

PERSONAL INCOME TAX IN NEW ZEALAND

WHO PAYS AND IS PROGRESSIVE TAXATION JUSTIFIED?

SINCLAIR DAVIDSON



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EXECUTIVE SUMMARY

This paper investigates personal income tax in New Zealand, and focuses in particular on the progressive nature of that tax. There are a whole range of arguments surrounding tax in general, and personal tax especially. Many common arguments are incorrect.

New Zealand is a relatively high-taxing economy. Tax comparisons are often made with member countries of the Organisation for Economic Cooperation and Development (OECD). Such comparisons are often ambiguous, given the differing definitions of tax and social security contributions. However, it is clear that New Zealand is not a low-tax economy, compared with non-European economies, on any measure and definition. When comparing tax ratios on a weighted basis, rather than the common – yet misleading – unweighted basis, the full extent of the New Zealand tax burden becomes readily apparent. Furthermore, New Zealand's top marginal tax rate cuts in very quickly at an income level of 1.2 times average per capita gross domestic product (GDP). This compares unfavourably with the United States at 8.5 times per capita GDP, or 9.5 times per capita GDP in Singapore.

Individuals pay almost 43 percent of total tax directly in the form of personal income tax. This paper also examines the distribution of the tax burden. There is a perception that 'the rich' do not pay their fair share of tax. Using New Zealand Treasury data for individual taxpayers, the paper shows this to be untrue. In 2004–05, the top 2.58 percent of taxpayers paid 24.07 percent of personal income tax. This group of taxpayers has seen its share of income tax increase since 2001–02. These taxpayers are paying 9.33 times more in tax than their population share.

In order to answer the question, 'Who finally pays for the public expenditures that are financed through the income tax?', the tax incidence literature is also examined. Various studies have investigated this issue in New Zealand. They suggest that between 40 and 60 percent of households receive more in government benefits than they pay in tax. The evidence shows that the tax burden is concentrated in households in the top half of the income distribution. The top 10 percent of households pay almost as much in tax as the next decile earns in income.

Tax debate often revolves around the notion of 'fairness'. It is argued that people should pay their 'fair' share of tax, and it is often assumed that progressive taxation is 'fair' taxation. The most sophisticated argument for progressive taxation is equality of sacrifice based on diminishing marginal returns, but economists have long discredited it. Other ad hoc arguments are equally unsatisfactory. Progressive taxation is inherently arbitrary and unfair. If 'fairness' is defined as proportional taxation, then high-income New Zealanders are paying far more than their fair share. Relative to their income share, the top 2.58 percent of income earners are paying 149 percent of their share in personal income tax.

Income tax policy is an emotive issue with facts and statistics early causalities. The empirical evidence is not consistent with some popular perceptions. Data presented in this paper show that New Zealand is not a low-tax economy and that better-off people pay much more than a proportionate share of income tax. In a democracy, everyone is entitled to their own opinion. They are not, however, entitled to their own facts.

PERSONAL INCOME TAX IN NEW ZEALAND WHO PAYS, AND IS PROGRESSIVE TAXATION JUSTIFIED?

The New Zealand tax system has undergone considerable change since the early 1980s. The 1982 McCaw Committee found that the system was in bad shape. It argued that New Zealand was relying too much on direct taxes relative to indirect taxes, and that tax avoidance was widespread with a steeply progressive income tax scale. In 1988, the top marginal tax rate was reduced from 66 percent to 33 percent. Other reforms, such as the introduction of a goods and services tax (GST) in 1986, expanded the tax base. The Organisation for Economic Cooperation and Development (OECD) has commended New Zealand's tax reforms, and noted that marginal tax rates are moderate.¹ The OECD is not an organisation known for its low-tax advocacy. Nevertheless, it has advocated steps to curb government expenditure and moves to a lower and flatter income tax scale.

This paper examines whether the New Zealand personal income tax system is fair in a classical economic sense. It looks first at the overall tax burden, identifies who pays personal income tax, and discusses the weakness of arguments for progressive taxation.

Is New Zealand a high-tax economy?

To determine whether New Zealand is a 'high-taxing' economy, a range of indicators was examined. First, some basic comparative data from the OECD are shown. Table 1 outlines the tax take (as a percentage of gross domestic product (GDP)) for New Zealand and selected OECD economies for 2001 and breaks it down into various components. Relative to the OECD overall (all 30 members), New Zealand's tax take is lower (33.8 percent of GDP compared with 36.9 percent). By European Union (EU) standards the New Zealand tax take (total tax as a percentage of GDP) is noticeably lower. European Union members, with an average rate of 41.0 percent, drive the 'high' OECD tax take. When we look at New Zealand's ratio relative to that of other English-speaking economies, New Zealand does not compare favourably. New Zealand's tax burden is higher than that for the United States (28.9 percent), Ireland (29.9 percent) and Australia (30.1 percent). Moreover, many countries that are not members of the OECD have lower tax-to-GDP ratios than New Zealand. Most high growth countries of Asia have a tax ratio of no more than 20 percent. For example, Hong Kong and Singapore, which have a much higher income per capita than New Zealand, have a tax ratio that is about half New Zealand's.

¹ T Dalsgaard (2001) *The Tax System in New Zealand: An Appraisal and Options for Change*, OECD Economics Department Working Paper No 281.

The ratio of government spending to GDP is arguably a better indicator of the tax burden than the tax ratio. Expenditure must be financed from current tax revenue, debt (which can be viewed as deferred taxation) or the sale of assets. Operating surpluses ('over' taxation) or deficits ('under' taxation) do not distort the expenditure measure of the tax burden. An analysis based on the expenditure ratio shows a similar picture to the tax ratio. The OECD forecasts that New Zealand's ratio of general government total outlays (including local government) to GDP will be 38.7 percent in 2004, compared with the OECD average of 40.3 percent. New Zealand's expenditure ratio is expected to be higher than that of Australia (36.2 percent), Ireland (35.8 percent) and the United States (35.2 percent). As with the tax ratio, the average spending ratio for the OECD is boosted by the EU ratio of 48.4 percent. The more dynamic countries in the Asia-Pacific region have much lower spending ratios than the EU and New Zealand.²

The structure of taxes in OECD countries is also shown in Table 1. Unlike other OECD countries, New Zealand and Australia finance social security spending from general revenue rather than from dedicated payroll taxes (social security contributions) payable by employees and employers. As a consequence, New Zealand appears to rely on personal income tax (42.9 percent) to a much greater extent than OECD countries on average (26.5 percent).

