The Treasury

Budget 2011 Information Release

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[2] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[3] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

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TEMPORARY REVENUE RAISING MEASURES

This note discusses some high level thoughts on temporary revenue raising measures to raise urgently $1 billion or more.

Are Temporary Tax Increases a Good Idea?

There does not appear to be a Treasury-wide view at the moment regarding whether time-limited disaster taxes are a good idea, although Treasury has probably historically resisted them. From a tax smoothing perspective we would not recommend temporary taxes, as deadweight losses are minimized if the tax rate is set so that, without further changes in rate, it funds the expected NPV of all future expenses. Temporary taxes are inconsistent with this. The usual arguments against hypothecated taxes apply here also. Through this lens the appropriate fiscal response is to borrow to fund the shock and permanently raise taxes by a little to fund the now-higher expected costs.

On the other hand this tax smoothing result assumes increased borrowing doesn't push up borrowing costs ie we are on the flat bit of the risk curve so the marginal borrowing associated with the disaster does not increase the price of all borrowing.

Also although time-limited taxes offend tax smoothing precepts, they have the institutional advantage of finishing, whereas if a normal tax is increased "temporarily" the government may struggle to bring itself to give up the revenue later – a commitment/ time-consistency problem. Markets and taxpayers anticipate that and respond (negatively) accordingly. So the time limited specific tax may have better signaling effects.

In summary there are arguments each way, some situation-specific, but the arguments in the first paragraph go to fairly strongly held Treasury advice (we support tax smoothing and oppose hypothecated taxes) so we would need strong opposing arguments to consider supporting temporary taxes.

Options for Temporary Taxes

Revenue raising options should meet a few criteria, in rough order of importance:

- Simple and quick to implement for both taxpayers and Inland Revenue
- Easily reversible;
- Able to be implemented through simple legislation or under the emergency earthquake powers;
- Not contrary to international obligations
- As widely levied as possible
- Ideally, as little economically damaging and as fair as possible, subject to the above conditions

Payroll levy

- Could operate similar to ACC levy- additional impost on every employee
- Short-term incidence: Could be levied equally between employers and employees- this would mean short-term incidence would fall equally on business and personal taxpayers
- Equity issues- as does not relate to non-employment income; and may also need to be capped at $100,000 (per the ACC cap) to take advantage of existing ACC arrangements.
- Could be implemented from 1 April 2011?
- Would need to be set at approximately $1 per $100 to raise $1 billion (if capped at $100,000 of income)

Temporary increase in GST

- Significant compliance costs on both introduction and removal
- Difficult politically to implement
- Not recommended

Surtax

- Additional tax payable on income tax.
- Would have greater compliance costs than payroll taxes due to need to be implemented more widely- would it require people to file? RWT etc?
- Could be implemented from 1 April 2011 at the earliest- more likely to be 1 July 2011
- A 1c surtax on all personal income would raise about $1 billion;
- This would be fairer than a payroll tax (and could be applied at a lower rate to raise the same amount of revenue) as it applies to all forms of income rather than just to labour income.

Additional impost on rate payments

- Would need to be considered with local Government and in the context of existing mechanisms;
- Could most easily be implemented from the next rates payment (when is this? Could it be implemented earlier)
- A relatively low rate would raise $1 billion- based on 2008 land values approximately 0.25% on land value would raise $1 billion (although existing rate structure would mean that in some cases the impost would be on land and on others on capital value).

Excises/import duties

- Levied on a narrower base/ could breach international obligations

What did Australia do to help fund the Queensland floods?

Following the Queensland floods, total Government expenditure on reconstruction is expected to be A$5.6 billion, funded by A$2.8 billion in spending cuts elsewhere, A$1 billion in delayed infrastructure spending and A$1.8 billion raised by a levy on taxable income.

The levy apples at a rate of 0.5% on all taxable income between A$50,000 and A$100,000, and at a rate of 1% on taxable income over A$100,000 for the 11/12 year only. Recipients of Disaster Relief Payments (related to floods) are exempt.

If NZ were to take a similar approach:

- Administratively, a levy could be applied in much the same way as the ACC levy currently works.
- To raise significant revenue, a levy would most likely have to be applied at a higher rate and/or a lower starting income threshold than the Australian example; a similar 0.5%/1.0% levy applied at income levels of $48,000 and $70,000 would only raise roughly $250m in one year. A flat 1% levy on *all* taxable income would raise roughly $1.2 billion.
- While raising marginal tax rates is not ideal (and would undo some of the recent tax cuts), a small credibly time-limited change is unlikely to have significant labour supply effects. One way to minimise the effect of higher marginal tax rates would be to lower the rate and maintain the levy for more than one year (i.e. spread out the cost to the taxpayer).