Exposing right wing lies

– behind the debate over the minimum wage, unemployment, tax and welfare “reform”

– Who is to blame for the economic crisis and what are the solutions?

Q & A by Mike Treen, National Director, Unite Union **$2**

Mike Treen speaking to Union protests against proposed “right to sack” laws

During the petition campaign on lifting the minimum wage we got asked lots of questions on what the impact this will have on the economy. Will it cause prices to rise? What about its effect on employment? The government has also tried to shift the blame for the growth in unemployment and beneficiary numbers on the unemployed themselves. This was a pattern all governments followed during the last deep recession in New Zealand during the late 1980s and early 1990s. The most recent budget continued the process of shifting taxation from the rich to the poor with the claim it will lead to economic growth and ultimately improve the lives of everyone. Is there any truth behind the government claims? A number of these questions are taken up in the following article in a “Question and Answer” format by Mike Treen, National Director of Unite Union. He also tries to draw the lessons from the experience of the last recession so we don’t repeat some of the mistakes made that weakened the labour movement’s ability to resist attacks on our rights and living standards.

Won’t an increase in the minimum wage just cause prices to rise even more? Don’t we need to keep wages under control to stop inflation rising?

No. Official statistics confirm that over the last three decades wages have failed to keep up with inflation – at least for the big majority of workers. Rather than wage increases pushing up prices, wages have unsuccessfully lagged behind price increases.

Inflation is above all a monetary phenomenon. In the last analysis it is the action of the government and central banks and their impact on money supply levels that determine a currencies real value and the overall price level. There is no automatic ability on the part of business to increase prices when wages (or other costs) increase.

In a competitive market prices are conditioned by the interaction between suppliers and consumers. An obvious alternative to raising prices is for companies to compensate for the wage increase with greater efficiency and productivity. One of the problems of the NZ economy over recent decades has been the relatively low productivity growth as employers have seen no need to invest significantly in new technology when cheap labour was available as an alternative. They could also absorb the rise by reducing their profit margins.

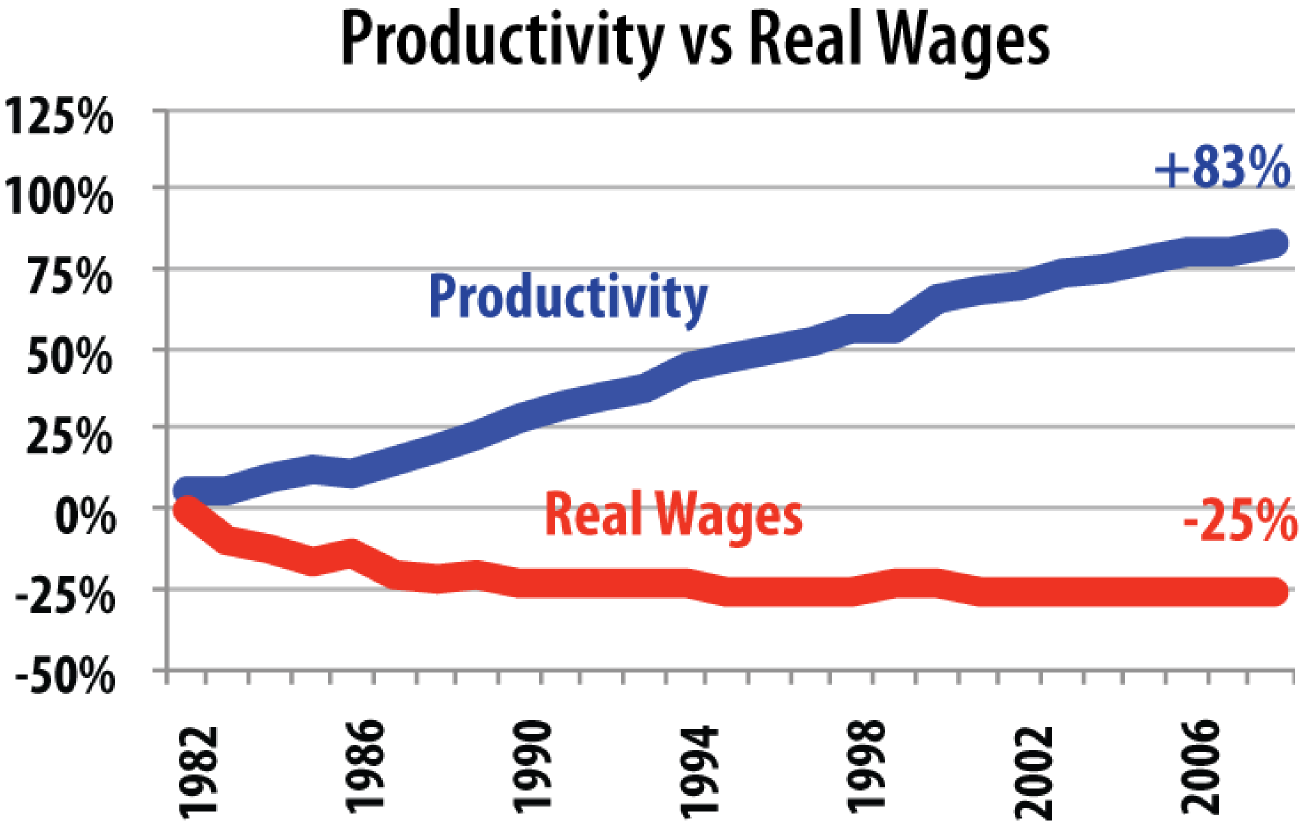
We were also told that if the cake was grown we would all benefit. Higher wages would come with increased productivity. We all heard the argument that a little pain now would mean riches for all to come. Productivity did increase - by 80% between 1978 and 2008.

But after peaking in early 1982, real wages fell by 25% according to the official wage measures collected by the government. So real wages are 25% lower but our output is 80% higher. Any benefits stayed stubbornly at the top. The “trickle down” theory that if we make some very rich we will all eventually benefit proved to be a lie. (See Graph 1)

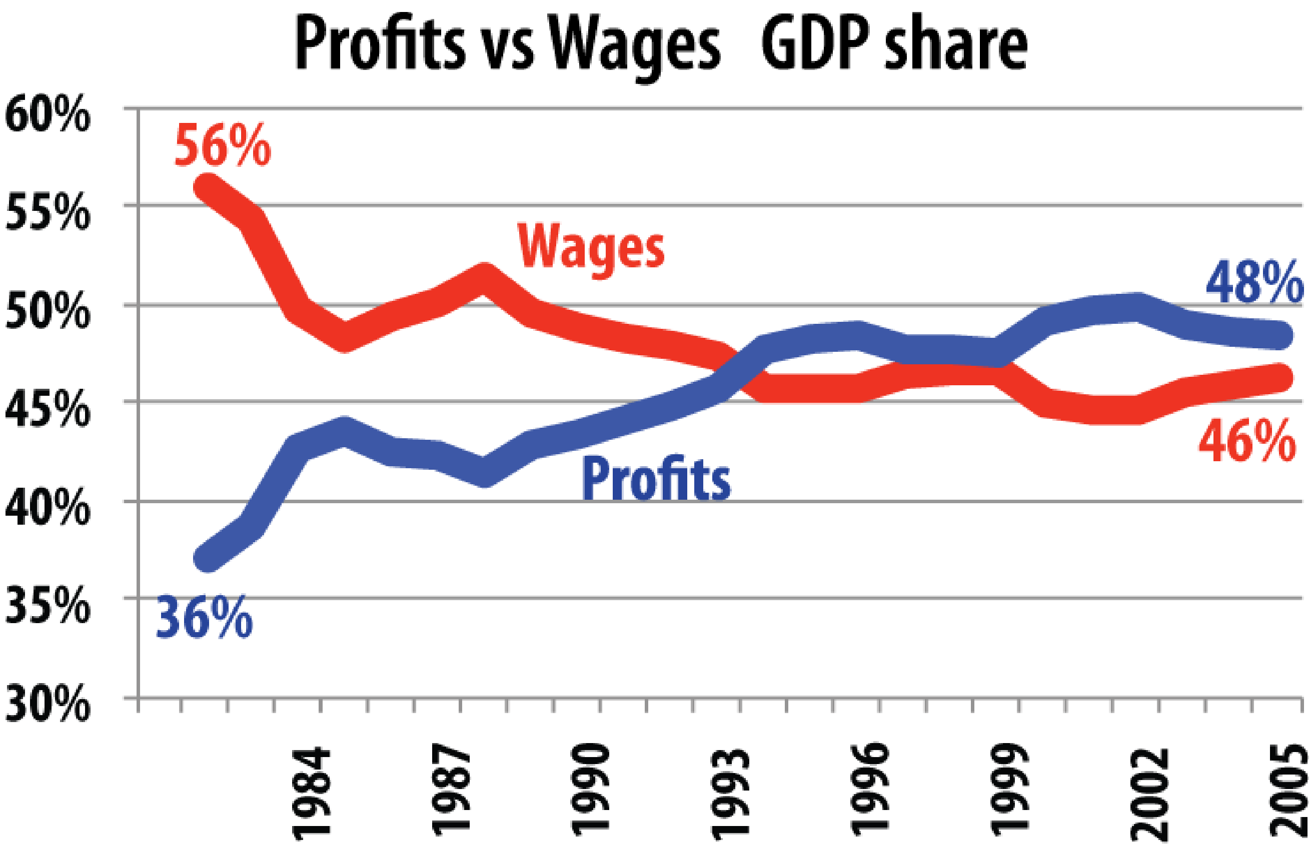
The shift in income from wages to profits is recorded in official statistics that measure the share of wages and profits in the economy. The period from the mid 80s to mid 90s saw a 10% drop in the share of GDP measured as “compensation of employees”. There was a corresponding rise in the proportion measured as “gross operating surplus”, that is profits and interest. (See Graph 2)

In today’s dollars that equals $18 billion from the pockets of workers to the coffers of capital. That in turn has been shared among the very rich shareholders and senior executives and is the ultimate source of the gross increase in salaries other benefits of this layer in recent years.

Graph 1



Graph 2



Won't wage rises higher than inflation just cause unemployment to rise? What about John Key's claim that an increase in the minimum wage to $15 will cause 8000 jobs to be lost?

No. There is no evidence that can connect rises in the minimum wage with increases in unemployment. In fact the opposite appears to be the case.

The figure for the alleged loss of jobs comes from the government's advisors in the Labour Department. They claimed an increase to $15 now would lead to the loss of between 5,000 and 8000 jobs. With a labour force of 2.1 million jobs this is actually margin of error stuff. However let's take a closer look.

For decades the right wing economists have argued that any increase in the minimum wage would lead to an increase in unemployment. The Act Party opposes any minimum wage at all. In the 2025 Task Force on closing the gaps with Australia former National Party leader and Reserve Bank Governor Don Brash argued for the reintroduction of a lower youth minimum wage with the claim it would help combat the increase in youth unemployment.

The Labour Department concedes that their estimates of up to 8000 job losses if the minimum wage was increased immediately to $15 was based on these economic theories in the following comment from its "Regulatory Impact Statement" on the minimum wage:

"The estimates of constraint on job growth are based on a neo-classical model of firm decision-making, whereby firms operating in perfectly competitive markets adjust output and inputs, including labour, in response to relative prices. This modelling approach does not adequately reflect the dynamic nature of employment responses to changes in minimum wages, and, in particular, any investments that employers may make to increase the productivity of low paid workers. One consideration for the impact on the demand for low wage workers is how minimum wages change relative to average wages. If minimum wages keep pace with average wages then we would expect to see little change in the relative demand for low wage workers or low wage jobs."

Instead of using a model for an economy that does not exist, we can use the actual changes that have occurred in New Zealand.

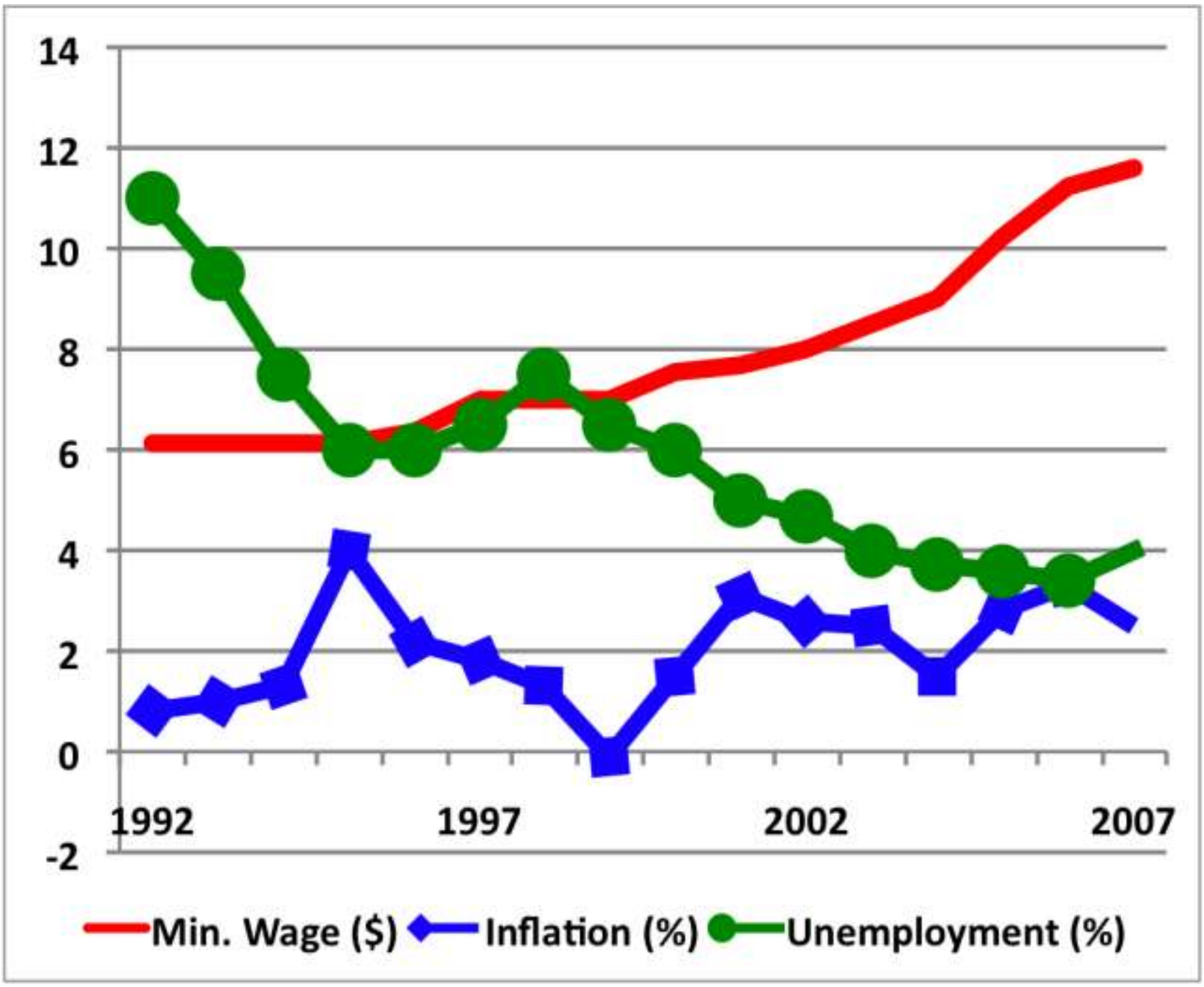
What was the actual impact of changes to the minimum wage on employment in New Zealand over the last decade? Is there any evidence it lead to higher unemployment?

Increases in the minimum wage were accompanied by growth in total employment and the percentage of the potential workforce employed.

When Labour was elected in 1999 the minimum wage for someone under 20 years of age was $4.20 an hour. The adult rate was $7.00. The previous National government had also believed higher minimum wages were bad for business (or at least their business mates) so had only increased it by only 87 cents an hour during their 9 years in power.

A study by Canadian Labour economist Jim Stanford reveals that "During the 1990s, when the minimum wage was frozen in nominal terms (and declining in real terms), New Zealand's employment performance was hardly outstanding. …... Initially, the employment rate declined (with the recession of the early 1990s). Even during the subsequent economic expansion, however, the employment rate barely exceeded its pre-recession level of around 60% of the working age population. The average employment rate for the decade as a whole was 59%. After 2000, however, when the minimum wage began to increase in real terms, the employment rate also began to increase substantially. It grew from 60% at the outset of the decade to a peak of over 66% by 2009 – before falling off with the global financial crisis and associated recession (See Graph 3). The average employment rate for the decade as a whole was 64%. New Zealand's overall labour market performed much better when minimum wages were being increased in real terms, compared to the preceding decade when they were being decreased in real terms."

Graph 3



What about the argument that a rise in the minimum wage affects the chances of young and inexperienced workers getting into employment?

Again the actual experience of the last few decades offers no evidence to support the view that the increase in the youth minimum wage (which was a significantly greater increase than the adult minimum rise) had an adverse effect on youth employment

During the Labour Government's term the adult minimum wage went from $7 an hour to $12 – an increase of 71%. The youth minimum wage went from $4.20 an hour for everyone from 16-19 years old in 1998 to $9.50 in March 2005 for 18 & 19 year olds and $7.60 for 16 and 17 year olds - an increase of 126% and 81% respectively. The youth rate for 16 and 17 year olds was largely abolished in 2008.

Youth unemployment during that time kept falling until it reached a low of 11.8% in December 2005 - a level not seen since 1987. When Labour lost the election the youth unemployment rate of 17.9% was still below the level when they were elected 9 years before.

A Treasury working paper in 2004 found that a 69 per cent increase in the minimum wage for 18 and 19-year-olds in 2001 and a 41 per cent increase in the minimum wage for 16 and 17-year-olds over a two year period had no adverse effects on youth employment or hours worked. In fact, hours of work increased for 16 and 17-year-olds relative to other age groups. "We find no robust evidence of adverse effects on youth employment or hours worked. In fact, we find stronger evidence of positive employment responses to the changes for both groups of teenagers, and that 16-17 year-olds increased their hours worked by 10-15 percent following the minimum wage changes."

The Labour Department report to the government on the minimum wage also conceded that "Research from overseas suggests that increases in the minimum wage may have a small negative impact on profitability, but find no evidence of it increasing the probability of firm closure."

Youth unemployment has increased significantly over the past year along with the general levels of unemployment. This is a consequence of an international recession that is a product of corporate greed not excessive workers needs. The current youth unemployment rate of around 25% is a terrible blight on our community – but the same level was reached in the recession of the early 1990s when youth rates existed and the minimum wage for adults was much lower in real terms.

The recession from 1987-93 was not as deep as the current one in terms of immediate GDP decline – but it dragged on for years. In this recession employers have frozen new hiring and cut hours for existing staff but hung on to older and more experienced labour in the hope there will be a quick recovery

A blog by Marty G on "The Standard" explained that there has been a longer term trend for youth unemployment to increase as a percentage of the total because of changes to the age structure of the workforce. He writes:

> "15-19 unemployment is always higher than that of other age groups. Yes it has risen more than the unemployment of other age groups but it has risen in proportion with the unemployment of other age groups. If the increase was due to the abolishment of the youth minimum wage then we would expect the increase in 15-19 unemployment to be disproportionate. It hasn't been disproportionate, in has been in proportion. Just like Maori unemployment has risen higher but in proportion with unemployment in other ethnic groups. If the Right genuinely think that abolishing youth rates increased 15-19 unemployment to be consistent they have to claim it also increased Maori unemployment, or find another explanation specific to Maori, or propose a lower minimum wage for Maori, and I don't see them doing any of that.
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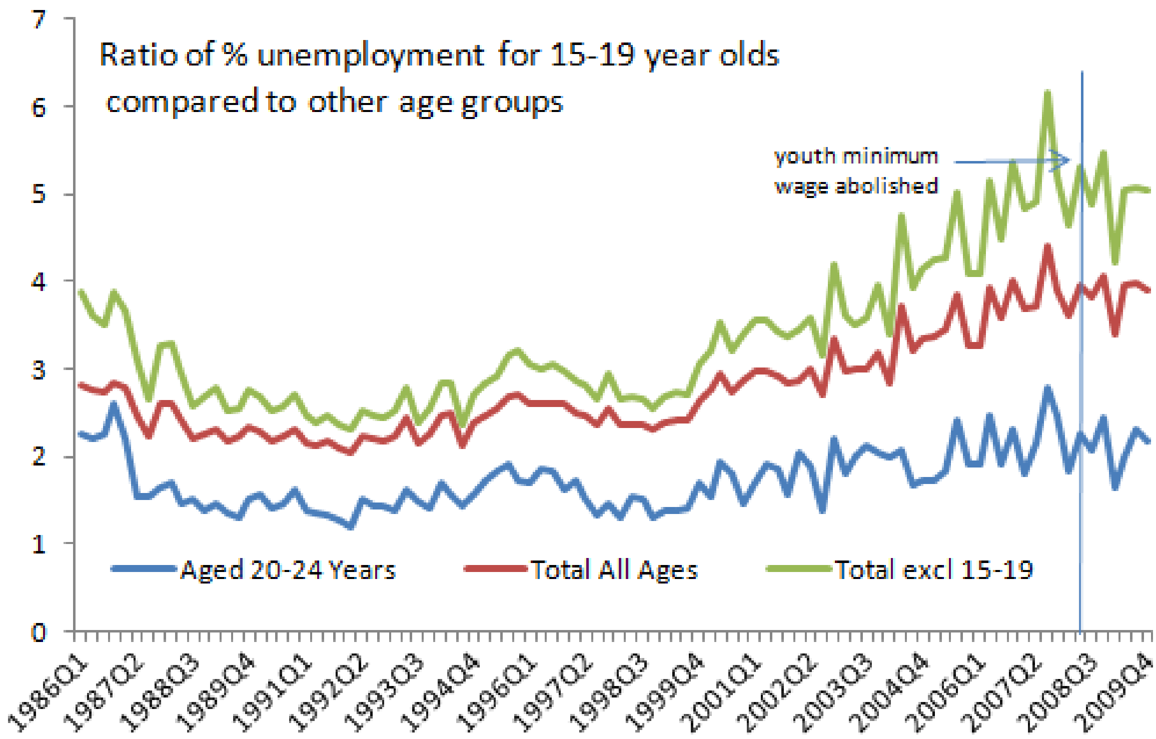
> "Look, I go swimming with a mate sometimes. He's a bit faster than me. He's done 10 laps by the time I've done 8. If we were to do more and he reaches 20 when I'm still at 16 would we say 'Jesus, what happened? How did you beat me by 4 laps when usually you beat me by 2? Did you have some extra weetbix for brekkie?' No. The gap is proportionally the same, it's just we've gone further. Likewise, the unemployment rate for the 15-19 year age group (only 2 years of which was covered by the youth minimum wage, remember) hasn't risen out of proportion to the unemployment rate of other age groups, the gap is bigger because total unemployment is higher [See Graph 4]:

Graph 4



> "There was long-term trend through the 2000s of the ratio of 15-19 unemployment to general unemployment rising (because unemployment between older people was falling more sharply) but there is no change associated with the abolishment of the youth minimum wage on April 1

2008. If the youth minimum wage was causing youth unemployment, the ratios should have jumped. The relationships between 15-19 unemployment and unemployment in other age groups have remained basically the same. They have all risen due to the recession, and they have risen in proportion to each other. No other explanation needs to be made up…. unless of course your real agenda is to undermine the wages of working New Zealanders." http://www.thestandard.org.nz/the-lie-behind-the-rights-attack-on-wages/

What is behind the recent government attacks on welfare recipients? Why did John Key recently say that the unemployed are slackers "who lack the will or desire to work as hard for their living as their fellow New Zealanders."

