A summary of the talks given at the 'Inequality: Causes and Consequences' conference organised by the Institute for Governance and Policy Studies on 19 June 2014

Beware of Utopian solutions to inequality, academic warns

New Zealand needs a better balance of universal and targeted services if it is to reduce child poverty significantly, Susan St John says.

Speaking at an Institute for Governance and Policy Studies conference, the Auckland University associate professor said the welfare system was in many ways "a mess". Because so many forms of income support – including Working for Families, the accommodation supplement and childcare subsidies – were reduced as income increased, many people were faced with very high effective marginal tax rates.

But policymakers should "beware of Utopian solutions" such as a universal child benefit, and must “learn the lessons of history”.

St John said that, as part of the 1991 reforms aimed at “doing away with all universality”, a “change team” had been asked to find an integrated solution to overlapping effective marginal tax rates.

They came up with ideas such as family accounts and smart cards, but “ten good men and six months later … they couldn't make it work.” This was deeply ironic, as the 1991 reforms “were predicated on this rationalisation”.

St John also questioned the current emphasis on creating incentives for people to be working, for instance through denying the in-work tax credit to beneficiary families. New Zealand superannuation was high enough to remove poverty and to reduce incentives to work, but more and more older people were working, she said. "Let us not believe that we need to have benefits and other payments at levels causing poverty in order to create behavioural change."

This kind of discrimination had started with the child tax credit in 1996, which gave more to those independent from the state and introduced the notion of "deserving and undeserving" poor. This was then made “much worse” by the in-work tax credit.

St John said this discrimination had taken $6 billion from the balance sheets of beneficiary families since 1996, $2.25 billion of it by denying them the child tax credit and $3.7 billion by denying them the in-work tax credit.

“It's no wonder those families have run through their assets, have borrowed from loan sharks ... or that their debt is compounding, just as the wealth of the rich is compounding.”

However, St John hailed the increasing agreement that Working for Families was "badly designed and too complex”, and that the in-work tax credit should not be dependent on the recipient’s hours of work or being off a benefit.

She added: "Unless the incomes of workless households with children can be boosted one way or another, major reductions in in child poverty will be very difficult to achieve."

Full reform of the welfare system would need a Royal Commission, which would also have to address the large amount of unpaid work, such as childcare, done principally by women. In general, she said, New Zealand's welfare system should return to the more “balanced” package of targeted and universal services it had prior to 1991.

Academics challenge received wisdom on inequality

Commonly held views about the social effects of inequality and the concentration of income in the top 1% may be wrong, two leading economists have argued at an Institute for Governance and Policy Studies conference on inequality.

Economist Brian Easton outlined his work on New Zealanders’ tax data, looking specifically at three groups: the top 10%, with incomes over $72,500; the top 1%, with incomes over $165,000; and the top 0.1%, with incomes over $500,000.

He analysed this data using a measure known as the Pareto coefficient, which described how “compressed” the top end of the income distribution was.

New Zealand’s Pareto coefficient indicated that incomes at the top end were clustered relatively close together rather than extending into very high ranges, making for an upper income distribution that was more equal than in many other developed countries.

Easton said his analysis took into account a number of factors, including the fact that the tax treatment of dividends had changed significantly in recent decades.

Since the 1990s, his analysis showed that the share of income going to the richest New Zealanders had remained “stable”, while changes in the Pareto coefficient indicated that inequality at that end of the spectrum may have fallen.

Easton said this might have been because many wealthy New Zealanders were no longer resident for tax purposes and would only pay tax on the New Zealand-sourced part of their income, reducing their apparent incomes.

When asked about the contradiction between his calculations and other accounts of inequality in New Zealand, which show rapidly rising income shares for the top 1% and other top earners, Easton said of the others, “They don’t make the same adjustments [to the data] that I make.”

Later on in the conference, Auckland University economist Tim Hazledine cast down on the findings of the influential book *The Spirit Level*. The book argues that inequality is the strongest cause of a wide range of health and social problems such as low life expectancy, high rates of obesity and poor educational results.

But Hazledine said there were a number of factors that could explain the close correlation between high levels of inequality and high levels of these health and social problems. There could be a third, “exogenous” variable causing both inequality and social problems, or inequality could be acting as a “proxy” for another more important variable. Reverse causation – social problems leading to inequality – was also a possibility.

