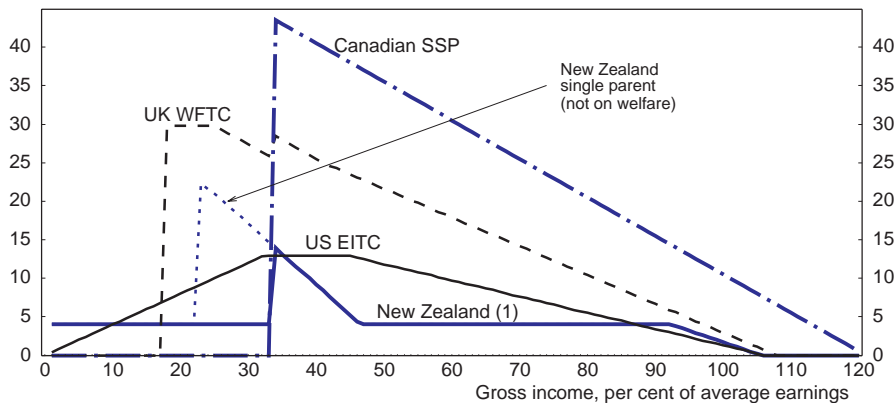
Time-limited benefit supplements may be more cost-effective

The government should also consider making some part of the benefit time-limited, especially if an in-work benefit is targeted at particular groups. For example, a temporary back-to-work bonus for the long-term unemployed may be effective, while some might see a permanent in-work benefit available only to sole parents as creating an inappropriate financial incentive to form single-parent households. In the long term, a large one-off financial push to such groups may be

Figure 35. **Employment-conditional benefit profiles**

For a family with two children, per cent of economy-wide average earnings

Benefit level, per cent of average earnings



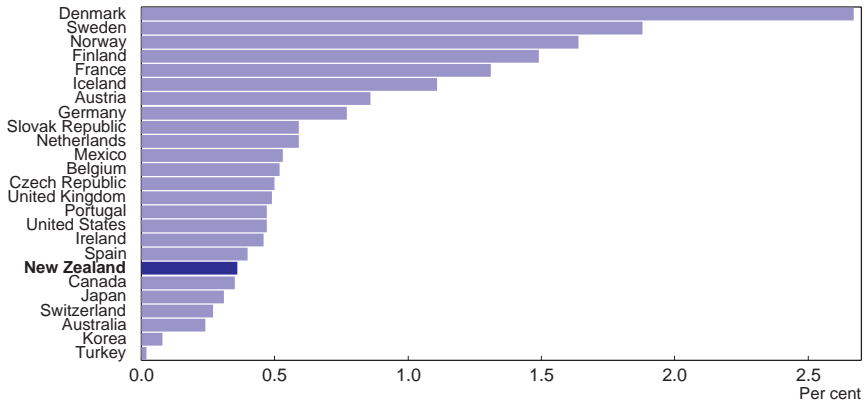
1. The flat portion of the New Zealand benefit profile is the Child Tax Credit; the "shark fin" pattern around 40 per cent of earnings is the Family Tax Credit. UK and US parameters are for 2002; NZ's are for 2002-03.
 Source: OECD.

a cost-effective approach if it has a permanent impact on today's jobless. But if it turns out that people revert to their present behaviour when a time-limited benefit runs out then the time limit could always be extended. It is important to note that such a time-limited in-work benefit would be in addition to a basic income support safety net; this is not a proposal to eliminate income support altogether after a certain period. For example, Canada's SSP offered a benefit for three years to those who moved off welfare into work, while Ireland has a three-year back-to-work allowance with a payment rate that decreases over time (while also offering a family income supplement that is not time limited). There is strong evidence that the duration of benefits affects recipient behaviour and that payment rates should fall the longer someone receives a benefit (Fredriksson and Holmlund, 2003). In contrast, New Zealand's benefit profile effectively rises over time as beneficiaries tend to make greater use of supplementary benefits the longer they remain unemployed. In any case, any time limit should be generous as the evidence is that people progress towards self sufficiency fairly slowly.

For groups such as sole parents, increasing access to childcare may be more effective

Many sole parents cite the lack of affordable childcare as a major barrier to employment. If that is the case then, dollar-for-dollar, expenditure targeted at making childcare more affordable or increasing the number of places is likely to

Figure 36. **Public expenditure on day care and pre-primary education**
Per cent of GDP¹



1. 1999 for all countries except New Zealand (2003-04), France, Ireland and Spain (1998), Netherlands (2001), and Japan (2002). This data should be used with caution as it may not be perfectly comparable across countries.
Source: NZ Treasury and OECD.

be more effective in terms of employment outcomes than an across-the-board in-work benefit, much of which would go to people for whom childcare is less of an issue. Public spending on childcare has increased in recent years but is still low by international standards (Figure 36). Most of that spending goes to fund places at early childhood centres, the majority of which are privately run, with the rest going to two childcare subsidies. The first is for low-income families participating in education, training or employment, available for up to 50 hours per week (increased this year from 37 hours). The second, the Out of School Care and Recreation (OSCAR) subsidy, contributes to the costs of before- and after-school care. Both subsidies are heavily income tested and are available only for approved institutions. Subsidy rates are low: the maximum payment rates are approximately NZ\$ 2.50 per hour for the childcare subsidy and NZ\$ 2.00 per hour for the OSCAR programme.

Recent policy changes will have conflicting impacts on access to childcare services. In the five years to 2003-04, direct funding of early childhood places has increased by 43 per cent and subsidies have risen by 32 per cent. These funding increases should significantly improve access. However, in the interests of raising quality the government is introducing pay parity between kindergarten teachers and primary school teachers and requiring staff in teacher-led services to be registered teachers. These changes are likely to raise costs and reduce the number of places available where there is a shortage of qualified staff. While maintaining

quality standards is important, the government needs to carefully balance that objective with its goal of reducing barriers to employment for sole parents.

Raising the minimum wage can reduce the effectiveness of employment-conditional benefits

Rethinking the level of the minimum wage should be part of the overall welfare reform package because the higher the minimum wage, the less sensible it is to use in-work benefits. Cross-country evidence shows that statutory minimum wages at typical OECD levels do not have major negative effects on total employment, but a high minimum wage reduces the employment prospects of disadvantaged groups (OECD, 2003f). Raising the minimum wage may reduce labour demand for these groups, in which case using an in-work benefit to encourage greater labour supply would be ineffective if the demand for workers at such wage rates is lacking. A goal of both a minimum wage and an in-work benefit is to reduce poverty among working households. Hence, if they are seen as part of a package, it would be feasible to lower (or freeze) the minimum wage at the same time as boosting in-work benefits. That would leave the income support element of the package intact at the same time as improving the employability of disadvantaged groups. However, one argument for maintaining a moderate minimum wage is that any increase in labour supply may drive down wages at the lower end of the distribution, cancelling out some of the positive effects. This is why the United Kingdom introduced a minimum wage at the same time as it extended its tax-credit programme.

Any minimum hours requirement should not be too high

A minimum hours-of-work requirement is a necessary part of an employment-conditional benefit to avoid people reducing their hours to very low levels. However, if set too high the policy will bypass some of those it is trying to help, such as single parents who may only be able to work part time. When the United Kingdom reduced its hours threshold from 24 to 16 hours per week, a significant number of inactive single parents moved from welfare to work, but it also reduced the number of hours worked by single parents who were already employed (Blundell, 2002). The government subsequently introduced a small 30-hour “full time bonus.” New Zealand currently requires 30 hours of work per week before a couple is eligible for the Family Tax Credit, and 20 hours for a single parent.

