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To what extent do you think policy makers should be concerned about the growing wealth and income inequality here in New Zealand? What advice would you provide about policies that might help to address these issues in New Zealand, and what trade-offs might these policies involve for New Zealanders?

Keywords: income and wealth inequality, economic growth, instability, Capital Gains Tax (CGT), Foreign Direct Investment (FDI), education, debt avoidance.

In *Capital in the Twenty-First Century,* Thomas Piketty (2014, p. 20) argues that the distribution of wealth is political by nature. The distribution system is not simply a result of economic mechanisms, therefore policy makers have a responsibility to intervene. In the following section I will discuss the history and nature of this responsibility as well as the impact of inequality on economic growth and political and economic stability. The second section of this essay will deal with advice and trade-offs surrounding policies that may help address the issue of income and wealth inequality in New Zealand. For this section I will focus on Capital Gains Tax (CGT), education and debt avoidance, discussing potential trade-offs of policies in these areas involved for New Zealanders with respect to Treasury's Living Standards Framework.

Policy Makers and Inequality

'No natural forces determine income, wealth, and the quality of human life' (Johnston, 2013, p. 13).

The post-WWII prosperity of countries such as the United States and New Zealand can be attributed, in part, to the efforts of governments to recover and rebuild their economies after the Great Depression and the two world wars (Johnston, 2014; Piketty, 2014). This demonstrates the considerable power possessed by the government to change the landscape of income and wealth inequality.

Inequality itself is a necessary fact of life, yet society dictates what levels of inequality we allow (Piketty, 2014, p.19). David Johnston argues inequality and the diminishing middle class has been the result of a choice made. His assertions pertain to inequality in the United States, further arguing that the United States has chosen reduced access to growing income, home ownership and higher education (Johnston, 2014, p. 13). By analysing New Zealand's growing inequality and its effects on home ownership and higher education access we can draw parallels with the United States.

Growing income and wealth inequality indicates we cannot rely solely on the market to slowly trickle down gains from success of capital advancement to the many, without who such advancements would not be possible. The idea that the benefits of economic growth will filter down to middle and low income households without intervention is flawed and has not come to

fruition (Obama, 2011). As the post-war period demonstrates, policy has historically been used to alleviate income and wealth inequality – a responsibility which policy makers have today.

Inequality, Economic Growth and Instability

A recent OECD (2014) study highlights income inequality as an obstacle to New Zealand's economic growth. It is, therefore, in New Zealand's economic and political interests to address growing wealth and income inequality. Growing inequality has seen wealth and income accumulation concentrated among the top one percent at the expense of middle and lower income earners. As the middle class shrinks, consumer spending, necessary to fuel economic growth, decreases (Stiglitz, 2013, p. 45). This may not directly affect the country if major consumers are located overseas. However, a shrinking middle class reduces household investment into education and reduces tax revenue. As a result the government does not have the means to invest in infrastructure and such schemes used to create jobs and attract FDI (Stiglitz, 2013, p. 45). Moreover, inequality is associated with 'boom-bust cycles', indicating a strong correlation between inequality and economic instability. Policy makers should be concerned with income and wealth inequality for its detrimental effects on economic growth and the further ramifications such affects may have on political stability.

Wealth and income inequality are indicators of other inequalities, and sentiments fostered by these can result in lack of trust and instability. Wealth and income inequality can significantly reduce investment in training and education for some social groups which ultimately leads to exclusion from the benefits of economic growth (Piketty, 2014, p. 22). High levels of inequality undermines values of meritocracy upon which democratic society is based (Piketty, 2014, p. 1), leading to political instability.

Political instability can undermine trust in the government and political institutions, and act as a deterrent for FDI, damaging chances of success for any replacement government. Correlations found between political instability and low economic growth demonstrate another indirect negative effect on economic growth and stability (Aisen and Veiga, 2013).

Inequality, Policy and New Zealanders: Capital Gains Tax

The first section discussed the need for policy makers to concern themselves with the growing income and wealth inequality by highlighting its effects on capital stocks and more widely on economic and political instability. The policies discussed here include changes to capital gains tax, greater investment in primary and secondary level education, and assistance with debt avoidance.

There is currently no CGT in New Zealand apart from taxes on capital gains made on residential property sold within two years (Inland Revenue, 2015; Radio New Zealand, 2015). The introduction of a CGT would affect financial and physical capital by increasing tax revenue which could be spent on further investment into New Zealand's financial wealth, housing and infrastructure. Furthermore, it would increase government capacity to grow and maintain in-kind services such as healthcare and education.

Tension exists around the extent to which policy makers should impose certain taxes on income and wealth. Taxation impacts social capital through interference with individual freedom and property rights (Treasury, 2011). Moreover, introducing taxes such as capital gains can deter FDI and lead some businesses currently located in New Zealand to move overseas to countries with more favourable tax policies (Gould et al., 2013). Reduced FDI can have implications for employment; fewer jobs are created and, in some cases, even lost (OECD, 2002; Pandya, 2010). This will further affect income and consumption (Taylor, 2010) and demand for in-kind services could increase.

