NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

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Comment
As the old union song *Solidarity Forever* goes, “they have taken untold millions that they never toiled to earn”. But now, as we witness a major meltdown in the financial system, it is trillions – not millions. And as unions have often observed, the titans of capitalism are always keen to see financial losses socialised while profits are privatised. And for these people, if there is a sticking point, it is that they want a bailout but not government equity (nationalisation) in the process.

And let’s face it – there have already been a few bailouts in recent weeks. The US spent $US 200 billion bailing out Fannie Mae and Freddie Mac and $US 85 billion for the insurance company, AIG. So this latest proposal is on top of massive government funding already as well as action by the Federal Reserve in broadening the range of collaterals accepted for the liquidities they inject.

For most of us, it is simply hard to comprehend how such massive profits can have been made through financial instruments that are based on reckless levels of debt and almost no equity. As one commentator (Benjamin M. Friedman) observed, “in many of these firms the activity has become further and further divorced from actual economic activity.” In fact there has been a financial frenzy based on a massive increase in risky financial instruments. There is a bewildering array of these instruments as I discussed in the January and March CTU Economic Bulletins.

For instance, there has been an enormous growth in derivatives, which unbundle the different characteristics of a security, such as the risk of a change in its price, or of a default. As Trevor Evans has noted, this makes it possible to trade these characteristics without having to trade the underlying security on which they are based.

Derivatives are usually forward contracts, options or swaps. A forward contract is an agreement to buy or sell a specified quantity of a commodity or asset on a date in the future at a price that is specified when the deal is agreed. An option is a contract that gives the purchaser the right either to buy or to sell something in the future at a specified price, but the purchaser is not obliged to exercise the option. There are many types of swaps such as an interest-rate swap where two parties agree to take over each others’ interest-rate

payments. A swap in general terms is the exchange of one asset or liability for a similar asset or liability for the purpose of lengthening or shortening maturities.

But this is not easy to describe. For instance there are even futures instruments known as "credit default swaps" that enable investors to bet on the odds that the banks' own corporate borrowers would not be able to pay their debts! Does this sound like casino economics to you? According to George Soros, such bets on credit defaults now make up a $US 45 trillion market that is entirely unregulated. And the Bank for International Settlements showed that the notional value covered by derivatives increased from US$ 99 trillion in 2001 to a colossal US$ 516 trillion in 2007. US finance sector debt went from 21 per cent of GDP in 1980 to 83 per cent in 2000 and 116 per cent in 2007.

Joseph Stiglitz says that in the current situation there are four main problems. The first is that the financial institutions have all these toxic products--which they created--and since no one trusts anyone about their value, no one is willing to lend to anyone else. The second problem is that there is a big and increasing hole in bank balance sheets--banks lent money to people beyond their ability to repay. The third problem is that the US economy has been supercharged by a housing bubble which has now burst. And the fourth problem is a lack of trust, a credibility gap. Stiglitz has also pointed that "national debt has already climbed from $5.7 trillion to over $9 trillion in eight years, and the deficits for 2008 and 2009--not including the bailouts--are expected to reach new heights. There is no such thing as a free war--and no such thing as a free bailout. The bill will be paid, in one way or another."

As I mentioned in March, leveraging reached absurd levels. At Merrill Lynch, $US1 trillion of assets was leveraged by around $US30 billion of equity. For such astute management, Merrill Lynch allowed its chairman and chief executive, Stan O'Neal to retire as chairman and chief executive, rather than sacking him, so he qualified for a $US161 million departure package.

There are now widespread European financial services and bank failures (Wachovia, Fortis, Bradford & Bingley, and Hypo Real Estate in recent times). The connection back to the housing price bubble is also playing out in many countries. The quarterly issuance of Australian residential market backed securities has fallen from $18 billion to around $2.5 billion.