Stronger activation and enforcement is needed at the same time

Recent experience in a range of countries with a wide range of social attitudes has shown that financial incentives are more effective when combined with strong job-search requirements and other activation policies (OECD, 2003g).⁹³ Examples include Canada, Denmark, Ireland, the Netherlands, Spain, the United Kingdom and the United States (Table 19). The majority of people who left

Table 19. **Activation policies in Denmark, Ireland, the Netherlands and the United Kingdom**

Denmark	
1989	First in a series of tighter definitions of the obligation to accept "suitable work".
1992	Job offers, previously made after 2½ years of unemployment, are brought forward for young people.
1994	"Active period of benefits" which starts after 4 years of unemployment. Individual action plans introduced. New government information systems to track communications between the PES and benefit institutions.
1995	Creation of a central government "availability inspection unit" to supervise the implementation of benefit eligibility criteria.
1996	"Active period of benefits" applies after 2 years of unemployment.
1999	The unemployed must be registered with the PES from the first day of unemployment. The relaxation of availability rules for 50-59 year-olds is limited to 55-59 year-olds.
2000	"Active period of benefits" applies after 1 year of unemployment.
Ireland	
1996	Labour force survey finds that only 25% of a sample of individuals on the Live Register (unemployment benefit register) confirmed to be ILO unemployed. A questionnaire is mailed to all beneficiaries and an anti-fraud drive initiated. Beneficiaries aged 18 and 19 and unemployed for more than six months are required to register with the placement service.
1998	Beneficiaries aged under 25 and crossing the six-month threshold of benefit receipt enter processes under Ireland's Employment Action Plan (EAP – part of the European Employment Strategy).
1999	24-34 year-olds crossing a 12-month threshold enter EAP processes. These processes require attendance at an interview.
2000	20-54 year-olds crossing a 9-month threshold enter EAP processes.
Netherlands	
Late 1980s	A "change in focus" which results in sanctions for UI benefits increasing from 27 000 in 1987 to 140 000 in 1994.
1991	Introduction of the Youth Work Guarantee.
1992	Guidelines as regards "suitable work" are defined. Sanction frequency for assistance beneficiaries increases sharply.
1995	Radical reforms to the institutional structure of benefit administration. "Melkert" jobs are introduced (participation in job creation schemes rose from about 20 000 in 1994 to 80 000 by 1999).
1996	New legislation concerning benefit sanctions. Sharply increased attention is given to the long-term unemployed: part of the direct grant to the PES is earmarked for the reintegration programmes for disadvantaged jobseekers, and another part is diverted to the benefit institutions for them to purchase such programmes.
United Kingdom	
1986	Programme of Restart interviews introduced. In later years many types and schedules of interviews are tested and successful models are applied nationwide.
1989	"Actively seeking work" becomes a condition for benefit eligibility. Benefit administration and placement offices are united at local level (over several years).
1991	Participation in a one-week job-search course is made obligatory for those who have been unemployed for over 2 years.
Early 1990s	"Stricter benefit regime" leads to a doubling of benefit sanctions.
1996	Benefit legislation radically overhauled.
1998	New Deal for Young People makes participation in a six-month labour market programme obligatory for all youth remaining unemployed after six months plus an additional four-month "Gateway" period.
2000	New Deal for Adults applies after 18 months unemployed.

Source: OECD (2003g).

welfare in these countries moved into work, although the proportion that ended up with neither benefits nor jobs does vary significantly (OECD, 2003g). Activation policies can also square the circle between providing benefits which are generous enough to alleviate poverty and the unintended consequences they may have on employment rates. A key to successful outcomes has been to apply activation strategies for long enough to change the work habits of beneficiaries. This culture change can take many years. Recently, however, New Zealand has taken some steps to reinforce job-search requirements for recipients of the unemployment benefit, but has moved against international trends by relaxing such requirements on recipients of sole parent benefits, sending mixed signals to those out of work. The government's preferred approach is to use case management to encourage and assist people to become self-reliant.

Not everyone on a benefit can or should work. Different countries make different social choices over who should be expected to be in the labour force. For example, the Nordic countries have had a long-standing philosophy that work is preferable to welfare and have been aggressive users of activation policies – increasingly so in the last decade or so (OECD, 2003g). In part, this reflects the growing appreciation that long-term dependency has more than just labour market and fiscal costs; it worsens health, self-esteem and school outcomes for children. As noted above, New Zealand's benefit system is relatively passive by OECD standards and there are several areas where applying some of the lessons from international experience would help move people into sustainable jobs.

First, work requirements need to be strengthened. While recipients of the unemployment benefit in New Zealand must be actively seeking work, there is wide variation across regions in how strictly the test is enforced. Overall, it is applied relatively gently (OECD, 2000b). From 1997 to 1999, notional work test requirements were extended to some other beneficiaries, such as sole parents, who had not previously been required to look for work. However, case managers rarely, if ever, imposed sanctions because of concerns for the beneficiaries' family. Policy reversals in 2000 made it easier to maintain receipt of certain benefits, and there was further loosening in 2001 when the work test was abolished for sole parents and widows. Instead, they must now develop a job plan with their case manager that lays a plan for re-entering the workforce when family responsibilities allow. New Zealand is therefore similar to Australia and the United Kingdom in having no formal work test for sole parents. In most other OECD countries, most lone parents must be available for work in order to qualify for assistance.

Until recently, there was virtually no requirement for those aged 55 and over to look for work, so some benefits have been used as early-retirement schemes. While employment prospects can be bleak for many older workers, especially those with low skills, allowing an easy work test regime for a quarter of the average person's working life is excessive. This year the work-test cut-off was

raised to 60 years; this is a welcome move and is well timed given that a large demographic bulge of unemployment and sickness beneficiaries is approaching the age-55 threshold.

Second, the unemployed need more contact with the public employment service. In New Zealand and an increasing number of other countries, an intensive interview takes place early on to develop an individual action plan. After that, contact can be too infrequent to ensure adequate progress on the plan:

- *In-person interviews*. Sole parents in New Zealand are called in once a year to review their job plan. In principle, recipients of the unemployment benefit should be called in for an interview at least every six months, although some clients are seen more often. However, it is up to the case manager to organise a meeting, so some clients go for years without seeing their case manager. In contrast, some countries – including Austria, the Netherlands, Sweden, the United Kingdom and Switzerland – conduct interviews at least every two months.
- *Signing in* is required weekly for the unemployed and can be done by telephone. In contrast, some other countries require regular confirmation of status by mail, but the majority require in-person visits. In most cases these must be fortnightly or monthly. These visits are often used for other types of contact such as job-search reporting, checking for job vacancies and providing information on labour market programmes.
- *Reporting job search efforts*. Most clients only have to confirm that they are actively seeking work, although a small proportion is asked to provide evidence of job applications. Practice varies greatly in other countries, but few monitor intensively or double-check job search activities. A handful require frequent reporting of job-search activities and expect four to eight employer contacts per month, although there is wide variation around this range depending on individual and local circumstances.

Third, consideration should be given to whether participation in a work or training programme should be compulsory in order to receive a benefit. In some countries, compulsion for certain groups is an integral part of their activation policies. In Denmark, for example, everyone must participate in an employment or training programme after they have been unemployed for a year. Countries that have tried obligatory schemes often have few people actually in the programmes, suggesting their existence can successfully motivate people to avoid the obligation. New Zealand adopted aspects of “workfare” for a little over two years in the late 1990s when work-tested beneficiaries were obliged to undertake training or part-time community work, with the work test being broadened at the same time to encompass other recipients. However, the reforms were not in place for long enough to assess their impact.