FDI can also influence human capital as some businesses invest in local staff training and education. Potential loss of business currently located in New Zealand and deterrence of future FDI could lead to reduced investment in human capital made by the private sector. Whilst FDI creates more employment it can have flow on effects for New Zealand's natural capital stocks. More businesses operating in New Zealand can lead to increased production of waste which the environment must absorb in the form of carbon emissions and other pollutants, endangering the climate, water and biodiversity and health (Lau et al., 2014). However, literature on the effects of FDI on natural capital are inconclusive as Kim and Adilov (2012) argue foreign business can introduce more sustainable and environmentally friendly practices.

To overcome potential trade-offs and gain the benefits of increased tax revenue a low rate CGT could be introduced. Piketty suggests a global tax on capital, arguing it would expose wealth to democratic scrutiny, which is a necessary condition for effective regulation of the banking system and international capital flows. A global tax would avoid the use of lower tax rates to attract FDI and we would witness other efforts to attract FDI such as greater investment into infrastructure. Currently, the logistics of setting and enforcing a global tax on capital are unfeasible. Instead, an agreed regional tax on capital could be entered into, for example between New Zealand and Australia. Once established this could include the Pacific and even expand to parts of Asia.

Inequality, Policy and New Zealanders: Education

Income distribution is affected by opportunities and achievement in education (Hills at al., 2013, p. 220; de Gregorio & Lee, 2002, p. 395). In the longer term, improvements made to the education system would see more opportunities for students who pass through the system irrespective of their present socioeconomic status and capabilities. Inequality is natural and results from society's heterogeneity, as different people have different levels of resources and capabilities (Sen, 1974, p.74).

Building more classrooms, increasing access to learning technology, hiring more teaching staff and reducing class size is an investment into human capital, resulting in greater achievement as teachers and students have heightened access to resources required to succeed (Dillenbourg et al., 2009). Investing into teaching staff and reducing class sizes can improve the quality of teaching, and investment into technology can assist students who learn by different methods, enabling a greater chance at academic success. Flow on effects include increases in employment and income and reduced demand for in-kind services such as welfare and healthcare as healthier living and lifestyles are afforded. Increases in employment and income will have ramifications for financial and physical capital, increasing tax revenue through income tax and GST, as income and consumption increase.

Investment into the primary and secondary schools system can affect the likelihood of students continuing on with higher education. The ramifications of this for social capital could include greater social and political awareness and participation (Putnam, 2000; Rahn and Rudolph, 2005; Ekici and Koydemir, 2014). Awareness and participation, combined with analytical and decision-making skills provide individuals with the tools to invest smartly into the future to benefit themselves and the wider community. Participation also correlates with a sense of freedom and security in personal, economic and political arenas which can serve to encourage further participation (Acharya et al., 2010; Shantayan, 2011).

Building new classrooms will also have implications for natural capital. The process of building new classrooms will involve significant carbon emissions in addition to the increased carbon footprint of schools for maintaining extra classrooms, although measures can be taken to reduce the carbon footprint (See NERI et al., 2009).

Inequality, Policy and New Zealanders: Debt Avoidance

Income inequality provides a market for personal loan companies, increasing household debt, and studies show this further perpetuates the problem of income and wealth inequality. Iacoviello's (2008, p. 925) study revealed a relationship between the rise of household debt and

growing income inequality, indicating the importance of this area for alleviating income and wealth inequality.

The Responsible Lending Code offers a guide to responsible practice for lenders (Ministry of Business, Innovation and Employment, 2015) and increasing financial literacy through schools and the workplace seek to reduce risks of vulnerable borrowers falling victim to predatory lenders. These two efforts engage in the promotion of human capital. By investing into New Zealand's financial literacy, this will improve individuals' skills and health. Creating employment and income, facilitating consumption and reducing the need and demand for in-kind services such as welfare. It can also have a significant impact on the health of New Zealanders as debt is found to correlate with psychological and physical distress (Selanko and Batinic, 2011; Sweet et al., 2013). The stresses associated with debt can damage an individual's economic freedom and security as well as their sense of personal freedom. This can damage New Zealand's social capital as a sense of freedom and security is necessary to maintain trust in political institutions.

Avoiding household debt can have implications for financial and physical capital. Firstly, reduction in debt could lead to increased consumption (Daneshku, 2005). As this increases so will tax revenue and welfare provisions will decrease, providing more resources necessary for further investment into public goods. Increasing tax revenue can also provide more resources necessary to invest greater efforts into preservation of natural capital and potentially offset any negative effects caused by increased FDI and construction and maintenance of new classrooms.

Summary

Policy makers should concerned with addressing New Zealand wealth and income inequality, and its social, economic and political implications. Using the Treasury Living Standards Framework I have discussed potential consequences of a capital gains tax, greater investment into primary and secondary educations, as well as the Responsible Lending Code and improving financial literacy for New Zealand capital stocks. Efforts in all three areas can lead to positive effects on financial and physical capital by increasing tax revenue. Investments made into education and debt avoidance can improve human and social capital. Both capital gains tax (if FDI increases) and the construction of new classrooms can be detrimental for natural capital, although increasing FDI, in some cases, and efforts made in sustainable practice can reduce these negative effects for New Zealand's natural capital. With action taken to ensure potential negative ramifications are offset, a capital gains tax, investment into education and debt avoidance could assist in alleviating New Zealand's growing income and wealth inequality.

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