Now we see the debate emerging about financial market regulation. On one side we have those that argue that too much regulation will stifle innovation. I note that Richard Long in today's DomPost argued against regulation but was in favour of criminalising short-selling! Hmmm … sounds like regulation to me. There is now widespread recognition that if these finance companies and banks are too big to be allowed to fail, then they are big enough to cope with greater regulation. And there are others that say it is enforcement of regulation that is the issue. Philip Stephens of the Financial Times argues that "the big mistakes of recent years have not been so much about the absence of regulation, but a failure to act. The central bankers and the regulators were simply asleep on the job."

So what can be done?

Right now the focus is on the bailout proposal in the USA. This is a massive cost – $US700 billion is nearly six times our GDP. Some economists believe that the government should rescue troubled banks directly, by buying special issues of preference shares. Stiglitz says the Scandinavian countries showed the way, almost two decades ago when they responded to a financial crisis by issuing preferred shares with warrants to reduce the public's downside risk and provide incentives and wherewithal to resume lending. Others propose making the banks fix themselves, by suspending dividend payments and issuing new stock—or even forcing them into bankruptcy courts, where they would have to swap debt for equity. For instance, Martin Wolf has argued in the Financial Times against the bailout because it can only deal with insolvency by buying bad assets at far above their true value, thereby guaranteeing big losses for taxpayers and providing an open-ended bail-out to the most irresponsible investors. He says the simplest way to recapitalise institutions is by forcing them to raise equity and halt dividends.The bailout is playing out right now so it is not easy to comment on the outcome.

Beyond the bailout there are longer term issues about financial market regulation. I have previously argued for greater controls of the credit rating agencies, and greater regulation of the non-banking financial institutions. Stiglitz argues also for a special financial sector tax to pay for the bailouts conducted so far and create a reserve fund. This institutionalises the moral hazard of these firms knowing there is money for bailout. But at least it is not public money. The European Trade Union Confederation has argued for: much tighter control of financial institutions' ability to leverage their operations, by strengthening the ratios of solid assets to liabilities; new forms of international regulation; government action to ensure that funds are available for investment in the real economy, helping develop green jobs and technologies and sustainable development, and; an urgent return of public policy attention to the major issues of income and wage inequalities. They say that “it is inequality and poor wage income for ordinary workers that are driving households into ever more debt through risky financial market techniques.”

The global union federation, UNI, has called for curbs on aggressive sales targets imposed on finance sector staff. Philip Stephens says that “governments need to find ways to reclaim some of the sovereignty lost to globalisation. That means more global governance: credible international rules.”

TUAC, the Trade Union Advisory Committee to the OECD, says that measures should go far beyond reviewing prudential rules for banks and encouraging more transparency on the market place. They say it is the national and global regulatory architecture that needs to be restored so that financial markets return to their primary function: to ensure stable and cost-effective financing of the real economy. TUAC noted that the G8 Summit in Hokkaido Japan expressed strong support for the recommendations of the Financial Stability Forum for the strengthening of banks' capital requirement for structured credit

product and off-balance sheet exposures of banks' own risk management procedures, for new accounting valuation of structured products, stronger oversight of rating agencies and more broadly for international cooperation to "encourage financial institutions to improve the quality of disclosures" about "complex and other illiquid instruments". But TUAC says as welcome as these recommendations may be – many of which relying on private sector voluntary cooperation – they seem seriously inadequate.

What is clear from all of this is that we need more government involvement, not less. We need a greater level of secure government bonds. We need more public housing so that people are not forced into debt. We need greater international co-operation by governments and international financial institutions. And, if there is a bubble that needs to burst, it is the arrogance of those who continue to pronounce the benefits of a system of global financial capitalism that is built on crazy levels of debt and risk with no regard for the conditions for workers, national cultures, the environment, poverty eradication long term economic development, or anything except for where that dollar can get the highest possible return in the shortest amount of time for the smallest group of people.

Consensus forecasts[1] published by NZIER
The consensus forecasts were updated in September 2008.

