NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

NZCTU Submission to the Savings Working Group

Contents

1. Introduction

1.1 This submission is made on behalf of the 39 unions affiliated to the New Zealand Council of Trade Unions Te Kauae Kaimahi (CTU). With 350,000 members, the CTU is the largest democratic organisation in New Zealand.

1.2 The CTU acknowledges Te Tiriti o Waitangi as the founding document of Aotearoa New Zealand and formally acknowledges this through Te Rūnanga o Ngā Kaimahi Māori o Aotearoa (Te Rūnanga) the Māori arm of Te Kauae Kaimahi (CTU) which represents approximately 60,000 Māori workers.

1.3 This submission considers the macro economic issues around saving and also focuses on saving for retirement.

2. Main Points

2.1 Measurement of savings is problematic. It is not clear whether New Zealand has a savings problem. Therefore any action should be cautious.

2.2 Cutting government spending to increase savings or economic performance has little justification, may worsen inequalities and in the short run return New Zealand to recession. New Zealand income tax levels are low in any case. Government savings will continue to be an important part of national savings.

2.3 New Zealand may have much more of an investment problem than a savings problem, particularly when considering the high level of private international liabilities. We make a number of recommendations with regard to quality control of overseas investment, capital controls, the design of KiwiSaver funds, support for local investment, particularly venture capital, by government and KiwiSaver funds, and the use of SOE and government infrastructure bonds.

2.4 There is increasing evidence that income inequality is a partial driver of low saving, high household indebtedness, and financial crises. A significant reason is found to be reduced bargaining strength of low and middle income employees. We make several recommendations to address this.

2.5 On retirement saving, we suggest that the primary reason to consider compulsory superannuation is the concern for income adequacy in retirement. New Zealand Superannuation is not adequate for many people. We support compulsory superannuation on the following conditions:

(a) That it is a maximum of 2 percent for workers when compulsory employer contributions reach 6 percent.

(b) That the Government contribution remains at 2 percent.

(c) That the minimum wage is increased by an additional amount at the time the compulsory worker contribution of 2 percent applies.

(d) That the Government contribution of 2 percent (of minimum wage or benefit level or another amount) applies to all those of working age that are not earning for a period.

(e) That New Zealand Superannuation remains as it is currently structured.

(f) That additional welfare payments are available to low income superannuitants.

(g) That there is a review of retirement income adequacy every 5 years.

3. Savings as an economic issue

3.1 We recognise the importance of savings as an issue for the New Zealand economy. However it is a complex issue and not as clear-cut as some commentators would have it.

3.2 In practice it is difficult to define New Zealand's level of savings. What is useful to be counted in it depends on the reason for asking the question. Even once defined, some savings are difficult to measure. Therefore radical actions are inadvisable.

3.3 A crucial question is whether New Zealand in fact has an investment problem rather than a savings problem. It is simplistic to identify New Zealand's international liabilities and chronic current account deficit as solely a domestic savings problem.

3.4 We should also note the important role that the New Zealand government has always played in saving, and that has been especially true in the decade leading up to the Global Financial Crisis. However business savings have presented a mixed picture.

3.5 Last but not least is the fact that New Zealanders have low incomes and high inequality in income and wealth by OECD standards. It should not be surprising if they find saving difficult. While taxes do impact on private saving, they also impact on government saving and have other important functions including income redistribution which indirectly affect people's ability to not only save but live dignified lives. New Zealand's tax rates are not high by international standards. Their importance should not be exaggerated.

3.6 In response to this range of issues and the others confronting New Zealand and New Zealand workers, the CTU has published an Alternative Economic Strategy. We include the recommendations from it that are most relevant to the savings issue as an Appendix to this submission. The full strategy is available at http://union.org.nz/policy/alternative-economic-strategy.

4. Measuring Savings

4.1 Treasury's discussion paper "Saving in New Zealand – issues and options" (September 2010) describes the problems in measuring savings. Statistics New Zealand has also analysed the problems in some detail and we presume will be consulted by the Working Group. Even international comparisons are difficult.

4.2 Savings measured by flows (income not spent on consumption) show much lower levels than savings measured by net worth (assets less liabilities). Both show declining private savings (including corporate savings) from the early 1990s, becoming negative while the government has made a major contribution throughout the period with the exception of the current international economic and financial crisis.

4.3 On the other hand a recent analysis by Trinh Le, John Gibson and Steven Stillman ("Household Wealth and Saving in New Zealand: Evidence from the Longitudinal Survey of Family, Income and Employment", Motu, September 2010) finds relatively strong household savings behaviour, but highly differentiated by income and wealth.

4.4 They find that while the proportion of New Zealanders' assets held in property (including their principal residence) is at the high end of countries they compare us with, it is not exceptional. This adds weight to the argument that New Zealand's problem is not the quantity of savings but the nature of investment.

4.5 Policy conclusions based on this contradictory data should therefore be cautious. While changes are required in the New Zealand economy, it is not clear that household savings is a major cause of our problems.

