Submission

by

THE NEW ZEALAND INITIATIVE

to the Tax Working Group

Te Awheawhe Tāke

on the

Future of Tax

30 April 2018

Presented by:
Dr Oliver Hartwich
Executive Director
The New Zealand Initiative
PO Box 10147
Wellington 6143
oliver.hartwich@nzinitiative.org.nz

1. Introduction and summary

1.1. This submission on the future of tax is made by The New Zealand Initiative, a think tank supported primarily by chief executives of major New Zealand businesses. In combination, our members' revenues account for one third of New Zealand's economy and provide employment to more than 150,000 people in New Zealand. The Initiative undertakes research that contributes to the development of sound public policies in New Zealand which help create a competitive, open and dynamic economy and a free, prosperous, fair, and cohesive society.

1.2. We strongly support an efficient tax system while recognising that no tax system can stand still. We agree that that the ability of the government to raise revenue 'rests ultimately on the consent and acceptance of all New Zealanders."

1.3. The Initiative has produced several reports over recent years which bear directly on some of the issues raised by the Tax Working Group in its background paper. These provide the foundation for our thinking and submissions herein.

1.4. **Submissions:**

A. Income Redistribution

1.4.A.1. The tax system should not be used as a device for further income redistribution. It is a myth that income inequality is rising in New Zealand just as it is that economic growth drives economic inequality everywhere. At present the top four deciles of the household income distribution fund government spending which benefits the bottom six deciles. The taxable income of top earners is very responsive to changes in the top tax rate.

1.4.A.2. The sources of contemporary income inequality matter. Educational attainment, the proportion of the adult population not in paid work, the hours worked, and employment age are all relevant factors.

1.4.A.3. Household formation and structure reflects perhaps up to half of disposable household income inequality while higher housing costs hit those on lower incomes hardest.

B. Capital gains and Wealth taxes

1.4.B.1. Capital gains and wealth taxes are not a recipe to solve the housing crisis. Only an increase in housing supply can achieve this. Matters other than wealth taxes should be investigated including boundary and density rules, local government funding, scalable construction models, building incentives and regulatory processes.

C. GST as a housing incentive

1.4.C.1. Furthermore, the tax system can incentivise and facilitate increased housebuilding through GST equivalent payments from central government to local authorities on all new housing.

D. Tax Credit where it is due

1.4.D.1. In New Zealand 91% of government spending is done by central government with 9% done at sub-central (local government) level. The bulk of local government funding comes from rates (property taxes) and so we do not see much jurisdictional competition between councils. Whether a council is doing well or not, it will be always able to tax its property owners. However, councils doing a great job to attract businesses and create more housing are not automatically remunerated for their efforts.

1.4.D.2. While central government typically benefits from economic growth local government typically funds most infrastructure which makes that growth possible. Through the trialling of special economic zones, incremental regulatory devolution, revenue and cost sharing for extractive industries, taxes could more closely mirror economic activity across New Zealand. Growth can be encouraged overall and especially in areas where it is efficient to do so.

E. GST Exemptions

1.4.E.1. No exemptions should be granted from GST. For the clear reasons which originally designed New Zealand's GST system cost and efficiency are maintained with a no exemptions policy. If redistribution targets are to be pursued these are better achieved openly and through direct measures.

F. Lifestyle Taxes

1.4.F.1. The New Zealand Initiative is highly sceptical of lifestyle taxes (alcohol, tobacco and junk food). There is no strong evidence that such taxes will achieve the intended public health outcomes.

1.4.F.2. We are concerned that these taxes regressively penalise those with the least ability or inclination to change their preferences.

1.4.F.3. Furthermore, we are unconvinced that lifestyle taxes are required to address externalities.

2. Income redistribution

2.1. Income can be measured at the individual, family or household level. It may be measured as pre-tax or post-tax market income or as disposable income (i.e. net of taxes and including government cash benefits). The Tax Working Group's briefing papers themselves point out that it is not clear whether income or wealth inequality is increasing, decreasing or staying the same. It depends on what one measures.

2.2. In our 2016 report *The Inequality Paradox: Why Inequality matters even though it has barely changed,* Dr Bryce Wilkinson and Jenesa Jeram examined a wide range of evidence and measures.