The goal of the National Government is to shift the blame for the crisis and growth in unemployment onto the victims. As representatives of big business they want us to blame the dole "bludger" or a DPB "cheat" who allegedly doesn't want to work. They want to point the finger of blame away from the responsibility of big business for the crisis.

John Key We wants those of us with a job to look at our brothers and sisters without work as somehow stealing our taxes. That is why the government is introducing time limits on access to the unemployment benefits, forcing sole parents on the domestic purposes benefit to be available for work once their child reaches six years of age, and making it much more difficult to access sickness or invalid benefits.

It was the same trick they tried in the 1990s – unfortunately with some success. This contributed to the inability of the unions and broader labour movement to unite and defend the living standards of the vast majority of working people – employed or unemployed - during the right wing economic and political offensive of the 1980s and 1990s.

What sort of policies did the government adopt in the 1980s and 1990s and how did those policies affect working people?

The economic and social policies adopted in the 80s and 90s included anti-union laws, benefits cuts, reduced access to education, health, housing and other social services and large scale unemployment and poverty. The promised surge in growth and incomes never followed.

The deep attacks on our rights and living standards began under the Rogernomics policies of the Third Labour Government from 1984-1990 (named after the then Minister of Finance, now ACT MP, Roger Douglas). These were guided by rightwing economic theories that promoted so-called free markets and private property above all else. These are commonly referred to as "neoliberal" economic policies.

Financial markets were deregulated, domestic industry protections removed, $10 billion worth of public enterprises like Telecom and the BNZ privatized, progressive income taxes for higher income earners replaced by GST on consumption. Taxes on wealth and property were largely eliminated. All important state sector appointments went to people from the same right wing big business elite – whether in the Treasury or Social Welfare departments. State Owned Enterprises were made to mimic the profit first behavior of their private sector counterparts. The Reserve Bank was freed from democratic controls to impose crippling interest rates. The dollar was floated to allow big business to move their money where and when they liked. The New Zealand dollar became the victim of international speculators who sent it on a roller coaster ride in value as the world's eleventh most traded currency. The Reserve Bank used high exchange rates to squeeze inflation, and squeezed the life out of agricultural and other exporters in the process. The Labour government effectively outlawed strikes outside of the contract negotiation period.

The National government from 1990 to 1999 completed the job. They cut the value of benefits and tightened access rules. The Employment Contracts Act (ECA) launched a full scale attack on worker rights resulting in major losses of pay and conditions in subsequent years. Before the ECA, around 720,000 workers had protection under awards or collective agreements; by 1996 that number had dropped to 350,000. The ECA made multi-employer bargaining illegal and union recruitment very difficult.

The deregulation fervor affected all areas of life. It was claimed it would improve "efficiency" and business was best left to decide its own rules. One result is the multi-billion dollar debt that home owners, councils and the government is landed with as a consequence of the "leaky homes" scandal.

What happened to workers real wages during the 1987-93 recession?

By the mid 90s the crushing of union strength and the emergence of mass unemployment had produced a real wage decline of 25% for the vast majority of working people and real wages have never recovered since.

Wages were measured in NZ by the Nominal Weekly Wage Index (discontinued in March 1987) and the Prevailing Weekly Wage Index (discontinued in June 1993). The nominal index measured rates as set down in awards and agreements and the prevailing index measured wage rates actually being paid. These could vary over time. For instance, actual wages paid in the early and mid 1960s rose above award rates due to labour shortages. The gap was then closed in the late 1960s and early 1970s as workers willingness to struggle in order to improve their living standards increased.

The prevailing index measured wages only from December 1977. Using this index and deflating by the Consumer Price Index gives a real wage series that can be used to monitor changes in workers real incomes. Doing this we find that real wages peaked in the March quarter 1982. From March 1982 to December 1992 the Prevailing Wage Index increased 74.5% while the CPI rose 127.7% - a real wage decline of 23.4%.

The nominal index also peaked in March 1982. Using a base of 1000 in the December quarter 1977 the real wage index (based on the nominal wage index) in March 1982 was 1097. If this is deflated by 23.4% we get a real index of 840. This allows us to do an estimate of where real wages stood in 1992 after this period of decline compared to earlier periods in NZ history since the nominal index goes back to 1914 and a real wage series using the same base exists in official statistics. The real nominal wage index first reached this level in March 1951 at 838 then fluctuated at or slightly below this figure until September 1969 when a period of real wage rises set in. The index first peaked in March 1975 at 1090, declined to 987, and then rose to 1097 in March 1982.

The Labour Cost Index replaced the PWWI in December 1992. Since then the wage and salary index rose from 868 to 1255 in December 2009. That is an increase of 45.6%. During that same period prices increased 46.1% producing a further real wage decline of .5%. What this means is that the real wage decline of the 1980s and early 1990s hasn't been restored since – including the nine years of a Labour government.

We know from experience in the industries the Unite Union represent that real wages have declined much further than that represented by the average ordinary time wage. These industries were hit by the removal of allowances, penal rates for overtime and weekend work, and casualisation of hours. We estimate the real income of housekeeping staff in major hotels is only 60% of what was earned in the 1980s

Why didn't the unions fight to stop these attacks?

Worker ability to resist the attacks on their rights and living standards was hampered by a central union leadership that had been bought off by the government and seemed to fear that the mobilisation of workers power would threaten their privileged positions.

Workers wanted to fight, especially when the ECA was introduced. Calls for a general strike were being made in meetings up and down the country. The Minister of Labour Bill Birch said he expected to have to make a lot of compromises in his draft law to quell the uproar. In the end the top leadership of the Council of Trade Unions squashed all moves for a united fight back. The failure of the union officialdom to lead any resistance resulted in tens of thousands of workers losing faith in unions as effective weapons of struggle.

From 1976 to 1986 there were never fewer than 100,000 workers involved in strike activity in any one year (See Graph 5). Nearly half a million workers were involved in 1979 when the

National Government under Prime Minister Muldoon tried to impose wage controls and was met with a general strike involving 300,000 workers. It is no coincidence that real wages peaked in NZ in early 1982. Numbers on strike halved to 50,000 in 1990 and 1991and halved again in the mid 90s. For 2007, 2008 and 2009 fewer than 5000 workers participated in strike action each year. Without a more generalized resistance there will be little hope of resisting the new demands from the bosses as the current recession continues.

Graph 5

Number of Employees involved in strike action 1951 - 2007

How did people cope with the loss of real wages?

Households made up for the loss in real wages by working more hours (principally by more women and young people) and going into debt.

A report by Simon Collins in the *New Zealand Herald* 25/11/06 found that average family income in 2001 in constant dollars was the same as in 1981 despite the fact that the proportion of women working went from 47% to 61% and the percentage of families working 50+ hours a week went from half to two thirds.

In New Zealand average household debt went from 60% of GDP 15 years ago to 160% today. This is the second most indebted in the OECD. Much of this went into housing with the banks fuelling a housing price bubble as prices doubled since 2000 – the same as they did in the UK and Australia. We were told not to worry. We were encouraged to use our houses as an ATM machine. Average household expenditure exceeded average income on average about 6% for those 15 years but increased to 15% in the mid 2000s. In the 3 decades before 1980 households saved on average about 10% of their income.

What happened to beneficiaries and their levels of support?

In 1991, National savagely cut the rates of all benefits, including the invalids and sickness benefits. The harshest cuts were for the unemployed.

The unemployment benefit was cut by 25% for young people, 20% for young sickness beneficiaries, and 17% for solo parents. They abolished the family benefit and made many workers ineligible for the unemployment benefit with a stand down period of up to a six months. The 1992 benefit cuts were worth approximately $1.3 billion – about the same size of each of the tax cuts handed out in 1996 and 1998. Unemployment benefits were stopped for 16 and 17 year olds and the youth rate for 18 & 19 year olds extended to the age of 25.

Benefits as a percentage of the average wage fell significantly after 1985.The single person unemployment benefit dropped from 42 to 30% of the average wage by 1996. National Super for a married couple went from 85% to 72%. A domestic purposes benefit for a parent with one child went from 80% to 53%. The benefit for an unemployed couple with two children went from 95 to 69% of the average wage. The real value of National Superannuation was cut by 40% when combined with the extension of the age of eligibility from 60 to 65 years between 1992 and 2001 (See Table 1).

Table 1

BENEFITS AS A PERCENTAGE OF THE AVERAGE WAGE

	Single unemployed aged 20+ (%)	Mrd couple on aged benefit/ National Super (%)	Widow/Solo parent + 1 child (%)	Married couple plus 2 children (%)
1960	37.1	65.9	70.0	78.2
1965	35.3	63.9	67.2	73.8
1970	35.3	64.0	64.6	74.0
1975	41.2	68.7	68.7	83.4
1980	37.1	79.1	72.0	87.2
1985	42.4	84.8	79.8	95.2
1990	37.8	75.9	67.2	84.0
1991	32.7	72.5	57.4	73.9
1996	30.2	66.4	52.7	69.3

(1996 FIGURES INCLUDE FAMILY SUPPORT OF $44.50 FOR THE FIRST CHILD AND $29.50 FOR THE SECOND)

How many people became unemployed? Who did it affect?

Official unemployment rates went from less than 4% in 1987 to a peak of 11% in 1993. For Maori and Pacific people official unemployment rates hit 25-30 percent. The numbers forced onto benefits more than doubled.

Nearly every working family was affected in some way. Economist Brian Easton calculated that "In the three and three quarter years from 1988, the equivalent of 43% of the labour force registered with the Department of Labour as unemployed (multiple registrations not included)." Clearly there wasn't a sudden explosion of some mass laziness psychosis that made us all quit our jobs and go on the dole. We had been hit by an economic hurricane imposed on us by a big business elite that controlled both major political parties.

The number of people forced onto benefits exploded in the early 1990s from around 140,000 on all forms of means tested benefits (unemployed, sole parent, Invalids & sickness) in 1985 to 340,000 by the mid 90s (about 13% of the working age population from 16-64). Total numbers remained high until peaking in absolute terms in 1999 with 370,000 on these benefits. Numbers dropped to 260,000 by the end of the 2000s (or 8% of the working age population) with the modest economic recovery. Today the numbers are climbing again as the recession kicks in. At the end of 2009 there were over 315,000 on these benefits - 66,000 on the unemployment benefit, 109,000 on the DBP and 140,000 on either the Sickness or Invalid benefits (9.5% of the working age population).

The extreme policing of access to the unemployment benefit by WINZ in recent years was designed to make the figures look good for the government. The number receiving it dropped to below 20,000 in March 2008. At the same time, according to the Household Labour Force Survey there were a total of 96,000 unemployed.

It is not surprising that during a period when numbers on the unemployment benefit were falling much faster than measured unemployment, the numbers on Sickness and Invalid benefits continued to rise significantly. Among the main drivers of these latter benefits has been the raising of the age for national superannuation, the elimination of the transitional retirement benefit that had been available to older workers from 1994 to 2003, ACC using any pretext to remove anyone from their responsibility (and on to benefits) if they could, and the casualised work environment that has intensified work to the point that few can survive if they have any disability. I have personally witnessed major hotels driving elderly cleaners with years of service out of work because they couldn't keep up with the growing targets they were required to meet.

The official unemployment figure is itself is a conservative measure. You are only counted as unemployed if in the survey period you didn't work at all – not even one hour, unpaid, in your parents' dairy. You are not counted as unemployed if you are too ill, in training, or had done no more than look in the newspapers for work during the previous month.

There is a broader measure of unemployment called the "Jobless" that is a more accurate measure of actual unemployment in society. This counts the workers who have given up looking for a job, those not working but who hadn't "actively" sought work, and those who are working part time but want more hours. At the end of 2009 this number was over 276,000 or 12% of the workforce. The Jobless number is usually nearly twice the official unemployment figure.

How did the government justify the 1991 benefit cuts? What did the government say about welfare recipients then?

Beneficiaries were demonized to blame the victim not the system for rising unemployment and more people being forced onto some type of benefit to survive. The very existence of the welfare state came under attack.

In the 1990s the then National Social Welfare Minister and later Prime Minister Jenifer Shipley sought to justify benefit cuts by demonising the benefit recipient and blaming them for society's social ills. In 1992 she wrote: "the welfare state itself through its mechanisms, produces young illiterates, juvenile delinquents, alcoholics, substance abusers, drug addicts, and rejected people at an accelerating speed." She counterposed "rampant welfarism" to "individual initiative and effort." In 1996 even the then head of the Social Welfare Department Margaret Bazley linked sole parenting to "at risk" children.

This became a common right-wing theme at the time but was completely without any factual basis. Bazley's own department's research found little evidence that being on welfare was causal of problems for children. Only 6 percent of beneficiaries' children come to the Child Youth and Families Service notice. The report concluded: "The results thus provide no support for stereo-typed notions of the children of beneficiaries as being highly likely to come to the attention of the CYFS. Indeed, the results establish that only a small minority of these children come to notice."

But facts did not deter Bazley and her ilk. The very title of the "Beyond Dependency" conference organised by the Social Welfare Department in 1997 was designed to promote the view that receiving a benefit was some chosen addiction rather than a necessary safety net to protect working people in the face of a ruthless restructuring and rationalisation of business at the expense of our wages and jobs. It aimed to blame the victim not the system which has destroyed so many jobs. Margaret Bazley's contemptuous attitude to the "clients" she supposedly served came through in a revealing interview with her at the time by Gordon Campbell in The Listener. Campbell asked Bazley if welfare "dependency" was caused by the mindset of the poor - or had the numbers risen because economic change has wiped out thousands of low-skilled manufacturing jobs? "Do you think that's it?" she replied. "I don't see it that way. I think that what we are dealing with is the evils of the welfare state." Just like what happened in Russia, she continued, after several generations of communism. Indifference among those who could help, apathy among the downtrodden. "We're seeing the same thing here, with the welfare state."

At the "Beyond Dependency" conference Blazey said 25 percent of children in New Zealand have no parent in paid work, with the figure for Maori children 48 percent and for Pacific Island children 45 percent. This she claimed is causing an intergenerational dependency problem, so now "we have got children whose only fantasy, whose only dream, is life on a benefit." The focus, she said, had to be on "the people who have lost their living skills, they're living in a chaotic state. They don't go to bed at a decent time, they don't get up in the morning, they don't get their kids to school, they don't feed them, they don't give them lunch so those kids are doomed to that same lifestyle." Bazely denied there was a problem of a lack of jobs. "I think the reason that they are not in jobs is not because the jobs aren't there. It's because other people are more attractive to employers." A hint of what Bazley has in mind for beneficiaries was given by those she invited to speak at the conference, including Jean Rogers, representative of the US state of Wisconsin which cuts off benefits for mothers after 12 weeks - before they have finished breast-feeding!

It is doubtful if the National politicians actually believed their own propaganda. They knew they couldn't create the necessary jobs, or make them secure enough, to eliminate unemployment. In fact the free market system they are so attached to needs unemployment to police the employed. *North and South* magazine reported in an election special for the 1999 election that "In a candid, if callous, interview for a recent Canadian television documentary on New Zealand's reforms, Jenny Shipley told interviewer Eric Malling that taxpayers might have to carry the present group of unskilled beneficiaries forever. Malling was incredulous and asked if that meant those people were being written off. Shipley replied: 'You can't change what you can't change, and I think that politicians and the community need to be honest about that. They have had their jobs destroyed, not by governments but by modernisation, by computer technology, by many of the things that have happened in agriculture in New Zealand. And so we must carry them.' She did pledge that the government would try to save the next generation."

Similar completely spurious arguments are being raised today by defenders of lower minimum wages. Business Round Table Chief Executive Roger Kerr quotes Professor Judith Sloan (a "labour economist" and member of the Don Brash-led 2025 Task Force which recommended a cut in the minimum wage for younger people) who wrote: "The causes of unemployment are well understood with labour market inflexibilities and perverse welfare incentives being the main culprits." Kerr then adds in brackets "A growing economy helps, but is a less important factor". Kerr then adds: "Sloan noted that labour and welfare policies can be changed 'unemployment is essentially a political choice.'"

National’s Social Welfare Minister Paula Bennet has resurrected this approach to beneficiaries today. She has appointed a “Welfare Working Group” to advise her on changes to the system. It has former Act president Catherine Isaac on it – who is coincidentally also the wife of Roger Kerr. As Gordon Campbell also notes in his Scoop article: “What also seems extraordinary is that some members of the working group – eg Adrian Roberts and Enid Ratahi Pryor – are also current contractors with Social Welfare. As such, they are involved in business relationships with the same state welfare system whose rules they are being asked to evaluate, with a view to change. How can they help to devise solutions to welfare dependency without being seen to be generating more business for their own enterprises? Answer: they can’t.” One of the two “scientific” advisors appointed to the panel is Peter Saunders a former Director at the right wing Centre for Independent Studies think tank in Sydney. Campbell checked him out and concludes:

> “Saunders, if I can put this succinctly, is a nut job. He writes fiction as well as right wing opinion pieces for the press in Australia and Britain, even though it can be hard to tell the difference. Let’s start with the opinion columns. In 1994, in his review of Charles Murray’s notorious book *The Bell Curve* on the alleged links between race and intelligence, Saunders concluded that social class, not race, was the real determinant of IQ: ‘Britain looks surprisingly like a society divided into classes on the basis of talent.[!] The pattern of social mobility is broadly consistent with what should happen in a perfectly open society with recruitment based solely on intelligence.’ The working class, in other words, are innately more stupid. No wonder more of them end up on welfare. Especially the sole parents.
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> “In this *Sydney Morning Herald* article published last year, Saunders gave passing mention to changes in sexual morality and family norms, before quickly moving on to finger the real culprit for the rise in solo parenting : the welfare system itself. ‘By making sole parenthood more financially viable, [former Australian Prime Minister Gough] Whitlam inevitably also made it more socially acceptable, even attractive, as a lifestyle choice. Today, single parenthood has become “normal”, and a key reason for this is that the welfare state supports, enables and endorses it. In this, as in other areas of welfare, when government pays money to people in need, it inevitably increases the number of needy people. This is the central paradox of the modern welfare state, and it helps to explain why the numbers have risen so dramatically.’
>
> “I’ll spare you the nostalgic praise for Margaret Thatcher, for whom a smitten Mr Saunders continues to hold a serious torch. For an even better sense of this expert that Paula Bennett is urging her working group to consult, we should turn to a novel called *The Versailles Memorandum*, that Saunders published late last year. To put it kindly, the book is a mélange of right wing paranoia, and Islamophobia. It describes itself this way in its publishing blurb: ‘The year is 2046. Across the United States of Europe, millions live under Sharia law in Special Islamic Zones. Four European cities have been contaminated by radioactivity from dirty bombs. In the Middle East, Israel has been incinerated by nuclear war. In the East London Special Islamic Zone, Aisha Sharizi is on the run from the religious police after having an affair with a kuffar boy. In Sydney, the body of a former cabinet minister is fished out of the harbour…’ etc

etc According to an admiring reviewer on Amazon.com, the book is “as important as Ayn Rand’s *Atlas Shrugged* in its warning of the fate that awaits us if we do not act to fight the tide of liberal-left thinking…”

But isn’t it necessary for there to be a big gap between benefit levels and wages to encourage people to get jobs?

This ignores the reality that during the decades of the 1960s and 70s benefits were higher than they are today relative to the average wage, yet the numbers on any sort of benefit other than for old age was tiny.