5. Savings, government expenditure and taxation

5.1 In particular the evidence is weak that the level of government expenditure is a brake on saving as the chair of the Savings Working Group appears to be suggesting. Almost half of New Zealand government expenditure is transfer payments for social purposes such as to provide income to people who are retired, in ill health or with family responsibilities and no other sources of income for example. It is also used to address the high levels of income inequality that grew during the 1980s and 1990s (for example Working for Families). We address the importance of this in more detail below.

5.2 Government expenditure excluding transfers, represented by final consumption expenditure, was 20.6 percent of GDP in 2009 according to the OECD. This was lower than the average of similar size small OECD economies (20.9 percent for economies within a range of a third to three times New Zealand's GDP in Purchasing Power Parity terms). Over the years 2002-2009, only in 2008 was New Zealand's final consumption expenditure greater than the OECD "similar size economy" average, and for most of those years considerably smaller. Only Chile, Ireland, Luxembourg and Switzerland had a lower ratio in 2002. By 2007, Austria, Greece, Slovenia and the Slovak Republic also had a lower ratio but New Zealand was still below the average, and these countries with lower final consumption by government are not necessarily ones we would want to emulate when considering for example the level of development of Chile and the current situation in Greece and Ireland. Small economies with consistently higher expenditure ratios include Denmark, Finland, Sweden and Norway, which have good records for growth, innovation and quality of life.

Final consumption expenditure by government as percent of GDP	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
New Zealand	17.0%	17.2%	17.4%	17.9%	18.5%	18.7%	19.9%	20.6%
OECD similar sized economy mean	20.1%	20.2%	19.8%	19.6%	19.3%	19.0%	19.4%	20.9%

"Similar sized economy" is one between and a third the size of New Zealand's GDP in purchasing power parity terms. Source: OECD.

5.3 As noted, the New Zealand government has been a major contributor to savings in New Zealand, both recently and historically. That is important not simply as a remedy for low household savings (if indeed that is a problem) but because it provides funds for infrastructural and social investment that our capital markets fail to provide and in many cases should not provide.

5.4 In the short to medium term while the New Zealand economy is stagnating and high unemployment is expected to continue for several years, government spending should be maintained to ensure the economy does not return to recession.

5.5 New Zealand's income tax rates are not high by OECD standards. The OECD's "All-in" average personal income tax rates comparison[1] shows that in 2009, New Zealand rates were the lowest in the OECD for a single parent with two children when cash transfers were taken into account, 12th lowest (out of 30) for a one-earner married couple without children and 3rd lowest when they have two children. A single person with no

[1] See http://www.oecd.org/document/60/0,2340,en_2649_34533_1942460_1_1_1_1,00.html#tbw (accessed 4 December 2010).

children was 4th lowest. Similarly, the total tax wedge (marginal personal income tax and social security contribution rates) for a single person without dependents in 2009 was 3rd lowest (out of 30 countries) at the average wage, and at wage levels 33 percent below and 33 percent above the average wage. It was 7th lowest at 167 percent of the average wage. New Zealand rates have since been lowered further.

6. A savings problem or an investment problem?

6.1 The work quoted above of Le, Gibson and Stillman suggests there may not be a household savings problem. Work by Scobie, Gibson and Le ("Saving for Retirement: New Evidence for New Zealand", Treasury, September 2004) tentatively suggested New Zealanders were saving enough for retirement. Further, New Zealand's apparently poor national savings record is driven in large part by the very large net flow of investment income abroad.

6.2 All of these suggest that household savings may not be the problem to be addressed. Rather, New Zealand's economic problems may be more directly related to the use of savings.

6.3 There are at least two caveats to this. Firstly, Le et al show savings are very unequally distributed. We return to this below. Secondly, while the level of savings may not be out of place by international standards, New Zealand has its very high level of international liabilities to contend with.

6.4 While on the basis of accounting identities, New Zealand's international liabilities can be correlated with low savings in New Zealand leading to superficial analyses such as "if New Zealanders don't save enough we must expect our assets to become increasingly overseas owned", and "New Zealanders have champagne tastes on a beer income and choose to spend too much abroad leaving us with international debt", these ignore causality.

6.5 Overseas investment policies other than for land (and even there the controls are acknowledged by almost all political parties to have been weak) have allowed overseas takeover of New Zealand businesses without any quality control. At the least, this bids up asset prices (as is widely acknowledged by farmers) beyond the price a New Zealand investor would pay. This has encouraged speculation on capital gains, whether on property or shares (such as in takeovers by private equity investors in recent years) rather than investing to increase production. Rates of return and interest rates have been bid up beyond what much productive investment can afford.

6.6 If the overseas investment improved the quality of technology, skills and management then increased profit rates could be justified, but there have been many negative examples including privatisations in the 1990s and highly debt-loaded private equity investment in the 2000's. This investment will have increased New Zealand's international liabilities both directly and in choking off productive local investment. The remittance overseas of the income on those liabilities has reduced our level of savings nationally. The income overseas investors receive from New Zealand (from all types of liabilities) is more than the contribution to our GDP of Agriculture, Forestry and Fishing combined.