2.3. The report concluded it is a myth that the increased income share for top income earners in New Zealand is due to a growing share of investment income in national income due to accumulated and concentrated wealth. Increasing labour income has been the main driver.

2.4. In addition, the real stock of capital in New Zealand has not grown faster than GDP. The private wealth ratio has instead risen because of the alarming increase in house process.

2.5. Changes in household structure also materially influenced household income inequality. The report found that on the evidence perhaps half the increase in disposable household income inequality was due to these changes. High housing costs hit those on lowest incomes hardest. Housing is a necessity and these costs cannot be avoided.

2.6. Against this backdrop of a less than conclusive case for spiralling income or wealth inequality, *The Inequality Paradox* pointed out that those earning high incomes paid more, much more, in taxes. Treasury research indicated that by 2010 only the top 40% of income tax payers were net taxpayers. i.e. the lowest six deciles of tax payers received more in cash and transfers than they paid in income tax and GST.

2.7. The taxable income of top income earners is very sensitive to the top tax rate and increases to it could lead to very disappointing results.

2.8. The New Zealand Initiative therefore recommends against any income tax changes to redistribute national income.

3. Capital Gains, Wealth Taxes and Housing

3.1. Our submission here relates to wealth and capital taxes in the housing context only.

3.2. The New Zealand Initiative has published extensively on the housing issues which confront New Zealand:

A. *Priced out: How New Zealand lost its housing affordability*, Michael Bassett and Luke Malpass (2013)

B. *Different places, different means: Why some countries build more than others*, Michael Bassett and Luke Malpass (2013)

C. *Free to Build: Restoring New Zealand's Housing Affordability*, Michael Bassett and Luke Malpass (2013)

D. *Up or Out: Examining the Trade-Offs of Urban Form*, Jason Krupp and Khyaati Acharya (2014)

E. *Empty nests, crowded houses: Building for an ageing population*, Jenesa Jeram (2014)

3.3. The Initiative submits that there is no need or sense in enacting new wealth or capital taxes to non-family home properties to somehow incentivise housing availability. The basic requirement is a supply of affordable housing, fit for purpose and demographic circumstances. This is first and foremost an issue of supply.

3.4. The factors which have accumulated over time to create New Zealand’s current housing crisis are well understood: They range from the planning system and the culture it has created to the limitations on the supply of land. They include questions of infrastructure funding and financing as well as matters relating to the size and the structure of the construction industry.

3.5. None of these are amenable to amelioration by the imposition of wealth, asset or capital-based taxes. We recommend no action in this regard save reference to Paragraph 4 below.

4. GST and Local Authority Funding

4.1. A key constraint on local government's ability to fund housing infrastructure (and disincentive to actively build the same) is the narrow range of funding options available to local government. Councils derives most if not nearly all their revenue from rates.

4.2. Local government needs a structure to share in the proceeds of population and housing growth. A key recommendation was made in *Free to Build: Restoring New Zealand's Housing Affordability* (2013) by Bassett and Malpass.

4.3. We recommended that local authorities receive an encouragement grant for every new house built in their area, provided the house meets minimum delivery deadlines from application to completion. Grants would be benchmarked on the GST levied on the house, recognising the impact of GST on hose process.

4.4. For example, for a house and land package of $600,000 inclusive of GST central government would pay the council $78,260.88 as a one-off grant. It would be a straightforward calculation and involve no new compliance costs to infrastructure or service providers.

4.5. These grants would also foster a pro-development attitude within councils and provide a predictable cash flow to local governments by increasing their revenue from ore developments. It would also incentivise councils to speed up and stream line application processes.

5. Empower local New Zealand

5.1. The Initiative's 2015 report *In the Zone: Creating a toolbox for regional prosperity* by Eric Crampton and Khyaati Acharya described a range of measures that could be adopted to promote regional prosperity.

5.2. A key recommendation was revenue sharing between central and local government based on growth and economic activity promoted within a region. A portion of the new income generated from increased activity in a region would be allocated to the local council.

5.3. A revenue sharing mechanism would apportion payments on improvements over a base period. Councils would have a greater incentive to provide high quality infrastructure. This would change growth to be seeing as a virtue and help to overcome resistance to change which is seen in some regional quarters.