A Labour Department report notes that “On 31 March 1952, only two people were receiving the Unemployment Benefit, the lowest end-of-year number in the post-war period. The first substantial rise was in 1967/68, when numbers jumped from 230 to 4,424 before dropping in subsequent years. The number jumped again ten years later, rising from 3,651 to 17,497 in 1978. It has risen continuously since (apart from a pause in the mid 1980s) to a peak of 181,236 on 30 June 1993. During the entire period of very low unemployment benefits were significantly higher as a percentage of the average wage than they are today.”

The fact there is no evidence to connect the level of benefits to people’s willingness to work was confirmed in a 1988 study on the DPB by the Social Welfare Department. It noted that numbers on the benefit in New Zealand had risen at a time when its value fell in relation to the average female wage. It also explained that Sweden had the highest proportion of working mothers (86 percent) and also the highest benefit levels. “It appears the Swedish solo mothers do not require a great financial incentive to take up employment, only sufficient reason to do so.” A central difference between Sweden and New Zealand is the broad availability of affordable, quality childcare, which remains a central barrier to sole parents working in New Zealand.

If there was ever a scene which confirmed that there is nothing voluntary about being unemployed it was the sight in January of 2500 workers lining up at dawn for minimum wage jobs on offer at Countdown in Manukau City.

What was the real reason for the leap in the number of people on benefits?

The fundamental, unanswerable fact is that the huge rise in the number of people forced onto a benefit for periods of their working life is because of the inability of the government or their “free market” to create sufficient work. The rise in benefit numbers matches the fall in full-time work available in the economy.

The Household Labour Force Survey began in March 1986. At the time there were 1,370,400 Full Time jobs which equalled 54.2% of the working age population. By the September quarter

1991 here were 1,169,100 full time jobs equal to 44.1% of the working age population. That was a loss equalling 266,440 full time jobs if the percentage of the working age population with full time jobs had been maintained. It is no coincidence that the number of people on benefits went up by a similar amount. It was not until the end of 1999 that full time job numbers surpassed the March 1986 number although it was still only 47.5% of the working age population. In December 2009 it was 1,673,500 or 49.2% - still behind the 1986 percentage by the equivalent of 5% or 168,500 full time jobs.

People don't need the "incentive" of benefit cuts to find work. This is a lie peddled to justify still further attacks on the welfare state. In fact, unemployment rose significantly in the two years immediately following the 1991 cuts as the economy was driven into a deeper recession by the cuts themselves.

We also need to always remember that there is a constant and huge turnover of people on benefits. During the recession of the early 1990s the average time on benefits did increase. But for even a longer-term benefit like the DPB, the increase was from only three years to three years and nine months between 1982 and 1996. 40 percent of people went off the DPB within a year of entry and only 25 percent remained in receipt of a benefit for at least six years. The average time on the unemployment benefit is only a matter of months.

The main victims of a recession are also the main beneficiaries in any economic upturn. The biggest falls in unemployment during the partial job recovery in the mid 1990s was for the longer-term unemployed with those registered two years or more declining by 54 percent between December 93 and late 96. The Maori and Pacific unemployment rates also dropped dramatically during the upturn.

As the upturn continued in the 1990s the number on the Domestic Purposes Benefit also trended down from a high of 115,000 in 1998 to a low of 97,000 in 2008. The growth of DPB numbers during the 1980s and 1990s was a product of fundamental changes in the nature of marriage and the family in New Zealand society. These changes were driven by the growing inability of working men to support a wife and family (even if she worked part time) because of the major decline in male wages and employment during that period. The decline in full time male employment was dramatic – from 901,000 in March 1986 to 748,000 by September 1992. Many of the so-called cheats are really just couples trying to cope with an impossible situation.

It is ironic that because of the introduction of in work tax payments to working single parents and low income families there is little or no savings from a person moving off the DPB and into part time work. Because of this fact even the hard hearted treasury officials advised against the work test regime on sole parents because the costs outweighed the benefits. The *Regulatory Impact Statement* from the Ministry of Social Development that accompanied the proposed welfare changes also conceded: "There is no research currently available which accurately quantifies the size of the behavioural response from these changes in policies. This prevents estimates, with the degree of accuracy required, from being made of the number of people who will move from benefit to work over a year, as a result of the proposed changes."

It remains a scandal that nearly 10 percent of the working age population is directly dependent on a benefit at any one time even if only half of these receive the benefit longer than a year. However, the attempt to shift the blame for this state of affairs onto the victim to justify ever more degrading restrictions must be rejected. With unemployment endemic, cuts to benefits force workers to compete ever harder for the available jobs forcing wages down even further. If the government gets us to look on "solo mums", "dole bludgers", and other receivers of benefits as a pariah "underclass" then they will have succeeded in their goal of breaking down the social solidarity we need to struggle against the social crisis we face.

Why do big business and the government want to cut welfare spending?

Big business wants to cut the costs of welfare for two reasons. Firstly, benefits above the barest minimum are seen as a barrier to lowering wages. The costs of welfare are also seen as a barrier to the government's programme of cutting taxes on business and the rich. Cutting social welfare and cutting taxes for the rich usually go hand in hand.

In 1991 the then Minister of Social Welfare Jenny Shipley blamed "high" benefits for making it difficult to lower wages. Explaining her support for benefit cuts she claimed: "Benefit payments have been high enough compared to wages that for many people there has been little financial encouragement to take on paid work and employers have been unable to attract workers at rates that would maintain the viability of their business." Commenting on what basis the benefit levels were decided she said: "Quite frankly, the research I rely on is the marketplace. If the marketplace cannot pay, there is no such thing as an arbitrary, isolated, adequacy level." The current government is also testing the water to impose time limits on benefits by forcing people to reapply after one year. Business Roundtable chairman Douglas Myers told the HR Nicholls Society in Melbourne in 1992: "The absence of any time-limit on the dole (following which people might be obliged to undertake training or qualify for restricted assistance) reduces the pressure on wages to adjust to competitive pressures."

By targeting the most vulnerable the government hopes to get support for large scale cuts to basic welfare for everyone. They can then use those cuts to finance tax cuts for business and the rich. And they are happy to lie to achieve that goal. John Key claimed in February that the government would save $10 million over their lifetime if 100 sole parent beneficiaries were moved off benefits and into work. In March he upped the ante and claimed that getting 5 percent of DPB recipients (around 2150 sole parents) with a child over six off the benefit would save $200 million. This calculation assumed the full cost of DPB over another 6.5 years on the DPB. This number doesn't actually match time usually spent on the DPB. What he also "forgot" is that nearly exactly the same amount would be spent or lost on Working For Families, In work Tax benefits, child care subsidies, payments from the other parent (which goes to the State) and the like if (as can be assumed) they work 20 or more hours a week. Working for Families alone would cost $170 million over the 6.5 years. That's the way our benefit/wage/tax system is set up. The biggest disincentive to working is the 100% marginal tax rates for income earned by beneficiaries over $80 a week. The proposed increase in this level to $100 (for those on the DPB and invalids benefits only) will do very little remove the real disincentives that exist to working more hours while transitioning off a benefit. This $20 increase is the first increase in the limit in two decades!

People on unemployment and sickness benefits will still only be able to earn $80 a week before their benefits are reduced by 70 cents for every dollar they earn. Promising to allow beneficiaries to earn up to $100 a week before their benefit is affected was one of the only good parts of National's pre-election policy and they have reneged on it. National's 2008 Benefits Policy Backgrounder notes: "After paying tax on their extra income, and losing part of their benefit, beneficiaries can be in a position where they are losing up to 92 cents of every additional dollar they earn. This is a disincentive for people to work even a few hours a week." The law change introduced by National will force sickness and unemployment beneficiaries to do exactly that.

As the economist Susan St John commented when releasing these calculations: "Reminiscent of the welfare attacks of the early 1990s, there is a disturbing lack of empathy for the hardship endured by the people who cannot work or who can only work part-time while on a benefit. Many are sole parents already carrying a huge load of caregiving work, others suffer ill-health that makes them unsuited to full-time or even any work. Then there are the alarming numbers of young people who are now pounding at the doors of tertiary institutes as the job market fails to absorb their growing numbers."

The intrusive and punitive work test regime will set up a costly new layer of bureaucracy to police those forced onto benefits by an economic system that has failed to create enough jobs. Solo mothers on the domestic purposes benefit will be expected to work a minimum 15 hours a week if their child is over the six. For some reason Widows are exempt from this requirement even if they have no dependent children – probably reflecting the governments elitist concept of deserving and undeserving poor. If you husband drops dead you are "deserving" and won't be work tested. If you are abandoned by a violent husband, or get pregnant outside of a good middle class family – you are "undeserving". Sickness beneficiaries will also be assessed for part-time work and required to seek work if deemed able to work at least 15 hours a week. The package also offers case managers a new range of penalties, including cutting payments by 50 percent and suspension of payments in full. The requirement that sickness beneficiaries must present medical certificates at four, eight, thirteen and 52 weeks to verify their condition will impose considerable extra costs on everyone now on a sickness benefit, mindful that a full examination with blood tests can easily cost nearly $100 a time.

How did the tax and benefit changes in the 80s and 90s affect the incomes of wealthy individuals and corporations?

As a result of the changes tax system there was a huge transfer of income and wealth from the poor to the rich under both the Labour and National governments from 1984-1996

The 1984-90 Labour government lowered the top corporate and personal tax rate from 66 cents in the dollar to 33 cents. A regressive consumption tax (GST) of first 10% then 12.5% on all goods and services was imposed which hits working people hardest. In 1981 24% of tax came from indirect sources. By 1991 it was 33%. Tax on business as a percentage of total taxation receipts went from 29.2% of the total in 1971 to 6.6% in 1990/91.

The flattening of tax rates led to a transfer of wealth from middle to high incomes, while the regressive nature of the universal GST redistributed the tax burden to the poor. According to Victoria University lecturer in economics and public policy Rob Stephens, changes in the tax structures between 1982 and 1988 meant that effective average tax rates including GST for couples on average earnings with two dependents increased from 18.7 percent to 24.1 percent. Average tax rates for similar couples on three times the average income declined from 40.3 percent to 34.9 percent.

The promise that wage earners would be compensated for the rise in consumption taxes and user charges by a cut in direct taxes proved to be a lie for most. Between March 1985 and March 1991 the average income tax rate for the bottom 20% of full time wage and salary earners increased from 15.7% to 18.3%, the middle 20% went from 25.1% to 23.6% while the top 20% went from 31.8% to 25%. It seems clear that for the big majority of wage and salary earners the tax changes would have made them worse off.

Economist Brian Easton wrote that the 1988 tax reform reducing the top rate from 48 to 33% resulted in a "substantial increase in the incomes of those on high incomes. Typically those in the top tenth of income recipients were about 25 percent better off." Easton calculated that in 1988 the top 10% of disposable household incomes (adjusted for size of household) averaged twice the average income. In 1991 they averaged 2.5 times the average largely due to the 1988 Douglas tax cuts.

From 1984 to 1998 the top 10% of households increased income by 43% and the bottom 50% of households decreased income by 14%.

A Statistics New Zealand report for the period 1982 to 1996 found that the gulf between rich and poor in New Zealand grew significantly. The wealthiest 10 percent of households increased their share of the country's after-tax income from 20 percent in 1982 to 25 percent in 1996. The middle 70 percent of income earners share dropped from 71 percent to 66 percent. The bottom 20 percent never earned more than 9 percent of total income.

A paper by Paul Dalziel of Lincoln University documents the actual experience in a paper titled: "New Zealand's Economic Reforms: an assessment". The charts below are from that paper. Dalziel wrote:

"There was a substantial shift in New Zealand's income distribution during the reform period. First, the lowest income deciles suffered a large loss of income during the depths of the recession in the early 1990s. The average income of the lowest decile in 1991/92 was 21.6% lower than in 1983/84, and that of the second decile was 10.3% lower. These two groups shared in the post-1991/92 recovery, but by 1995/96 their average incomes were still 8.7% and 4% lower than in 1983/84. Secondly, half of the New Zealand distribution had lower real incomes in 1995/96 than before the start of the reforms, and for 40% of the distribution the loss of income was greater than 3%. These data support reports by a wide variety of community

Table 2

Table 4. Average per capita real income, New Zealand, 1983/84–1995/96

Decile	1983/84, measured in 1995/96 $	1991/92, measured in 1995/96 $	Percentage change from 1983/84	1995/96, measured in 1995/96 $	Percentage change from 1983/84
Lowest	4464	3498	− 21.64	4075	− 8.71
Second	9256	8306	− 10.26	8890	− 3.95
Third	11,869	11,053	− 6.88	11,487	− 3.21
Fourth	14,286	13,457	− 5.81	13,799	− 3.41
Fifth	16,486	15,817	− 4.06	16,397	− 0.54
Sixth	19,273	18,350	− 4.79	19,686	2.14
Seventh	22,976	22,084	− 3.88	24,047	4.66
Eighth	28,181	27,578	− 2.14	30,053	6.65
Ninth	35,193	35,670	1.35	39,253	11.54
Top 10%	55,795	58,784	5.36	70,569	26.48

groups in New Zealand during the 1990s that poverty and social exclusion have caused widespread problems, particularly among low-income households with children (confirmed by Stephens et al., 2000, p. 31). Finally, Table 4 [renamedTable 2 above - ed] shows that large gains were made at the top end of the income distribution during the recovery that peaked in 1995/96. Compared with 1983/84, the average income of the top 10% had increased by more than one-quarter (26.5%).

"Note carefully that this result does not simply say that the income distribution in New Zealand widened during the course of its economic reforms. As is well known, income distribution dispersion is a global phenomenon (see, for example, Dixon, 1998; Easton, 1996). In New Zealand, however, it appears to have been accompanied in the 1980s and 1990s by a significant fall in the absolute amount of real purchasing power by the lowest-income groups. At the beginning of the reform process in New Zealand, a government-sponsored Economic Summit Conference (ESC) agreed unanimously that the costs of economic adjustment 'should not be borne by the relatively disadvantaged', but 'policy should aim to minimise the impact of social and economic dislocations on vulnerable groups and communities' (ESC, 1984, p. 304). The data reveal that these objectives were not achieved." (See Table 2 + 3)

Table 3

Table 2. Share of aggregate income, New Zealand, 1983/84–1995/96

Decile	1983/84 (%)	1991/92 (%)	1995/96 (%)
Lowest 10%	2.05	1.63	1.71
Second	4.25	3.87	3.73
Third	5.45	5.15	4.82
Fourth	6.56	6.27	5.79
Fifth	7.57	7.37	6.88
Sixth	8.85	8.55	8.26
Seventh	10.55	10.29	10.09
Eighth	12.94	12.85	12.61
Ninth	16.16	16.62	16.47
Top 10%	25.62	27.39	29.61
Gini coefficient	0.353	0.382	0.404

We were told the economic changes imposed during the Rogernomics revolution were needed to stop New Zealand slipping behind Australia and other high income countries. What was the actual experience of those years?

Instead of the gap closing with Australia the neoliberal reforms led to a collapse on growth rates, slowing productivity growth, and a widening in the income gap with Australia and other OECD countries

According to NZ herald columnists Brian Gaynor's Blog the most recent data shows "Average weekly earnings have increased by 89% in Australia since mid-1994 and by just 64% in New Zealand. As a result the gap between average earnings in the two countries, in NZ dollar terms, has risen from $233 to $576 per week."

The Dalziel paper also shows that the economic shocks of the period took New Zealand from a situation where the gap in GDP per capita with Australia nearly doubled from 17% in 1984/5 to 31.5% in 1992/93. Since then the gap has continued to widen. He writes:

"Figure 2 [Graph 6 below] presents quarterly index data for Australia's and New Zealand's per capita real GDP (seasonally adjusted) from March 1978 to December 1998, with both series scaled to equal 100 for the calendar year 1978. The graphs show the two economies following a very similar growth path until the end of 1981. The world recession of 1982 then had a larger impact on Australia than New Zealand, but Australia had made up the lost ground by September 1985. New Zealand experienced a temporary two-quarter surge in GDP in 1986 (associated with the introduction of its indirect tax, the Goods & Services Tax, on 1 October); otherwise, the two series are again similar until June 1987, which marks the beginning of a widening divergence between the Australian and the New Zealand data…..

Graph 6

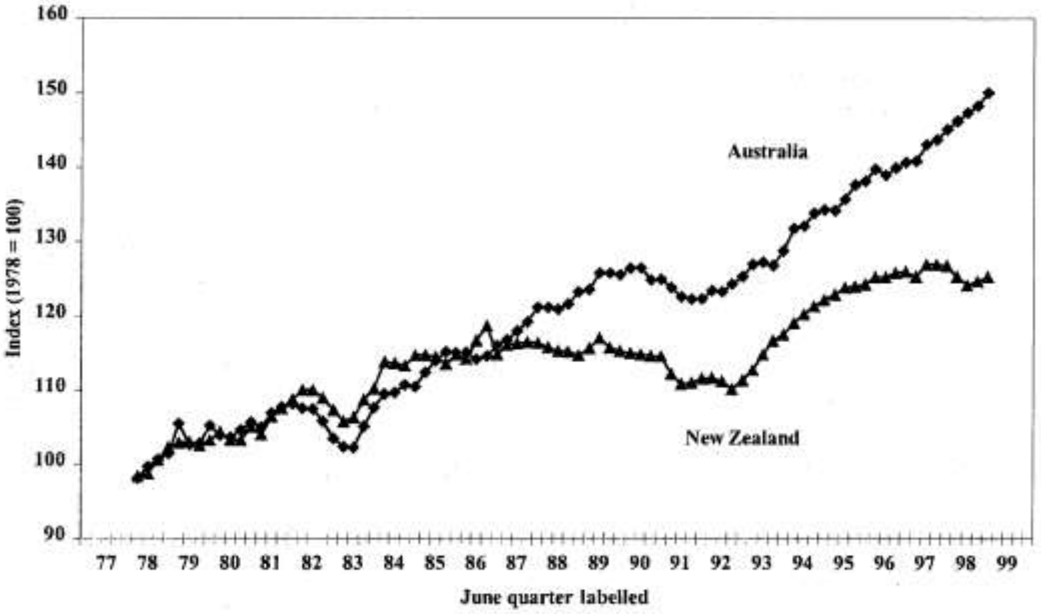


Fig. 2. Per capita real gross GDP (seasonally adjusted), Australia and New Zealand, 1978(1)–1998(4).

"The cumulative effect of this divergence is very large. By 1998, the value of the real output index for Australia in Fig. 2 [Graph 6] was 18.5% higher than that of New Zealand. Since per capita nominal GDP in New Zealand that year was NZ$25,980, this suggests that every New Zealander could have received an extra $4806 in 1998 if their country had continued to grow at the same rate as Australia after June 1987. This is a very large figure, amounting to just over $18 billion in the aggregate. Over the entire 1987–88 period, the sum of the Australia–New Zealand differential equals 1.16 times New Zealand's total per capita GDP in 1998; that is, $30,000 per person or $114 billion in the aggregate. These statistics demonstrate that, compared with Australia, New Zealand sacrificed a large volume of real per capita GDP after 1987." (see Graph 6)
http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan015710.pdf

Dalziel also documents a similar divergence in labour productivity between New Zealand and Australia.

"The most surprising data are in Fig. 7 [Graph 7], which shows real GDP divided by the number of full-time equivalent workers employed, rescaled so that the 1978 calendar year values equal 100. From March 1978 to September 1984, the two series are almost indistinguishable. For the next 4 years, New Zealand's labour productivity index lies below that of Australia (except for the quarters affected by the introduction of the Goods & Services Tax in the middle of 1986), but catches up by the beginning of 1989. The series are then indistinguishable again until December 1990, after which labour productivity growth falls away in New Zealand compared with Australia (especially after December 1991). Over the last 8 years of the sample, the gap increased substantially, so that between 1990 and 1998 workers in Australia increased their productivity by 21.9 percentage points whereas the increase in New Zealand over the same period was only 5.2 percentage points. Figure 7 shows that since 1992 labour productivity growth in New Zealand has been considerably below that of Australia, after similar rates for the previous 14 years." Dalziel concludes with an obvious point: "This observation raises profound questions for New Zealand policy makers about the effectiveness of labour market reforms intended to raise labour productivity." (see Graph 7)

Graph 7

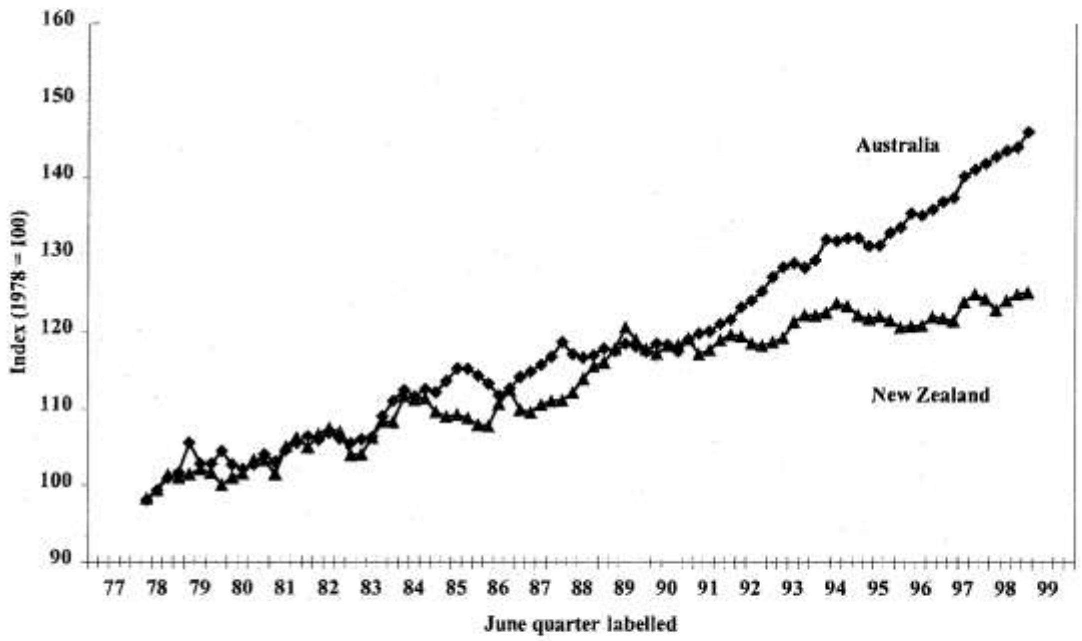


Fig. 7. Labour Productivity, Australia and New Zealand, 1978(1)–1998(4).