6.7 As Supachai Panitchpakdi, Secretary-General of the United Nations Conference on Trade and Development (UNCTAD) and former head of the WTO said when visiting New Zealand recently, "UNCTAD had studied privatisations around the world and observed numerous instances where foreign buyers asset stripped their acquisitions". Referring particularly to the privatisation of New Zealand Rail, he said, "If you allow asset stripping you are not going to privatise in a way that you can stabilise your own economy so I was surprised that it happened." Rather than privatisations he advocated "new foreign investment that lifted New Zealand's productive capacity in primary production such as farming, but also in manufacturing linked to the agricultural sector or perhaps in renewable energy products". He said that the quality of overseas investment was important and that "UNCTAD was seeing more government intervention around the world to determine its composition" reflecting "more articulation of investment policies to support national policies: 'Are you going to help enhance my labour productivity? Are you going to follow my environmental and competition rules?'"[2] New Zealand does not have those quality controls.

6.8 Inland Revenue, in work for the 2010 Budget and the Tax Working Group[3], analysed Management Magazine top 200 businesses and found evidence of very high debt loading of overseas businesses compared to New Zealand controlled ones, location-specific rents (higher profit rates due to dominance in a market which is specific to the location of the firm in New Zealand) and relatively low levels of exporting – accompanied by high levels of profit. This is significant economically: IRD comment that "Major industries, such as banks and the resource sector, appear to earn

[2] "NZ urged to harness foreign investment", by Adam Bennett, *New Zealand Herald*, 22 November 2010.

[3] "Where to from here for tax reform? Rate alignment and the company tax rate", Inland Revenue Policy Advice Division report to the Minister of Revenue, 28 January 2010 (PAD2010/6).

economic rents and total about one-quarter of total company tax collections."[4]

6.9 In addition we have a legacy of privatisations which continue to be a drain on New Zealand and failed to provide technology or expertise which could not have been provided by local ownership. There is also a legacy of private equity owned firms with high debt loadings which became precarious as a result of the financial crisis.

6.10 To give just two examples of the effect of privatizations on New Zealand's liabilities: the Ameritech/Bell Atlantic/Fay, Richwhite, Gibbs, Farmer syndicate bought Telecom for $4.25 billion in July 1990, when the company had shareholder funds of $2.5 billion. Shareholder funds declined over the next several years despite cost-cutting because of large capital payments to its shareholders who walked out of the company from 1997 with a realised capital profit of $7.2 billion, in addition to a share of over $4.2 billion in dividends[5] – adding approximately $10 billion to New Zealand's international liabilities. Between 1990 and 1998 the company's shareholder funds halved to $1.1 billion by when it was heavily in debt. In the decade from 1995 to 2004, Telecom paid out dividends of $6.7 billion from net earnings declared in New Zealand of $5.4 billion, of which approximately $5.0 billion went overseas[6]. Yet Telecom failed to provide a modern broadband infrastructure to the country, which the government is now preparing to remedy at substantial cost to taxpayers.

6.11 The New Zealand Rail was freed of debt by a $1.6 billion injection by the government prior to privatisation in 1993 for $328 million. The purchasers, mainly overseas residents, paid only $107 million and borrowed the rest. According to Brian Gaynor they "were responsible for stripping out $220.9 million of equity in 1993 and $100 million in 1995"[7]. By the time they had sold out, they had made total profits of $370 million, mainly tax free because of the lack of capital gains tax, and under accusations of insider trading[8]. Under co-owner Wisconsin's management the safety record was appalling (by 2000, fatal accidents for employees were eight times the

[4] "Tax policy report: The company tax rate", Inland Revenue and Treasury report to the Ministers of Finance and Revenue, 12 February 2010 (T2010/373 and PAD2010/43).

[5] "Testing years ahead for Telecom", by Brian Gaynor, *New Zealand Herald*, 26 May 2001.

[6] "Telecom: What a winner!", financial report on winner of the 2004 Roger Award, Sue Newberry, available at http://canterbury.cyberplace.org.nz/community/CAFCA/publications/Roger/Roger2004.pdf.

[7] "Investment: Track record costly to public", by Brian Gaynor, *New Zealand Herald*, 21 October 2000

[8] "A tough case ... and a long one", by Brian Gaynor, *New Zealand Herald*, 16 October 2004.

national average) and reinvestment and maintenance were abysmal, leaving the operation in a crippled state. They sold out to Toll of Australia who similarly failed to maintain the system, and who then sold it back to the government in two tranches for a total of over $700 million plus ongoing costs to the government of several hundred million dollars to repair the rail network and replace the antiquated rolling stock. It is difficult to estimate the total costs to the country, but the total cost to the government will be almost $4 billion[9], greatly magnified by the neglect of the private owners.

6.12 The other main form of overseas investment is financial debt. Bank lending, until the global financial crisis forced the intervention of the Reserve Bank, has been funded in substantial part by overseas borrowing by the big four Australian banks which dominate New Zealand's financial system. The use of these sources was not "demanded" by New Zealanders, but it was a decision taken by the banks in order to continue their volume of lending. The ready availability of, for New Zealand purposes, limitless funds, assisted the property price bubble which reduced the affordability of housing and rural property. When offered such funds it is hardly surprising that New Zealanders accepted them (as they did in the boom preceding the 1987 share market crash). At June 2010, 74 percent of New Zealand's net international liabilities were owed by the banks.