Whether participation in active labour market programmes (ALMPs) is made compulsory or not, careful attention should be paid to the programmes on offer. New Zealand's approach is broadly consistent with OECD recommendations based on what works among ALMPs (see Box 5 of the previous *Survey*). There is a strong emphasis on training programmes, and assistance is being increasingly directed towards youths. Most interventions focus on job-search assistance, motivation and work confidence, while training programmes are increasingly focussed on specific labour market opportunities rather than just foundation skills. Employment subsidies are also in line with OECD recommendations: they are for a limited duration and targeted at the long-term jobless.

In summary, a system of mutual obligations combined with improved financial incentives can be a successful approach to encouraging labour market integration. On the individual's part, that requires a commitment to look for work, or possibly training as a first step. The government's commitment involves employment assistance in the form of case management, training and childcare support. The government is taking some steps in the right direction, but needs to go further. The system of active case management has been inadequate in the past, partly because caseloads have been too high. However, recent funding increases should reduce caseloads to more reasonable levels (from around 220 to 160 per case manager of the unemployed, and from 300 to 150 for sole parents). A package of reforms earlier this year (the so-called "Jobs Jolt") included some minor tightening or clarification of work obligations in certain circumstances, but the more substantial element was to send "clear and strong expectations" that recipients of the Unemployment Benefit should be available and actively looking for work. The government also intends to streamline the sanctions process, making work obligations easier to enforce for case managers. Time will tell how much stricter the regime will become, but these steps are in the right direction. The government now needs to ensure that the Personal Development and Employment Plans currently being negotiated with DPB recipients are enforced, and that they lead to genuine labour market integration rather than perpetual participation in training or community activities.

Disability reforms may help activate those who cannot work full time

The number of people on disability benefits is low but, as in most countries, has been showing a trend increase for a couple of decades.⁹⁴ Half of the increase since 1992 can be explained by the rise in the age of eligibility for the public pension. The increase in sickness beneficiaries was briefly halted in the mid-1990s when eligibility criteria were tightened and, in 1998, when the benefit rate was aligned with the unemployment benefit. However, the rising trend has since resumed. Eligibility may need to be reviewed as part of a reform package to ensure that tightening in one area is not offset by people

migrating to disability benefits. For example, sickness and invalids benefits are currently available to anyone who cannot work full time in their usual job. Eligibility is discrete: people are either sick or not. There is no spectrum of different levels of incapacity, recognising that some people may be able to work at less-than-full productivity. There is a need to support such people with a package that contains rehabilitation and vocational training, employment subsidies tailored to work capacities, and supported jobs (with individual employment assistance granted to employees or employers). However, the government has been making considerable progress in these directions, shifting disability benefits from passive income-support schemes towards more active rehabilitation programmes.

Maintaining the benefits of labour market flexibility

The labour market framework is one of the most flexible in the OECD. Employment protection legislation is about as liberal as in Australia and Ireland, less so than in the United States, the United Kingdom and Denmark, but with much more flexibility than in most Member countries (Nicoletti *et al.*, 1999). The non-intrusive contractual approach to labour market arrangements has most likely contributed to the fairly swift and sizeable increase in employment rates following economic restructuring, to the pickup in productivity growth and to the economy's resilience in the face of economic and climatic shocks. It does not appear to have led to difficult or unpleasant working conditions – most employees report a high degree of cooperation with their employer, and nine out of ten are satisfied with their jobs overall.⁹⁵

Since 2000, however, there has been a clear trend towards reduced labour market flexibility and increased labour costs. While each measure on its own has been fairly benign, their cumulative impact may have been more material (Box 2). The most important reform was the replacement of the 1991 *Employment Contracts Act* with the *Employment Relations Act* (ERA) in 2000. The intention of the ERA was to redress a perceived imbalance in bargaining power between employers and workers, to promote collective bargaining and to be more consistent with ILO Conventions on freedom of association and the right to organise and bargain collectively. Its major features include a requirement to bargain in “good faith”, and mediation as a first step in the event of disputes. It also limits use of fixed-term agreements, restores to unions their monopoly on collective bargaining and restricts firms from replacing striking workers. However, union membership was not made compulsory, and workers can still choose whether to bargain for an individual or collective agreement. The Act also imposed various administrative costs on employers. Other labour market reforms separate from the Act include increases in the minimum wage, especially for young people, and stricter health and safety requirements.

Box 2. Flexible labour markets help growth and resilience

There is increasing evidence that flexibility in wage-setting and labour adjustment can have sizeable benefits for economic performance in both the short and long term. Stricter employment-protection legislation (EPL) and high costs of unskilled labour (*e.g.* a high minimum wage) reduce the pressure on the employed to moderate their wage claims in a downturn, and the same factors can curb the adjustment of employment to a changing economic environment. Safeguarding labour market flexibility is important for two reasons.

First, flexible economies tend to grow faster, with rigidities having a stronger impact the further a country is behind the technological frontier. Strict EPL lowers productivity in systems with an intermediate degree of centralisation/co-ordination – *i.e.* where multi-employer wage bargaining is predominant without co-ordination. This is the direction that the NZ government seems to want to move in its industrial relations reforms. Hiring and firing costs also hamper entrepreneurship and impede the process of firm creation and destruction, with several recent studies having found that firm turnover is an important determinant of productivity growth. Adjustment costs can also reduce investment in new technologies because it becomes more difficult to retool and re-organise the labour force in response to changing market opportunities.

Second, flexible economies are more resilient. They tend to get hit less hard by economic shocks and bounce back quicker. That in turn results in smaller swings in output, inflation and exchange rates. Recent OECD work on the impact of structural and labour market rigidities on economic resilience has found that a flexible economy:

- is better placed to take advantage of permanent supply shocks (such as a rise in productivity) and to weather temporary supply shocks (such as droughts). With wages and prices moving more quickly, monetary policy is more able to speed up and smooth out the adjustment process (*e.g.* US policy being more able to “test the economy’s speed limit” and accommodate the productivity pick-up in the 1990s);
- has an advantage when hit by a temporary demand shock (such as the Asian crisis), though possibly at the cost of a larger inflation response in the very short term (OECD, 2003i). The initial impact on unemployment is about the same in flexible and rigid economies, but it takes longer for unemployment to recover when adjustment is held back by labour-market rigidities. In assessing the overall social loss, if policymakers care more about unemployment than inflation, or care more about the medium term than about short-term blips, then cumulative social losses are much lower in the flexible economy.

Further reforms are in the pipeline. The ERA is currently being reviewed, largely because it has not achieved its goal of increasing collective bargaining. There has been virtually no increase in the proportion of collective or multi-employer

agreements, and unionisation has edged up by only a few percentage points. Some unions have argued that the obligation to bargain in good faith lacks teeth, and the government is considering steps that will promote rather than simply permit collective bargaining. To do so, it may have to reconsider the rule that unions must have at least 15 members, since that rules out most small enterprises from having workplace-based unions. Most workers who want to be covered under a collective agreement would have to seek a multi-employer agreement, which is clearly much harder to negotiate. The government is also concerned that unionisation may be held back by a free-rider problem in which employers negotiate a collective agreement and then give the same conditions to their employees who are on individual agreements. This reduces the incentive for workers to join a union.