Economic historian Brian Easton estimates that New Zealand's GDP per capita as a percentage of the OECD average went from 98% in 1986 to 84% by 1993.

So why did the government and big business carry out such a disastrous programme?

The actual purpose of the "reforms" was to break the back of the workers movement in order to prevent any resistance to an economic and social programme that substantially increased the share of wealth going to the rich. From that viewpoint the reforms were a success.

The real purpose may of course not be the stated purpose. Alan Budd, a former adviser to Britain's Conservative Prime Minister Margaret Thatcher wrote about his role in implementing very similar policies to those in New Zealand: "The nightmare I sometimes have about this whole experience runs as follows: I was involved in making a number of proposals which were partly at least adopted by the government and put into play by the government. My worry is as follows; that there may have been people making the actual policy decisions, or people behind them, or people behind them, who never believed for a moment that this was the correct way to bring down inflation. They did however see that this would be a very good way to raise unemployment. And raising unemployment was an extremely desirable way of reducing the strength of the working classes; if you like, that what was engineered here – in Marxist terms – was a crisis of capitalism which recreated the reserve army of labour." The "reserve army of labour" being a reference to mass unemployment being used as a weapon to break the power of organized workers.

As the billionaire Warren Buffett once quipped: "There's class warfare, all right - but it's my class, the rich class, that's making war, and we're winning." Indeed.

Mr Buffett made the comment in a 2006 New York Times article after discovering that even with his "immense income" from dividends and capital gains, he "paid far, far less as a fraction of his income than the secretaries or the clerks of anyone else in his office ... 'How can this be fair?'"

But Mr Buffet as a money capitalist is governed by the laws of his system to accumulate as much as possible as rapidly as possible. His class ensures the political and state system serves their interests. Therefore the class war will continue – however "unfair" it may be to his sensibilities. As the financial crisis becomes a system crisis for European countries there has been a massive escalation in class war launched against working people in Greece, Romania, Latvia with 10-30% wage cuts and the radical reduction in all forms of social protections. The rest of Europe will likely follow with lesser or greater intensity. But working people will be made to pay the price. The only question is, will this be a one-sided class war of neo-liberal measures by the capitalist class? Or will it be a two-sided class war with the workers fighting back? It is here that the Greek workers and their allies among the working farmers and the urban middle classes are showing the way forward.

Is the productivity gap the only reasons there is such a big wage gap between New Zealand and Australia?

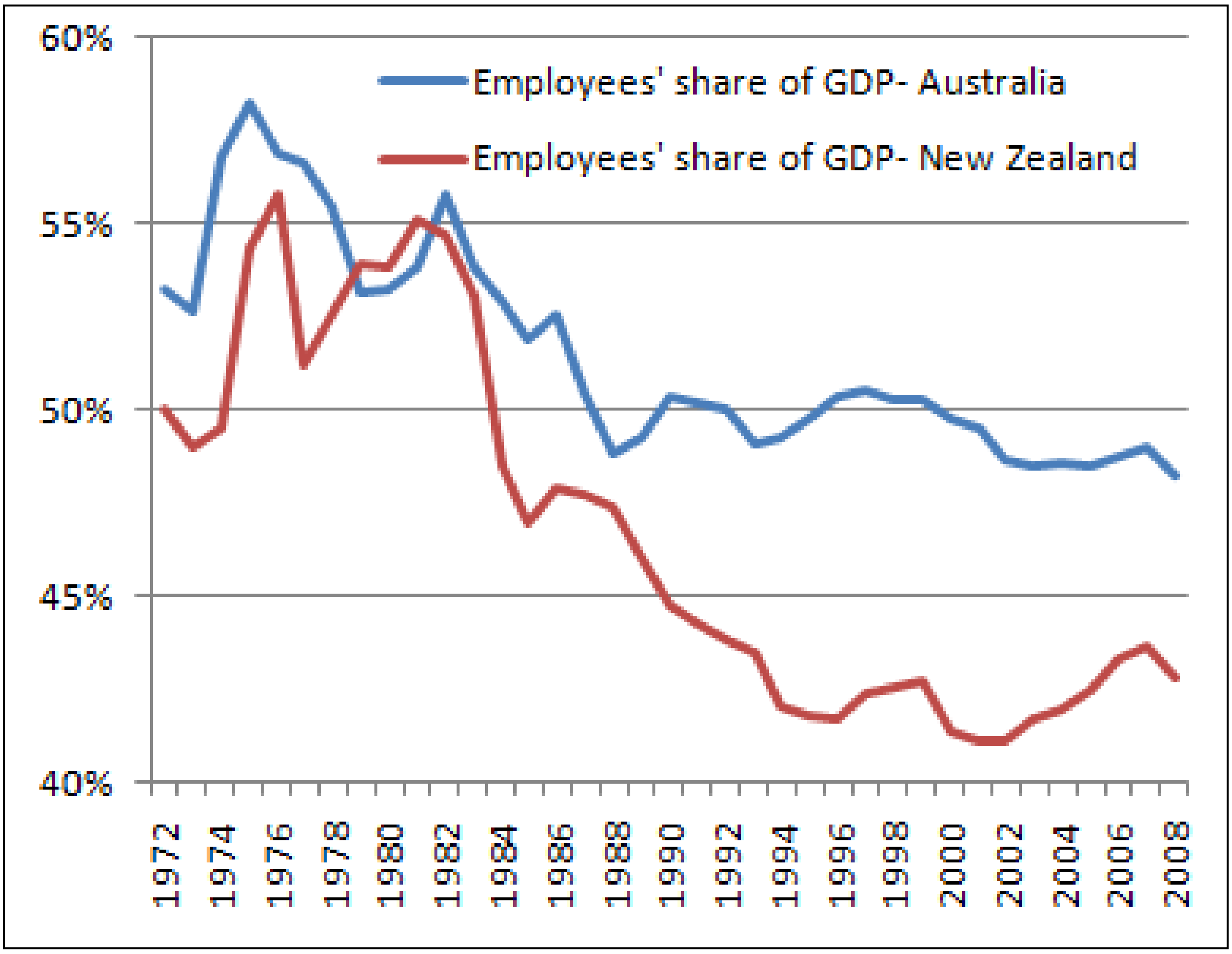
Part of the reason for the wage gap between Australia and New Zealand was the fact the Australian working class and their unions had greater success in resisting the attacks on their wages and therefore their share of national income

According to another article by Marty G on the blog "The Standard" much of the difference in wages with Australia is accounted for the larger decline in New Zealand in share of GDP going to workers (See Graph 8). In my view that is accounted for by the greater strength on unions in

Australia and their ability to resist the attacks on their wages and living standards over recent decades. Marty G wrote

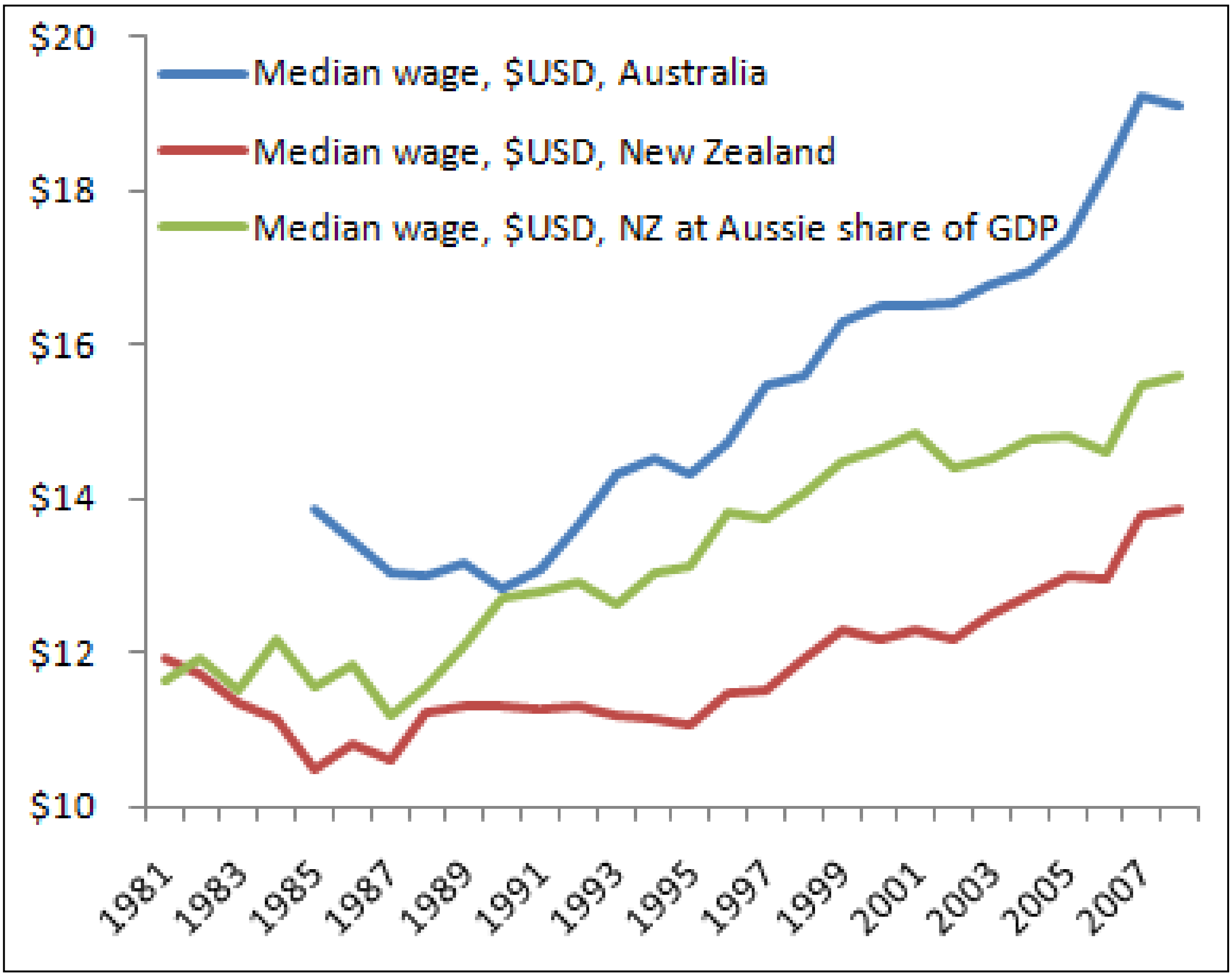
> "30 years ago, according to John Key," wages in Australia and New Zealand were the same. Since then New Zealand wages have stagnated and Australian wages haven grown away from us to the point where they are nearly 40% higher.
>
> "The conventional wisdom is that this is due to faster economic growth in Australia, driven by higher labour productivity. But that's only part of the story.
>
> "The gap grew as Kiwi workers' share of GDP fell, and the share going on business profits grew, much more than what happened in Australia. This is due to policy changes in the 1980s and 1990s that advantaged business and weakened workers' bargaining power.

Graph 8



> "What if Kiwis workers had been allowed to keep the same share of the economic pie as workers in Australia have. What if the rightwing neoliberal revolution hadn't set out to purposely hold down wages and we had followed Aussie's path instead?
>
> "About half the wage gap would disappear if Kiwi workers had the same share of GDP as Aussie ones do. If Key really wants to close the wage gap, he should imitate Australia – better workers' rights and a higher minimum wage. Unfortunately, National seems determined to head in the other direction. Why anyone believes we will catch Australia by doing the opposite of what they are doing, I don't know." (see Graph 9)
> *http://www.thestandard.org.nz/fair-share-for-workers-best-way-to-close-gap-with-aussie/*

Graph 9

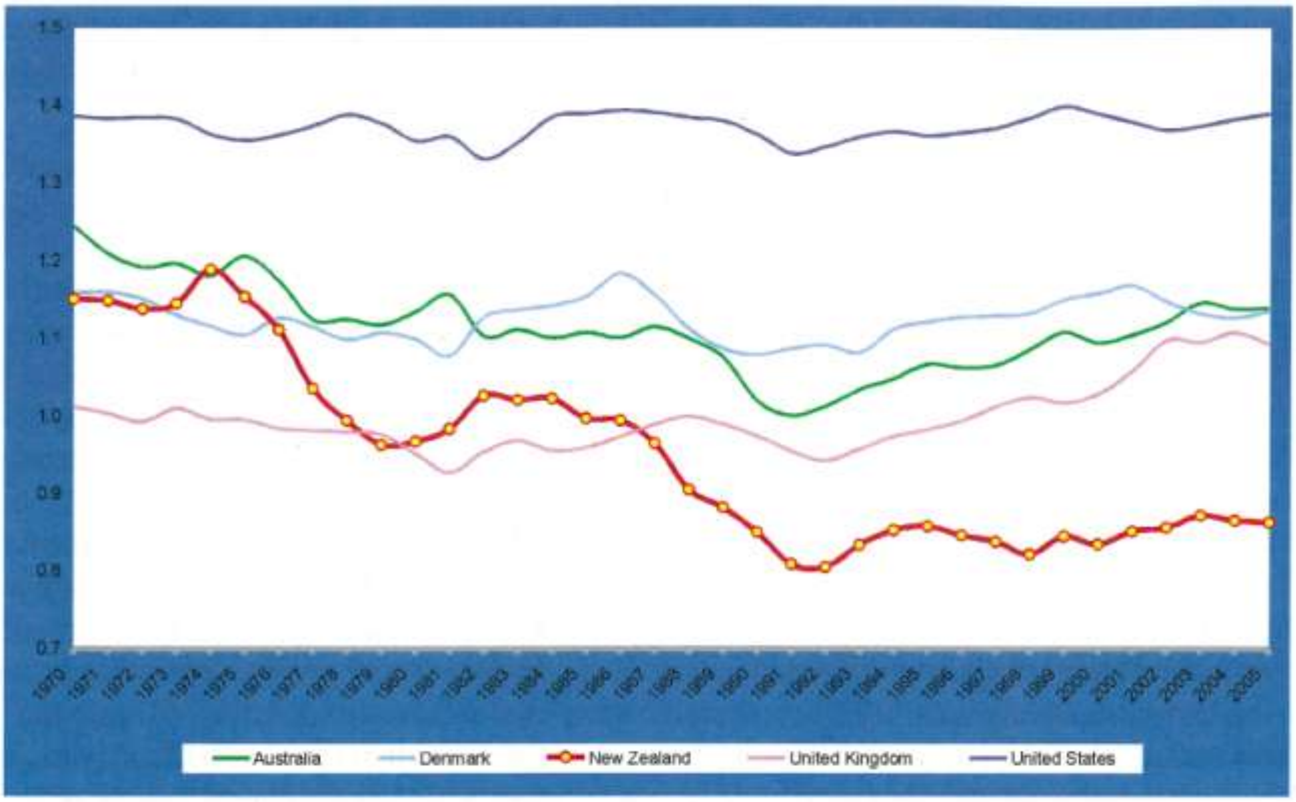


One of the other claims made by the right wing economists in the 1980s was that New Zealand needed the type of neoliberal reforms they advocated because the economy was performing poorly and deeply in debt. How have the changes made affected New Zealand's economic position internationally?

The changes have actually left the economy more deeply in debt than ever before. The only change is that the overseas debt is "private" rather than held by the government under a controlled currency and exchange rate system. But in the end working people will be paying the bill.

This question is dealt with very well in the CTU Alternative Economic Strategy which explained that the reforms were "unsuccessful even in neoliberal terms". In terms of national output per person (GDP per capita) "New Zealand has steadily fallen further behind in its OECD rankings". (See Graph 10)

Graph 10



Real GDP per capita as ratio of OECD average

The CTU paper does note one “success” – attracting foreign investment. New Zealand “now has one of the highest concentrations of foreign direct investment (investment where control of the company is intended) in the developed world, equivalent in 2008 to 42 percent of GDP compared to an average of 25 percent in the other developed economies and the world as a whole. …. But the direct investment into New Zealand has been of low quality, usually in the form of takeovers rather than new ‘greenfield’ investment introducing new technology and creating employment.”

In the decade 1986 to 96 almost half of the foreign direct investment was associated with the sale of privatized state assets. From the late 1990s it has been associated with Private Equity and investment company buyouts “with many of them quickly resold in highly indebted conditions.” Even the cheerleaders of foreign investment in the Treasury felt compelled to acknowledge in a 2008 paper that “some analysts argue that New Zealand receives substantial foreign direct investment inflows but has yet to benefit from spillovers [of expertise and new technology into the rest of the economy]”

The CTU paper also notes that “Another part of the overseas investment has been the exceptionally high levels of international debt. The cost of paying the dividends and interest on those debt and equity investment liabilities has given us one of the highest current account deficits in the OECD…..About one dollar in five from exports of goods and services goes on servicing liabilities: the financial debt alone ($256 billion at March 2009) would take four and a half years to pay off. Bank debt accounts for over 70 percent of the international debt, and has been used largely to finance mortgages, contributing to the property price bubble of recent years and encouraging excessive investment in property compared to productive investment by firms. Related to this, and a direct result of the opening of capital markets is the exchange rate which is chronically over-valued as far as the balance of trade is concerned, burning off exporters through both the high value of the New Zealand dollar and its volatility. The dollar – the 11th most traded currency in the world in April 2007 according to the Bank of International Settlements – is largely driven by international capital movements rather than the 'real economy' of goods and services trade."

The end result is that New Zealand now has a much larger overseas debt and servicing costs than existed before the economic "reforms". The economy has also suffered from the decimation of manufacturing and other productive sectors to be replaced by low wage service jobs.

New Zealand Herald columnist Brian Fallow pointed to the dangers of the high debt in a column on April 1:

> We are up to our chins in debt to the rest of the world and this, the International Monetary Fund warns, remains a key area of vulnerability for the economy.
>
> Net foreign liabilities at the end of 2009 were $167 billion, equivalent to 90 per cent of the economy's output last year.
>
> The increase in the external debt mirrors a big increase in household debt - a legacy of the last boom.
>
> Whether a wariness of debt will be an enduring legacy of the recession that followed remains to be seen.
>
> Right now, at least, households are decidedly debt-averse and businesses even more so.
>
> Reserve Bank data out on Tuesday showed business sector debt in February was nearly 8 per cent lower than a year earlier.
>
> Households, which find it harder to shed debt than businesses do, had increased their debt levels by just 2.7 per cent over the year ended February, and the annual increase has been no higher than that at any stage in the past year. Consumer debt is down 4 per cent on a year ago.
>
> All this is despite the fact that interest rates are at cyclical lows.
>
> ANZ says the effective mortgage rate - the average rate people are paying on their home loans - is 6.7 per cent, down from 8.8 per cent at the peak in September 2008.
>
> Floating mortgage rates are around 5.85 per cent, compared with an average 8.2 per cent since 1999.
>
> BNZ estimates debt servicing costs are running below 10 per cent of household disposable income, from a high of nearly 14 per cent two years ago. (If this looks low, remember most households have either paid off the mortgage or are renting).

Enjoy it while it lasts. The Reserve Bank expects to start raising the official cash rate "around the middle of the year".

It does not expect it will have to push it as high in this cycle as it did in the last one - an eye-watering 8.25 per cent. But the reasons for that carry little joy for borrowers.

One is that wholesale interest rates now incorporate a much wider risk margin than in the lax years before the crisis. This is expected to persist.

It means a higher cost of funds for the banks, and higher lending rates for borrowers, for any given level of the OCR.

The other factor is that the wholesale yield curve is positive again - that is, longer-term interest rates are higher than short-term ones. As deputy governor Grant Spencer put it last week, "borrowers have nowhere to hide".

Borrowers have piled into floating rates or short-term fixed ones, so a higher OCR will bite harder and sooner.

By contrast, during the boom borrowers could effectively dodge, or at least delay, the impact of ever-higher official cash rates by taking cheaper longer-term fixed-rate mortgages.

This imparted what Governor Alan Bollard called a "sponginess" to the monetary policy brakes to the extent that he had to just about stand on the brake pedal for years, with serious spillover effects on the productive sectors of the economy, before it had the desired impact in the mortgage belt.

A key factor in avoiding another destructive housing boom, of the kind which seems to be emerging across the Tasman, is whether people's expectations of house-price inflation (or capital gains as we prefer to think of it) come down.

They ought to. It is fantasy to imagine double-digit annual rises in house prices can be sustained indefinitely when the incomes out of which mortgages and rents are paid increase much more slowly than that.

The effective real interest rates that apply in the housing market are nominal mortgage rates deflated not by the consumers price index but by expected house-price inflation. The higher the latter is, the more attractive any given nominal mortgage rate is.

So more realistic expectations of house-price rises should mean monetary policy does not have to work as hard, and less pressure on the cost of capital for businesses.

Right now sentiment in the housing market is on the grim side. Having more people out of work than at any time in the past 16 years does not help, but perhaps the bigger factor is nervousness and uncertainty about tax change in next month's Budget.