6.13 There are therefore good policy reasons to consider forms of capital controls, both over foreign direct investment, to ensure its quality and effect on New Zealand's international liabilities (as Panitchpakdi suggests), and over offshore funding for bank lending to limit its use and increase its match with overseas earnings. The increased use of capital controls has been noted with approval by the IMF, UNCTAD and others, with a strong movement in Europe in support of a form of international transactions tax. For example, among other restrictions on international capital movements, South Korea has restricted the use of bank loans in foreign currency in order to ensure that foreign currency loans are for overseas use only[10]. Such measures could be used to reduce New Zealand's international indebtedness and the likelihood that overseas borrowing again inflates domestic asset values to the detriment of household indebtedness and the tradable sector.

6.14 There are other aspects relevant to the investment of savings. New Zealanders now have at least a quarter of a century of catastrophic

[9] "Government Toll buy a sad indictment", by Brian Gaynor, *New Zealand Herald*, 10 May 2008.

[10] "South Korea Imposes Currency Controls for Financial Stability", by Kavaljit Singh, http://tinyurl.com/27j4y7b.

failures of investment institutions, from the 1987 sharemarket crash to unprincipled behaviour of financial advisors to the scandalous state of the finance company sector in the last few years. It is little wonder that New Zealanders are not adventurous with their investments, with start-up companies finding it difficult to raise local funding. It will take considerable time before many New Zealanders have confidence in anything but the banking sector or property for lodging their savings, and even the banking sector relied on government guarantees during the financial crisis. This is unfortunate for the development of the economy.

6.15 KiwiSaver funds are one way in which New Zealanders have shown a degree of confidence in investing in other than bank deposits. Their conservative choice of schemes is another sign of their lack of confidence. A major attraction of KiwiSaver undoubtedly lies with the employer contributions and government subsidy, but concerns regarding security are likely to rise as investment returns begin to dominate the change in value of their funds, rather than contributions which dominate while accumulated funds (per individual saver) are at their present low values. The managers of the funds are after all the same as those of funds which were stressed by the global crisis, and often found wanting. It is possible that the government involvement in the scheme means savers feel safer investing in it despite any significant difference in the security of their funds. It is therefore important that consideration is given to the prudential aspects of these funds.

6.16 The lessons of the financial crisis also undermine confidence that financial education is the answer to problems of confidence in investing. While financial education continues to be important, the fact that even professional investment managers so frequently got it wrong demonstrates how difficult it is for amateurs (i.e. most savers) to safeguard their savings. This means greater emphasis is required on regulatory protections and in some cases government guarantees.

6.17 The way the investment funds invest is a problem for New Zealand. On the principle of spreading risk, the majority (and for many funds, all but a very small part) of incoming contributions are invested overseas. This also applies to government investment funds such as the New Zealand Superannuation Fund and ACC. While this increased outward investment may help New Zealand’s current account deficit by increasing inward investment income, it does not reduce our very high gross international liabilities (which are an important factor in New Zealand’s credit rating and vulnerability to international crisis or threats of capital flight) nor the problems of low quality and volatile inward overseas investment. Consideration needs to be given to regulations or incentives to increase the proportion of these funds that is invested locally.

6.18 New Zealand continues to have a problem in finding funding for firms in the various stages of startup to the point where they reach sustainable commercial viability. For simplicity we refer to all of these stages as "venture capital". The Venture Investment Fund has reportedly been successful in seeding venture capital funding but has no further funds to invest. Fund managers in the venture capital market are concerned that funding (whether private or public) has all but dried up, particularly for sub-$100 million investments, with serious consequences for firm development and New Zealand's economic development. Venture capital requires patient investors willing to take significant risks. Large long-term funds like the New Zealand Superannuation Fund are concerned about both the risk and the time required to perform due diligence on (for them) small projects. KiwiSaver funds have a permanent need for liquidity to provide for the right of savers to switch funds at relatively short notice. They are therefore unlikely to be significant long term investors, even among the minority of "growth" funds which could invest at least a small proportion in such high risk ventures. Consideration needs to be given to expanding the Venture Investment Fund and providing other vehicles that can channel savings into venture capital investments within these constraints. It may require a degree of carefully designed government guarantee, or other public investment institutions focussed on finance for economic development.

6.19 We reject the idea of selling shares in state owned enterprises as a way out of the investor confidence trap that has been created by poorly regulated markets and an unwarranted faith in markets to balance themselves. The likelihood is that the shares will end up in the hands of overseas investors, as they did with local electricity network companies whose shares were initially distributed to those who happened at the time to be customers, and in most other privatisations. Indeed in many cases international trade and investment agreements prevent the government taking action to stop this. It is an experiment that can only be tried once. Once they have been sold and the experiment fails, what do we do next?