The review is also looking at whether continuity of employment should be automatic in the event of the sale of a business, transfer of undertakings or contracting out. It is unclear what this will entail. The ERA currently requires collective agreements to contain a clause that describes workers' rights when a business is sold but leaves the terms up for negotiation. The new legislation may simply guarantee that employees can continue with the new owner under their existing terms and conditions. There is a difficult trade-off here between trying to protect the position of workers on the one hand and encouraging entrepreneurship on the other, as a dynamic process of firm creation and destruction is a key determinant of productivity growth. Moreover, it is unclear whether workers would actually be better off. Being less able to sell a failing business, an employer might be forced to close it, with the consequent loss of jobs. Nevertheless, automatic continuity of employment is common practice in the OECD. Imposing the same in New Zealand would reduce flexibility, but the impact may not be severe because three quarters of collective agreements already contain negotiated provisions along these lines.⁹⁶ However, the proposal may go further by giving workers the option to take redundancy, receive whatever severance payments they are entitled to, and potentially then go back to their old job with the new owner. A clause along these lines was in the original draft of the Employment Relations Bill, but was rejected before it became law. To reinstate it would be a serious mistake.⁹⁷

Holiday provisions are also being reviewed. Two reform proposals are currently before Parliament. The first proposes various changes to holiday and sickness leave, including giving employees who work on public holidays a day in lieu as well as time-and-a-half compensation for the day worked (including for salaried staff). It also creates a double liability for employers in seven-day-a-week operations when Christmas and New Year holidays fall on a weekend. These changes will increase labour costs and reduce flexibility in industries with non-standard working arrangements. The second proposal would increase the minimum annual leave entitlement from three to four weeks, effective from 2007. Whether minimum holiday standards should be an individual or a social choice could be debated endlessly, but it does not seem an appropriate time to be lengthening mandatory

Table 20. Trial period before compensation is available for unjustified dismissal

	Type of worker	Trial period		Type of worker	Trial period
Australia	All workers	Not legally regulated.	Japan	All workers	Not legally regulated but varies mainly between 2 and 6 months.
Austria	All workers	1 month.	Korea	All workers	Not legally regulated, varies from case to case.
Belgium	Blue collar White collar	7-14 days. 1-6 months. ¹	Mexico	All workers	Not legally regulated.
Canada	All workers	Typically 3 months.	Netherlands	All workers	1 month for contract of up to 2 years duration; 2 months for longer contracts.
Czech Republic	White collar	3 months.	New Zealand	All workers	None. Case law tends to reduce the rigour of provisions where employee is on probation.
Denmark	Blue collar White collar	0 month. 3 months.	Norway	All workers	1 month.
Finland	All workers	4 months.	Poland	All workers	Minimum 2 weeks, ranging up to 3 months.
France	Blue collar White collar	1 week – 2 months. 1-3 months.	Portugal	All workers	60 days.
Germany	All workers	6 months.	Spain	All workers	2-3 months depending on company size. ⁴
Greece	All workers	3 months.	Sweden	All workers	Maximum of 6 months. Does not exclude claim for damages.
Hungary	All workers	3 months.	Switzerland	All workers	1 month, sometimes extended by collective agreements to 3 months.
Ireland	All workers	12 months. ²	Turkey	All workers	1 month, sometimes extended by collective agreements to 3 months.
Italy	Blue collar White collar	1 2 weeks. ³ 3-8 weeks.	United Kingdom	All workers	2 years. ²
			United States	All workers	Wide range.

1. For Belgian white collar workers, the trial period can be up to 12 months if pay exceeds € 28 000 per year.

2. In Ireland and the United Kingdom, shorter trial periods are commonly agreed between employer and employee, but claims under statutory unfair dismissal legislation are not normally possible until after the periods shown.

3. For Italy, the trial periods cited are those common in collective agreements which are enforceable.

4. Spain: trial period can go up to 6 months for qualified technical staff and 9 months for managers.

Source: OECD (1999).

vacations when one of the government's key goals is to increase per-capita incomes.

As part of the review, the government should clarify and simplify severance provisions. Cumbersome procedural requirements when using fixed-term agreements and in cases of personal grievances have become grounds for dispute. Also, judicial interpretations in personal grievance cases have been inconsistent. These factors may also be influencing hiring and firing decisions. In a survey of firms in 2002, 84 per cent said they would be more likely to increase staff numbers if there was a trial period during which new staff could be laid off without the risk of a personal grievance if things did not work out. Indeed, New Zealand is unusual in not having a minimum probation period for new employees (Table 20).

Notes

1. Unless otherwise noted, “average” in this *Survey* refers to unweighted averages of the relevant countries.
2. In 1991, output is estimated to have been 6 per cent below potential. Hence, at least 6 percentage points of the growth since then can be attributed to a cyclical bounce-back. However, if potential output fell more sharply than current estimates suggest, perhaps because a significant portion of the capital stock became obsolete, then more of the growth since 1991 could be attributable to a recovery in the sustainable growth rate rather than being cyclical.
3. Several studies using a variety of approaches also confirm that a pickup in the trend rate of productivity growth occurred around the middle of the 1990s. See Razzak (2002), Black *et al.* (2003a) and Buckle *et al.* (2002). Downing *et al.* (2002) provide a range of estimates of potential output growth that are broadly consistent with the Secretariat’s estimates.
4. This projection assumes that the participation rate of each age group remains unchanged at its 2002 level, and implicitly also assumes either zero migration or that migrants have the same participation rates and age composition as the New Zealand-born.
5. In the OECD there are 18 agglomerations in 11 countries that are bigger than Sydney (population 4 million), and 30 that are larger than Melbourne (3.2 million) (www.xist.org/charts/city_million.php).
6. For example, see McCallum (1995).
7. For most of the 1990s, around one-third of school leavers left with no qualifications or with School Certificate only (Ministry of Education Briefing to the OECD, December 2001).
8. For example, the reading performance of 10 year-olds in the PIRLS (2001) study was equal to the average of the 17 OECD countries that took part, but had the largest variance.
9. For every ten new entrants to high-decile (most advantaged) schools who are competent or expert in maths, seven new entrants to low-decile schools meet the same standards. By senior secondary school, for every ten students from high-decile schools who qualify to enter university, only three from low-decile schools have comparable grades (Ministry of Education, 1999).
10. The inter-quartile range of PISA’s school mean index of economic, social and cultural status is below the mean and median of the OECD. See Table 8.4 of OECD (2001a).
11. Children from the top 5 per cent of Maori and Pacific families as measured by the PISA *International Socio-economic Index of Occupational Status* scored around 500 on the PISA combined literacy scale. That is approximately the same score as children from the bottom 5 per cent of Pakeha families. See Figure 6.1B of Sturrock and May (2002).
12. In terms of gross flows, 1.35 million New Zealanders have left since 1970 with the intention of staying away for at least a year, while 0.7 million have returned (although a

small number of these would have been people who left before 1970). Around 1.1 million foreigners arrived over that period, and 0.5 million left. Note that these figures refer to NZ citizens rather than the New Zealand-born population. Therefore, some of the NZ citizens who emigrated over that period were people born overseas but who later gained NZ citizenship while they were there.