Payroll taxes, however, are a form of income tax.³ Whether they are collected from employers or employees is of little significance from an economic perspective. Thus,

Table 1: OECD comparisons on tax, 2001

	Total government outlay (% GDP)*	Total tax (% GDP)	Proportion of total tax				
			Personal income tax	Corporate income tax	Social security (employer/employee)	GST	Other
Australia	36.2	30.1	40.8	14.9	0.0/0.0	29.1	15.3
Canada	40.1	35.1	37.1	10.0	6.0/8.3	24.7	14.0
Ireland	35.8	29.9	29.7	12.1	4.4/9.4	37.3	7.0
Japan	36.9	27.3	20.1	12.7	15.1/18.8	19.0	14.4
Korea	24.2	27.2	14.1	12.3	10.7/7.5	39.6	15.7
New Zealand	38.7	33.8	42.9	11.3	0.0/0.0	35.5	10.3
United Kingdom	42.6	37.3	30.2	9.5	6.8/9.6	31.3	12.6
United States	35.2	28.9	42.3	6.5	10.8/12.5	16.1	11.8
European Union	48.4	41.0	25.8	8.9	9.2/16.1	30.1	10.0
OECD	40.3	36.9	26.5	9.4	7.9/15.2	31.3	9.7

* Data are for 2004.

Source: OECD in Figures (2004) and OECD Economic Outlook 75, Statistical Annex.

² Organisation for Economic Cooperation and Development (2004) *OECD Economic Outlook 75 Statistical Annex*, Paris: OECD, p 239.

³ This is likely to be the case for most workers who are not internationally mobile, or second-income earners.

social security contributions can be viewed as being broadly equivalent to personal income tax. On this basis, New Zealand collects about 42.9 percent of its total tax revenue from personal income tax compared with 49.6 percent for the OECD. Other categories of taxes (company, GST and other) account for a somewhat higher proportion of total tax in New Zealand than is the case for the OECD as a whole.

A larger sample of economies is examined in Table 2. Here, data are drawn from the World Bank's World Development Indicators Online. The data are segmented by geographic region. The first column shows the top marginal tax rate (for some economies it excludes social security contributions). The second column shows the income threshold (in US dollars) at which the top marginal tax rate applies, and the final column shows the ratio of threshold income to GDP per capita (purchasing power parity basis). The first column shows that the top marginal tax rate for New Zealand is not high by continental European standards (especially when social security is considered). The rate is high, however, when compared with the Asia-Pacific region. China is the only country in the region that has a higher top rate. The income threshold for New Zealand is very low by international standards. Most economies with lower income thresholds are either emerging or transitional (former socialist) economies. Unlike the situation in many countries, New Zealand's income tax base is relatively broad and provides limited scope for taxpayers to avoid the top tax rate. This accentuates the impact on income earners of the low income level at which it applies. In the final column, a comparison between threshold income and GDP per capita is made. The top marginal tax rate applies very quickly to income in New Zealand. With the exception of Australia and Hong Kong, New Zealand has the lowest ratio in the region.

Peter Burn, in a recent Centre for Independent Studies paper, makes the argument that OECD comparisons can be misleading. Burn indicates that these comparisons usually consist of unweighted averages. He points out, however, that three-quarters of the OECD countries by number of members are high-taxing European countries, yet they only comprise 35 percent of OECD GDP. Burn recalculates weighted averages for the tax take by GDP share and trade-weighted share and concludes:

The level of Australian taxation is about the same as the weighted average level of tax in all OECD countries. Australia is, however, more heavily taxed than our most important OECD trading parties.⁴

It is possible to recreate Burn's analysis here. On the basis of 2002 taxation statistics, four weighting techniques were employed. First, a GDP at purchasing power parity weight was calculated, second a GDP at official exchange rates weight was calculated, third a population weight was employed and finally, the New Zealand Reserve Bank Trade Weighted Index weighting was used to weight the OECD tax levels. The results of this exercise are shown in Table 3. The New Zealand tax take ratio in 2002 was 34.9 percent.

On an unweighted basis, the New Zealand tax take appears 'reasonable'. The OECD average is 36.3 percent. If we look at the unweighted averages for OECD sub-groups,

⁴ Peter Burn (2004) *How Highly Taxed are We? The Level and Composition of Taxation in Australia and the OECD*, Centre for Independent Studies, Sydney.

Table 2: Ratio of marginal tax threshold income to GDP per capita, 2002

	Top personal tax rate (%)	Income threshold (US\$)	Threshold income to GDP per capita*
<i>Australasia</i>			
Australia	47.0	35,149	1.10
New Zealand	39.0	31,561	1.21
<i>Europe</i>			
Austria	50.0	48,698	1.83
Belgium	50.0	28,596	1.49
Czech Republic	32.0	10,988	0.60
Finland	35.5	52,843	1.95
Germany	48.5	52,659	1.89
Greece	40.0	22,402	1.16
Hungary	40.0	5,999	0.33
Ireland	42.0	26,805	0.77
Italy	45.0	67,011	2.47
Netherlands	52.0	47,352	1.58
Poland	40.0	18,278	1.83
Portugal	40.0	50,045	2.60
Romania	40.0	3,743	0.59
Slovak Republic	38.0	14,087	0.94
Spain	29.2	44,794	2.95
Sweden	25.0	50,767	–
United Kingdom	40.0	48,413	1.69
<i>Asia-Pacific</i>			
China	45.0	12,048	2.69
Hong Kong, China	17.0	13,462	0.50
India	30.0	3,139	1.22
Indonesia	35.0	22,371	6.13
Japan	37.0	148,478	5.32
Korea, Republic	36.0	66,644	3.66
Malaysia	28.0	65,789	7.37
Pakistan	35.0	11,111	5.52
Philippines	32.0	9,320	2.42
Singapore	22.0	184,438	9.53
Thailand	37.0	92,379	13.62
<i>North America</i>			
Canada	29.0	65,206	2.19
United States	38.6	311,950	8.46

* Data are for 2002. Numerator is threshold income for marginal tax rate in US dollars and denominator is GDP per capita (purchasing power parity basis in current US dollars).

Source: World Development Indicators Online.

Table 3: Weighted and unweighted total tax to GDP ratios, 2002

	Unweighted (%)	Weighted (%)		
		GDP (PPP)	GDP (Forex)	Population
OECD	36.3	31.2	31.4	30.9
OECD Americas	26.1	26.3	26.5	25.0
OECD Pacific	29.2	26.3	26.3	26.2
OECD Europe	38.9	38.7	39.0	37.5
English-speaking	31.8	28.3	28.3	28.7
Euro-Zone	39.8	39.8	39.8	39.5

Source: Data from *OECD Revenue Statistics 1965–2003*, *OECD in Figures* (2004) and author's calculations.

however, the picture changes dramatically. Compared with the North American and Pacific regions of the OECD, the New Zealand tax take is high. From the unweighted data, it is also immediately apparent that the European tax ratios are much higher than the other regions. Recall it is these countries that are likely to distort the data. When the data are weighted, the high tax burden in New Zealand becomes even more apparent. The New Zealand tax ratio is higher than the OECD weighted average. It is much higher than the weighted average for the OECD Americas region, the OECD Pacific (note this weighted average includes New Zealand) and the English-speaking OECD. Weighting the tax ratio by the Trade Weighted Index gives a score of 31.0 percent. At 34.9 percent, New Zealand has a higher tax ratio, on average, than its major trading partners.