6.20 In any case, the partial privatisation proposition is highly problematic. As an example, take the state owned electricity generators and retailers: Meridian, Genesis and Mighty River. Their "principal objective" by law as SOEs is "to operate as a successful business"[11], which makes them act in many ways like their private sector competitors, Contact Energy and TrustPower. Although the definition includes a responsibility to be "a good employer; and an organisation that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so"

[11] State-Owned Enterprises Act 1986, s.4.

the commercial imperatives in practice are primary, particularly in a competitive environment. Therein lies a problem for an electricity system that needs to balance wider needs such as security of supply, environmental impacts, and low cost. Their public ownership could be used to restore some of that balance if their profits were allowed to be compromised. Their public ownership is after all not simply to make money for the government.

6.21 But as soon as a private shareholding is introduced, there will be an expectation that they will produce dividends that are as good as competing investments. The flexibility in objectives that full public ownership provides will disappear. They will be fixated permanently on the pure profit-maximising objective of running as a successful business, the only public benefit (not insignificant) being that some of the profits return to the public purse. The electricity system will continue to malfunction and the pressure will build for them to be fully privatised.

6.22 Using them to deepen financial markets is a once-only short term expediency – and at the same time a tribute to their success compared to much of the private sector which has either failed or been sold to overseas interests. But it is a misuse of essential public infrastructure.

6.23 A more acceptable way to encourage private investment in SOEs would be for them to issue bonds, and similarly for the government to issue infrastructure bonds, which would be available to retail investors. There is a strong demand for such securities at present, with corporate and local government bonds being quickly taken up at interest rates not far above rates for 5 year bank term deposits. We suggest that such bonds should be in the form of “Kiwi Bonds” which are available only to New Zealand residents and institutions owned by them.

7. Income distribution and saving

7.1 The readiness of New Zealanders to use debt to maintain their standards of living should be seen in the light of the slow growth in wage rates. For example the average total hourly wage grew only 17 percent in real terms over the 20 years from June 1989 to June 2009 while labour productivity rose 44 percent. The two-thirds of employees earning below the average wage are likely to have seen even slower increases. For example, the average total hourly wage for workers in the lowest paid industry, Accommodation, Cafes and Restaurants, fell 3 percent in real terms over that period and wage increases by industry were correlated with wage levels – in general the higher the wage, the higher was the real rate of increase. New Zealand had the fastest increase in income inequality in the

OECD from the mid 1980s to the mid 1990s[12] and still has high levels of inequality by OECD standards. Many people have struggled to maintain their standard of living and have borrowed (encouraged by lenders) in an attempt to do so.

7.2 This pattern of low wage growth for workers and increasing inequality, leading to unsustainable borrowing, is an international phenomenon. Its effects were summed up by Dominique Strauss-Kahn, Managing Director of the International Monetary Fund in a speech on 1 November 2010[13]:

7.2.1 "But globalization also had a dark side. Lurking behind it was a large and growing chasm between rich and poor—especially within countries. An inequitable distribution of wealth can wear down the social fabric. More unequal countries have worse social indicators, a poorer human development record, and higher degrees of economic insecurity and anxiety. In too many countries, inequality increased and real wages stagnated—failing to keep up with productivity—over the past few decades. Ominously, inequality in the United States was back at its pre-Great Depression levels on the eve of the crisis.

7.2.2 Fundamentally, the growth model that co-existed with globalization was unbalanced and unsustainable. Growth was driven by too much borrowing in some countries, made possible by too much saving in others. For a while, this seemed to work. But the illusion of stability was forever shattered by the wild ride of the global financial crisis. A runaway financial sector took risk to new heights, making sure that the inevitable fall was especially hard.

7.2.3 Inequality may have actually stoked this unsustainable model. In countries like the United States, borrowing seemed to allow ordinary people to share in the rising prosperity. Like the Great Depression before it, the Great Recession was preceded by an increase in the income share of the rich, a growing financial sector, and a major rise in debt... Of course, the unbalanced pattern of growth had a variety of causes, but we would be foolish to ignore the distribution of wealth."

7.3 IMF researchers have modelled the effect of the very large income inequalities in the US, which are now at the same proportions they reached at the time of the 1929 Wall Street Crash. In the paper "Inequality, Leverage and Crises" (IMF Working Paper WP/10/268, November 2010), the model presented by Michael Kumhof and Romain Rancière, demonstrates"

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[12] "Household incomes in New Zealand: trends in indicators of inequality and hardship 1982 to 2009", by Bryan Perry, Ministry of Social Development, August 2010, p.149.

[13] "Human Development and Wealth Distribution", http://www.imf.org/external/np/speeches/2010/110110.htm

> how high leverage and crises can arise as a result of changes in the income distribution. Empirically, the periods 1920-1929 and 1983-2008 both exhibited a large increase in the income share of the rich, a large increase in leverage [i.e. debt] for the remainder, and an eventual financial and real crisis. The paper presents a theoretical model where these features arise endogenously as a result of a shift in bargaining powers over incomes. A financial crisis can reduce leverage if it is very large and not accompanied by a real contraction. But restoration of the lower income group's bargaining power is more effective.