13. Fabling and Grimes (2003) use NZ firm-level questionnaire-based data and find that business performance is strongly correlated with the purchase of external technology and having fully up-to-date core equipment. IT-related factors were found to be considerably more important for small and medium-sized firms than for their larger counterparts.
14. As a rough approximation, road use expands at the same rate as income, so investment levels need to keep pace with GDP (Ingram and Zhi, 1997). In New Zealand, annual investment levels are currently insufficient to cover depreciation and growth in demand. Over the next ten years, expenditure on road building is budgeted to grow by an average 3.3 per cent per annum, well short of the forecast 5 per cent nominal GDP growth (NBNZ, 2003). That projected level of investment could be sufficient to reduce congestion only if those funds get channelled primarily to bottleneck areas by not fully maintaining the under-utilised parts of the road network.
15. The FDI β can be measured by regressing the (log) change of New Zealand's FDI on the (log) change of world FDI. The resulting β coefficient is 0.51 (with a t-value of 1.1) over the period 1980-2001.
16. See, for example, "Red tape worry as firms cut investment", INL Newspapers, 5 May 2003, and "New Zealand rules forcing investors overseas, say fish farmers", INL Newspapers, 30 June 2003.
17. This refers to the OBERAC, or operating balance of the Core Crown (central government) excluding revaluation effects and accounting changes.
18. By contrast, New Zealand has the highest proportion of graduates in life sciences among OECD countries.
19. A Design Industry Taskforce was also set up and has produced its report (2003), which however makes it clear that rather than an industry *per se*, design represents a capability, and design-led firms are present in a variety of different sectors.
20. The tax break resulted from a tax loophole that the government closed in 1998, but which could still be exploited by films which began production before that date. The film producers were allowed to claim an up-front tax deduction for the entire cost of the film trilogy.
21. The average bound tariff (simple average across all lines) is 13.8 per cent, compared with an average of 4.2 per cent in the Quad countries (United States, the European Union and Canada). However, the average applied MFN tariff is much lower, 4.1 per cent (WTO, 2003).
22. Thus, indicators of FDI restrictions that disregard screening requirements put New Zealand's FDI regime among the least restrictive in the OECD. On the other hand, given the difficulty of taking into account the way a screening system is actually implemented, if the very presence of a screening requirement is considered as a restrictive element, New Zealand's regime would be regarded as more restrictive than the OECD average (Golub, 2003).
23. For example, even though Ireland had a corporate tax rate of 10 per cent (12.5 per cent since 2003) against New Zealand's 33 per cent, in 2001 the average effective tax rate on an investment from the United States to Ireland was only 1 percentage point lower

than that of a comparable investment to New Zealand (Yoo, 2003).

24. It has even been suggested (Simmons, 2002) that New Zealand may be functioning as a “nursery economy”, nurturing innovative ideas and small businesses that, however, can only be fully exploited by offshore firms.
25. For residential consumers, one additional factor is that the price of access to low-speed Internet access is maintained artificially low, because under its “kiwi share” agreement with the government, Telecom is obliged to provide a free (unmetered) local calling option, which includes both voice traffic and normal (low-speed) Internet access. Moreover, given that Telecom was offering only metered broadband access, many consumers were probably reluctant to move from unmetered to metered access.
26. There is no general capital gains taxation in New Zealand. Capital gains from equity participations arising in the context of certain arrangements are taxed, while others are not. The key factor is whether holding and trading securities are normal part of an entity’s business: for example, a mutual fund is considered to hold its security portfolio on revenue account and is taxed on any resulting capital gains, while a small investor is not. However, this criterion leaves significant room for interpretation, particularly when new financial arrangements emerge.
27. A survey by the Auckland Chamber of Commerce found that the smallest firms (those with 1-5 employees) devote up to 30 times as much of their resources per employee to compliance as those with 100 employees or more.
28. The Environment Court already has the power to award costs against frivolous objectors.
29. In addition to financing for research projects on a contestable basis, each CRI receives from the FRST a “non-specific” funding top-up equal to 10 per cent of the previous year’s total allocation, whose purpose is to support longer-term capability enhancement. In some cases, CRIs can also bid for government funding for large capital expenditures that they cannot finance out of their own budget.
30. The CRI Act states that each CRI “shall, in fulfilling its purpose, operate in a financially responsible manner so that it maintains financial viability”. This is interpreted to mean that it should recover the full cost of the research performed, including the cost of capital employed (see CCMAU, 2002).
31. Comparable data on tertiary education expenditure exist only for 2001, and for New Zealand they refer only to the public sector component, which is 0.9 per cent of GDP, against an OECD average of 1 per cent of GDP (OECD, 2003d). However, public spending on tertiary education has risen by over 30 per cent between 2001 and 2003, and is probably now above the OECD average.
32. In order to have access to public funding a tertiary education organisation must submit a charter and an annual profile indicating strategic plans, proposed activities and performance targets, which are then assessed by the TEC and have to be found consistent with the objectives of the TES.
33. A review of the course classification system used to set funding categories has been recently undertaken to address some distortions in funding rates that may affect the behaviour of providers and students. However, the government has not taken up the suggestion made by the Tertiary Education Advisory Commission in its fourth report (TEAC, 2001) to differentiate the proportion of public funding across courses and disciplines according to national strategic goals.

34. In addition to this financing managed by the TEC universities, as already mentioned earlier in this chapter, are also eligible for funding allocated by the FRST for specific research projects on a contestable basis.
35. In 2001, foreign students represented 6.2 per cent of all tertiary students enrolled in New Zealand, a proportion above the OECD average, with students from Asia and Oceania representing 80 per cent of the total. The number of NZ tertiary students enrolled abroad was equivalent to 3.5 per cent of domestic enrolment, below the OECD average of 4 per cent; three-fourths of them were studying in Australia and most of the remainder in the United States and the United Kingdom (OECD, 2003d).
36. Another dry weather episode occurred in 1992.
37. In a recent study (Energy Link, 2002), the elasticity of demand for electricity was found to be virtually nil at relatively low prices, and to start rising (in absolute terms) gradually only above a price of 10 cents/kWh (which is about twice the historical average price). Even then, demand would fall by only 2 per cent at 20 cents/kWh and by 6 per cent at 40 cents/kWh.
38. The net cost of contracting for and operating the reserve has been estimated at about NZ\$ 60 million a year, which represents a little over 2 per cent of what New Zealanders spend annually on electricity (at retail prices). Thus, the amount of the levy would not need to be very large.
39. According to the government's recently released *Energy Outlook to 2025* (Ministry of Economic Development, 2003b), new generating capacity for a total of 3 350 MW (relative to a present capacity of 8 700 MW) will be needed by 2025, partly to replace old plants (especially in the years 2006-10) and partly to meet increasing demand. The latter is projected to grow at an annual rate of 1.2 per cent, assuming GDP growth of 2.5 per cent (rather modest relative to both recent experience and official objectives) and gains in energy efficiency exceeding those realised in the recent past. Thus, investment needs could be significantly larger if economic growth is higher and/or the government's National Energy and Conservation Strategy is less successful than projected.
40. Passenger transport was discontinued in the 1990s, except for commuter train services in Wellington and Auckland.
41. Some of this fall is likely to be explained by the change in Australia's welfare policies for NZ citizens in early 2001. Another factor may have been the increased insecurity worldwide following the terrorist attacks of September 2001.
42. The main data on net migration flows concern so-called "Permanent and long-term" migrants. These are people who, on arrival in or departure from New Zealand, declare their intention to remain in their country of destination for more than one year. Such inflows thus include many people with temporary work permits and returning New Zealanders, in addition to those who have obtained a settlement visa, while it is only the latter who are included in the planning totals. Outflows include people emigrating definitively or for "overseas experience" as well as people who have been in New Zealand temporarily.
43. Resident spouses of NZ citizens can apply for citizenship after two years of residence.
44. About 30 000 intended to stay longer than one year, but not permanently (this distinction – that between "permanent" and "long-term temporary" – can be made in the Australian statistics, but not in New Zealand's) and around 17 per cent of these were not NZ-born. In this three-year period, China, Hong Kong, Taiwan and South Korea together provided one in four of the non-NZ-born settlers, one in six of the long-term