Thus, while pro-tax lobbyists may argue that New Zealand is a low-tax economy, this is only true when compared with a group of high-tax economies in continental Europe. When compared with a larger sample of economies, and the OECD on a weighted average basis, it becomes clear that New Zealand is relatively high-taxing, and for its region particularly high-taxing. James Gwartney observed that countries that levy tax at around the level imposed by New Zealand cannot expect to sustain growth in income per capita of at least 4 percent a year.⁵ This is the rate required to achieve the government's objective of returning New Zealand's per capita income to the top half of the OECD rankings.

Who pays personal income tax in New Zealand?

The New Zealand Council of Trade Unions (CTU) argues that:

... tax policy should aim to lift the burden of the greatest contribution to taxation from working people (and particularly the low paid) and to shift it on to those who can afford to pay, ie the wealthy and the corporate sector.⁶

⁵ See Winton Bates (2001) *How Much Government? The Effects of High Government Spending on Economic Performance*, Wellington: New Zealand Business Roundtable, p 26.

⁶ New Zealand Council of Trade Unions, CTU Policy: (4) Economic Policy, <www.union.org.nz/policy/10783747241795.html> (last accessed 5 July 2004).

Table 4: Personal income tax share

Income (\$)	2001–02 (%)	2002–03 (%)	2003–04 (%)	2004–05 (%)
1–10,000	2.68	2.26	2.16	1.59
10–20,000	12.10	11.51	11.29	12.01
20–30,000	9.78	9.25	8.82	7.99
30–40,000	13.14	12.05	12.43	11.07
40–50,000	11.92	12.40	11.04	11.51
50–60,000	9.83	9.70	8.95	8.78
60–70,000	6.30	7.06	8.29	8.49
70–100,000	11.78	11.78	13.43	14.49
100,000 +	22.46	24.00	23.59	24.07

Source: New Zealand Treasury, 'Key Facts for Taxpayers' (various issues).

It is commonly believed that low-income earners shoulder the burden of income tax and high-income earners engage in tax avoidance and evasion. This belief is not limited to New Zealand.⁷ It is, however, incorrect and usually unsubstantiated. In order to determine who pays New Zealand personal income tax I investigated the 'Key Facts for Taxpayers' document published each year by the New Zealand Treasury. Since 2001–02 this document has contained a table entitled 'Who pays tax ... and how much?', Table 4 summarises the information contained in those tables.

Table 4 indicates that 'wealthy' people (that is, those earning more than \$100,000) *already* bear the greatest burden of personal income tax. Individuals with an income in excess of \$100,000 (fewer than 3 percent of individual taxpayers in 2004–05) are paying over 20 percent of all personal income tax in New Zealand. This is a very large contribution by those individuals. People who earn less than \$40,000 (79 percent of taxpayers in 2004–05) will only pay 33 percent of the total personal income tax take in 2004–05. Their share has declined since 2001–02.

In Table 5, the percentage of tax paid to the percentage of population is compared. Any number greater than one (unity) indicates that a particular income group pays a greater share of tax than their proportion of the population. For example, in 2004–05, 2.58 percent of the taxpaying population will earn more than \$100,000, yet they will pay 24.07 percent of income tax (the ratio is 9.33).

This demonstrates the progressivity of the New Zealand tax system. Individuals at reasonably low levels of income (\$30,000 or less) are contributing less in tax than their numbers contribute to the population (32 percent). The New Zealand tax system raises a large component of personal income tax from an extremely small number of individuals, in particular, those who earn more than \$100,000.

⁷ See my Australian monograph (2004) 'Who Pays the Lion's Share of Personal Income Tax?', Sydney: Centre for Independent Studies.

Table 5: Tax share to population share (ratio)

Income (\$)	2001–02	2002–03	2003–04	2004–05
1–10,000	0.12	0.11	0.11	0.10
10–20,000	0.38	0.39	0.38	0.37
20–30,000	0.75	0.75	0.71	0.69
30–40,000	1.08	1.09	1.06	1.03
40–50,000	1.52	1.53	1.50	1.44
50–60,000	2.04	2.08	2.01	1.94
60–70,000	2.60	2.62	2.57	2.49
70–100,000	3.73	3.73	3.59	3.45
100,000 +	9.40	9.47	9.69	9.33

Numerator is percentage tax paid and denominator is percentage of tax paying population in income group.

Source: New Zealand Treasury, 'Key Facts for Taxpayers' (various issues).

Who bears the tax burden?

The 1986 Nobel laureate in economics, James Buchanan, once posed the question, 'Who finally pays for the public expenditures that are financed through the income tax?'⁸ On the face of it this is a very simple question. Economists, however, tend to provide complex answers. Many economists might answer the question by undertaking a tax incidence analysis.⁹ This type of analysis involves estimating the impact a tax has on the income of a given individual or group of individuals – usually a household or family. The results of incidence studies are particularly sensitive to assumptions about the allocation of spending and taxes among individuals or households.

A number of such studies have been undertaken for New Zealand.¹⁰ Some have estimated the impact of taxes and public spending on household income.¹¹ Recent studies have been based on the Statistics New Zealand 1997/98 Household Economic Survey. Consequently, the results are very similar. James Cox reports that the top 40 percent of households pay 69.5 percent of total tax (direct and indirect taxation). The remaining 60 percent of households pay 30.5 percent of tax yet receive 72.6 percent of total government social expenditure.¹² By implication, the net tax situation (that is,

⁸ James Buchanan (1999–2002) 'The Icons of Public Debt', in *Debt and Taxes: Volume 14, The Collected Works of James M Buchanan*, Indianapolis: Liberty Fund.

⁹ The classic US study in this field is by Pechman and Okner who found that the US tax system was "essentially proportional for the vast majority of families" (p 10). J Pechman and B Okner (1974) *Who Bears the Tax Burden?*, Washington, DC: The Brookings Institution.

¹⁰ John Creedy has written an excellent overview. See John Creedy (1997) *Statics and Dynamics of Income Distribution in New Zealand*, Wellington: Institute of Policy Studies.

¹¹ See James Cox (2001) *Middle Class Welfare*, Wellington: New Zealand Business Roundtable, chapter 5, for example. Also see the Tax Review 2001, Issues Paper, Wellington, chapter 4, especially p 91.

¹² Cox, above n 11, p 130.