7.4 After presenting the facts of the sharp growth of inequality preceding the financial crisis, they draw a link to the rapid growth in household debt. They note that between 1967 and 2005, “the real hourly wages of the top 10 percentile [of men] increased sharply by a cumulative 70 percent, the real hourly wages around the median declined by 5 percent, while the wages of the bottom 10 percent declined strongly, by around 25 percent”. In addition, they use findings that “that the rise in income inequality has been much more pronounced than the increase in consumption inequality” and that “that households at the bottom of the distribution of income and wealth are becoming more indebted than households at the top”: in other words, low income and low wealth households borrowed to maintain their standard of living.

7.5 Funds for the raised household debt were provided by a small (5 percent) elite whose incomes rose sharply. Growing inequality “created political pressure, not to reverse that inequality, but instead to encourage easy credit to keep demand and job creation robust despite stagnating incomes. It has also been suggested that the increase in wealth of the richest households has played a role in increasing the demand for investment assets.” This lead to a sharp growth in the financial sector – its share in GDP almost doubled between 1981 and 2007 “and most recently accounted for an extraordinary 8 percent of U.S. GDP”.

7.6 Their model demonstrates that a financial crisis can arise under these conditions due to the accumulation of ultimately unserviceable debt. However they find that even large loan defaults are unlikely to prevent a further crisis and that lasting resolution is “restoration of poor and middle income households’ bargaining power”. This “can be very effective, leading to the prospect of a sustained reduction in leverage that should reduce the probability of a further crisis”. They attribute a significant part of the rise in income inequality to the decline in unionisation in the US. Restoration of bargaining power therefore implies recognition of the importance of unions in maintaining a balance between labour and capital. Other factors identified are bonuses at the “very top end” of the income distribution; increasing returns to post-secondary education; and foreign competition and “offshoring” of jobs.

7.7 While this is only a model and requires extension to an open economy, it adds to the credibility of the published analyses and views of prominent economists such as Paul Krugman, Raghuram Rajan, Robert Reich and Robert Wade linking increasing debt, inequality and crises.

7.8 The data is not available to provide a similar comparison for New Zealand, but the implications should be investigated by policy makers. We do know that household income inequality has risen steeply (see above). We also know that according to the national accounts, New Zealand's financial sector almost doubled its share of GDP from 1972 (3.6 percent) to 2007 (7.0 percent); it had 4.6 percent of GDP in 1981. Its rise and current size may therefore not be much different to the US in relative terms.

7.9 In New Zealand's case of course, the funding of consumption to substitute for inadequate lower and middle incomes came substantially from overseas. It may have been moderated by more generous transfers through the social welfare system than in the US.

7.10 The role of income inequality in household debt accumulation should therefore be considered an important policy issue. We need to understand its role compared to other policies aimed at increasing incentives for saving, rather than coming to precipitate conclusions on the effects of government expenditure and taxation. Cutting government expenditure on either benefits (transfers) or services to low and middle income households is likely to further increase inequality in disposable incomes or increase costs on essentials such as health and housing. A return to more progressive tax systems may be beneficial for savings as well as other reasons.

7.11 Objections will be raised that such measures produce disincentives to saving and work. However, sharply reduced benefit levels in the early 1990s and more regressive tax systems (including introduction of GST), neither of which were substantially reversed by the 1999-2008 governments, have in practice failed to encourage higher rates of saving. Labour force participation increased during the 2000s despite mildly increased progressivity of the tax system. It seems that the negative (i.e. income) effects of increased inequality outweigh any incentives to save and work.

7.12 In any case, New Zealand's income tax rates are not high by OECD standards, as we established above.

7.13 It would be much preferable if income inequality was addressed at source in market incomes. As the IMF paper notes, strengthening workers' bargaining power by stronger legislative support for unions and collective bargaining would be the most effective way to do that.

7.14 Other measures which address low wages should include a significantly increased minimum wage and better protection and income replacement for vulnerable workers and displaced workers. “Flexicurity” policies used in northern Europe provide security of employment along with sufficient flexibility to allow firms to adapt to changing circumstances. They provide high levels of income replacement when a worker becomes unemployed along with strong “active labour market” support including financial and direct assistance with retraining, job matching and searching, and relocation if necessary.

7.15 There should also be action to moderate the effect of open economies on inequality, such as outsourcing offshore.

8. Retirement saving

8.1 The current level of New Zealand Superannuation (NZS) is between $255 and $334 a week. This is an inadequate level of retirement income. It is recognised that there are many issues that impact on adequacy of retirement income including housing costs and equity, wage levels before retirement, health and so on. Income adequacy is the fundamental issue therefore that impacts on our approach to a retirement savings policy.

8.2 It will be increasingly necessary to supplement NZS. Already there are over 1.5 million people in KiwiSaver. We consider it best to build on the current format of KiwiSaver rather than propose a new scheme. We support going to a 6+2+2 scheme as outlined above.