- temporary; Pacific Islanders constituted about 20 per cent of the non-NZ-born total flow, and the United Kingdom some 13 per cent.
45. Furthermore, since the changes in Australian welfare arrangements for NZ citizens, arrivals in Australia of NZ citizens born in Asia have fallen much more than those of NZ-born. But no obvious fall in applications to enter New Zealand from Asia has occurred, as would be expected if this were a significant factor.
 46. See L.E.K. Consulting (2001). Although the sample was quite large (1 500 people), it may not be representative of New Zealanders abroad. Little other concrete information is available, however.
 47. International English Language Testing System. This rates English language ability on a scale of 1 to 9 with 1 being a non-user and 9 being an expert user. Principal applicants under the General Skills or business categories are required to take the test if they cannot demonstrate that they have an English-speaking background (*e.g.* by coming from an English-speaking country or having an academic or professional qualification from an English-speaking country); since November 2002 General Skills applicants are required to score a minimum of 6.5 (between “competent” and “good” user), whereas 5 (“modest” user) is required of Business skills applicants, increased from 5 and 4, respectively. Average scores in 2001-02 for successful applicants from various countries were: South Africa 7.0; Philippines 6.6; India 6.4; Romania 6.2; Russia 5.8; China 5.7; Japan 5.6; South Korea 5.5.
 48. Parents, children and adult siblings are admitted subject to various additional conditions. These include requiring the “centre of gravity” of the family to be in New Zealand or, for adult children and siblings, a suitable job offer. NZ residents can also “sponsor” family members not otherwise eligible for entry, guaranteeing them accommodation and financial support for the first two years; this is subject to an annual quota, currently set at 250.
 49. The Pacific Access Category (PAC) includes a quota of 1 100 Samoans a year, allowed entry if they have a job offer and are aged 18-45. Smaller quotas exist for Tonga (250 people), Tuvalu (75) and Kiribati (50, increased to 75 in July 2003); in July 2003, a quota of 250 was introduced for Fiji nationals, not previously eligible under the PAC. Apart from asylum seekers decided on a case-by-case basis, there is a quota of up to 750 people per year for refugees nominated by the United Nations High Commission for Refugees.
 50. This total is the sum of the three streams, but the government intends to treat each stream independently and not compensate for over- or under-runs in one stream by varying admittances under other streams.
 51. The NZ government fears that moves to restrict entry to well-qualified applicants will have an adverse effect on the quality of future applicants, though it is not clear whether empirical evidence supports this. Some research shows that rapid processing times for applications can have an impact on choice of destination country for some migrants. Oliver (2000) finds that Chinese emigrants tend to be indifferent *ex ante* between Canada, Australia and New Zealand, looking basically for physically and politically congenial destinations. New Zealand’s rapidity in processing applications was taken by many as meaning that the country was keen to admit people because it needed them; hence, potential migrants assumed, jobs would be easy to get.
 52. Onshore applicants already working in New Zealand may be exempted from this requirement if they pre-pay for English language tuition, on a scale that varies inversely with their IELTS test score. The partners and adult children of skilled and

- business migrants must also meet English language requirement, a little less strict than for the principal applicant, or else pre-purchase English language tuition.
53. According to Stuart (2000), (Asian) business migrants found that the business plan they submit to the New Zealand Immigration Service is irrelevant and is ignored in New Zealand.
 54. A thorough investigation of applicants' qualifications and work experience will be undertaken only when they apply from the pool.
 55. Larsen and Vincent-Laurin (2002) estimate that revenues due to foreign students were around US\$ 200 million in the year 2000, 4.7 per cent of total NZ services exports. Australia earned ten times as much, almost 12 per cent of services exports, and the United Kingdom and the United States were even bigger earners in absolute terms, but in terms of the importance of such revenue in exports of services, New Zealand was thought to be second only to Australia.
 56. One of the growing areas in education exports is distance learning, the modern version of correspondence courses, where students do not actually leave their home country; direct familiarity with the exporting country is obviously not a by-product in this case.
 57. Seven per cent of all foreign tertiary students in OECD countries in 1999 were from China, and 5 per cent were from Korea. Concerning China, the latest "wave" of student movement from there, and inflows of business oriented migration, contrast with a previous significant movement in the late 19th century, when inflows of unskilled Chinese labour were important in a number of countries – this was the origin of a long-established community of Chinese in New Zealand whose ancestors were involved in New Zealand's gold rush.
 58. In the past, students would often have had to return to their home country and apply from there; this restriction now applies only to students benefiting from scholarships offered under New Zealand's development aid programme.
 59. This instruction may not have been sufficiently clear. There are suggestions that in some cases schools took account only of current operating costs in calculating fees to be charged overseas students and may therefore have overburdened their investment budgets. This practice does not seem to be widespread, however.
 60. One might also compare immigrant arrivals with turnover in the labour force, but it is hard to know what measure is appropriate. For example, in 2001, an average of about 85 000 people obtained jobs in each quarter who had not been working in the previous quarter, compared with an average of 10 to 15 000 immigrants arriving each quarter. This still takes no account of those who change jobs or of higher frequency movements into and out of employment.
 61. A pilot project has been undertaken to set up a longitudinal survey of immigrants ("LisNZ") similar to that which already exists in Australia. Useful results will not be available for several years, although some preliminary results are discussed below. For research purposes it would be helpful to have a parallel longitudinal survey of the NZ-born – one of the limitations of the otherwise extremely valuable Longitudinal Survey of Immigrants in Australia is the lack of directly comparable information on the Australian-born.
 62. As indicators of how well New Zealand integrates its immigrants, these figures do not take into account variations in the characteristics of successive cohorts of immigrants and natives, nor of how each cohort changes through time (notably, it gets older and gains experience on the job relative to the population average), however.

63. Note that these data concern employed people. Since the Pacific Islanders also have relatively high unemployment early on, as discussed in later sections, the relative income of the average recent Pacific Island immigrant will be even lower.
64. In 1991, only 28 per cent of Pacific Island origin people had an upper secondary qualification (62 per cent overall), and the Household Labour Force Survey was not able to report a figure for tertiary education since it was too small compared with the sampling error (see Ministry of Social Policy, 2001).
65. This is consistent with the finding (discussed in Chapter I) that differences in proficiency at school are related to a large extent to ethnic background. Pacific Island immigrants and their NZ-born descendents, who with Maori are the most disadvantaged groups, probably represent a larger percentage of the non-English speaking children than of total immigrant children of NZ-born children of immigrant parents.
66. This survey interviewed a sample of immigrants who arrived or whose application was approved in late 2000 or early 2001; they were interviewed 6 and 18 months after arrival (or after approval in the case of on-shore applications).
67. Information from the Australian longitudinal survey shows that while 63 per cent of immigrants arriving in 1993-95 (principal applicants only) were unemployed or out of the labour force 4-5 months after arrival, this figure falls to 48 and 42 per cent after 1½ and 3½ years, respectively. These figures for Australia varied enormously according to the immigrant category. For skilled migrants the figures were 33, 15 and 11 per cent, respectively, for preferential family migrants (which would include many spouses) they were 69, 56 and 51 per cent.
68. These data have been produced from a LisNZ pilot test and are restricted to a small sample of migrants settling in specific areas, speaking a given set of languages and arriving in New Zealand over a particular two month period (December 2000 and January 2001). Wave 1 of the pilot consisted of 690 migrants and Wave 2 of 540 migrants. Data from this test are indicative only, as they are derived from a sample designed to evaluate the LisNZ methodology, not to produce reliable statistics. The data should therefore be treated with caution.
69. Again, as these are not longitudinal data, the improvements with length of stay are a function of time but also of other possible differences in the characteristics of the different cohorts of immigrants.
70. BERL (2003) uses data from the 2001 census to look at fiscal receipts and public expenditures accounted for by immigrants, distinguishing them principally by length of residence and region of origin, and compares their contribution with that of the NZ-born. Being based on census data, it is not able to look at immigrants according to the programme under which they were admitted, unlike recent work for Australia (Access Economics, 2002). It cannot take direct account of how the contribution varies through time, notably as immigrants age and become likely recipients of greater amounts of pension and health expenditure, and some expenditure estimates for migrants are based on the assumption that they have similar behaviour to NZ-born with similar age and incomes. The authors further note that the results cannot necessarily be seen as the fiscal *impact* of immigrants, since some of these impacts would show up through the effects on revenues and expenditures accounted for by enterprises and by NZ-born people whose position had been affected by migration. Other aspects of the methodology include the assumption that expenditure items not mentioned in Table 14 are invariant with respect to population size. Many items are calculated by applying, for example, statutory tax rates applicable to people as a function of their incomes, in the absence of census data on actual tax payments. For each kind of tax and expenditure item, the