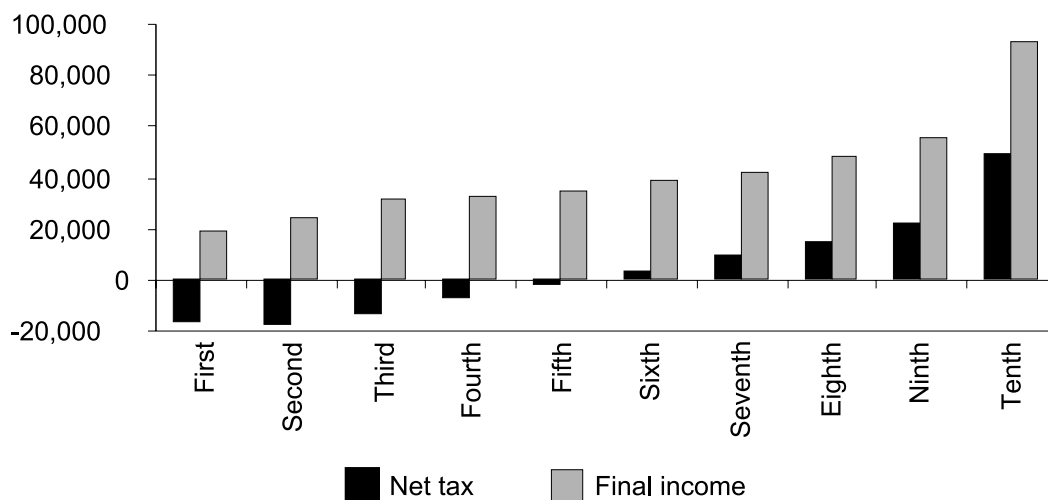
total tax less government benefits) for most New Zealand households is *negative*. The Issues Paper published as part of the 2001 Tax Review chaired by Rob McLeod makes a similar point – showing, however, the bottom 40 percent of households with negative net tax contributions.¹³

Figure 1 is created using data from a New Zealand Treasury study.¹⁴ Final income is defined as market income plus total social expenditure less total tax. Net tax is defined as total tax less total social expenditure. In essence, the data indicate that the top 50 percent of households bear the tax burden, with the bottom 50 percent receiving more in social expenditure than they pay in taxes. Another way of expressing this finding is that the top 50 percent of households pay for all public expenditure in New Zealand, net of social expenditure.

Is progressive taxation ‘fair’?

The McLeod Report noted that philosophical arguments can be made for and against both progressive and proportional tax systems, and that each can be described as being ‘fair’.¹⁵ It identified no advantages, and several disadvantages, of a progressive income tax. For example, it demonstrated that a proportional 25 percent tax rate would be fiscally neutral, be simple, and resolve several complex taxation issues. Further, it reported that progressive taxation alone does little to address income redistribution issues, which are better handled through government expenditure programmes. In such circumstances,

Figure 1: Final income and net tax in New Zealand 1997/98



Source: Data from Ron Crawford and Grant Johnston (2004) and author's calculations.

¹³ Issues Paper, above n 11, p 91. The exact source of the data reported here is not clear.

¹⁴ Ron Crawford and Grant Johnston (2004) *Final Household Incomes in New Zealand, 1987/88 and 1997/98*, New Zealand Treasury Working Paper, June.

¹⁵ Tax Review 2001, Final Paper (McLeod Report), Wellington, p 58.

Richard Epstein questions why a government would bother with the complexity and inefficiency of a progressive tax.¹⁶ The McLeod Report proposed a flatter two-step income tax scale which is consistent with a move to a less progressive tax structure.

The shortcomings of a progressive income tax identified in the McLeod Report were similar to those noted in a classic article by Walter Blum and Harry Kalven as “constituting a loose kind of *prima facie*” case against the principle of progressive taxation:

- (a) The first such consideration is the price paid for progression in terms of complicating the structure of the income tax, expanding opportunity for taxpayer ingenuity directed to lawfully avoiding taxes, creating very difficult questions of equity among taxpayers, and obscuring the implications of any given provision in the tax law ...
- (b) A second basic objection to a progressive tax on income is that it is a politically irresponsible formula. Under any progressive system today the higher surtax rates are almost certain to apply only to a minority of voters. This means that a majority are allowed to set the rates which fall exclusively on the minority. No majority ... can pass fairly or responsibly on an issue so infected with its own immediate self interest ...
- (c) A third line of objection to progression ... is that it lessens the economic productivity of the society.¹⁷

Blum and Kalven observed that most arguments for progressive taxation of income focus on the justice with which the system distributes the total tax burden. Such justifications generally assume that a tax on income is borne by those who are required to pay it, whereas the reality is that the initial burden of income tax may be shifted to consumers or other suppliers of services.

In a detailed analysis of equity as a social goal, Cathy Buchanan and Peter Hartley rigorously demonstrated that regardless of rhetoric, proponents of progressive taxes over proportional taxes “must be motivated by envy and not by compassion”.¹⁸ Their conclusion took account of the inefficiencies that arise from progressive taxation and reduce total national income over time, and of political incentives to adopt tax scales and spending policies that appeal to marginal voters, who tend to earn a middle income. As the authors put it:

The key issue in tax policy is the extent to which a compassionate concern for the poor ought to be balanced against the efficiency losses of high tax rates. A flat tax accompanied by cash assistance targeted at the poor, or possibly means-tested vouchers for education, health care and other services deemed necessary, would maximise the benefits from assistance per dollar of cost. Taxes that are progressive in the marginal rates focus attention

¹⁶ Richard Epstein (2004) *The Case for a Flat Tax*, Wellington: New Zealand Business Roundtable.

¹⁷ Walter J Blum and Harry Kalven Jr (1978) [1953] *The Uneasy Case for Progressive Taxation*, Chicago and London: University of Chicago Press, pp 14–21.

¹⁸ Cathy Buchanan and Peter Hartley (2000) *Equity as a Social Goal*, Wellington: New Zealand Business Roundtable, p 183.

instead on redistributing income to the marginal middle-class voter who is not poor or deserving of compassion, and may often have a higher standard of living than many of the intended targets of high marginal tax rates.¹⁹

Progressivity is usually ‘valued’, however, because it is said to be ‘fair’. Michael Cullen, for example, posed the issue of taxes as follows:

National and ACT want tax cuts for the wealthy. We want a better standard of living for the great majority. National is now promising tax cuts, around two thirds of which will go to the top 5 percent of taxpayers and the predominantly foreign-owned corporates. By rejecting those and asking the top 5 percent to pay a little more, Labour will be able to [implement a list of campaign promises]. It really is a matter of fairness.²⁰

This quote contains many elements typical of the campaign of misinformation and obfuscation employed to defend high taxes. For example, under a progressive tax system, tax cuts will always favour high-tax individuals in the first instance. Tax cuts that return income in the same ratio as it was collected must, by construction, favour high-tax individuals over low-tax individuals – as we have seen, they pay most of the tax. Those individuals who either do not pay tax, or pay very little, are not going to benefit directly and immediately from a tax cut. They will benefit directly, however, by facing a lower rate of tax as their incomes rise, and from the faster growth in the economy induced by a flatter tax structure. Moreover, the notion of ‘asking the top 5 percent to pay a little more’ is nonsense. As the highly regarded US judge, Justice Learned Hand, indicated, “taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant”.²¹ This, of course, is one of the great dangers of a progressive tax. As Friedrich Hayek indicates, “there is no reason why ‘a little more than before’ should not always be represented as just and reasonable”.²²

The common argument, ‘It is really a matter of fairness’, is saying the ‘rich’ do not pay their fair share of tax. This is, of course, a value judgment, pure and simple. Those who argue this way often imply (and sometimes explicitly claim) that the ‘rich’ have not earned their wealth – it is inherited, illegitimate or acquired through good fortune. Australian Labor MP Wayne Swan, for example, writes that progressive taxation delivers “fairness rather than reward for inherited wealth”.²³ Unlawful earnings should be confiscated, but other sources of wealth, whether based on skill, luck or hard work, are legitimate, as is the desire of parents to leave money to their children or others close to them.