8.3 It is recognised that compulsion for low income workers can force them to forgo consumption in favour of savings. We considered exemptions or lower levels of contributions (e.g. 1 percent) for workers below a certain income level. In order to ‘keep it simple’ and recognising the one-off impact in the year it begins, we support compulsory savings at all wage income levels. We argue however that the minimum wage should increase by an additional amount at the time compulsory savings apply to all workers. We also note that most workers in KiwiSaver contribute at 4 percent whereas we are proposing a compulsory minimum contribution of 2 percent.

8.4 We support the continuation of the hardship mechanisms and suggest the definition is reviewed before compulsory worker contributions apply.

8.5 We also recognise that the overall cost to Government includes tax concessions. We therefore do not argue that the tax exemption on employer contributions should rise beyond the first 2 percent even when the level of contribution reaches 6 percent. This is to assist payment by the Government of 2 percent of (say) the minimum wage, or their applicable benefit, to all those not in paid employment and aged 15 – 64 years.

8.6 There are arguments in favour of annuities. It is possible that with many more KiwiSavers a stronger annuity market will emerge although it is likely some government role will be needed to achieve this. However to argue both for compulsory savings and compulsory annuities is a step too far in our view. Workers are likely to resist a requirement to convert a proportion of their lump sum at aged 65 years to an annuity, even though there are strong welfare grounds to support such an approach. The annuity would sit alongside the NZS 'annuity' in any case if that occurred.

8.7 A major question is whether compulsory savings will impact on the eligibility and format of current NZS. However if retirement income based on NZS is inadequate, the most direct way to address it is a compulsory top up mainly funded by employer contributions, given a rise in the real value of NZS is unlikely.

8.8 There is already pressure to increase the retirement age or take other cost saving measures such as lifting the age of eligibility or indexing NZS to CPI inflation rather than wages. We remain steadfastly opposed to this. Many workers are physically and mentally exhausted now at age 65.

8.9 There are other welfare payments that can apply to superannuitants. Given the inadequacy of the NZS, these should be reviewed as part of a policy package. For instance there is a stringent asset test applied to accommodation supplements and an energy subsidy could be considered. Such matters should be regularly reviewed.

8.10 We therefore support compulsory superannuation on the following conditions:

(h) That it is a maximum of 2 percent for workers when compulsory employer contributions reach 6 percent.

(i) That the Government contribution remains at 2 percent.

(j) That the minimum wage is increased by an additional amount at the time the compulsory worker contribution of 2 percent applies.

(k) That the Government contribution of 2 percent (of minimum wage or benefit level or another amount) applies to all those of working age that are not earning for a period.

(l) That NZS remains as it is currently structured.

(m) That additional welfare payments are available to low income superannuitants.

(n) That there is a review of retirement income adequacy every 5 years.

9. Appendix

From the NZCTU Alternative Economic Strategy

Items directly addressing the issues in this submission.

Financial system

Provision of finance for economic development

New Zealand industry suffers from the lack of suitable finance for development. Funding could come from

- A government owned development finance agency with social partnership governance raising funds from direct government contributions, investment from other government investment funds (such as ACC and the New Zealand Superannuation Fund) and privately subscribed bonds. This would provide both development funding (including venture capital and “patient funding” during further development phases) and an investment vehicle to increase local equity in New Zealand firms
- Long term Kiwi bonds for infrastructure, which may be attractive for superannuation purposes
- Encouraging greater proportion of the New Zealand Superannuation Fund to be invested locally by use of partial government guarantees to the Fund on investment consistent with the economic development strategy
- Encouragement for private (e.g. KiwiSaver) superannuation funds to invest locally through a 10 percent reduction on tax paid by a fund on income from New Zealand investments, to be reviewed after five years.
- Encouraging domestic savings and their investment in economic development through changes in housing policies, and further expansion of the KiwiSaver scheme (see below).

Monetary policy and the exchange rate

The single focus of monetary policy on consumer prices and the use of interest rates as the predominant tool to control inflation has damaging effects on economic development by frequently forcing up interest rates beyond rates that make new projects feasible, and raising the exchange rate by attracting foreign funds to profit from the higher rates. Monetary policy can be an important tool in economic development and stabilising the economy. It needs to return to that vital role, while maintaining the control of inflation as one of its objectives. However the exchange rate will remain a problem while there are no controls on capital movements.

We should review both the Reserve Bank Act and the Financial Responsibility provisions of the Public Finance Act to support the following policies:

- Ensure the Reserve Bank has sufficient powers to take action on the exchange rate and international capital flows
- Give the Reserve Bank an active role in stabilising the exchange rate through management of international capital flows and currency controls, seeking cooperation and agreements with other nations.
- Peg the exchange rate to increase its stability
- Broaden the terms of reference for monetary policy beyond inflation to include employment, living standards, the exchange rate and other matters.
- Reduce the reliance of monetary policy on interest rates for example by direct control of the money supply, capitalisation ratios, and liquidity regulations
- Consider other monetary policy mechanisms such as empowering the Reserve Bank to increase or reduce a small slice of superannuation contributions. This would be subject to the outcome of a specific inquiry into the advantages and disadvantages of compulsory superannuation. If compulsory superannuation did result, the new monetary policy mechanism would work as follows, once compulsory employer superannuation contributions have reached 6 percent:
    - A 2 percent compulsory worker superannuation contribution
    - In order to tighten monetary conditions, the Reserve Bank could require an increase of up to a further 1 percent compulsory contribution (that is, no more than 3 percent in total), the proceeds of which would go into a special Holding Fund, in which each individual's contributions were identified.
    - When monetary conditions are relaxed, the Holding Fund contributions are released back to the contributors, giving each the option of taking it as cash or adding it to their superannuation funds.
- Increase the powers of the Reserve Bank Board of Directors, and widen community representation on it

Retirement

New Zealand Superannuation should be maintained, supported by the New Zealand Superannuation Fund to which contributions should be resumed as soon as practicable.