Hazledine’s analysis of *The Spirit Level*’s data for American states showed that while inequality was closely correlated with health and social problems, low income – as measured by the income of the poorest quarter of a state’s inhabitants – was even more closely correlated. This indicated that “poverty matters more than inequality per se.”

However, both poverty and inequality “appear to be determined” by other factors, such as rates of smoking and obesity in a state’s population. The apparent direction of this causation needed to be further investigated, Hazledine added.

Inequality hitting 30-year-olds, academic says

There is already "considerable" inequality by the time people reach their late 30s, with the wealthiest thirty-somethings owning more than half the wealth of their peer group, Simon Chapple says.

Speaking to an Institute for Governance and Policy Studies conference on inequality, the Otago University academic set out recent findings from the Dunedin longitudinal study, whose participants were born in 1972-73 and had their assets analysed at age 38.

The median or middle person in the study had assets of $167,500, but the average person had $360,000, indicating that some very high asset owners were pulling the average up. The biggest wealth holding in the study was worth $7.3 million.

Most of the participants’ wealth was in housing, with businesses and farms the only other significant asset class.

Inequality of wealth amongst the participants was very similar to that of the general population, Chapple said. The top 10% had half of all assets, the middle 40% had 43%, and the bottom half of participants had just 6%.

Inheritance was unlikely to be a big factor because, at age 38, most people in the study still had both parents alive.

Social factors, such as socio-economic status or gender, could not explain this wealth inequality, but nor could individual factors such as IQ, Chapple said.

Further research would examine whether wealth inequality could be predicted by levels of self-control in childhood, personality, childhood health, and the death of a parent as a proxy for inheritance.

However, it was clear there was "considerable" wealth inequality within Generation X, and that "most wealth inequality is not between generations or over the lifecycle" but is within each generation.

Chapple also noted that people who were in a relationship had four times the wealth of people who are single. This could be partly due to problems with measurement, because it was difficult to value joint assets.

But it could also reflect the increasing trend for wealthy people to partner each other, the fact that partnering was "an institution for wealth creation" in its own right, and the fact that some of the single people would have had partnership breakups that reduced their wealth.

Look more at rich neighbourhoods, says researcher

More attention needs to be given to wealthy areas and the "neighbourhood effects" created by the clustering of rich individuals, professor Philip Morrison has argued.

Speaking at an Institute for Governance and Policy Studies conference, Morrison said geography –in the form of residential segregation between rich and poor areas – could affect people's attitudes towards inequality.

This particularly mattered because polling evidence showed that only half of New Zealanders felt that it was the government's job to narrow income gaps.

People moving between high and low deprivation areas was a relatively rare phenomenon, Morrison said, citing research looking at residential moves between 2001 and 2006. "The vast majority of people, when they move, will move to areas that are the same as the one they left. There is a high degree of socio-economic stability."

This was especially true for people in the most deprived areas. "Starting off in a very deprived neighbourhood may indeed constrain social mobility in geographic terms, especially if the movers have relatively low incomes."

He added: "There are some inklings... that geography does matter."

This research also implied that, rather than focusing on poor neighbourhoods, more attention should be paid to “the spatial clustering of the rich".

Morrison said: "If you really want to establish the importance of neighbourhood effects, you don't look at the poor, you look at the rich, because they are the ones who are residentially sorting

themselves to maximise neighbourhood effects … the rich are very, very sensitive to location. We need to shift our attention from the poor to the rich, and their residential sorting decisions."

Morrison and fellow academic Barry Martin had developed an 'affluence index' as a counterpart to the traditional deprivation index.

It showed the rich clustered in downtown Wellington and Auckland, contrasted with "the increasing suburbanisation of the poor". While Auckland had 30% of the overall population, it had half of the most affluent areas. This effect was even more extreme in Wellington, which had just 9% of the population but 40% of the most affluent areas.

However, the reasons behind this clustering and its advantages were not yet well understood, Morrison said. "The rich have the most to gain from manipulating area externalities, but so far we appear not to have developed instruments that might measure the incentives to social exclusion by the rich and their practices."