¹⁹ Buchanan and Hartley, above n 18, p 188.

²⁰ Michael Cullen, *Budgets for fairness, opportunity and security*, press release, New Zealand Labour Party, 9 November 1999.

²¹ Judge Learned Hand, *Commissioner vs Newman*, 159F 2D 848, 850–851 (CA2 1947).

²² FA Hayek (1960) *The Constitution of Liberty*, Chicago: University of Chicago Press, pp 313–314.

²³ Wayne Swan, *The Australian*, 9 January 2004.

Another argument is that income inequality is somehow undesirable and the tax system should operate to equalise after-tax income.²⁴ Ludwig von Mises described this as the ‘Total Confiscation’ principle.²⁵ The CTU proposes an egalitarian objective as a principal goal of a tax system.²⁶ As noted, the McLeod Report shows that New Zealand’s progressive tax does little to reduce income inequality, but that considerable income is redistributed through government expenditure, including the welfare system. Few economists, or voters, would support using the tax system to equalise after-tax income. As Steven Landsburg has indicated, such redistribution “is unacceptably costly, in terms of efficiency and the centralisation of power”.²⁷

A subtle version of this idea is the ‘ability to pay’ principle. This is often invoked in New Zealand. The revenue strategy agreed by the National–New Zealand First coalition in 1996 proposed, as an aim of government policy, a tax system that “is fair, with all taxpayers making an equitable contribution, *based on their ability to pay*” (emphasis added).²⁸ As James Buchanan has noted, “Most of us, save for a few anarchists, recognize the need for the state to exist and also recognize that there are goods and services which can be best provided by the government.” Taxation exists to finance such goods and services and an appropriate safety net, but the government should only collect the level of funds necessary to finance those activities.²⁹ Funds collected in excess of that amount are an unwarranted taking of private property. Von Mises is quite contemptuous of the ‘ability to pay’ principle and is worth quoting in full:

The actual fiscal policies of all countries are today exclusively guided by the idea that taxes should be apportioned according to each citizen’s “ability to pay.” In the considerations that finally resulted in the general acceptance of the ability-to-pay principle there was some dim conception that taxing the well to do more heavily than those with moderate means renders a tax somewhat more neutral. However this may be, it is certain that any reference to tax neutrality was very soon entirely discarded. The ability-to-pay principle has been raised to the dignity of a postulate of social justice. As people see it today, the fiscal and budgetary objectives of taxation are of secondary

²⁴ Henry Simons (1938) *Personal Income Taxation*, Chicago: University of Chicago Press, p 19, for example, thought income inequality was “distinctly evil”.

²⁵ L von Mises (1949) (4th rvsd edn) *Human Action: A Treatise on Economics*, San Francisco: Fox & Wilkes.

²⁶ New Zealand Council of Trade Unions, above n 6. “The CTU acknowledge the central role of taxation in funding public services ... and in providing a basis for redistributing income and in creating a more egalitarian society.”

²⁷ Steven Landsburg (1997) *Fair Play: What Your Child Can Teach You About Economics, Values, and the Meaning of Life*, New York: Free Press, p 119.

²⁸ See Appendix A, *Supplementary Briefing Papers, Volume 1, Tax Policy*, Inland Revenue Department (November 1999).

²⁹ Von Mises, above n 25, p 737 indicates, “under a liberal system of government these expenditures are small compared with the sum of the individuals’ incomes”. Ted Sieper suggested that spending equal to 14–15 percent of GDP might be a generous allocation for those functions most usefully performed by the New Zealand government, including transfers. See E Sieper (undated) ‘A Formal Review by E Sieper of Gerald W Scully’, *Taxation and Economic Growth in New Zealand*, New Zealand Treasury, p 14.

importance only. The primary function of taxation is to reform social conditions according to justice. From this point of view, a tax appears as the more satisfactory the less neutral it is and the more it serves as a device for diverting production and consumption from those lines into which the unhampered market would have directed them.

The idea of social justice implied in the ability-to-pay principle is that of perfect financial equality of all citizens. As long as any inequality of income and wealth remains it can as plausibly be argued that these larger incomes and fortunes, however small their absolute amount, indicate some excess of ability to be levied upon, as it can be argued that any existing inequalities of income and wealth indicate differences in ability. The only logical stopping place of the ability-to-pay doctrine is at the complete equalization of incomes and wealth by confiscation of all incomes and fortunes above the lowest amount in the hands of anyone.³⁰

An alternative interpretation of 'ability to pay' is a 'price discrimination' argument: the 'rich' can afford to pay more in tax than the 'poor'. Although this may well be true, it does not justify progressive taxation. After all, the 'rich' are not required to pay more for their groceries than the 'poor' although they can afford to do so. It follows that those who claim to support price discrimination in taxation would also have to support price discrimination by the private sector, which is generally unlikely. Taken to its logical conclusion, the ability-to-pay principle collapses into the 'Total Confiscation' argument.³¹

The most popular, and perhaps sophisticated, argument for progressive tax is the 'equality of sacrifice' principle. Hayek believed that this argument carried the day in favour of the progressive tax rates that were introduced at the turn of the twentieth century.³² The idea is based on diminishing marginal utility where the more an individual has of a particular commodity the less they value it. Consequently, the 'rich' value their last dollar less than the 'poor' value theirs. On these grounds, the 'rich' can be taxed more than the 'poor' to equalise the tax burden.

The 'equality of sacrifice' principle may sound plausible, but economists have savaged this line of reasoning. Hayek has written that an improved understanding of utility theory itself has "completely destroyed the foundations of this argument".³³ Paul Samuelson, who cannot be categorised as an anti-tax conservative, writes that "[t]oday such arguments are not very fashionable ...", and shows that a progressive income tax is not consistent with diminishing marginal utility.³⁴

The 'equality of sacrifice' theory itself relies on some strong and easily violated assumptions. For example, it assumes that individuals can be divided into income groups that are homogeneous within themselves, derive the same satisfaction from income and

³⁰ Von Mises, above n 25, p 738.

³¹ Von Mises, above n 25.

³² Hayek, above n 22, p 309.

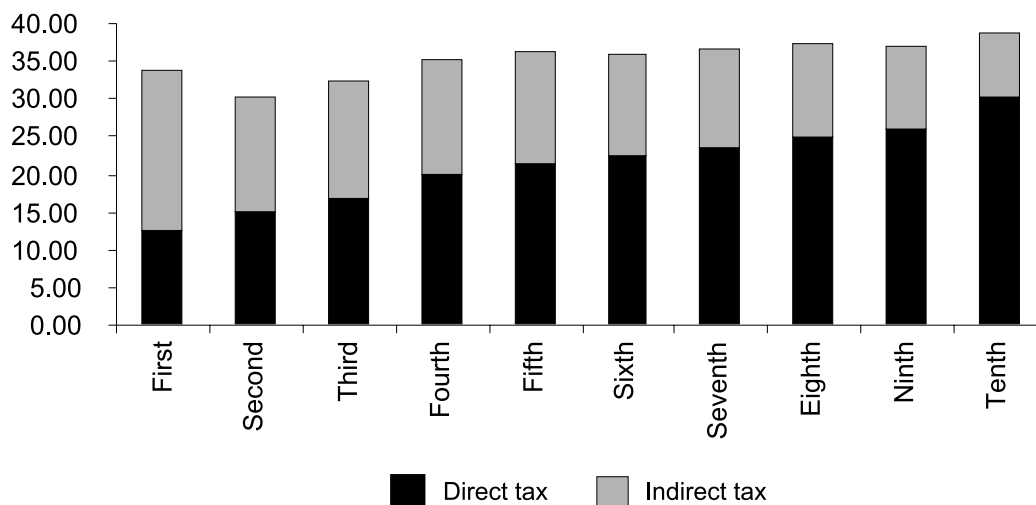
³³ Hayek, above n 22.