The changes are expected to reduce both the incentive for people to shelter taxable income in rental property investments and the ease with which they can do so.

How much and for how long that weighs on house prices generally remains to be seen.

Meanwhile, business borrowing is likely to recover with the economy.

After contracting for five straight quarters, business investment in plant and machinery rose in the December 2009 quarter with imports of capital goods.

They need to. Much of the productivity and income gap with Australia is explained by capital shallowness - significantly lower levels of physical capital employed per worker.

What then of the third component of national savings, the Government?

Next month's Budget might paint a slightly rosier picture, but the half-year fiscal update delivered last December projected another six years of fiscal deficits, pushing the Government's net debt from just 6 per cent of GDP in 2008 to 30 per cent in 2016 before it starts trending town again.

On its own that is not a scary number. Net debt was that high as recently as 1998 and 30 per cent is downright modest compared with where many advanced economies' governments are heading.

But it cannot be looked at in isolation and when set alongside the parlous state of the external accounts it does not present a reassuring picture.

Net external debt of 90 per cent of GDP is conspicuously high by international standards. We have got away with it so far in part because almost all of it is private-sector obligations, much of it held by the banks and backed by vanilla mortgages.

But with the Government having switched from saving to debt accumulation, and with household savings rates still negative, the increase in Crown debt will have to be funded by foreign savers.

Competition for their funds will be fierce, from larger governments with bigger deficits to finance and higher credit ratings, and increasingly from corporate borrowers as the world recovery gathers momentum.

Bond yields are bound to rise and the combination of mounting debt and higher interest rates will pre-empt a growing share of future tax revenues.

The current account deficit is a measure of the extent to which national savings fall short of funding investment spending within the economy. For 2009 it was $5.5 billion or 2.9 per cent of GDP, or 3.8 per cent if you ignore the impact of Australian-owned banks losing a tax case.

That could well be as small as it gets. The IMF expects it to be back at 8 per cent of GDP by 2015, heaping ever more debt on the mountainous - nay, alpine - pile already there.

The liberalisation on financial markets was also meant to make the raising of capital for business easier and cheaper. What was the result?

The raising of capital was made easier and cheaper – but the small investors who handed over their life savings to the new financial speculators were wiped out twice – in 1987 and again in 2006

The first round of liberalisation resulted in a financial boom and collapse in the period 1984-87. This saw tens of thousands of small investors lose their life savings. Financial companies were exposed as little more than Ponzi schemes using new borrowings to repay old debt and claming false profits. Amazingly nothing was done to regulate this market until we had the experience repeated with the wave of financial company collapses that began in 2006. This has led to billions of dollars being wiped out in value. Again small savers who invested their life savings with the best and brightest of the financial world have been wiped out. The fund owners and managers have been largely protected with few prosecutions and their own fortunes protected behind the ubiquitous family trusts.

New Zealand Herald columnist Brian Gaynor summed up the experience in a March 6 article:

> Investors were presented with positive financial accounts, consistent with our accounting standards, which encouraged them to invest in finance companies that were only able to repay investors if they attracted new borrowings when borrowers defaulted.
>
> The Companies Office, Securities Commission, accounting profession and independent directors were asleep at the wheel as many investors lost a major percentage of their life savings.
>
> Owners of these finance companies, particularly Mark Hotchin and Eric Watson, are still issuing woefully inadequate investment statements and prospectuses as they continue to borrow money from the public.
>
> Why are these businessmen still able to raise money from the public without fully disclosing their involvement in failed companies?
>
> Ponzi schemes are an investment proposition whereby the promoters announce unrealistic returns and repay loans, or interest on these loans, from contributions made by new investors.
>
> Many of our property-related finance companies involved interest on loans being capitalised and this interest was only received by the finance company when loan principals were repaid.
>
> Take, for example, a finance company with $500 million of interest capitalised loans to property developers and $500 million of debenture borrowings from the public at an average interest rate of 8.5 per cent a year.
>
> This finance company has to pay annual interest of $42.5 million on these debentures yet it may receive no interest on its property development loans unless they are repaid, which is often not the case.
>
> Thus, in this simple example, the finance company would have an annual cash deficit of $42.5 million and interest on debentures, plus any redemptions, could only be paid out of funds contributed by new investors.
>
> This large cash deficit was concealed by accounting policies that allowed companies to accrue, or take into account, interest over the duration of a loan rather than when interest was paid. Thus finance companies would show that they had received interest when they hadn't and reported a profit even though they had a substantial cash deficit from operating activities.
>
> To make matters worse, dividends were then declared out of these non-cash profits and paid out of newly acquired debenture funds.
>
> Thus the interest on debentures, the repayment of debentures and the dividends paid to the owners of these finance companies were all sourced from new debenture money.
>
> This result, while unintended, has the same effect as a Ponzi scheme, and Ponzi schemes are quickly shut down by most competent regulators around the world.

> In addition, it appears that a number of owners of finance companies sold properties to developers at vastly inflated prices and these purchases were 100 per cent funded by a finance company owned by the vendors.
>
> In other words, investors in property-related finance companies were like lambs to the slaughter. They didn't have a chance, particularly when the property development market collapsed and most developers couldn't repay their loans or the capitalised interest on these loans.

The Listener reported April 3 that "According to a tally kept by business journalist Bernard Hickey….48 finance companies with a total of $6 billion in investor funds have failed since the first, National Finance, went under in May 2006. Judging by the estimated returns from receiverships and moratoria, he estimates $3 billion of that money will never be recovered by investors.

"Hickey thinks 100,000 people have been directly affected by the finance company scandal – 'people who have lost money, or whose parents have lost money'." As one observer commented to the listener: "Ma and pa investors have been skinned alive."

It reminds me of the joke "the best way to rob a bank is to own one". Except in this case the people robbed were small investors and their life savings – often retired with no way of recovering from the disaster.

Among the solutions to the economic problems we have today are those tried last time – higher GST and cuts to the top marginal tax rate. What will be the effect today?

The effect of these changes will be the same as last time – increased taxation on working people, less tax on the rich, and a growth in inequality and poverty.

We are being told that reducing the top tax rates and increasing GST will again be beneficial to "the economy". If it didn't work last time why should we expect it to this time?

Working people pay their taxes from their wages before they see it. They also pay GST, petrol taxes, user charges and the various sin taxes for liking alcohol or tobacco. All these taxes (whatever the alleged benefits on our health or the environment) are grossly unfair as they take a much larger proportion of our incomes than the rich. We never have a choice.

The bosses however treat taxation as some sort of voluntary activity. They look on the government as some charity to which they may donate if they feel motivated. They don't like taxes and as often as not avoid paying them.

Only about half of a sample of 100 of the wealthiest people in New Zealand pay the top marginal tax rate on their income, according to The Tax Working Group report in January

2010. “These taxpayers are not necessarily doing anything wrong but are merely taking advantage of the opportunities offered by the current system to shelter income from higher rates,” the group's report said. “This calls into question the integrity and fairness of the system," the report said. According to Mark Weldon from the New Zealand Stock Exchange Association who sat on the Tax Working Group, these wealthy tax avoiders include “some on the government’s own Tax Working Group.” Rather than calling for stricter policies and making people pay the tax they should, the Tax Working Group proposed to reduce the top marginal rate and so legitimise their avoidance.

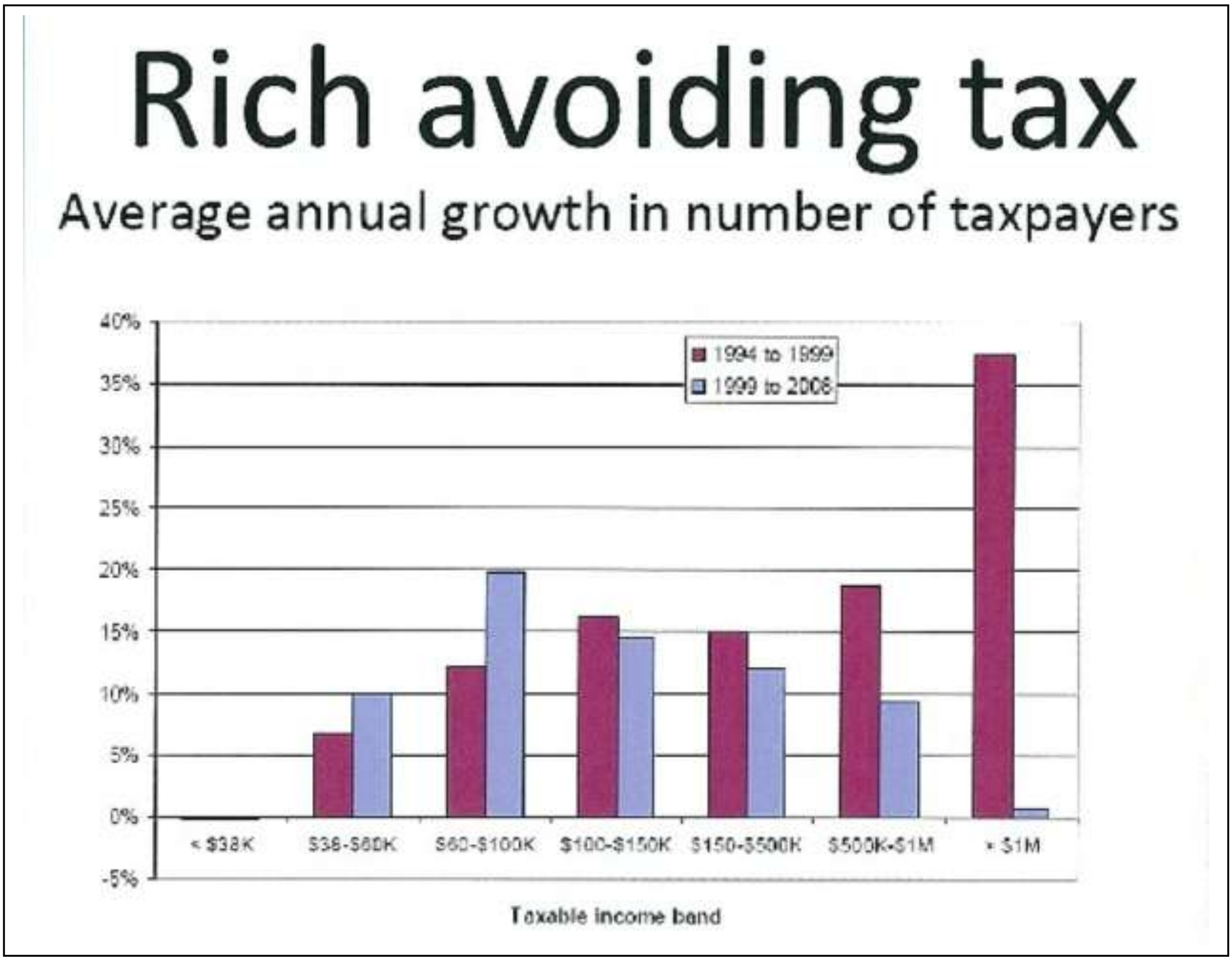
All the main banks this year had to agree to pay billions of dollars in back taxes for years of avoidance. According to their own internal emails they simply chose how much they paid using complex financial arrangements according to what they thought they could get away with politically. Shareholders of companies don’t have to pay full taxes on dividend income. If the company pays company tax on their profits, then for New Zealand shareholders this is treated as them paying tax on their income. So if the company pays a 30% tax on their profit, and if the wealthy individual pays the current top marginal rate of 38%, then they only have to pay 8% on their dividends. This little trick for the wealthy is only allowed in Australia and New Zealand.

Despite the cuts to top tax personal and company tax rates an IRD survey in the mid 1990s of 500 publicly listed companies found 35% paid no tax. The same study found tax avoidance had increased by 40% in the past decade. It seems rather than reducing avoidance the big cuts to the top marginal tax rates only increased the appetite for the rich to avoid taxes.

There is also an almost complete absence of capital gains taxes in New Zealand. Capital gains are a major part of the income of the wealthiest people. A recent report from the Inland Revenue Service in the United States for example found that the 400 best-off taxpayers paid an average tax rate of 16.6%, lower than in any year since the IRS began making the reports in 1992. To make the top 400, a taxpayer had to have income of more than $138.8 million. As a group, the top 400 reported $137.9 billion in income, and paid $22.9 billion in federal income taxes. About 81.3% of the income of the top 400 households came in the form of capital gains, dividends or interest, the IRS data show. Only 6.5% came in the form of salaries and wages.

There are no proposals for any wealth taxes to get the super rich to pay a fairer share of the tax burden. The only proposals are to increase that burden on working people. The graphs below from the Tax Working Group report were used by financial consultant Bernard Hickey as part of a presentation he did early in 2010. The first shows that the number of people who declared an income of a million dollars or more increased by around 37 percent in the five years 1994 to 1999. The increase dropped to almost zero for the nine years to 2008 after the top marginal tax rate was increased to 38 cents after Labour was elected in 1999. His headline summed it up “Rich avoiding tax.” (See Graph 11)

Graph 11

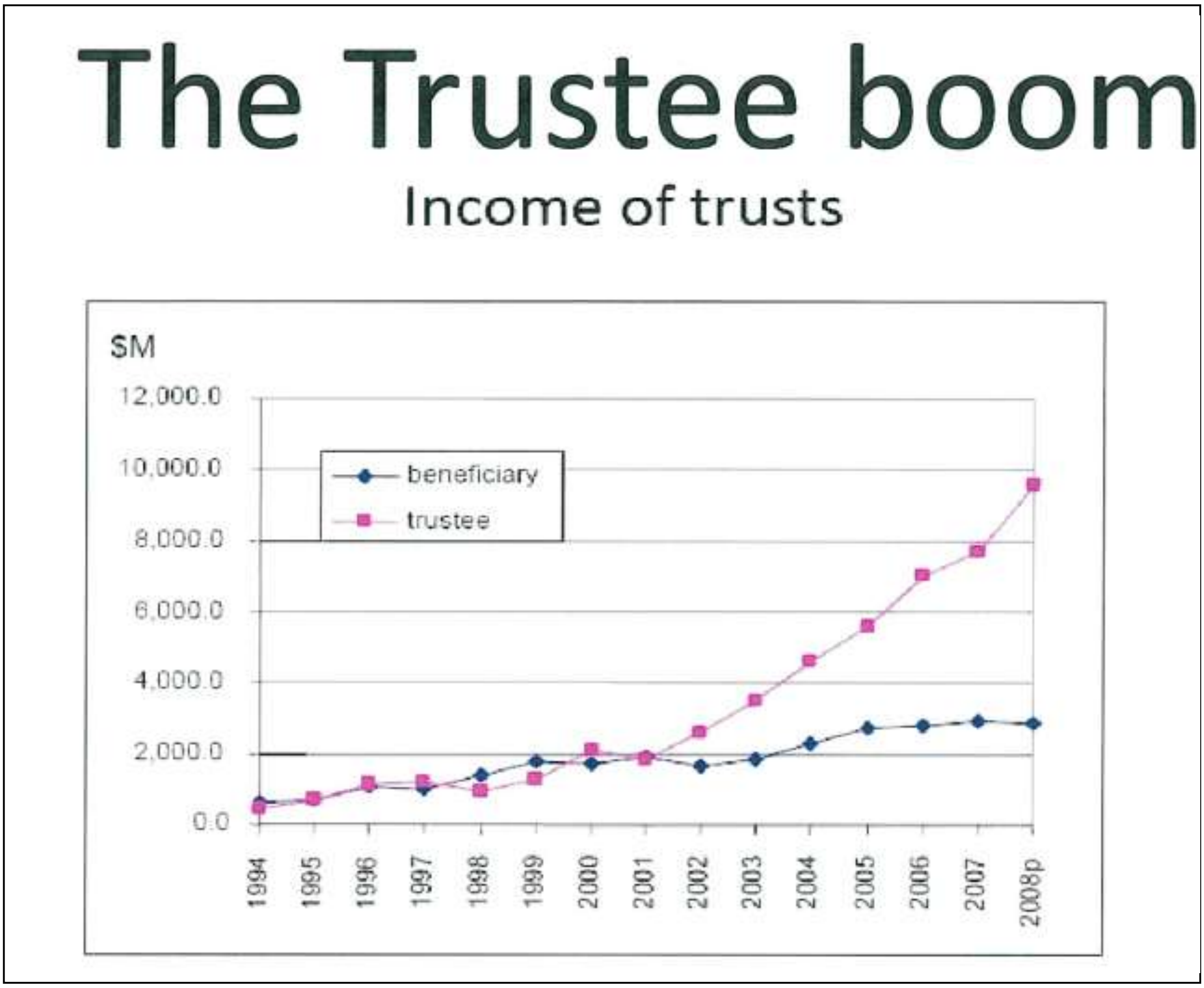


The second graph headed "The Trustee Boom" shows how there was an explosion in the use of trusts which have a 33 cent tax rate to avoid higher marginal income tax rates. Trustee income increased fivefold from around $2 billion to $10 billion while the beneficiary income stayed static. The Treasurer Bill English used a so-called family trust to own his Wellington home and then rent it to him with the government picking up to cost. The Tax Working Group estimated that the 'ability to shelter income in trusts cost the government roughly $300 million in tax revenue in 2007". (See Graphs 11 + 12)

Even one of New Zealand's richest men agrees it is unfair that he effectively pays no tax. Sam Morgan, who created online auction website Trade Me in 1999 and sold it in 2006 for more than $700 million, has criticised the tax system as unfair to "working people".

Flush with tax-free cash from the sale of Trade Me, he said the system meant he effectively dodged the tax man. "I was lucky enough to sell my company in a country with no capital gains, so I paid no tax on the sale. Now I've got no income effectively, because I don't have a proper job, so the tax that I pay is minimal. The tax I do pay, I throw money into my charitable foundation. I can't touch that money, it is for charitable purposes. I pay basically no tax. And that's not right, but what am I supposed to do?" Mr Morgan said the idea of a 25 per cent flat tax rate promoted by his father, economist Gareth Morgan, was part of a "quite hardcore" manifesto. "The amount of tax people pay in different areas is not fair. The people that pay the most tax are working people."

Graph 12



The government claims no one will be worse off after the GST and tax rate changes. But a reduction in the top marginal rate for incomes over $70,000 will give 90 percent of any tax cut benefit to the top 10 percent of income earners who earn above that threshold. As Gordon Campbell commented in his Scoop column: “the government has used a peculiar notion of ‘balance’ within this tax debate. The tax cuts will make a small elite much, much better off – while, at best, the various compensation packages will leave the rest of us no worse off. That’s not balance – that is a transfer of wealth, and it is a mechanism for increased income inequality.”

New Zealand’s highest paid CEO is Paul Reynolds of Telecom. His salary is $7 million a year. Since his appointment he has presided over the XT network debacle and a halving in the company’s share price – a loss of $4.5 billion in value. For all his hard work he will got about $4800 a week in tax cuts in this year’s budget after paying the invreased GST.

It may be time to lift the threshold for the 38 cent rate to kick in at say $100,000 as proposed by Labour Party leader Phil Goff - but there should be another higher marginal rate of 45 cents at incomes of three times the average wage (about $150,000) with still higher marginal rates at $250,000 and $500,000.

It may also be time to look at a universal basic income (UBI) as an alternative to the targeted regime like Working for Families. In 2008 WFF went to 384,000 families with an average annual amount of $6,500. A family with three children under thirteen would continue to receive some benefit until their combined income reached $106,000. It is a consequence of a system of low wages and no universal child benefits. The tax system has become the way to subsidise wages. But because it is targeted these families end up with additional income being hit by their normal tax and the abatement of the benefit creating an effective tax rate of over 50 percent for most.

A UBI could combine a tax free allowance for all adults from age 18 of say $200 a week with a universal child allowance of say $100 weekly for each child. This could be paid for by higher marginal rates especially at the top end and serious wealth taxes (including capital gains and death duties) for those with accumulated wealth from generations of profiting from the labour of the rest of society. This would remove the stigma associated with being on a benefit as everyone would get a universal entitlement to the wealth created by society. There would be no limits on any extra income earned which would simply be taxed at the relevant rate. A minimum marginal tax rate on earned income of 25 percent would mean essentially all income up to $40,000 would be tax free. Higher marginal rates would kick in at steps above that that would in effect claw back the universal entitlement from those who don't need it. An idea similar to this (but without higher marginal rates for higher earners and leaving out the question of universal child allowances) was put forward by economist Gareth Morgan after sitting on the Taxation Review Group. He described it as "the Big Kahuna" – a way of thinking outside the square on the existing benefit / tax regime. He believed it possible with various wealth taxes being introduced. It is certainly an idea worth serious discussion.

How does GST affect different income groups?

GST – like all consumption taxes – is unequal in its impact. Because working people spend a higher proportion of their incomes they pay a higher percentage of their income on GST.