Wage gap big source of inequality, says CTU

Workers are being denied their fair share of economic growth, driving inequality far higher than it would otherwise be, CTU economist Bill Rosenberg has argued.

Speaking to an Institute for Governance and Policy Studies conference, he said there was "a very clear relationship between wage inequality and general household inequality".

Wages made up three-quarters of the typical household's income, so if they were unequally distributed or wage earners were missing out, that would have a significant effect on income gaps.

The Gini coefficient measure of inequality for market income (salaries, wages and other work-related income) had increased sharply since the 1980s, from 42 to 52, Rosenberg said. Between 1988 and 2010, market incomes had not risen at all for the bottom half of the population, despite increased numbers of households where both parents worked.

The share of income going to labour (wage and salary earners) as opposed to capital (lenders and investors) had dropped from 60% in the 1980s to a little over 50% today. This meant it had lost one-sixth of its value – equivalent to $19bn a year or $10,000 per worker today.

The total loss to wage and salary earners over that period was equivalent to $1.2 trillion, if the income had been used to pay back mortgage borrowing, Rosenberg said.

In general, New Zealand's labour share was extremely low by international standards, where 60-70% was typical, according to the economist Thomas Piketty. New Zealand's labour share was the third lowest in the OECD, behind only Chile and Mexico.

The fall in New Zealand's labour share was not caused by a big shift towards low-wage industries, Rosenberg said. “Virtually all” the change was the result of changes in the labour-capital split within existing industries.

Nor could it be explained by increased capital intensity – and in fact the Productivity Commission had said was more likely to be due to poor wage growth.

International Labour Organisation analysis showed that, typically, the fall in the labour share was caused principally by increased financialisation (explaining 46% of the fall), globalisation (19%), technology (10%) and the loss of bargaining power and unionisation (25%).

One of the other striking features of New Zealand's inequality story was the way that, in the early 90s, wages became disconnected from growth in the rest of the economy.

Before 1990, when GDP increased, wages did as well, but since then, GDP had increased substantially and wages had not. The same was true of productivity and real wages, Rosenberg said. If the average hourly wage had risen in line with productivity growth since 1990, as economic theory suggested it should, it would now be $38, but instead it was around $28.

Action urged on energy poverty

Options for lowering the price of energy for the poorest consumers are needed to tackle energy poverty in New Zealand, Ian McChesney has argued.

Speaking to a conference organised by the Institute for Governance and Policy Studies, the co-founder of Community Energy Action said 60% of the most deprived households reported putting up with being cold in order to manage their heating costs, while 40% of those households were unable to pay their electricity bills on time.

This was clear evidence of 'energy poverty', defined as the inability of households to afford a sufficient level of energy services in their home.

Poor households faced the problem that the most efficient heating appliances "are the ones that cost many hundreds of dollars" upfront, an investment few of those households could afford to make. "That's just typical of the capital barriers that many low income people face."

The number of people disconnected from non-payment had risen from just 2000 per quarter in 2008 to nearly 10,000 a quarter this year. On top of that, around 20,000 households a year "self-disconnected" to go on pre-payment meters.

Household energy prices had also been increasing much faster than the consumer price index. People were now spending a bigger proportion of their income on power then they were in the 1980s, and even those amounts were probably inadequate for their actual needs, based on international evidence.

In short, it was estimated that up to a third of households had "some level of energy deprivation". The policy response to date had focused on insulation, but there were "major gaps".

One option that should be explored more was a social tariff, a form of discounted rate or rebate for vulnerable groups used widely in Europe and North America. They were normally mandated on power companies and funded by levies on other consumers.

In France, for example, the state provided discounts of up to €200 a year on gas and €90 a year for electricity to around 4 million households, adding 2-3% to consumers' energy bills.

California, meanwhile, had a highly regulated energy market and ran a number of programmes including the California Alternative Rates for Energy scheme and the Energy Savings Assistance programme. These were "large, multi-year, multi-billions of dollars" schemes reducing energy costs for poor households, with ambitious targets of 90-100% take-up.

Social tariffs in some form were "worth having on the policy agenda", McChesney added.