³⁴ P Samuelson (1983) [1947] *Foundations of Economic Analysis, Enlarged Edition*, Cambridge: Harvard University Press, p 227.

consume the same bundle of goods and services. It assumes that this satisfaction is measurable, comparable and known to the tax authority. John Stuart Mill suggests that decision makers will never have this type of information “with the degree of certainty on which a legislator or a financier ought to act”.³⁵ Taken to its logical conclusion, the application of diminishing marginal utility to income leads to the stereotyping of particular income groups and is inconsistent with observable economic traits such as wealth accumulation.³⁶ It is difficult to believe that individuals make great sacrifices to increase their wealth when they do not value the marginal increase in that wealth very highly. Hayek is correct to refer to the whole idea as being a “regrettable mistake”.³⁷

There are other arguments for progressive taxation, such as the notion that progressive income tax compensates for regressive indirect taxation. The data do not support this notion for New Zealand. Figure 2 is created using data from a New Zealand Treasury study.³⁸ Household expenditure on direct and indirect taxes is calculated as a percentage of gross income (market income plus social welfare benefits). With the exception of the second and third deciles, the total tax rate is roughly proportional across the ten groups. Many studies report that the expenditure of low-income groups is considerably higher

Figure 2: Direct and indirect tax proportions of gross income (1997/98)



Source: Data from Ron Crawford and Grant Johnston (2004) and author's calculations.

³⁵ JS Mill (1899) [1848] *Principles of Political Economy*, New York: Augustus M Kelley, p 807.

³⁶ “Indeed, the well-publicised holdouts by well-heeled athletes and entertainers suggest that the rate of decline is probably lower than many egalitarians suspect, if only because of the enticing prospect that additional wealth brings on to the scene new opportunities – for example, civic leadership, fine art – that are largely closed to individuals with lesser wealth.” Richard Epstein, above n 16, p 12.

³⁷ Hayek, above n 22, p 309.

³⁸ Crawford and Johnston, above n 14.

than their reported income. For this reason, their ratio of tax on expenditure to income is likely to be significantly overstated, and the real extent of proportionality masked. At low levels of income, however, there is a great deal of churning with households paying more in indirect tax than they receive in market income. This implies that the welfare system pays benefits in order for some households to pay tax.

Goods and services tax is sometimes claimed to be a regressive tax. This claim is inaccurate. By and large, people consume over their lifetimes what they earn – inheritances and bequests are typically small relative to lifetime earnings. Goods and services tax is therefore best seen as a roughly proportional tax.

Others argue that equality is realised when taxation and government expenditure are evaluated concurrently. John Quiggin, for example, has written “while taxation payments are roughly proportional to income, the benefits of public expenditure are about the same for all members of the community”.³⁹ He says that while low-income earners receive higher welfare benefits, “middle and upper income earners receive a greater economic benefit from services such as police and national defence, since they have more to lose”.⁴⁰ Some 150 years ago, John Stuart Mill wrote in answer to this sort of argument that “we should have to consider who would suffer most if [government] protection were withdrawn ... it must be, that those would suffer most who were weakest in mind or body, either by nature or by position”.⁴¹ In his *Utilitarianism*, Mill was explicit that “the rich would be far better able to protect themselves, in the absence of law or government, than the poor, and indeed would probably be successful in converting the poor into their slaves”.⁴²

Epstein observes that income or financial wealth is an inadequate measure of a person’s total resources. Wealth can be thought of as the sum of hedonic pleasures and financial assets. Hedonic pleasures include things as routine as good health, happy marriages and being able to laugh and enjoy life. They are broader than the more familiar description of non-work as leisure. When a person’s income is taxed and that person is supplied with, for example, police protection, the government is not only protecting the individual’s property but also their liberty and hedonic resources. As Epstein puts it:

Large differences of financial wealth obviously exist. But, setting aside people who are seriously ill, the dispersion of hedonic wealth in society will generally be much narrower ... A flat tax hits financial wealth but the revenues it generates are used to protect both financial and hedonic resources. It follows then that redistribution will occur towards people who are relatively poor in financial terms. Suppose, for example, that a society’s hedonic wealth varies by a ratio of 1:5 and its financial wealth by 1:10. The government taxes on the 1:10 ratio and returns a gain to individuals on the 1:5 ratio. There is a greater rate of net return from government expenditures to individuals with lower financial wealth.

³⁹ J Quiggin (1998) *Taxing Times: A Guide to Australia’s Tax Debate*, Sydney: UNSW Press.

⁴⁰ Quiggin, above n 39, p 21.

⁴¹ Mill, above n 35.

⁴² JS Mill (1962) [1861] *Utilitarianism*, London, J M Dent & Sons, p 55.

It would be a mistake, therefore, to believe a flat tax has no redistributive component. That would only be true if public resources solely protected financial assets. But that is not true if one believes the function of government is to protect property and liberty. Liberty has major non-pecuniary elements.⁴³

Another common argument is that progressive taxation is necessary given that high-income earners have more scope to engage in tax avoidance and evasion. Tax avoidance consists of those activities where income and assets are legally transformed from a high-tax incidence to a low(er)-tax incidence. As JP Morgan – the famous banker – argued in response, “[i]f the Government objects to tax [avoidance] it should change the law. Congress should know how to levy taxes. It is not up to us taxpayers to repair the mistakes of Congress”.⁴⁴ The authorities aim to collect as much tax as the parliament decides to impose. In any event, tax avoidance is a legal and legitimate activity. The words of Justice Learned Hand (1947) are instructive here:

Over and over again, courts have said that there is nothing sinister in so arranging one’s affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands.⁴⁵

Similarly, Lord Tomlin in the House of Lords has ruled as follows:

... every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the *Commissioners of Inland Revenue* or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.⁴⁶

Tax evasion on the other hand is the illegal non-payment of taxes and is not condoned. The opportunities for tax evasion are probably evenly spread across the income spectrum. The question becomes, ‘To what extent should the average citizen worry about tax evasion?’

In order to answer this question I have performed some ‘back of the envelope’ calculations. Estimates of the ‘hidden’ economy vary, but figures of about 10 percent are common.⁴⁷ Consequently, I use this rate as the ‘size’ of the New Zealand hidden economy. According to the Crown budget documents, the New Zealand GDP in 2001

⁴³ Epstein, above n 16, pp 9–10.