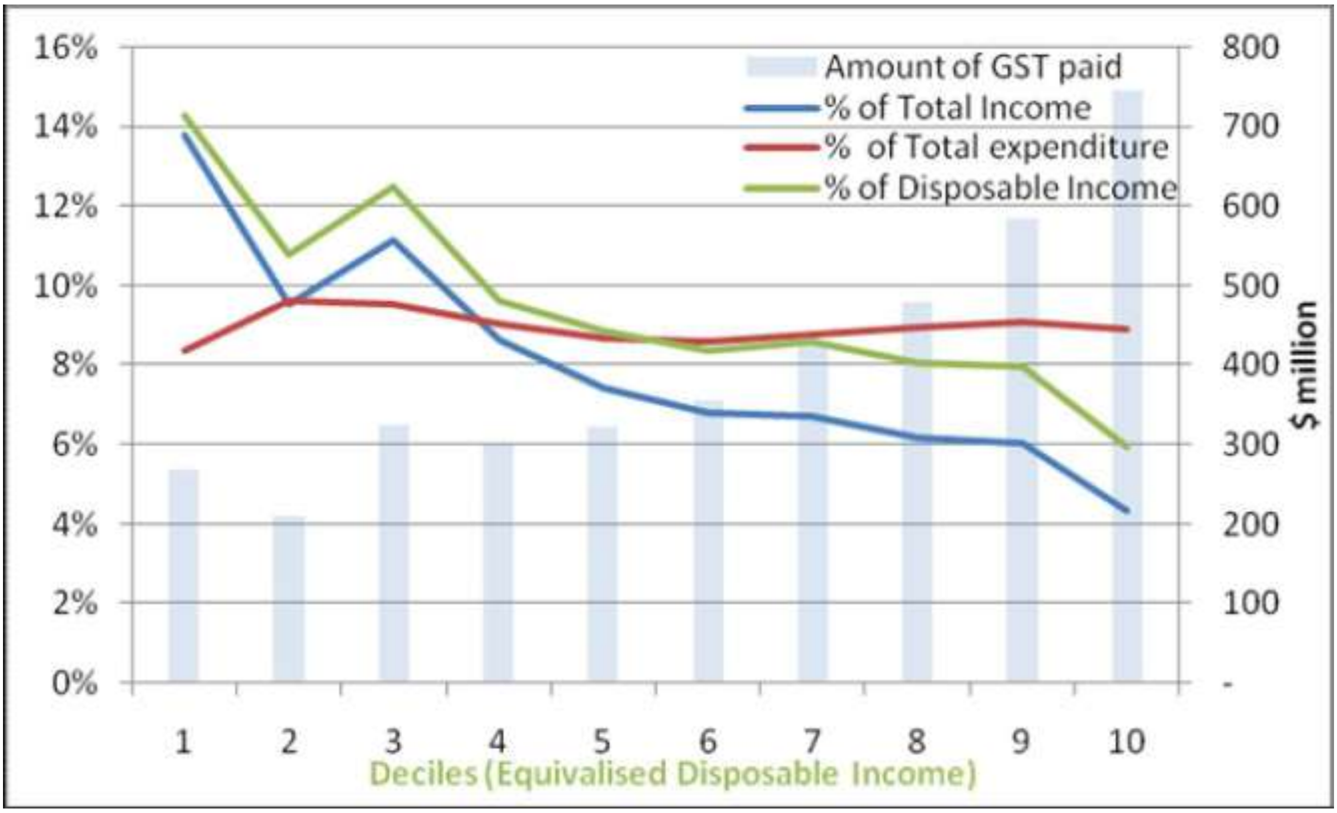
CTU economist Bull Rosenberg looked at this in recent CTU Economic Bulletin. He writes:

> "Some more detail on how GST affects low and high income people: The graph below comes from research carried out for the Tax Working Group ("Changing the rate of GST: fiscal, efficiency and equity considerations", available at *http://www.victoria.ac.nz/sacl/cagtr/twg/Publications/GST_paper.pdf*. It shows the proportion of both income and expenditure that is paid out in GST for each income group in the country.
>
> "On the far left is the 10 percent of households ("decile") with the lowest annual disposable incomes, corrected ("equivalised") for the number of people in the household. "Disposable income" means income after income tax and credits such as Working for Families have been

taken into account. On the far right is the 10 percent of households with the highest such incomes.

"The two downward sloping lines show the percentage of income that is paid in GST. The higher one (in green) shows it for disposable income, the lower one (in blue) for gross income. For the lowest income households, it is as much as 14 percent of their income. How can it be more than the 12.5 percent GST rate? Because many low income households are spending more than their income – getting further into debt, living on gifts from relatives, or using up their savings. For the highest 10 percent of households, only 4 percent of their total income or 6 percent of their disposable income goes on GST. (See Graph 13)

Graph 13



"The third, much more gently sloping, line (in red) shows the percentage of expenditure that is paid in GST. It is still higher for lower income households, and even if it was perfectly level across the income range doesn't reflect ability to pay. It is much more painful for a low income household to go without $10 than it is for a high income household.

"So beware of arguments that GST actually affects those on higher incomes more, or to the same extent, as those on low incomes because they pay more in dollar terms or because people at any level of income spend everything they earn over their lifetimes. That assumes wealthy people eventually consume all their income. "

The government claims that they need to reduce tax on the rich and companies to boost growth in the economy. What is the record in New Zealand and overseas?

Unfortunately for the government the periods of highest growth in NZ and the USA were associated with higher not lower taxation. The Treasury estimates that the 2010 tax changes will produce a total increase in growth of 1% over 7 years!

As Gordon Campbell explained in his May 18 Scoop column:

> **When asked by Scoop** at post-Cabinet press conference on May 17 to name a couple of countries where tax cuts had resulted in economic growth, Prime Minister John Key cited the United States. Surprising, given that
>
> (a) over half of the benefits from the Bush tax cut programme have accrued to only five per cent of the population, *http://www.ctj.org/pdf/bushtaxcutsvshealthcare.pdf*
> (b) they cost more than the health reforms enacted by Barack Obama and
> (c) since they were deficit financed, the Bush tax cuts have also added a huge $379 billion bill in interest payments to their initial $2.11 trillion in revenue foregone.
>
> More to the point, the Bush tax cuts did not result in economic growth. For wider yet related reasons, the Bush era ended in the worst recession in decades. As New Zealand's own recent history has also shown, there is no causal link between tax cut programmes that disproportionately benefit the wealthy, and economic growth. At best, such tax cuts appear to trigger only brief, import-driven retail binges that drive up inflation – what we get in tax cuts, we pay for soon after in higher interest rates – and leave us with a worse current account deficit.

A similar point is made in more detail by CTU Secretary Peter Conway in a pre-budget address to the Fabian Society on May 12 (Peter Conway: "Tax: A Budget preview" *http://www.fabians.org.nz/images/stories/RES-PC-WGTNmay2010.pdf*

> Slemrod and Bakija[1] examine the relationship between the marginal income tax rate and productivity in the USA. They found that from 1950 to 2002, periods of strong productivity growth actually occurred when the top tax rates were the highest and, on average, high-tax countries were the most affluent countries.
>
> Also in the USA, in a study looking at the effect of tax cuts in 2001, the Center on Budget and Policy Priorities noted that in 1993 the US increased the top marginal tax rate from 31% to 39.6%. But this did not damage growth. In fact the economy experienced its longest economic expansion in history during the 1990s. Real GDP grew by an average of 4% a year from 1993 though to 2000, almost 50% faster than the average from 1973 to 1993.
>
> Despite major tax cuts in 2001, 2002, 2003, 2004, and 2006, the economy's performance between 2001 and 2007 was far from stellar. Growth rates of GDP, investment, and other key

[1] **Joel Slemrod and Jon Bakija (2008).** ***Taxing Ourselves: A Citizen's Guide to the Debate over Taxes*****, 4th edition.**

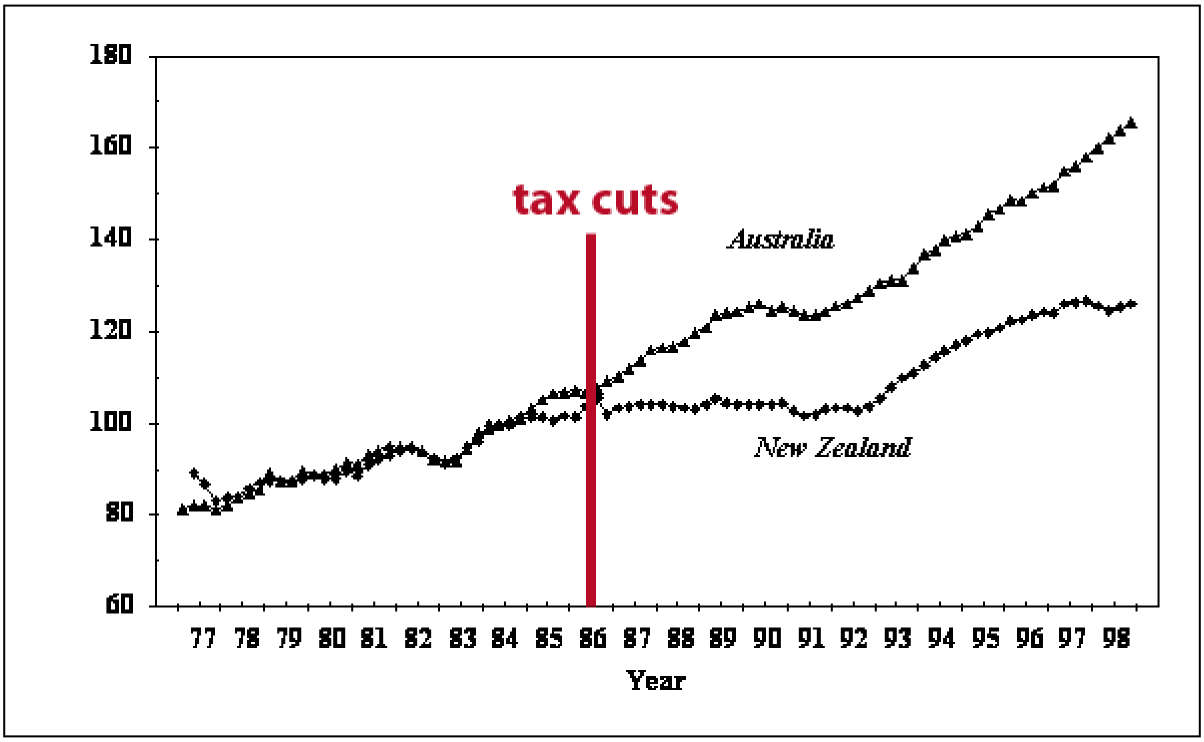
economic indicators during the 2001-2007 expansion were below the average for other post-World War II economic expansions.

In New Zealand, the average annual growth rate in the five years before the 2000 increase in the top tax rate was 1.9% whereas in the five years after the increase in tax it was 3.52%. Economic growth in the period after the major 1986 reductions in personal and company taxes was not impressive. Essentially it flat-lined.

In the 1984-92 period our average annual growth rate in real per capita GDP was 0.4% compared with 3.02% in Australia and even when the growth rate recovered from 1992 to 1998, the average annual rate was 3.3% compared with 4.24% in Australia.

The graph below essentially tells the story before and after the 1986 changes. It is as depicted by Paul Dalziel[2] using quarterly seasonally adjusted real Gross Domestic Product for Australia and New Zealand between 1977 and 1998, scaled so that the average value for the calendar year of 1984 equals 100.

Graph 14



I have added a vertical line showing the timing of the huge cuts from 66 and 48 cents to 33 cents for both the top personal and company tax rate. (See Graph 14)

These statistical juxtapositions do not show anything particularly useful and five years is not a long period in terms of a lagged effect on economic growth. I would not argue these figures prove that lower tax harms economic growth. But they at least show that tax cannot be a major

[2] Dalziel, Paul. (2000) New Zealand's Economic Reform Programme was a Failure, Department of Economics and Marketing Canterbury, New Zealand.

> factor compared with other significant influences on economic growth. Surely if after a massive cut in both income and company taxes in 1986 we see no evidence of an impact on economic growth, that particular line of argument should be abandoned by its proponents. And if we see a growth rate in the five years after an increase in the top tax rate in 2000 that is almost double that of the average rate for the five years before the cut, again it is hard to see a growth dividend. But we all know that lots of other things are affecting those numbers. That's the point.

Another argument in favour of tax cuts on incomes is that they are needed to keep people in New Zealand. Do people migrate because of allegedly high tax rates in New Zealand?

There is no evidence to support the claim that people leave New Zealand because of the allegedly higher tax rates.

There is a logical fallacy in the government's argument when most people come out only marginally ahead when other changes like increases to GST, ACC levies and other consumption taxes are included. The main reason people leave is because there is a large wage gap between New Zealand and Australia and that won't be closes by fiddling with the tax rates. The Treasury estimates a further real wage decline over the next year of over 3% as a consequence of inflation outstripping wage growth.
The recent history of tax and migration in New Zealand doesn't support the argument either. As Peter Conway notes in his paper:

> And we have the evidence of migration rates to Australia post reducing the top tax rate from 66 cents in the dollar and also post increasing the top tax rate to 39 cents in 2000.
>
> So in the five years following the massive cut in the top tax rate from 66 to 33 cents net migration was -21,500, -13,700, -16,800, -24,400, -1,200, +11,700. This is a loss of 65,900 people.
>
> In the 5 years following an increase in the top tax rate from 33 cents to 39 cents, net migration was -9,100, -11,400, +28,100, +42,000, +25,700 and +9,300. This is a gain of 84,600 people.
>
> But hang on, shouldn't it be the other way around?
>
> I am not saying that people left or came here because the top tax rate was reduced or because the top tax rate went up.
>
> I am just saying that the top tax rate doesn't look like it is a driver of migration flows.

Isn't it unfair that a small number of taxpayers pay most income tax?

What is unfair is that 10 percent of New Zealanders own half the country's wealth and receive 34% of the declared income. The bottom half of income earners have 7% of the wealth and receive 16% of income. (http://www.teara.govt.nz/en/income-and-wealth-distribution/5/3Inequality) In both areas the gap been growing in recent decades as a consequence of past changes and will accelerate with the recent budget.

The goal of a progressive tax system is to ensure that everyone get a fair go. Those who can afford to should assist in everyone getting access to decent health care, education, housing and employment. If someone can't afford to put food on their table why should they be taxed at all while the wealthy are debating the brand of wine they will drink or whether they should spend winter in Europe or not.

Because so much income of the wealthy is not taxed, and because a third of all government tax income comes from consumption taxes already, it is inevitable that the wealthy will pay a disproportionate share of income taxes.

Prior to the budget income tax worked out as follows for individuals:

- The top 10% get 34% of the income and pay 44% of income tax.
- The next 10% get 18% of the income and pay 18% of income tax.
- The next 30% get 32% of the income and pay 27% of income tax.
- The next 50% get 16% of income and pay 11% of income tax.

So what we are really seeing is the interaction of widening income inequalities and the tax system. As income inequality widens, tax rates should become more progressive if anything – not less. As Peter Conway commented in his Fabian Society presentation:

> This is an important issue. We are also likely to hear arguments that when transfers (such as WfF) are taken into account, those on top incomes are paying an even higher proportion of (net) taxes. But the fundamental point is this: if the bottom half of income earners share 16% of income and the top half of income earners share 84% of income, then we need to do more to lift incomes for those in the bottom half – rather than cut taxes primarily for those in the top half.

The fact that government s have chosen to provide tax relief for families through tax credits like Working for Families was also a way of avoiding the need to address low wages throughout the economy. Instead of their being universal family benefits available to everyone as in the past we have a targeted benefit through the tax system with all the anomalies and marginal tax rates applying if a family's income improves.

Who benefits from the tax changes?

The benefits overwhelmingly and disproportionately benefit the already wealthy.

The "NO Right Turn" website produced the following chart and commentrary:

> So, who benefits from National's budget for the rich? As usual, I've done the numbers. And the results are completely unsurprising: [See Table 4]

Table 4

Who benefits from National's tax cuts?							
Income range	**% of taxpayers**	**benefit from cut to bottom rate ($ million)**	**Benefit from cut to lower middle rate ($ million)**	**Benefit from cut to middle rate ($ million)**	**Benefit from cut in top rate ($ million)**	**Total ($ million)**	**% of total**
$0 - $20K	45%	268.62	51.45			320.07	9%
$20K - 50K	31%	299.32	506.70	1.53		807.55	22%
$50K - $70K	12%	115.36	490.28	271.92	109.65	987.21	26%
$70K+	12%	105.56	448.63	248.82	822.50	1625.51	43%
						3740.34	100%

(Methodology: This calculation is for the total package. Effects are calculated from Treasury's 2010 detailed model data, percentages and numbers of taxpayers from Budget 2010 *Who pays income tax and how much*?.

Due to a lack of information on projected income distribution, I've been forced to use the bands from the latter).

Not on the table: those earning over $150,000, the top 2%, pocket $430 million, about 11.5% of the total. This is almost exactly the amount the government has to borrow to fund this package. The people of New Zealand will be saddled with further debt to pay for the greed of the few at the top.

Also not on the table: the effects of increased GST. This will effectively claw back everything gained by those earning under $20,000, and most of what is gained by those earning under $70,000. Only the rich will be better off. And that's without even getting into the effects of higher ACC charges or reduced government services.

Basically, the vast majority of New Zealanders have just been screwed over for the benefit of a tiny percentage of parasites at the top. John Key is right - we shouldn't be envious: we should be angry.

Bill Rosenberg from the CTU did some further calculations using the government's figures. His conclusion:

Tax cuts were as expected the feature of the budget. The outcome is fundamentally unfair as the table below shows. Someone on the minimum wage of $26,520 gets an extra $4.13 a week but someone on four times the minimum wage or $106,080 gets an extra $43.08 a week. Their tax cut is 10 times more than the worker on the minimum wage.

From 1 October 2010 GST will rise from 12.5% to 15% and the new personal income tax rates will be

- 10.5% on income to $14,000 (was 12%)
- 17.5% on income between $14,001 and $48,000 (was 21%)
- 30% on income between $48,001 and $70,000 (was 33%)
- 33% on income above $70,000 (was 38%)

Our calculations after accounting for GST give the following examples: [See Table 5]

Table 5

Annual income	26,520	53,040	79,560	106,080	300,000	393,000	7,000,000
Per Week:					Average CEO of large company	Prime Minister	CEO of Telecom
Income Tax cut	13.81	31.18	50.15	75.65	262.12	351.54	6,704.42
GST increase	9.68	18.15	25.54	32.57	83.94	108.58	1,858.98
Total tax cut	4.13	13.03	24.61	43.08	178.18	242.96	4,845.44
% of income	0.8%	1.3%	1.6%	2.1%	3.1%	3.2%	3.6%

There is an official tax calculator at *www.taxguide.govt.nz* that gives these figures.

> This is an unfair Budget that favours high incomes, and whose only real new contributions to economic development are the changes in tax on property (which we will need to see how easy it is to avoid) and to commercial research. Education, Health and other social services will be fighting to stand still. There will be continuing job losses and restructuring in the public sector. This is in the context of an improving economic environment – though still with risks – which would have allowed the government to be both more generous and build investment, skills and capability for the future while addressing inequality rather than adding to it.

Won't the tax changes at least stop the tax avoidance by the wealthy as the government asserts?

Most of the changes have simply legalized some avoidance while creating opportunities to do so elsewhere. Past evidence shows the rich will continue to do everything they can to avoid tax.

Because the top income tax rate is now the same for Trusts and individuals that source of evasion is removed because there is no need for it. However the opening up of a 5% gap between the top rate and the new 28% company rate creates even more opportunites. These are detailed in a report by Rob Stock on the Stuff website headed "A new bow for wealthy fiddles" (*http://www.stuff.co.nz/business/3728127/A-new-bow-for-wealthys-fiddles*)

> The Budget won't stop the rich fiddling tax behind the secret screens of trusts, say tax experts, and could result in much of the income produced by the assets of the very wealthy being taxed at 28 percent.
>
> From October 1, tax changes announced in the Budget will give the rich the 33 percent tax rate many have already granted themselves by using trusts to convert large swathes of their income into tax-free capital payments.
>
> But Thomas Pippos, managing tax partner at Deloitte, said swapping the five percentage points difference between the soon-to-be-reduced 38 percent top personal tax rate and the 33 percent trust rate, for a five percentage point difference between the 33 percent trust rate and the planned 28 percent company tax rate would auger the rise of the "investment company".
>
> Pippos expected the rich would set up "investment companies" to hold the assets that were currently held in trusts. The trusts would remain to hold the shares in those investment companies.
>
> Income earned by the investment companies would be taxed at 28%, and, so long as it was left in them, there would be no further tax, said Pippos.
>
> If company earnings were paid out to the trust as dividends, further tax would be levied to take the total tax paid up to the trust's rate of 33%, said Pippos, unless the money was paid out to beneficiaries on lower tax rates, in which case there would be no further tax to pay.
>
> Pippos said the rich did not have to draw on all the income available from their investments and would be happy to leave much of the money they made in the investment companies, which

would be free to reinvest it. "If people leave the money in a company, it becomes accumulated savings and that tax difference becomes permanent," Pippos said.

The new trust tax rules will not end one of the current trust tax fiddles that rich trust users exploit.

Income to a trust is taxed at 33% unless it is paid out in the tax year it is earned or six months thereafter, in which case it is taxed at recipients' tax rates. That means income can be streamed to a non-working partner who is a beneficiary at rates of between 10.5% and 30%, although distributions to beneficiaries under the age of 16 are taxed at the trust rate of 33%, a rate brought in in 2004 because so many rich people were using trusts to pay income to their kids, which they then used themselves.

There is an odd morality in changing tax rates so those rorting the system are rewarded. As Peter Conway commented in his paper:

> When it comes to discussing tax a rather curious logic emerges, which is that when someone avoids tax it is somehow an integrity problem of the tax system rather than an integrity issue for the taxpayer! This leads the debate into some strange places. When we have suggested putting up the top tax rate to 45 cents, say, for income above $150,000 or three times the average wage, one of the responses we have got is, “there would be an integrity problem”. In other words, the top income earners would avoid this tax. OK, but then what about increasing the trust rate also? But more importantly, the integrity issue is at least a moral one. Are we to believe that all those who structure their affairs to avoid any trickle down via the tax system will use their lower taxes to generate a trickle down by other means?
>
> Those who consistently demonise taxes and attack government expenditure contribute to this atmosphere where it is ‘fair game’ to avoid taxes. We then see advocacy for a GST rise which is hard to avoid – but hits at those who were not manipulating their affairs to avoid tax in the first place!