This should be augmented by a KiwiSaver scheme which is enhanced both to increase saving and to include people unable to provide for their own retirement. Because the majority of KiwiSaver fund clients are workers, governance of funds should include union representation.

Such enhancements should only occur after an appropriate inquiry into advantages and disadvantages but could include:

- Compulsory employer contributions of 6 percent phased in over 4 years
- Compulsory employee contribution 2 percent
- Government top-up 2 percent
- Addressing equity issues: conduct an inquiry into addressing equity issues, such as those resulting from lower pay rates and lifetime incomes of women with a view to beneficiaries and non-working parents receiving a government contribution in lieu of the employer contribution

Taxation

It is essential that the state is sufficiently resourced to carry out its functions and carry out its important redistributive role. Taxation can also encourage and provide support for productive investment and for other positive directions society determines.

Progressive income taxes are important sources of income and play a central part in redistribution, lessening income inequality, which becomes increasingly important in the context of resource-limited economic growth.

Income tax: Create a tax-free band and/or a tax rebate for those on incomes under $35,000. The income tax scales should be augmented by a 38 percent rate on income more than approximately twice the average wage ($100,000) and a 45 percent rate on income more than approximately three times the average wage ($150,000).

Reduce GST to 12.5 percent and progressively replace it with other forms of taxation including asset taxes (see below), the international Financial Transaction Tax and the FAT tax explained above, and taxes or increased royalties on commercial use of resources.

Polluters should face taxes on their emissions, including greenhouse gas emissions (see Climate Change below), with the aim of them paying the costs of all significant “externalities” (side effects such as pollution and global warming). However this should be done in a way that ensures people on lower incomes do not end up paying an unfair share of the burden.

We should investigate improvements to the welfare system through the tax system including at least partially replacing Working for Families with a tax free threshold on personal income, like in Australia. See also Social Security below.

Address tax avoidance through

- Sufficient resources to IRD to track down evasion;
- Ensuring that Trusts other than registered Charitable Trusts cannot be used for tax avoidance;
- Changes to the company tax regime.

Company tax

- Return the company income tax rate to 30 percent;
- Investigate income taxation of closely held companies to make it difficult to use them for tax avoidance and to provide tax relief for struggling local owners of small firms (for example for such firms, tax all income to individual resident shareholders at their personal tax rate, whether the income is retained in the company or paid out in dividends);
- Apply thin capitalisation rules to overseas owned companies with a debt threshold at 50 percent;
- Consider ceasing tax deductibility of interest on related party borrowing;
- Taxes on commercial use of resources and on externalities as described above;
- Taxes on excess profits as the result of market dominance.

Additional sources of revenue should include:

- Ending deductibility of rental property losses against personal income.
- A capital gains tax or a "Risk Free Rate of Return" tax on assets, subject to equity considerations: that is they should be designed to be progressive, aimed primarily at investors, and exempt a household's primary occupied home.

Union Change

The Union Change programme being developed by the CTU will:

- extend union coverage and collective bargaining to the widest possible group of workers;
- introduce a rights-based framework for coverage by collective agreements, participation in unions, and workers' voice in their workplace and industry about the way work is organised and their place in it;
- create mechanisms for national and industry level standards setting;
- create a broader union movement including forms of organisation that allow workers to easily associate and participate;
- Develop a formal proposal for a more structured approach to social partnership. This could include considering the desirability of establishing a Living Standards Review Authority reporting to a National Tripartite Social/Economic Council. Every three years it would review standards of living, social and tax policy, price levels and increases, and productivity changes. It would hear submissions from the NZCTU and Business NZ, and initiate tripartite discussions and make recommendations and agreements on measures to address equitable distribution of incomes.

Employment

Full employment should be a central objective of government policy.

- Adopt a policy of "Flexicurity" which provides security of employment along with sufficient flexibility to allow firms to adapt to changing circumstances.
- Provision for security of employment would be funded partly from compulsory experience- and size-rated employer levies and partly from general taxation, underwritten by government including:

- Maintenance of 90 percent of prior income during unemployment for up to 12 months, conditional on commitment by the worker to acquiring new skills if necessary, and job searching;
- Active labour market policies to provide support to find new jobs and assistance in moving to another region if necessary;
- Financial and practical support for acquiring new skills and qualifications;
- Tripartite design, governance and implementation of the programme;
- Normal unemployment benefits to apply after 12 months if still unemployed.