Evidence backs focus on tackling poverty, says school researcher

The background of students and their families, including their level of poverty, account for around 60% of the differences in student achievement, Cathy Wylie says.

Speaking to a conference organised by the Institute for Governance and Policy Studies, Wylie said studies that measured more than just in-class effects found that "formal education", in contrast, accounted for just 20% of the differences. A further 20% was unexplained.

Wylie, a chief researcher at the New Zealand Council for Educational Research, said the school system was profoundly affected by the rich-poor divide, legacies of colonisation, and the Matthew effect, in which schools that already had a lot were given even more.

Students from poorer backgrounds needed greater learning opportunities than their more advantaged peers, but the segregation of New Zealand schools by socio-economic status, driven partly by housing segregation, made that very difficult. It also militated against creating schools with an even socio-economic mix, even though that was one of the best environments for children's development.

Wylie also noted that colonisation's legacy had left Maori with "a profound lack of trust" in the school system, while in contrast Pacific families were "too trusting" and failed to challenge the system sufficiently. It would take "at least a generation more" to re-establish needed levels of trust and confidence in those communities.

Meanwhile, Tomorrow's Schools, which saw schools competing against each other, militated against an effective sharing of knowledge about what policies could increase attainment.

The Shine initiative in Porirua had shown great results in boosting primary school students' reading ability, but the average reading ability for the Porirua high schools intake remained relatively low. That was because knowledge was not shared widely, but also because many families with "high educational aspirations" sent their children outside of the area. Around a quarter of the potential high school intake left the Porirua area, half of them from wealthier communities.

Wylie said that most education researchers would, if forced to make a choice with limited resources, support moves to tackle poverty over those affecting what happened in schools. They were "weary" with incoherent educational policies, understood the difficulty of shifting educational attainment "on a large scale", and knew that recent research had showed that boosting family income "on its own makes a difference to children's outcomes".

Research had shown that a $1,000 increase in family incomes led to a 5-22% increase in cognitive outcomes and a 9-24% increase in social and behavioural outcomes.

However, policies to boost the effectiveness of teaching were also important, Wylie said. "We need a number of policies to be working in concert with each other," she added, citing studies that showed "similar effect sizes [as those above] for cognitive gains from investment in formal education".

Piketty has created paradigm shift, says economist

Thomas Piketty's *Capital in the Twenty-First Century* has "superseded" much of mainstream economics to date and revealed capitalism's natural tendency towards a steady state of high inequality, Geoff Bertram says.

Speaking at an Institute for Governance and Policy Studies conference, Betram, a senior research associate at the institute, said Piketty's work was "an exercise in intellectual construction that supersedes the way economists have been thinking for a long time".

Far from being heterodox, it was "tackling mainstream economics head-on, on its own terms" and solving some of the "puzzles" that had bewildered neo-classical economists.

Rather than looking closely at issues of "production", as many economists did, Piketty had assumed that the growth rate of the world economy was essentially fixed. Instead, he had focussed on "appropriation" – the division of that production among different groups.

In Piketty's model, "labour" – defined as all the human effort that went into production – had only a "residual" claim on the rewards of that production, and was "always subject to the claims of the wealthy to collect their rents".

This was the normal state of affairs except when disturbed by "war and taxes" – which were exactly the two forces that characterised the twentieth century and made it an historical anomaly.

In the nineteenth century, the owners of capital had achieved a steady state of dominance over the economy, with the stock of wealth in a typical European country being worth around seven years of the income produced in that society.

While that level had plummeted in the early to mid twentieth century, it was now rising sharply back towards its nineteenth century level, driven by increased savings that was building up capital without high growth rates to dilute the concentration of wealth.

“Can you feel an equilibrium coming?” Bertram asked, pointing to what he said was one of Piketty’s greatest contributions: identifying that there was a natural equilibrium in capitalism – with high inequality and wealth assuming a dominant position – and that this equilibrium was determined by the ratio of savings in the economy to its economic growth rate.

This insight showed the twentieth century to have been “a low-inequality disequilibrium”.

However, while Piketty had acknowledged that very high levels of inequality could continue “only if they are tolerated”, Bertram said, his failure to provide a theory of how that tolerance was determined was “the missing piece” in his book.

Max Rashbrooke