Doesn’t society need inequality to give people incentives to produce wealth? Aren’t we all better off in the end?

The actual experience of New Zealand proved the opposite. Although those at the top did very well the rest of us ended up much worse off. Real wages declined, benefit values declined, unemployment soared, and communities became harsher and less caring as the dog-eat-dog values of corporate capitalism came to predominate. Basic human solidarity declined and crime, drug abuse and youth suicide soared.

British academics Richard Wilkinson and Kate Pickett have written a thoroughly scientific study of inequality in their recent book “The Spirit Level – Why more Equal Societies nearly always do better”. It might be summarised as "the rat race is bad for our wellbeing" but is more sophisticated than that. Their recommendations are not that we should have completely equal societies. They are that we should make a priority of working towards greater income equality and giving people greater control of their lives. Their web site contains videos, papers and other resources and its summary of possible remedies includes:

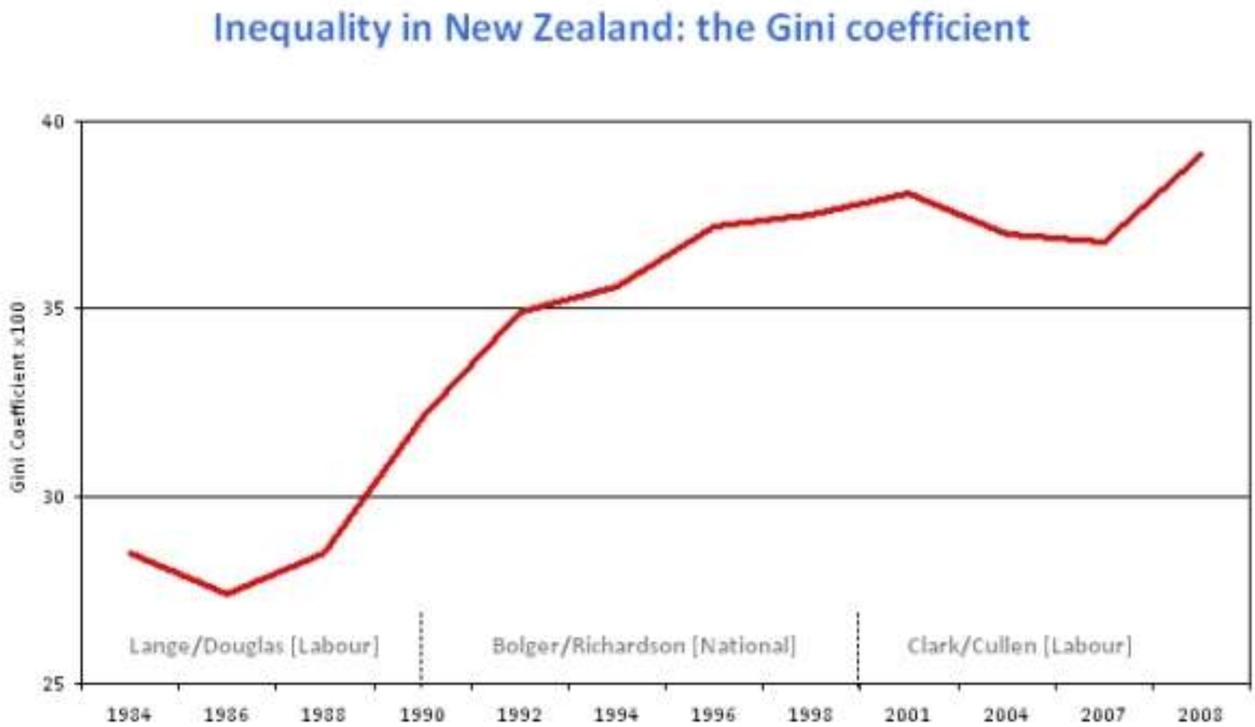
“As well as more progressive income and property taxes and more generous benefits, we also need policies to reduce differences in incomes before taxes and benefits. That means higher minimum wages, more generous pensions, running the national economy with low levels of unemployment, better education and retraining policies, increasing the bargaining power of trade unions”.

An international survey on inequality published by *The Economist* in November 1994 compared the top 20% of households’ income to the bottom 20%. New Zealand came in third after USA and Australia. “It is no coincidence” *The Economist* noted, “that the biggest increases in income inequalities have occurred in economies such as those in America, Britain and New Zealand where free market economic policies have been pursued most zealously.” The rise in inequality in New Zealand was in fact the highest of all countries in the Organisation of Economic Cooperation and Development (OECD).

The Council of Trade Unions (CTU) Alternative Economic Strategy document reports that “Wealth inequality – the ownership of assets – is even more extreme.” Using net wealth figures – that is, after deducting debt – from Statistics New Zealand the paper notes that “The top one percent of the population over 15 owns 16.4 percent of the wealth. The richest 10 percent own over half – 51.8 percent – of the country’s wealth owned by residents. At the other end of the scale, the least wealth 50 percent of the population own only 5.2 percent of the wealth. Maori, though 10.4 percent of the population own only 4.3 percent of the wealth and Pacific peoples are the worst off – they make up 4.9 percent of the population but own just only 1.32 percent of the wealth. Their median wealth is just $6,700, less than a tenth of the $69,800 median for the whole population. The Maori median is $18,000.”The current worldwide economic crisis is in part a consequence of the grotesque increase in inequality over recent decades.

World Bank Economist Branko Milanovic argues this strongly in a recent article in *Yale Global* titled “Income inequality and speculative investment by the rich and poor in America led to the financial meltdown”. For the wealthy he argued “there is a limit to the number of Dom Perignons and Arami suits one can drink or wear”. Money went in search of riskier and riskier investments encouraged by a financial sector raking in bigger and bigger commissions. However, “the increased wealth at the top was combined with an absence of real economic growth in the middle.” Like in New Zealand “Real median wage in the United States has been stagnant for twenty five years, despite an almost doubling of GDP per capita. About one-half of all real income gains between 1976 and 2006 accrued to the richest 5 percent of households.” For the rest of us, again like New Zealand, “People began to live by accumulating rising debts on their credit cards, taking on more car debts or higher mortgages.”

Graph 15



There are many ways to measure inequality. The Gini co-efficient is one of the more sophisticated as it measures inequality across the whole of society rather than comparing extremes in income. If all the income went to one person, the Gini co-efficient would be 100. If all income was evenly shared, the co-efficient would be 0. For most OECD countries, the co-efficient ranges between 30-50. The graph shows rapid increases in the gap between the rich and the poor from 1986 until 2001 coinciding with a period of massive deregulation, labour reforms, and benefit cuts. Real incomes for lower and middle income families fell while rich households saw their incomes soar. Working for Families and an increase in the top tax rate to 39% reversed 15 years of rising inequality. The effect was short-lived, however, and we now seem to be caught in a period of rising inequality once again.

In conclusion he wrote: "We should not focus on the superficial aspects of the crisis, on the arcane of how 'derivatives' work. If 'derivatives' they were, they were the 'derivatives' of the model of growth pursued over the last quarter a century. The root cause of the crisis is not to be found in hedge funds and bankers who simply behaved with the greed to which they are accustomed (and for which economists used to praise them). The real cause of the crisis lies in huge inequalities in income distribution which generated much larger investable funds than could be profitably employed. The political problem of insufficient economic growth of the middle class was then 'solved' by opening the floodgates of the cheap credit. And the opening of the credit floodgates, to placate the middle class, was needed because in a democratic system, an excessively unequal model of development cannot coexist with political stability." (See Graph 15)

Did the fourth Labour Government from 1999 to 2008 change much of the legacy left from the changes brought about during the late 1980s and early 1990s?

The Fourth Labour government never challenged any of the fundamental policies put in place by its predecessors. During a period in office of almost continuous economic expansion only minor tinkering was allowed. The commitment to economic liberalisation continued.

Reforms under Labour from 1999 to 2008 were very modest given the economic growth and decline in unemployment. For example, the minimum wage was brought back to the level of 50% of the average wage it had been at in the late 1980s and paid parental leave was introduced. But union membership and bargaining power remain very weak. The restrictions on the right to strike outside bargaining have stayed in place. Real wages for the vast majority of workers remain on average 25 percent down in real terms.

In relation to those at the bottom of the income heap, beneficiaries, the labour government continued and reinforced the approach that people on benefits need large gaps between their incomes and those working to give them an incentive to get a job. Rather that restoring the benefit cuts made by National they used the same arguments to refuse to include those on benefits for the assistance low income wage earners with children get through working for families and similar "in work tax credits". This has resulted in tremendous hardship for many people losing their jobs who suffer both the wage income loss and the in work tax benefits as well. Many workers lose a large part of the benefit of any wage increase as their credits get reduced.

Why is it important for working people to defend what's left of the 'welfare state'?

Although it has been severely weakened, the welfare state remains worth defending. It was established as part of the labour movement's attempt to moderate the divisions and competition imposed on us by the market system. To defend the right to live our entire lives with some form of social and economic security, to begin looking at education, health care, unemployment benefits and pensions as social rights for all. If we can't save it now, for this generation, we risk losing it forever.

The unemployment benefit doesn't go to "them" - some permanent "underclass" (although a small but significant layer of the working class has been placed in long term unemployment.). It goes to "us" as we regularly face bouts of unemployment and it gives us some small buffer against financial disaster. It is also true that it can help prevent us from being forced to take any job at any wage just to survive and that helps protect the wages and conditions of all workers.

Prior to the 1935 Labour government, unemployment relief was financed through a "poll tax" on all males, and help made conditional on joining relief work gangs in the country at rates of pay the British Medical Association declared not enough to maintain health and working capacity. The pension was means tested on income and property. The moral rulers of the time ensured that only those of "good moral character and sober habits" could receive it. Excluded from the pension were "Asiatics" (citizen or not), "aliens", and anyone who had deserted their partner or been sentenced to prison in the previous 12 years. A local magistrate investigated each application. Maori couldn't get unemployment benefits and "illegitimate" children were excluded from child allowances. Removing this degrading and intrusive system was the crowning achievement of the labour movement of the time. Minimum wage levels reached 80% of the average wage at the end of World War 2.

Forcing the government to socialise the costs of health, education and housing as a social right ensures that people aren't subject to the vagaries of "the market" when periodic unemployment can force families onto the breadline. Our goal should be to ensure that every single child has an opportunity to get an education, every old person is protected from freezing in winter, every young mother has a choice to leave an abusive partner and provide the

minimum for her child. It is laying basic principles of social solidarity that can be extended to wider areas of the economy and society. The right wing instinctively senses this and is part of the reason it seeks to cut back or privatise delivery of any social service.

The fight to lift the minimum wage is part of that broader struggle. The union movement is aiming to raise the minimum to two-thirds of the average wage and Unite Union is supporting an increase to $15 an hour immediately as a step to that goal. This was the level that existed in the 1950s and 60s and as late as 1973 under the Kirk Labour government. This was also the time period when New Zealand had virtually zero unemployment. An immediate increase to $15 would directly affect nearly half a million workers. Increases in the minimum wage also strike a blow against the gross inequalities that continue to exist in society. All wage systems are built from the bottom up. A low minimum wage drags all workers down. A higher minimum will help increase wages for workers further up the ladder as well.

What is the economic picture for working people over the next few years?

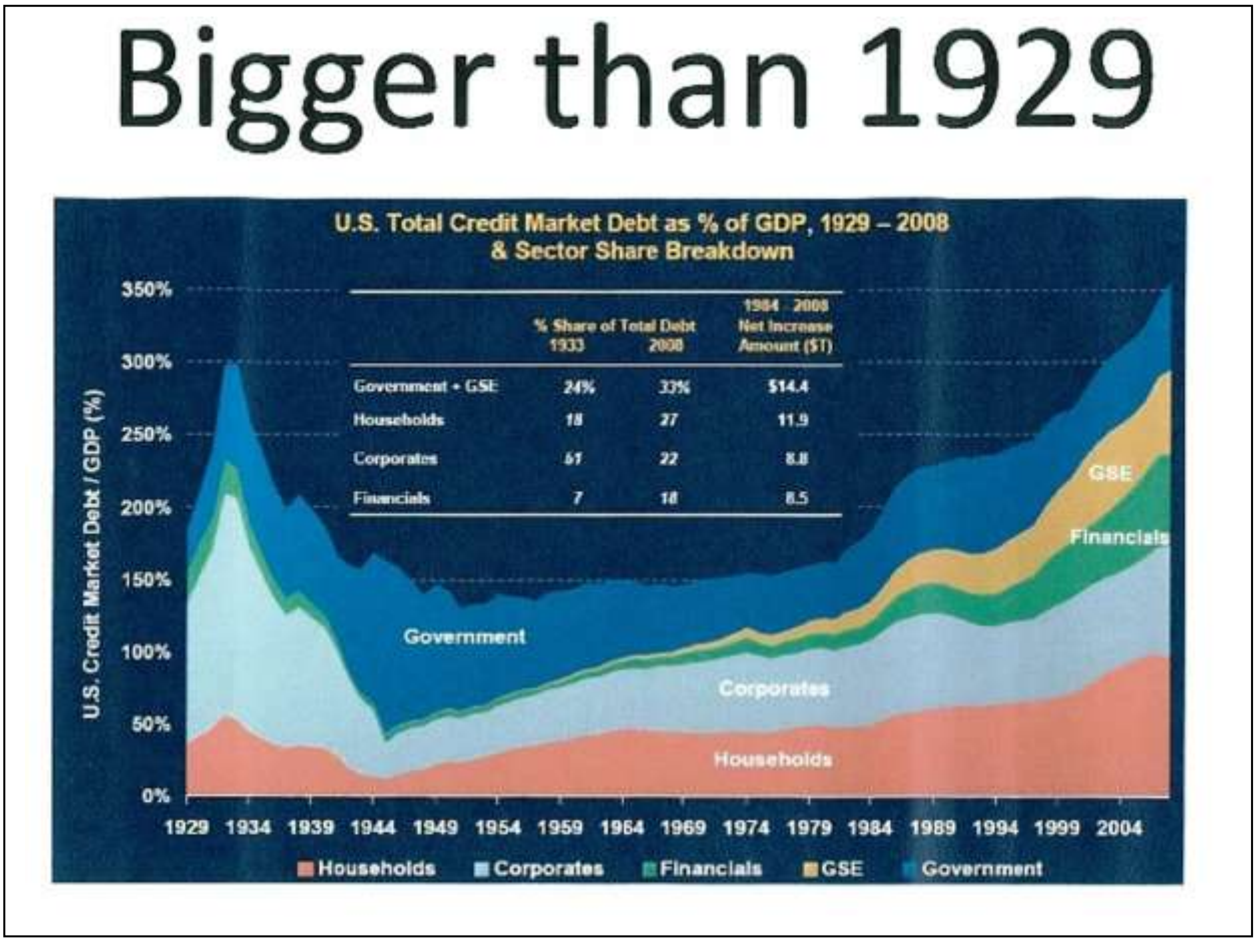
The economic situation remains grim for workers around the globe. While the financial bailout of the banking system has stabilised things for a period – with some very modest growth – these appears to be no sustained recovery on the horizon. There is very little private lending, investment or job growth outside government stimulus packages.

Across the globe this system seems to produce more goods and services than can be marketed profitably. Each time it runs into trouble it has sought to expand its sphere of operations. Trade barriers in poorer countries get knocked down while they are maintained in the rich. Industries are privatised. Controls on the movement of capital get lifted. Property rights are entrenched. Wages get cut in one country to get a competitive advantage over another.

Promises were made that if the rich got richer eventually it would trickle down to the rest of us. Greed became normalised as a necessary part of getting ahead. Grotesque salaries were paid no matter what the performance of the companies. Outright fraud became commonplace. But it was never enough. New crises kept emerging – except now they had immediate international consequences as capitalism was tied together by a thousand threads in every country.

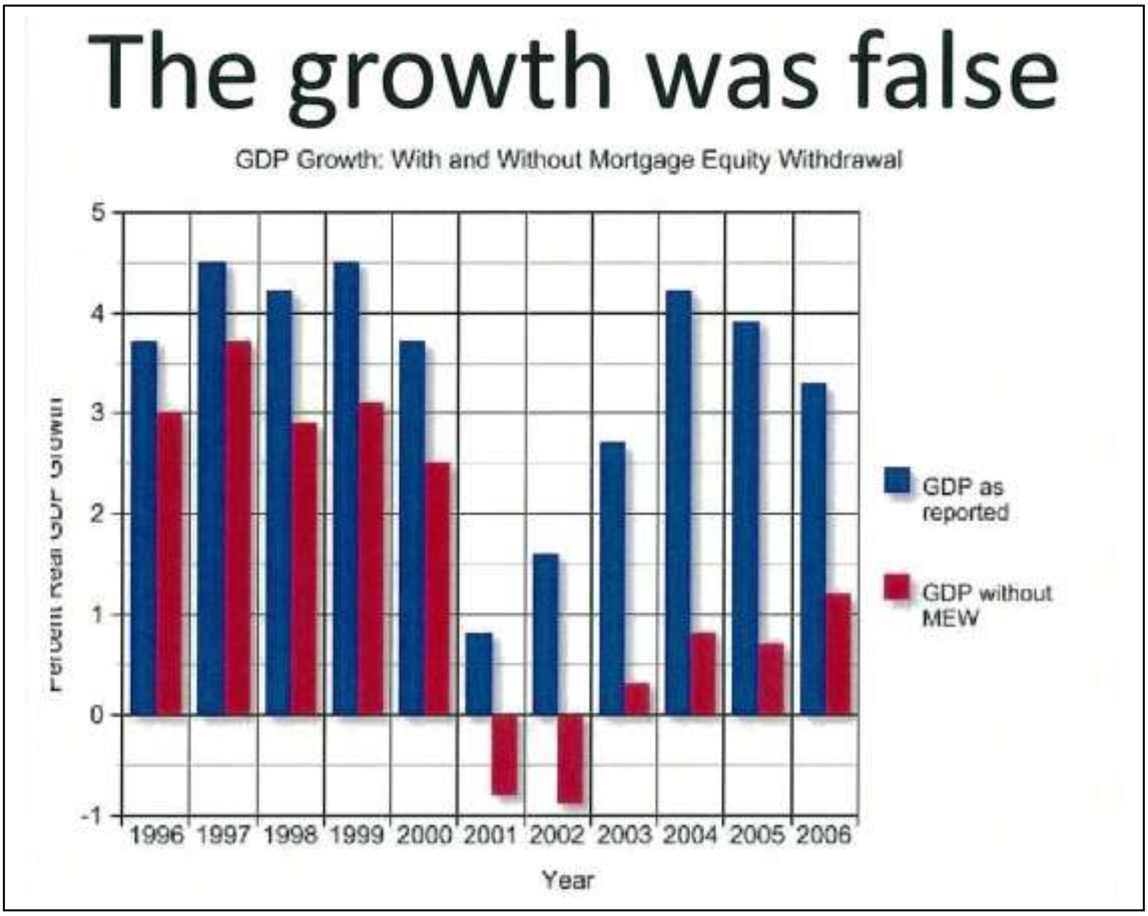
The world's banks were given even more freedom to create debt on a colossal scale to keep everything ticking over. Personal, corporate and government debt kept on growing. In the US total debt went from 163% of GDP in 1980 to 346% in 2007 (Rod Oram SST 5/10/08). In New Zealand average household debt went from 60% of GDP 15 years ago to 160% today. Bernard Hickey has produced the following graph which compared the debt bubble, and its various components, to previous periods of US history including the prelude to the 1929 crash and the Great Depression that followed.