March Year % change	**2009**	**2010**	**2011**
GDP	0.2	2.1	3.1
CPI	4.2	2.8	2.7
Wages (QES)	5.1	4.0	3.7
Employment	0.4	0.6	1.4
Unemployment	4.4	4.9	4.8

Economic Snapshot
Consumer prices rose 1.6 percent in the June 2008 quarter, and were up by 4.0 percent annually. The next CPI update is on 21st October 2008. Food prices rose 2.7 percent in August 2008, and increased by 10.6 percent over the past 12 months. Unemployment is at 3.9 percent. Maori unemployment is 7.1 percent and Pacific peoples' unemployment is at 6.5 percent, compared with 2.8 percent for European/Pakeha. The minimum wage is $12.00 an hour and $9.60 for new entrants aged 16 or 17 for the first 3 months or 200 hours whichever ends first. Ordinary time hourly wages, as measured by the Quarterly Employment Survey (QES) for June 2008, were up annually by 5.3 percent (5.4 percent in the private sector and 4.8 percent in the public sector). The QES showed that the average ordinary time hourly wage is now $23.63 ($21.96 in the private sector and $30.58 in the public sector). The female rate of pay is $22.23 which is 87.6 percent of the male wage at $25.38. The Labour Cost Index (LCI) shows that ordinary time wages went up by 3.5 percent in the June 2008 year (3.5 percent in the private sector and 3.7 percent in the public sector). However for workers who got an increase in the last year, the median

[1] The consensus is made up of the average of forecasts from NZIER, Berl, ANZ- National Bank, ASB Bank, BNZ Bank, First New Zealand Capital, Deutsche Bank, UBS, Westpac, Reserve Bank of New Zealand and Treasury. Because the consensus forecasts are done only every 3 months, some of the more recent forecasts will be more accurate.

increase was 4.1 percent and the average increase was 5.8 percent. The next update of wages data is on 3rd November, 2008. Economic growth decreased by 0.2 percent in the June 2008 quarter following a 0.3 percent decline in the March 2008 quarter. On an annual basis, the economy grew by 2.6 percent over the year to June 2008. The next GDP update is on 23rd December. On 11th September, the Official Cash Rate (OCR) was reduced from 8.0 percent to 7.5 percent.

Food Prices

Food prices rose in the year to August 2008 by 10.6 percent and by 2.7 percent in the August 2008 month. This is the largest monthly increase in 19 years. Vegetable prices increased by a total of 36.4 percent over the past four months, with the wet weather effecting growing conditions. Grocery food prices rose by 13.1 percent in the August 2008 year, while fruit and vegetables rose 19.1 percent. Over the past year cheddar cheese has risen 64.8 percent, bread 17.4 percent, milk 12.5 percent, and butter has gone up by 87.6 percent.

GDP

GDP figures out last week confirmed that we are in a technical recession. There has been a half percent contraction in the last 6 months. The 0.2 percent drop in the June quarter was fairly broad-based. Construction, finance, retail and agriculture were all down. But manufacturing was up by 1.4 percent. On an annual basis economic growth was 2.6 percent for the June 2008 year. Some predictions are for a 0.5 percent drop in the September quarter and the Consensus Forecast is for only 0.2 percent annual growth in GDP for the March 2009 year.

Government Accounts

The Pre-election Economic and Fiscal Update (PREFU) is on 6th October. As I mentioned in the last CTU Economic Bulletin, it will not be pretty. Some of it will be for good reasons such as the higher than anticipated uptake of KiwiSaver. But the fiscal impact of the recession and the flow-on effects of lower forecasts on growth and predictions of higher unemployment will all take their toll on the accounts. I think the PREFU will also show that this Government's tax cuts were a stretch. Ok –it needed to be done for a host of reasons, but the state of the books will make it hard to justify $2.7 billion a year on average for tax cuts over each of the next 4 years. Of course, the tax cuts do "prime the pump" in a Keynesian sense at the right time so from that perspective as well as the assistance they will provide alongside Working for Families for families, it is a good time to be boosting take home pay. But debt to GDP ratios will rise and the cash deficits will be even larger than the $3.5 billion predictions we saw at Budget time in May.