5.4. It is possible to provide indicative estimations. Auckland Council collects roughly $1.45 billion in rates with other revenue bringing that up to $3.5 billion. As at 2014 Auckland contributed 35.3% of national GDP. If taxes correspond to GDP share, then Auckland contributed $21.7 billion of the $61.5 billion of the tax revenues collected by the government.

5.5. If Auckland received an even share of any increase in taxes it remitted to central government than a 1% increase in activity/taxes would see a $217 million increased tax take of which Auckland would receive $108 million.

5.6. Correspondingly higher amounts would be remitted for higher growth rates. For example, a 5% increase would see $542 million back into Council coffers.

6. GST Exemptions

6.1. No exemptions should be granted from GST. If redistribution targets are to be pursued these are better achieved openly and through direct measures. Direct cash transfers are usually more efficient that redistribution attempts via the tax system. Our 2016 paper *The Outside of the Asylum* by Eric Crampton compares New Zealand's clean GST regime to messier overseas examples.The report is a cautionary tale about the perils that arise from introducing exemptions.

7. Lifestyle Taxes

7.1. The New Zealand Initiative has analysed lifestyle taxes (alcohol, tobacco and junk food) and has concluded that such taxes should be rejected on two main grounds. First, there is no strong evidence that lifestyle taxes will achieve the intended public health outcomes. And second, evidence that these taxes will work is necessary but not sufficient: overriding personal liberty requires a strong justification.

7.2. Our 2016 report *The Health of the State* by Jenesa Jeram looked at the public health studies that are used to justify sugar taxes and other junk food taxes. *The Health of the State* found many common flaws in such studies. A major flaw is that many studies that claim strong price-responsiveness focus on consumer expenditure but do not consider the fact people might be downshifting to cheaper brands or cheaper sizes ("family sized" or bulk items). Switching from Coca-Cola to homebrand cola will cost less but will not yield health benefits.

7.3. There is also insufficient evidence to suggest that junk food taxes will materially reduce obesity. In Official Information Act documents released to the New Zealand Initiative, the Ministry of Health found "insufficient evidence that a sugar tax would be effective in reducing obesity".

7.4. The regressive nature of lifestyle taxes is also a concern, as it has the potential to increase (not decrease as public health advocates claim) financial and health inequities. Imposing a regressive tax on poorer people 'for their own good' is only likely to be beneficial if the targeted population see it that way and respond accordingly, otherwise it is deeply punitive. Our 2018 report *Smoke and Vapour: The changing world of tobacco harm reduction* by Jenesa Jeram finds that tobacco excise system is now causing more harm than good.

7.5. The ability to ring-fence revenue (also known as hypothecated taxes) for positive expenditure (health services, health promotion, education, etc.) does not justify lifestyle taxes. If the purpose of the tax is to discourage behaviour, then the tax will not raise much for these programmes. And if these health-promoting programmes are as valuable and laudable as experts claim they are, then why not make the case for funding them out of the existing government budget?

7.6. Lifestyle taxes also cannot be justified on the grounds of addressing 'externalities' and recuperating the cost to taxpayers. For example, it is an unfortunate truth that the costs of obesity to the public purse over a lifetime are likely to be much, much lower than the direct medical costs of disease because of fiscal savings in foregone superannuation. Meanwhile, it has been acknowledged by The Treasury that smokers more than "pay their way" in the tobacco excise they pay compared with the costs they might impose on the health system.

7.7. Alcohol excise is a blunt tool for addressing the harms of excessive drinking, when a range of more targeted measures can be implemented.

7.8. Though a strong evidence base is necessary for any new policy, it is not a sufficient justification for introducing one. Any policy also needs to be scrutinised on a philosophical basis. Lifestyle taxes are a blunt policy tool that affects the entire population: is this an acceptable reason for overriding personal liberty?

7.9. If lifestyle tax advocates ignore the benefits of consuming these products (the enjoyment people get), they ignore the very reason people might not act the way advocates want them to.

7.10. Lifestyle taxes are likely to be regressive, are not supported by an evidence base, might not address the costliest fiscal problems, and are unlikely to guide behaviour in ways policymakers necessarily intend.

Wellington, 30 April 2018

Dr Oliver Hartwich
Executive Director