Graph 16



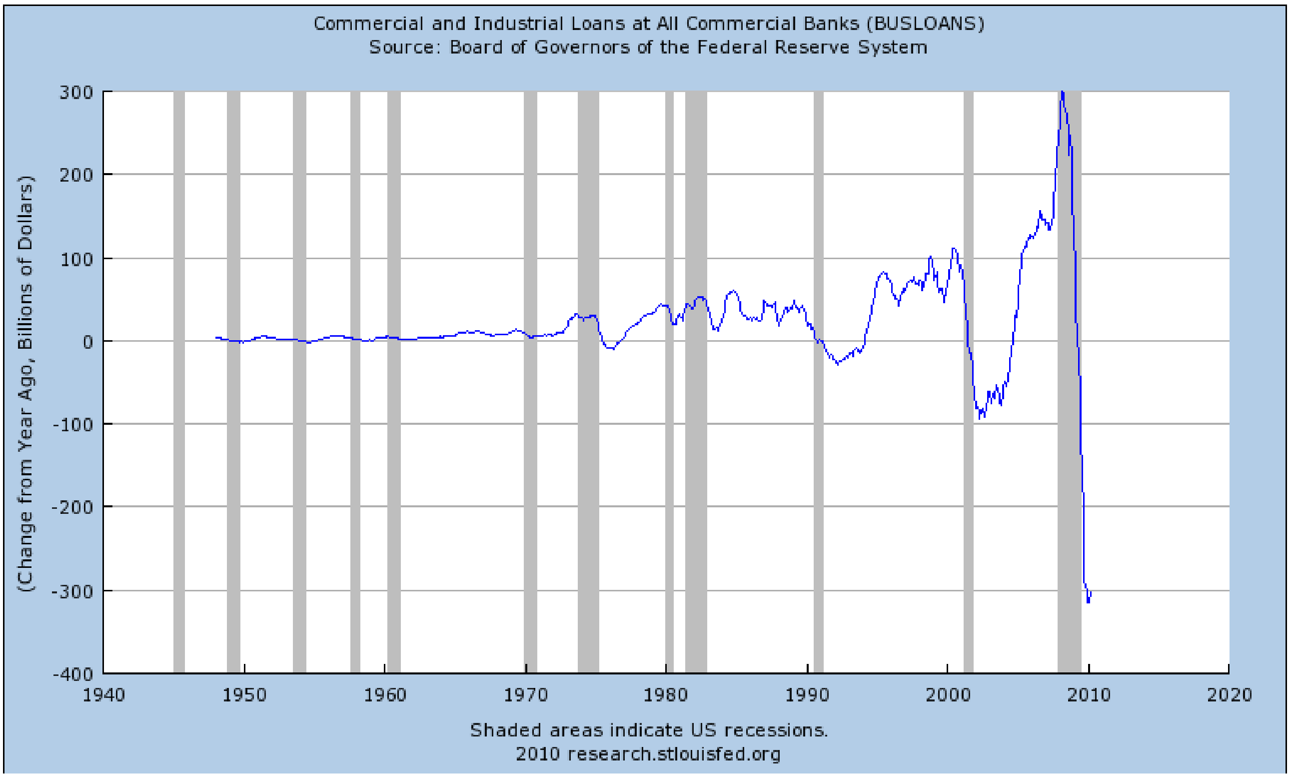
Another graph by Hickey – “The growth was false” shows that nearly all of the growth in the US economy after 2001 was financed by withdrawing money out of people’s homes through borrowing against their homes. (See Graph 17)

Graph 17



The collapse of the housing and credit bubble has led to a collapse in commercial and industrial lending in the US. The graph below [See Graph 18] from the US Federal Reserve reveals the shrinking of commercial bank lending comes principally at the cost of the real economy, visible in commercial and industrial lending. Instead of newly cranked up lending for the real economy, the large commercial banks are revitalizing speculative trading on their own accounts. The reserve bank injections into the financial system and the relaxed reporting requirements enable them to conceal the enormous decline in lending and to show and distribute (in dividends) further paper profits.

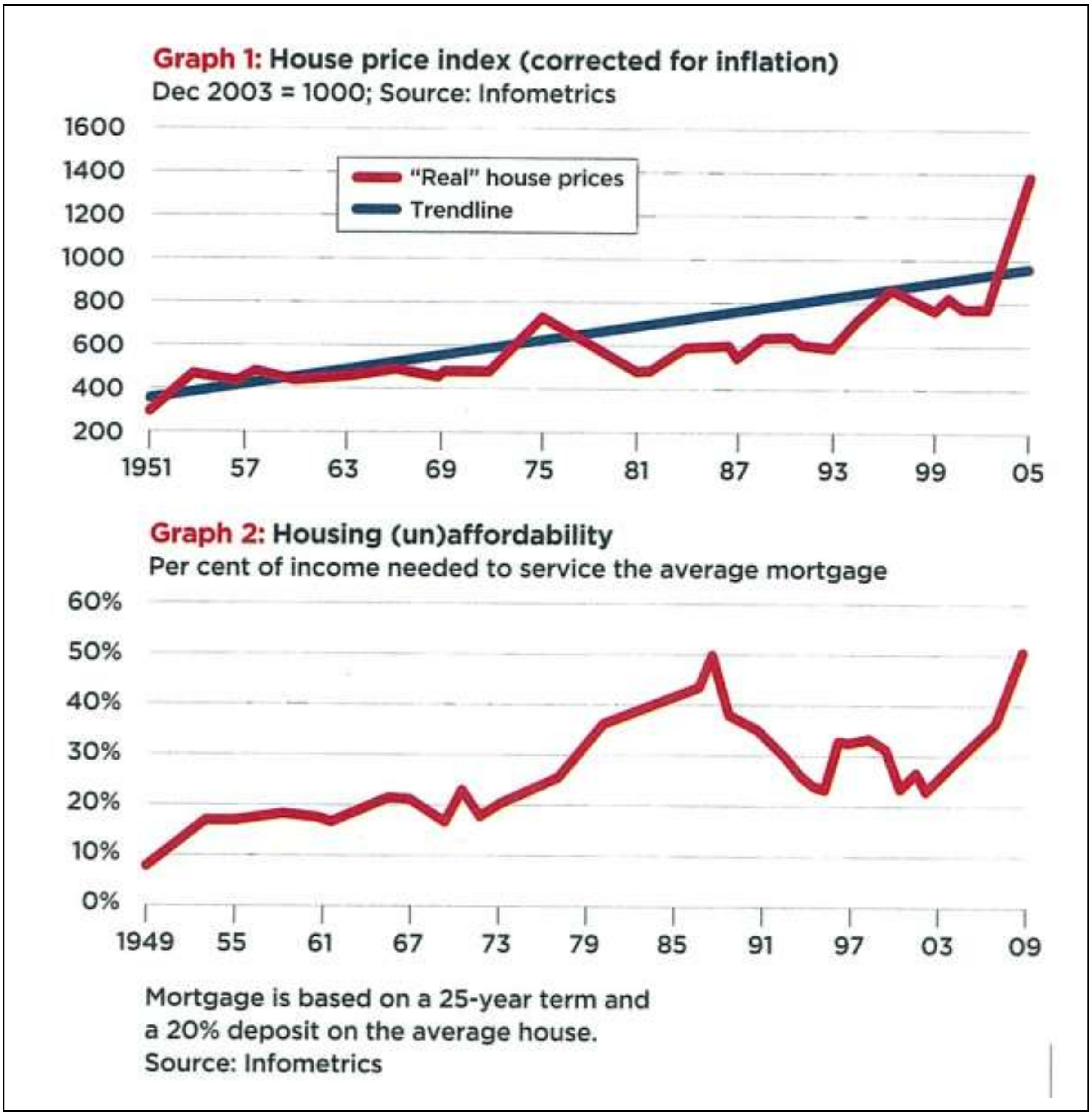
Graph 18



In many countries of the world there was a housing bubble. But in New Zealand it was bigger than most. Writing in the Listener on October 18, 2008, economist Gareth Morgan noted that "average house prices used to be twice a graduates salary; nowadays it is eight times that and the median salary is less than the interest on the average mortgage." He included a chart (See Graph 19 below) which showed that the housing affordability for a 25- year 80% mortgage went from 20% of average income for decades to 50% in a surge after 2000. Another chart revealed house prices were 45% above the 30-year trend line. "Median house prices rose from 3.5 times the median household income in 1991 to 4.6 times the median household income in 1997, levelled off until 2001, then rocketed to 6.3 times the average household income last year, roughly double the average in North America. Prices have fallen slightly since then to 5.7 times the median household income last month."

Private sector credit grew by six times in the last two decades – from $44 billion in 1998 to $266 billion in 2008. Half the bank lending was funded by cheaper overseas borrowing, often short term. Most of that went into mortgages for residential property. But the debt fuelled buying spree also affected credit card debt, commercial real estate, the stock market, and

Graph 19



agricultural land. This was always going to end in tears. The government refused to do anything as it couldn't "interfere" in the operations of the free market – that is the freedom of big business to rob us blind.

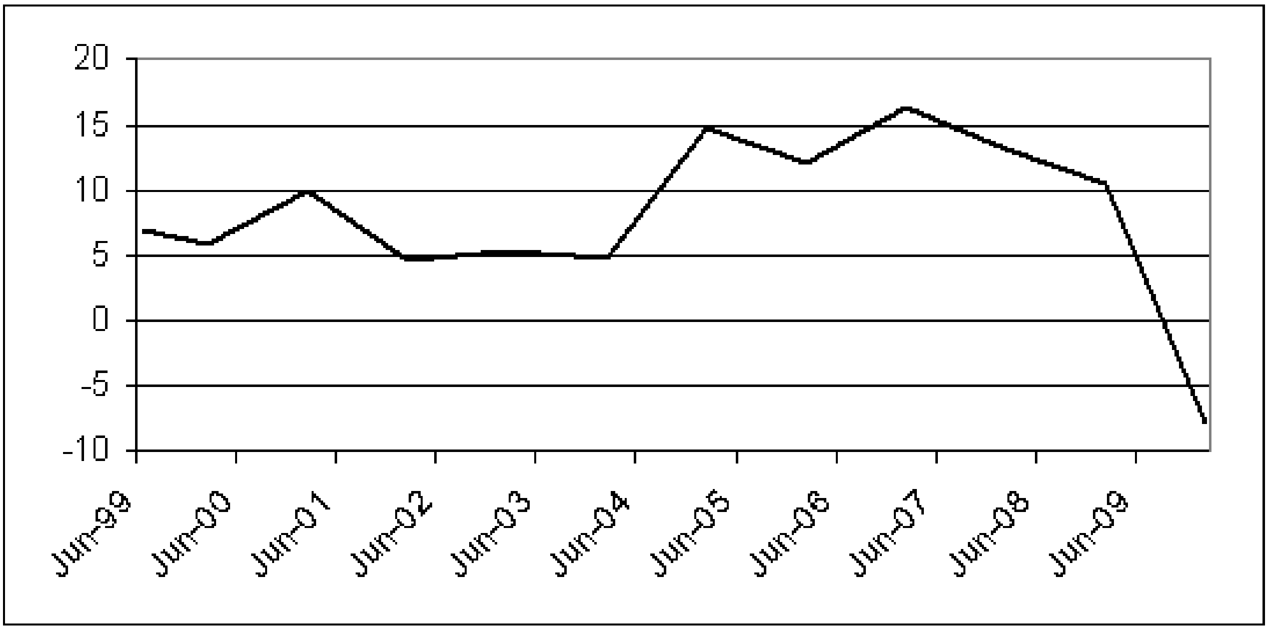
Now the banks worldwide are in trouble as the bloated financial merry go round comes to a halt and we discover their massive debt creation (which gave them billions in commissions and fees) ended up in the hands of households and businesses who could not repay.

As the bubble deflates in housing prices many working people will be left owing more on their houses than they are worth. A Canterbury University study by Professor Chris Eves reported in the Sunday Star Times (21/12/08) estimates that it is true for 20% of mortgages already.
In New Zealand farm prices and sales volumes have collapsed in the last two years as the withdrawal of easy credit has dried up farmers appetite's for capital gains. The national median farm sale price was $1.045 million in the three months to February 2009, down 40% from the $1.75 million in the three months to February 2008, Real Estate Institute of New

Zealand figures show. House sale volumes in February 2010 were the lowest for a February since REINZ began collecting figures in 1992.

Everyone will be cutting back on spending – households and businesses. Banks will be intensifying the cutbacks by radically reducing their lending in a desperate attempt to restore their balance sheets. The Reserve Bank figures for bank lending confirm this fact (see Graph 20 below).

Graph 20



Reserve Bank chart on annual percentage change in business borrowing from banks

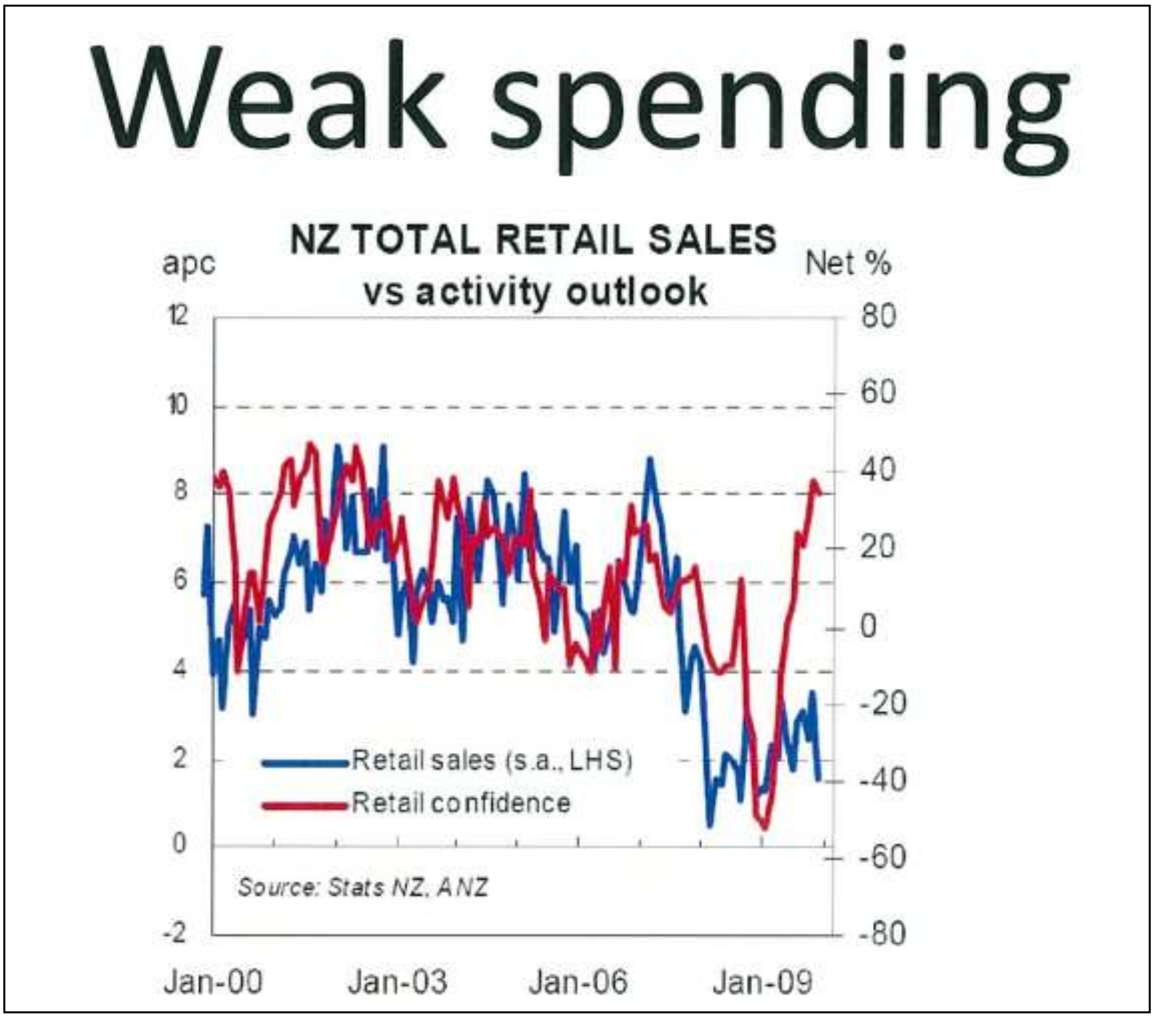
We are entering a period of stagnation at best. If house property prices start dropping further we could be in for a downward spiral with unknowable consequences. Will it be serious recession with 10% unemployment like the 1990s? Or are we looking at 30% unemployment like the 1930s Depression? No one knows.

With the recession biting, unemployment rising and banks restricting lending – it seems households are cutting their expenditure and retail sales have fallen significantly (See Graph 21). Big ticket items like motor vehicles are seeing their sales hit a brick wall.

Household expenditure in NZ is about two-thirds of GDP. If average household expenditure were to drop in New Zealand from 115% of GDP to just not spending more than current income then that would equal at least a 10% decline in GDP.

Just like the seemingly virtuous circle of more debt = more production = more jobs then the reverse will be a vicious circle of debt reduction = production decline = job losses on a large scale. As Rod Oram wrote in the SST: “The danger, though, is that the economy will collapse. If the slowdown starts to bite deeper, we’re risking a vicious downward spiral. Business confidence will crumble then capital spending and employment will drop; a rise in unemployment will wreak havoc on highly indebted households; banks will sell off repossessed properties; and the housing market will tumble.”

Graph 21



The New Zealand economy was kept ticking over these last 15 years on debt. The combination of declining real wages, benefit cuts and overall government expenditure cuts produced a deep recession in the early 1990s driving official unemployment over 10%. We got out of it because the rest of the world started their debt fuelled growth path and we picked up the coat tails and added our debt explosion for good measure.

The Government plans to combat the impact of the recession by a boost in spending of about 2% of GDP each year for the next few years. This hardly seems adequate even as a short term measure. For the longer term the government appears devoid of any idea of what to do except a replay of the failed policies of the 1990s – tax cuts for the rich, cutbacks for the poor, and hope for the best.

The world economy has stabilised but the cost has been enormous. Governments in the US, the UK and China are running budget deficits equal to 12% or more of GDP. The US and UK have also resorted to simply printing money, policies not seen the inflationary 1970s. Entire countries like Greece, Latvia and Iceland are threatened with bankruptcy. The housing crisis in the US remains unresolved and new crisis like the debts to the commercial property and bond markets in the US are still developing.

In a column headed “Bond vigilantes run the game” in the March 28 New Zealand Herald Bernard Hickey had a rare admission of who ultimately calls the shots – the “bond investors”.

This term actually refers to people who are the super rich members of a ruling class that, in a completely unproductive and parasitic way, controls the world's financial wealth. They use their power to suck more of the world's wealth through interest charged on the accumulated government and private debt. They can hold governments to ransom to impose anti working class social and economic policies on pain of crippling interest rates or, like Greece today, a refusal to finance their growing debts at all. Hickey explains the process:

> A grumbling noise has started within the bowels of the US bond market that everyone who either saves or borrows in New Zealand should know about.
>
> It is the sound of bond vigilantes stirring and telling political leaders to stop spending and borrowing or they will push up interest rates to ruinous levels.
>
> It will mean higher interest rates and restraints on Government spending for all of us, and for a long time.
>
> The phrase "bond vigilante" was coined in the early 1990s, when bond investors started telling US and other governments to spend less money.
>
> Whenever these bond investors worry about debt rising too fast, they push up interest rates by selling these bonds.
>
> They became quite influential because whenever they pushed up long-term bond yields it immediately affected household borrowing through mortgage rates, which were connected to these wholesale markets. They forced politicians to cut benefits and impose new taxes.
>
> New Zealand had its own bond vigilantes. They helped push then-finance minister Ruth Richardson to slash benefits in her "mother of all budgets". She was rightly worried that investors would hike interest rates unless the government showed it could reduce spending.
>
> The bond vigilantes went into abeyance through most of the 2000s because government debt was beaten down to relatively low levels and short-term interest rates were kept (artificially) low by central bank governors such as Alan Greenspan and Ben Bernanke.
>
> They have stayed quiet in the past two to three years as the recession and low inflation drove bond yields lower.
>
> But that era is now over. Governments in Europe and America took on enormous debts from the private sector to avoid complete financial collapse in late 2008 and early last year.
>
> They also spent like drunken sailors on infrastructure and benefits to keep their economies going.
>
> That was fine for a year or two, but now their budget deficits are out of control, over 10 per cent of GDP and public debts are racing towards or are already over the crucial 100 per cent of GDP level.
>
> Once over that threshold, it is difficult to avoid a vicious debt spiral. Low interest rates are crucial once debt is that high. Rising interest rates make such deficits unsustainable and therefore mean the bond vigilantes have real power. Now those long bond yields are rising. Last week, everything came to a head. The US Government had to sell US$118 billion ($167 billion) worth of bonds in three auctions.

> The US Federal Reserve stopped buying mortgage bonds and ratings agencies warned America's AAA credit rating was in danger unless it got its deficits under control.
>
> All this matters for New Zealand because rising US long-term interest rates will slow the world's largest economy. They also set the base for fixed mortgage rates here.
>
> The indebted developed world has begun a long, painful period of deleveraging where growth is slow and new jobs are scarce. Bond vigilantes are back in charge.

The New Zealand economy has also stabilised with growth in GDP in the second half of 2009. But at the end of 2009 GDP remains 2.1 percent below its peak in December 2008. The increases seen in GDP are largely driven by restocking inventories rather than job creating investment. In New Zealand the GDP decline was moderated by the fact we are the only country that had such a large property price boom not to have seen a significant decline in prices. With growth rates still below what is needed to stop unemployment growing, there will continue to be downward pressure on house prices. The economy in 2008-2009 also benefited from exceptionally high commodity prices internationally – especially for dairy products. That cycle will inevitably come to an end.

Going into this recession we were in a much worse situation than 1990. The proportion of households spending more than 30% of their income on housing has gone from 11% in the late 1980s to more than twice that today. Twenty percent of NZ families with children live in severe or significant hardship according to the Ministry of Social development.

Real wages haven't recovered and families are under pressure already. There can be no return to debt creation as a substitute to an expansion of real incomes for the big majority. The deep inequality that grew in New Zealand society and the absolute poverty that exists at the bottom of the income ladder must be addressed. That is why raising the minimum wage to two thirds of the average wage is a vital first step giving everyone a fair share of the economic pie.

The only long term solution is a democratic plan for the economic and social development of New Zealand as a whole. That must begin with taking the banks and major financial institutions out of the hands of the private profiteers. Vital national infrastructure like telecoms, power and transport also should be in the hands of the state and subject to community control and workers participation in management. The books of these companies should be open to public inspection. We can then have a democratic national discussion to draw up a plan that is in the interests of the majority not the self-serving greed of the tiny minority who have created this crisis.

The argument that there isn't enough money for pensions, welfare, health and other social benefits is a fraud. Never in the history of humanity has there been more productive capacity in the world, more potential to provide every human being with sufficient food, shelter, medical care, education and other necessities. The problem is that most of that productive capacity is in the control of a tiny minority. If, despite the wealth that exists, our rulers don't believe they meet our basic needs then we should push them aside and reorganise society to give priority to meeting human needs not serving private profit.

unite

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