amounts calculated in this way for each population group identified are grossed up in equal proportions so that the overall totals match actual budgetary expenditures and revenues.

71. This view is shared in other traditional “settlement” countries – Australia and Canada, for example – and is based partly on the fact that these populations and societies would not exist in anything like their current form without the substantial and consistent (albeit fluctuating) immigration flows that have continued for more than a century. It is also partly based on the observation that certain “agglomerations” tend to have higher productivity growth rates, with this growth appearing to be associated with high research and development activity. If successful research and development activity itself depends on geographical concentrations – or “critical masses” – of researchers in particular fields, then larger populations are likely to generate higher per capita income growth.
72. For example, a recent empirical study on economies of scale at the whole economy level (Ades and Glaeser, 1999) restricted itself “to the poorer economies where increasing returns seem to operate”.
73. Eaton and Eckstein (1997) suggest little relation between city size and growth in a study of France and Japan. Wheeler (2002) showed a similar result for city data in the United States, but found a U-shaped relationship between population and growth using data on counties.
74. Many immigrants – recent policy measures are likely to make this an increasing proportion – arrive with jobs already set up for them, and thus add to supply almost immediately; the share with jobs of course increases with time since arrival. Once people have jobs, however, they become more creditworthy. If they were credit-constrained before finding employment, they could potentially do even more dis-saving than before, and add more to demand than to supply, even as output rises as immigrants move into employment.
75. The study does not specify precisely what is meant by the short term, though it is less than one year.
76. Some of these inflows were probably accounted for by business immigrants who subsequently placed their “investment” funds on deposit, rather than adding directly to demand. These inflows may also contribute to a rise in the exchange rate, which occurred in the mid-1990s and signs of which have recurred of late. The close link between the fluctuations in these inflows and in migration flows is partly artificial, since the data are estimated on the basis of a link between migration flows and transfers; the transfers are not observed directly. Estimates of current account transfers due to migrants (“workers’ remittances”) are not separately available in the balance of payments data, as the methodology is thought insufficiently reliable to allow their separation from other current flows. They seem to be much less important than the capital flows, however.
77. The differences in share between the two populations are negligible except for construction and agriculture. A survey by NZIS of migrants who arrived in 2000-01 shows larger, but still small, differences for nearly all industries, with the same exceptions of construction and agriculture.
78. See, for example, the 2003 OECD Economic Surveys of Spain and Luxembourg. NZ agriculture employs a number of working holiday makers for seasonal jobs, however. These would not show up in the labour force survey data quoted in the text.

79. New Zealanders abroad are well-known for their use of networks for information; it is unlikely that many of them who move abroad and remain there did not have fairly good information about what to expect when they left. They can therefore be expected to have made a “rational” decision.
80. Or at least their welfare is increased. Many abroad may choose low-skilled or part-time work to benefit from greater leisure but perhaps lower incomes, for part of their stay.
81. This was a non-representative sample of some 1 600 expatriates, contacted, for example, through university alumni associations, employers organisations or New Zealand consulates.
82. The research covered a group of people who graduated from Irish universities in 1992 and were resident in Ireland in 1998. Males who had worked abroad between the two dates had incomes some 10 per cent higher than those who had not. No difference was found for females.
83. The study by Winkelmann and Winkelmann (1998) was commissioned by the government in 1997 to investigate this issue.
84. This includes the planned longitudinal survey of immigrants mentioned earlier.
85. See *e.g.* Chiswick *et al.* (2002), and, for similar results for the United Kingdom, Shields and Wheatley Price (2001).
86. Since this survey did not cover employers who had the ability to take on immigrants but did not, it will be biased towards favourable outcomes if employers select successfully. It was based on a study of 387 employers in 2000-01.
87. See www.newkiwis.co.nz and www.hi-q.org.nz/main/index.html
88. The Auckland Chamber of Commerce believes that as many of 70 per cent of vacancies are not normally advertised but filled through word of mouth, an obvious disadvantage for newly arrived immigrants.
89. Of those who received the unemployment benefit continuously for the two years from October 1997 to September 1999, half stayed on the benefit for the following 12 months, while a little over a quarter left and remained independent. Gobbi and Rea (2002) looked at a cohort of both short-term and long-term unemployed who left the unemployment register in 1993. Half were back on the benefit within a year and 70 per cent were back within four years.
90. In 2003, 83 per cent of long-term (more than one year) unemployment benefit recipients had no dependent children. The proportion is roughly the same for the sickness benefit.
91. See Tables 3.2 and 3.5 of OECD (2002f). The paragraph refers to net (after tax) replacement rates relative to a job paying two-thirds of the average wage (as the majority of beneficiaries who are able to find work are likely to be in a low-paying job).
92. See OECD (2003f) and Blundell (2002) for a more thorough discussion.
93. See OECD (2001d) and Fredriksson and Holmlund (2003) for reviews of the theory and evidence.
94. In June 2003, 4.1 per cent of the population aged 15-64 receiving either a Sickness or an Invalids benefit. This is similar to levels in Germany and Canada, but is well below the OECD average of 5.8 per cent (in 1999). Some countries, such as Poland, Norway, the Netherlands and Sweden have disability rates above 8 per cent of the working-age population. See OECD (2003h).
95. This is based on a University of Auckland Business School survey released in June 2003.