⁴⁴ Quoted in J Coffield (1970) *A Popular History of Taxation: From Ancient to Modern Times*, London: Longman. JP Morgan used the term ‘evasion’ but, according to Coffield, meant the term ‘avoidance’.

⁴⁵ Judge Learned Hand, above n 21.

⁴⁶ Lord Tomlin, *IRC v Duke of Westminster* (1936) 19 TC 490, [1936] AC 1.

⁴⁷ David Giles has undertaken some estimates and finds a long run value of 8.8 percent. Giles and Caragatta (2001) speculate that the ‘hidden’ economy will vary with the tax rate, and for a 40 percent tax rate estimate a ‘hidden economy’ of 10.83 percent. Giles, DEA and PJ Caragata (2001) “The Learning Path of the Hidden Economy: Tax and Growth Effects in New Zealand”, *Applied Economics*, 33, pp 1857–1867.

was \$116 billion. Total tax revenue as a percentage of GDP for that year was 33.8 percent. Assuming that all hidden economy activity is otherwise legal, the 'missing' tax becomes \$3.9 billion. That may seem a large amount of tax revenue, but it translates into \$1,380 per taxpayer.⁴⁸ Now, I am sure that many taxpayers would want to have their \$1,380, but consider my assumptions. Most hidden economic activity is likely to be otherwise illegal – to be activity the authorities would rather stamp out than tax. If as little as 15 percent of the hidden economy could be taxed, the benefit per taxpayer is \$207. It follows that the gain to individual taxpayers of a 'crackdown' on tax evasion may be very small. I have not addressed the question of how much more police power the Inland Revenue Department would need to have to trace every last dollar of tax revenue. The pro-tax lobby, however, tends to be silent on the exact benefits that would flow from eliminating tax evasion. Before a rational choice could be made about the benefits of eliminating it, the government would need to identify how much legitimate tax is being evaded and what the costs of collecting that tax would be. New Zealand voters may rationally decide that it is not worth the effort.

Despite all the weaknesses of the arguments used to justify it, however, progressive taxation is the norm in most economies. Hayek provides a description of how progressive taxation was introduced, arguing that it was smuggled in under false pretences when the 'equality of sacrifice' argument was still novel. Those who argued that progressive taxation was 'the thin end of the wedge' were dismissed as outrageous scaremongers.⁴⁹ Of course, as in many other areas, principle has followed practice and while tax authorities may have argued that progressive taxation allows for equality of sacrifice and so on, it is more likely that they knew more revenue could be raised with a progressive tax.⁵⁰

Progressive taxation and the tyranny of the majority

Under a progressive tax system, 'fairness' tends to be arbitrarily defined according to whatever the current tax rates are.⁵¹ As long as an individual pays the amount specified by the parliament and not a dollar less, they have paid their 'fair share'. However, under this definition, any share of tax paid could be considered 'fair'. In the end, any sense of fairness in a progressive system of taxation can only be arbitrary and will therefore always be contested.

⁴⁸ In 2001 there were 2,846,000 individual taxpayers.

⁴⁹ Charles Adams in *For Good and Evil: The Impact of Taxes on The Course Of Civilization* (London: Madison Books, 1993) also provides an excellent discussion of the introduction of progressive taxes.

⁵⁰ Hayek points out that the basis of public finance has been "to raise the largest sums with the least resistance." See F Hayek (1979) *Law, Legislation and Liberty, Volume 3, The Political Order of a Free People*, Chicago: University of Chicago Press, p 52. See also Margaret Levi (1988) *Of Rule and Revenue*, Berkeley: University of California Press.

⁵¹ John Kerry, the 2004 Democratic presidential candidate, campaigned on a policy that would force the 'rich' to pay the same fair share of tax as they did under President Clinton. Mr Kerry did not define the how or why of 'fair'.

This is very different in a proportional tax system. Scottish journalist John Ramsay McCulloch wrote:

The moment you abandon the cardinal principle of extracting from all individuals the same proportion of their income or of their property, you are at sea without rudder or compass, and there is no amount of injustice and folly you may not commit.⁵²

In his discussion of taxation, Hayek argues that proportional taxation is intuitively fair, while progressive taxation is arbitrary and unjust.⁵³ In particular, he maintained that proportionality “provides a rule which is likely to be agreed upon by those who will pay absolutely more and those who will pay absolutely less”.⁵⁴ Adam Smith similarly supported proportional taxation because it rested on a commonly understood criterion of fairness as equal treatment, and John Stuart Mill wrote, “I can see no fairer standard of real equality than to take from all persons, whatever may be their amount of fortune, the same arithmetical proportion of their superfluities”.⁵⁵ There is, therefore, an intuitive sense of ‘fairness’ in the idea of proportionality that is completely absent in progressive taxation systems.⁵⁶ Following Smith, Mill and Hayek, I define ‘fair’ taxation as proportional taxation. Based on this definition, we have already seen in Table 5 that many individuals in New Zealand are *not* paying their fair share – they are paying much more.

In order to estimate the extent of fairness in the New Zealand personal income tax system, I estimated the ratio of the share of tax paid to share of income earned. When the ratio is less than one (unity), that implies that individuals are paying less than their fair share. On the other hand, when it is more than one (unity) it implies they are paying more than their fair share of taxes. The results are shown in Table 6. Given the limitations of the publicly available data, however, some care needs to be taken when interpreting them. I have had to make a number of assumptions when estimating the results. For example, the New Zealand Treasury has a category of income earner ‘\$100,000 +’. I have assumed that these income earners earn \$181,000 on average.⁵⁷ For all other groups, I have multiplied the number of taxpayers by the average income for the group (taxpayers in the income category \$1–10,000 would have an ‘average’ income of \$5,000). This assumes that income is evenly spread over the category. This need not be the case but in the absence of detailed income information it is the ‘best guess’.

⁵² JR McCulloch, ‘On the Complaints and Proposals Regarding Taxation’, *Edinburgh Review* LVII (1833), p 164.

⁵³ Hayek, above n 22.

⁵⁴ Hayek, above n 22, p 314.

⁵⁵ Mill, above n 35, p 807.

⁵⁶ Landsburg, above n 27, argues that “Children and economists agree that fairness is about symmetry”, p 98.

⁵⁷ I thank Greg Dwyer for this estimate.

Table 6: Estimated tax share to income share (ratio)

Income (\$)	2001–02	2002–03	2003–04	2004–05
1–10,000	0.67	0.63	0.63	0.56
10–20,000	0.72	0.71	0.71	0.71
20–30,000	0.84	0.83	0.80	0.80
30–40,000	0.87	0.86	0.85	0.85
40–50,000	0.95	0.94	0.93	0.93
50–60,000	1.05	1.04	1.02	1.02
60–70,000	1.13	1.11	1.11	1.11
70–100,000	1.23	1.21	1.19	1.17
100,000 +	1.46	1.45	1.50	1.49

Source: Estimated from New Zealand Treasury 'Key Facts for Taxpayers' (various issues).