How on earth the National Party can promise higher debt and more tax cuts in these circumstances is a mystery. Perhaps if they promise to bring a bit forward on the tax cuts (so the second tranche is in April 2009) and add on another year and include everything this government has promised they could get to their $50 promise. But we will have to wait and see on that one!

Balance of Payments and International Investment
The current account deficit for the June 2008 year was $14.97 billion or 8.4 percent of GDP. But 93 percent of that deficit was made up by the international investment deficit due to bank borrowing to fund mortgages and repatriation of profits to foreign owners. Net debt is $159.2 billion. Most of this is private sector debt. The Government with $17.6 billion accounts for just 6.1 percent of our gross international liabilities of $289 billion. Bank borrowing is much higher at $138.9 billion.

Trade
The monthly trade deficit was $750 million, down from $808 million in July. Export receipts were better than expected but according to the BNZ this is due to the timing of oil export shipments (from the new Tui field), early-season dairy prices, and the overhang in meat processing (related mainly to the earlier drought).The annual trade deficit is $4.3 billion. This compares with deficits of $6.3 billion in August 2007, and $6.5 billion in August 2006. The value of the New Zealand dollar is 13.1 percent lower than at its peak in July 2007.

Retail sales
Retail sales fell 0.8 percent in the month of July. Of the 24 sub groups within retail sector, thirteen had increased sales, while 11 industries had decreases. Where there were increases, they were small, and to be found in clothing and softgoods, and department store retailing. Motor vehicle sales were down 5.3 percent in the month, and supermarket and grocery stores were down 2.0 percent. Some predictions are for retail volumes to be down by 4 percent for the September year.

NZ Super Fund
The New Zealand Superannuation Fund had an $881 million loss ($716 million before tax) which was a negative 4.92 per cent return before tax. At the end of its June 30 financial year, the fund's overall assets had grown to $14.13 billion. The average annual return has been 10.01 percent. It is expected to grow to around $109 billion by 2025. No capital withdrawal is allowed before July 1, 2020.

Housing and Property
Quotable Value report a 4.5 percent decline in national property values over the past year with an average sale price of $391,487. REINZ report a median price of $330,000 – $10,000 less than reported last month, and a 5.7 per cent drop on the August 2007 national median price of $350,000. There were 1,328 new housing units authorised in August 2008. This is the lowest monthly total since December 2000. The total value of residential building consents has fallen 33 percent since mid-2007.

Migration
In the year ended August 2008, there were 86,700 permanent and long-term arrivals, up 3,700 (5 percent) from the August 2007 year. Over the same period, there were 81,800 departures, up 7,500 (10 percent). Net migration was 4,900 in the August 2008 year, down from 8,700 in the August 2007 year

and below the annual average of 11,800 recorded for the December years from 1990–2007. In the year ended August 2008, there was a net inflow of 7,600 migrants from the United Kingdom, down from 8,800 in the August 2007 year. The net inflow of 4,800 from India was up from 3,100 in the August 2007 year and 2,100 in the August 2006 year. There were also net inflows from the Philippines (3,700), Fiji (2,800), and South Africa and China (each 2,600) in the August 2008 year. The net outflow to Australia was 33,300 in the August 2008 year, compared with 25,900 in the August 2007 year. This is the highest annual net outflow to Australia since the February 1989 year (33,600). There were earlier peaks in the January 1989 year (33,700) and the December 1979 year (33,400). Statistics NZ say that net outflows to Australia were recorded in each broad occupation group, led by service and sales workers and professionals (each 2,200), and trades workers (2,100). There was also a net outflow to Australia of 13,500 people without an occupation, of which most were children or students.

Executive excess

A recent survey of US CEO's pay packets makes for shocking reading, especially given the current state of the US economy. Compensation last year for the chiefs of the 500 companies averaged US$ 10.5 million, or 344 times the average workers' pay. But the CEOs who manage the top 50 hedge fund and private equity corporations averaged annual pay packets of US$ 588 million - more than 19,000 times the average workers wage.

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