96. In a sample of around 1000 collective agreements struck under the ERA, the Department of Labour (2003) reports that three-quarters of agreements covering two-thirds of employees contained clauses dealing with the sale or transfer of all or part of the business (by law it should be 100 per cent, but there are no penalties for non-compliance). The vast majority of these say that workers that remain employed with the new owner on the same terms and conditions will have no entitlement to redundancy compensation.
97. Germany is the only OECD country where a worker who voluntarily quits in such circumstances would be entitled to redundancy compensation. An EU Directive specifies that staff will continue to be employed on the same terms and conditions, but leaves it up to member states to decide what should happen when someone voluntarily decides not to work for the new owner. In Denmark, severance payments can be received if a worker quits because the change in ownership results in a serious deterioration of his position. See Blanpain and Engels (1998), IPD (1995) and Watson Wyatt (1997) for details on labour law at the EU level and in its member states. The EU Directive referred to is number 77/187 as amended by Directive 98/50. Practice in Australia varies across states, with some providing neither continuity of employment nor the automatic transfer of accrued benefits.
98. Unless otherwise noted, GDP refers to the production-based measure which is regarded as more reliable than the expenditure-based measure.
99. In raw form the surplus was only NZ\$ 2.0 billion (1.5 per cent of GDP), which was slightly below both the previous year's outcome and the Budget forecast, despite much higher revenue growth than expected: a reduction in the assumed discount rate led to a large reduction in the balance because of its effect on the valuation of the government's unfunded pension liability for its employees (NZ\$ 10.7 billion) and of outstanding accident insurance claims (NZ\$ 9.2 billion in gross terms and NZ\$ 4.3 billion in net terms). Higher estimates of long-term labour-cost increases also contributed to the rise in estimated accident insurance claims, as did investment losses and asset devaluations in defence and electricity. Full funding of the accident claims liability is targeted for 2014.
100. Statistics New Zealand has not published any accounts for general government since those for 1997. All such statistics in the text below are OECD estimates.
101. The full government contribution is nearly NZ\$ 1½ billion per year. The Fund is expected to start investing in the final quarter of this calendar year. At mid-year it had assets of NZ\$ 1.9 billion.
102. This figure differs from the government's published net debt estimate as it subtracts off the financial assets of the NZ Superannuation fund.
103. Indeed, if the analysis went further out into the 21st century, the estimated gap would get much larger as the operating balance would deteriorate at an accelerating rate and net debt would rise explosively. Some other countries (such as Denmark) are trying to ensure that their public finances are balanced over a much longer horizon than 50 years.
104. This would go so far as including demographically driven changes, settlements of legal claims and estimated student loan losses. Some pre-specified volatile items will be excluded and covered only in end-of-year assessments. While capital spending will of course be included, it is to be hoped that the revised approach will allow a clearer trade-off between current and capital initiatives.
105. The impact of the latter will need to be limited and largely net out over time, or else the credibility of the process will be at risk.

106. The priority areas for change identified by that review were: "i) Achieving better integrated, people focused, service delivery;... ii) Addressing fragmentation and improving alignment;... [and] iii) Enhancing the people and culture of the state sector..." (Briefing for Parliament, Public Finance (State Sector Management, Bill, p. 4).
107. Crown entities number around 2 780 of which some 2 600 are School Boards of Trustees. The remainder have various forms: some are statutory bodies (the ACC, for example), others are companies (such as the nine Crown Research Institutes) and a few are single-member entities, like the Commissioner for Children.
108. Such a proposal was also made by the State Services Commission (2003).
109. On current prices, without the emission charge, coal-fired plants have a slight economic advantage and would make up 31 per cent of the new 2 200MW to be installed, against 14 per cent for combined cycle gas turbines (Ministry of Commerce, 2000). Even at low levels, the emissions charge could substantially change that balance, as a tax of NZ\$ 13 per tonne (about US\$ 8) of CO₂ would lift the price of coal relative to gas by 9 per cent. This could encourage further exploration efforts as gas fields run out.
110. Leaving the farm sector aside indeed means less emission reductions than what a first-best tax would bring. New Zealand will hence have fewer permits to sell on the international market, which generates negative effects on the terms of trade and on national income. The estimated economic loss is very small, however, at 0.1 per cent of household consumption, because the forecast for the price of permits (NZ\$ 13 per tonne of CO₂) is very low, in line with the current consensus (see IEA, 2002 and NZIER, 2001a).
111. OECD calculation based on data reported in NZIER (2001b). The NZ\$ 40 figure is drawn from the equalisation of net present values at a discount rate of 10 per cent as indicated in NZIER (2001b). Though NZIER (2001b) mentions a 10 per cent discount rate, it finds a different figure for the threshold because it equalises the respective internal rates of return, a methodology which is not appropriate.
112. Recent national data are not comparable with the previous report on the subject (Ministry of the Environment, 1997). A national update on water quality, which should identify trends over time, is due for public release in early 2004. Such a long interval since 1997 hinders the public from being able to follow the evolution of water quality nationwide. Regional councils, however, issue public reports with comparable data more regularly, which allow some trends to be identified.
113. Having increased by 51 per cent to 3.9 million cows between 1990 and 2002, the dairy herd generates effluent equivalent to that from 52 million people (Poore, 2003).
114. An average of 7 839 such bacteria per litre was found in surface water samples taken at 465 stations in the period 1995-2001, a level suitable for livestock watering but well above the swimmability threshold of 2 000 per litre.
115. *Campylobacter* was found in 60 per cent of water samples taken at 25 sites in a study carried out for the Ministry of Health (2002).
116. Under the RMA of 1991, all discharges of contaminants must have a resource consent from the relevant regional council or be authorised by a rule in a regional plan.
117. This remark is based on conclusions in Statistics New Zealand (2002b), but no data have been reported to the OECD to substantiate it.
118. This estimate includes capital expenditure on sewage collection and treatment but also on drinking water supply and stormwater collection.
119. At the 6-digit Harmonised System level.

120. The Quad countries comprise the United States, the European Union, Japan and Canada.
121. Tariff rates now in the range 17-19 per cent, such as those on textile, footwear and clothing, will decrease to 10 per cent by July 2009. Other rates will fall to 5 per cent by July 2008.
122. New Zealand imports no fresh eggs or poultry and bans all non-pasteurised cheese apart from a closed list of specific cheeses made in Switzerland. Some WTO members have officially expressed their criticism of the requirements that New Zealand imposes on the import of dairy products (WTO, 2003).

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BASIC STATISTICS OF NEW ZEALAND

THE LAND

Area (1 000 sq. km)	268.0	Urban population, ¹ percentage of total (June 2003)	78.6
Percentage of total pasture and arable land, 1996	49.5	Population of major urban areas (June 2003, 1 000 persons):	
		Auckland	1 199.3
		Wellington	363.4
		Christchurch	358.0

THE PEOPLE

Resident population, June 2003 (1 000)	4 009.5	Civilian employment, 2002 (1 000)	1 876.8
Inhabitant per sq. km	15.0	<i>of which:</i>	
		Agriculture, forestry and fishing	159.8
		Manufacturing	289.9
		Trade (wholesale and retail)	420.5
		Education, health and community services	310.5

PARLIAMENT AND GOVERNMENT

Present composition of Parliament:			
Labour Party	52	Present Government : Labour Party	
National Party	27	Next general election: July 2005	
New Zealand First	13		
ACT New Zealand	9		
Green Party	9		
United Future	8		
Progressive Coalition	2		

PRODUCTION (2002)

Gross Domestic Product (NZ\$ millions)	125 428	GDP per capita (NZ\$)	31 842
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FOREIGN TRADE (2002)

Main exports (percentage of total):		Main imports (percentage of total):	
Fish and seafood	22.1	Machinery and transport equipment	40.6
Manufactures	20.0	Manufactures	18.7
Dairy produce	16.7	Mineral, chemicals, plastic materials	25.6
Meat	13.8	<i>of which:</i>	
Wood and wood products	11.5	Mineral fuels, lubricants, etc.	9.3

THE CURRENCY

Monetary unit: New Zealand dollar		Currency unit per US dollar, average of daily figures:	
		Year 2002	2.1633
		November 2003	1.5915

1. Defined as the population in the 30 main and secondary urban areas.

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