It appears that taxpayers earning more than \$60,000 in 2004–05 are paying at least their fair share of tax. This translates into 90 percent of all taxpayers paying less than their fair share in personal income tax.

It is statistics such as these that indicate why progressive income tax survives despite being economically inefficient and unfair.⁵⁸ The 'tyranny of the majority' sustains progressive taxation. Most voters do not wish for equal treatment. Andrew Norton writes that individuals may support higher taxes in the belief that they themselves will not actually pay the tax.⁵⁹ The McLeod Report compares a revenue neutral proportional tax with the current progressive income tax.⁶⁰ Eighty percent of households pay less tax under a progressive system. The bottom decile pays (approximately) the same in tax, and the top decile would pay less under a proportional system.

The introduction of the progressive tax has more to do with "a popular majority inflicting burdens on a wealthy minority which it did not share itself".⁶¹ John Stuart Mill was able to refer to progressive taxation as "a mild form of robbery".⁶² The tyranny of the majority is that the top 5 percent (or so) can be 'asked' to 'pay a little more'. In a perverse sense, progressive taxation becomes a tragedy of the commons. The majority has the power to expropriate the property of a minority. This property becomes a common resource for the 'solution' of societal ills and is over-exploited, to the detriment of the economy and economic growth.

⁵⁸ The potential for economic inefficiency is well-documented elsewhere and I have not concentrated on efficiency arguments. For the reader's convenience, inefficiencies arise because taxes provide disincentives to consumption, work, savings and investment and result in the so-called 'deadweight' losses from taxation.

⁵⁹ Andrew Norton (2004) *Will You Still Vote for Me in the Morning? Why Politicians aren't Rushing to Increase Taxes*, Policy Monograph 65, Sydney, Centre for Independent Studies.

⁶⁰ McLeod Report, above n 15, p 59.

⁶¹ Coffield, above n 44, p 249.

⁶² Mill, above n 35, p 808.

Classical liberal philosophers such as Mill, Herbert Spencer and Hayek have discussed the tyranny of the majority at length. Spencer wrote in 1884, “The great political superstition of the present is the divine right of parliaments.”⁶³ John Stuart Mill, in his classic work *On Liberty*, wrote:

There is a limit to the legitimate interference of collective opinion with individual independence: *and to find that limit, and maintain it against encroachment*, is as indispensable to a good condition of human affairs, as protection against political despotism [emphasis added].⁶⁴

Similarly, Hayek has written, “It is not ‘antidemocratic’ to try to persuade the majority that there are limits beyond which its actions cease to be beneficial.”⁶⁵ In *Law, Legislation and Liberty*, Hayek sets out a ‘model’ constitution and specifically deals with taxation.⁶⁶ He makes the argument that there is a ‘built-in’ bias towards expanding the role of the state. In the case of New Zealand, total tax revenue increased from 24.7 percent of GDP in 1965 to 33.8 percent of GDP in 2001. This is because ‘needs’ are decided and then the revenue is raised. The McLeod Report states, for example, that “[t]he personal income tax has two objectives: generating revenue for the government and reducing income inequality”.⁶⁷ There is seldom talk of any constraint.⁶⁸ Hayek’s solution to the ever-expanding state and the tyranny of the majority is two-fold. First, he advocates the adoption of a constitutional rule providing for the distribution of the tax burden:

Nothing would probably provide a more salutary discipline of expenditure than such a condition in which everybody voting for a particular outlay would know that the costs would have to be borne by him and his constituents in accordance with a predetermined rule which he could not alter.⁶⁹

Second, Hayek argues for a roughly proportional tax system under which “the majority which determines what the total amount of taxation should be must also bear it at the maximum rate”.⁷⁰ His recommendation on the maximum rate of personal income tax, to be borne by the majority of taxpayers, is the proportion of total taxation to GDP. For example, if New Zealanders thought that 25 percent was an appropriate figure for total revenue to GDP, then 25 percent should be the top marginal tax rate. Hayek stressed

⁶³ Herbert Spencer (1982) *The Man Versus the State with Six Essays on Government, Society, and Freedom*, Liberty Fund, Indianapolis, p 123.

⁶⁴ JS Mill (1962) [1859] *On Liberty*, London: JM Dent & Sons.

⁶⁵ Hayek, above n 22, p 117.

⁶⁶ F Hayek (1979) *Law Legislation and Liberty: The Political Order of a Free People*, Chicago: University of Chicago Press.

⁶⁷ McLeod Report, above n 15, p 86.

⁶⁸ See Bryce Wilkinson (2004) *Restraining Leviathan: A Review of the Fiscal Responsibility Act 1994*, Wellington: New Zealand Business Roundtable, for a comprehensive discussion of constraints.

⁶⁹ Hayek, above n 66, p 126.

⁷⁰ Hayek, above 22, p 322.

that the majority could decide to reduce the tax rate further for some individuals. For example, low-income earners (strictly defined) could pay a lower rate of tax or benefit from a low income rebate (a feature of the current New Zealand tax system).

Conclusion

New Zealand witnessed a robust tax debate in the late 1990s. The low-tax lobby lost that debate and a government promising to raise taxes on the 'rich' was elected in 1999. There are two quotes from that time – both from Keith Rankin – worth reproducing here:

The present push to cut income tax is a cynical attempt by a small number of privileged people who benefited from huge tax deductions in 1988 to win another similar gain. Tax rates appear to be high today because low-income earners get very few tax concessions. These privileged people are using high taxes paid by low earners to justify further tax concessions for themselves.⁷¹

The second quote is:

The anti-tax lobby is disingenuous in another way. By focussing on the high total tax revenue rather than on the low tax rates paid by large companies and high income earners, they are actually using the distress of low income New Zealanders to justify further tax cuts which will only provide net benefits for high income New Zealanders.⁷²

Rankin makes two arguments. The explicit argument is that high-income earners (and those who argue for tax cuts) are self-interested individuals exploiting low-income earners. The second, less explicit, argument is that low-income earners are paying high rates of tax. Many people believe that the 'rich' do not pay their fair share whereas everyone else pays an ever-increasing share of tax. Data presented in this paper show this is not the case.

The 'high-tax lobby' (comprising groups in politics, academia, trade unions, the media and the welfare industry) has hijacked public debate by creating false impressions and perpetuating a campaign of vilification and obfuscation.⁷³ Income tax is an emotive issue. Statistics and facts risk being casualties in the lead-up to the 2005 general election. The income tax burden is not falling disproportionately on middle-income earners and the poor. Some people continue to argue that New Zealanders in general, and better-off New Zealanders in particular, can and should, pay more in tax. In a democracy, everyone is entitled to their own opinion. They are not, however, entitled to their own facts.

⁷¹ *New Zealand Herald*, 9 September 1998, p A15.

⁷² Keith Rankin, February 1998, *The Caragata Tax Report; a Nail in the Coffin of the Fiscal Contract*, <http://www.ak.planet.gen.nz/~keithr/rf98_caragata.html> (last accessed 5 July 2004).

⁷³ Geoffrey de Q Walker (2004) *The Tax Wilderness: How to Restore the Rule of Law*, Policy Monograph 60, Sydney: Centre for Independent Studies.