Improving the Living Standards of New Zealanders

Moving from a framework to implementation

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Our (Treasury's) Vision

To be a world class Treasury working for higher living standards for New Zealanders.

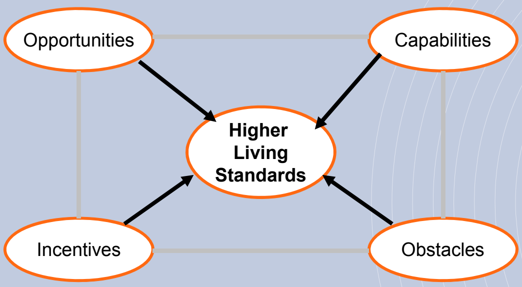
Fundamentals – *WHAT* is it all about?

What is "improving standards of living" all about?

It is about increasing the freedoms of individuals to enjoy the kinds of lives they wish to live. [Note: this is perfectly aligned with the Australian Treasury's positioning of economic policy and strategy: *"In understanding its mission, Treasury takes a broad view of wellbeing as primarily reflecting a person's substantive freedom to lead a life they have reason to value."*]

Need to focus on achieving this across society and across generations – that is what equity and sustainability are all about.

HOW do we help increase living standards – how can government help?



- Providing opportunities
- Building capabilities
- Improving incentives
- Removing obstacles

All of the above are about maintaining and building:
- physical/financial capital
- human capital
- social capital
- natural capital

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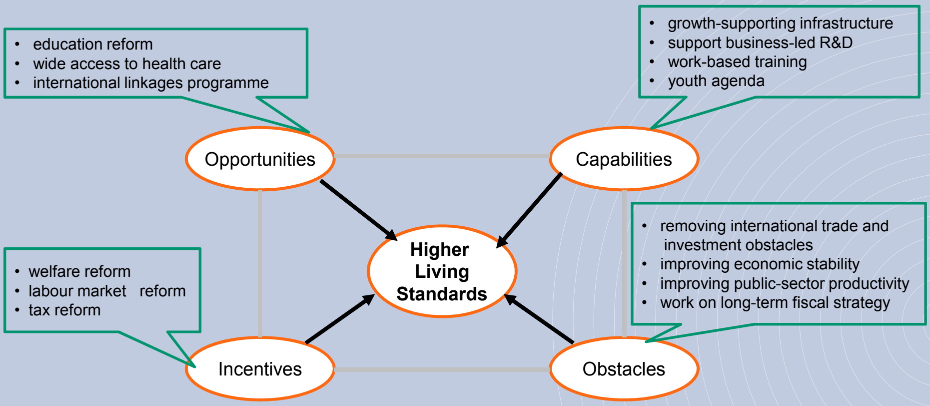

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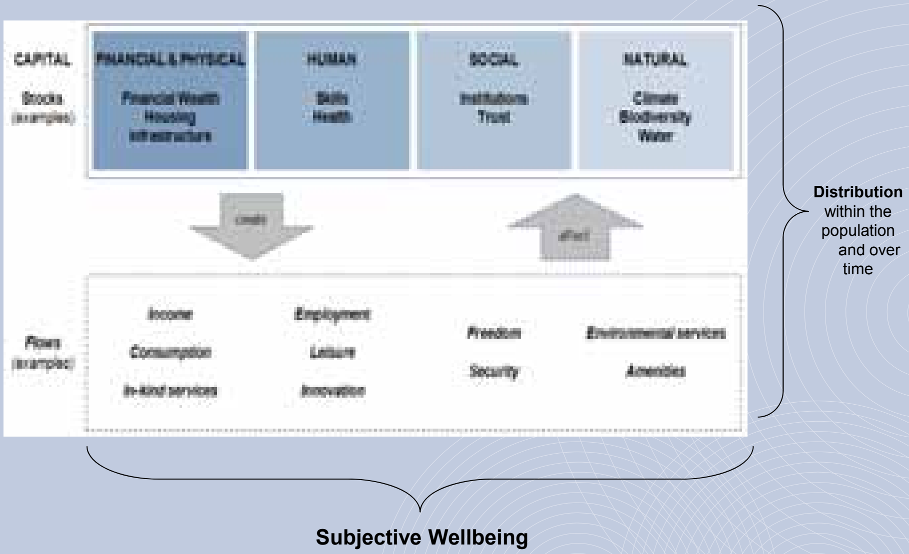
The Living Standards Framework



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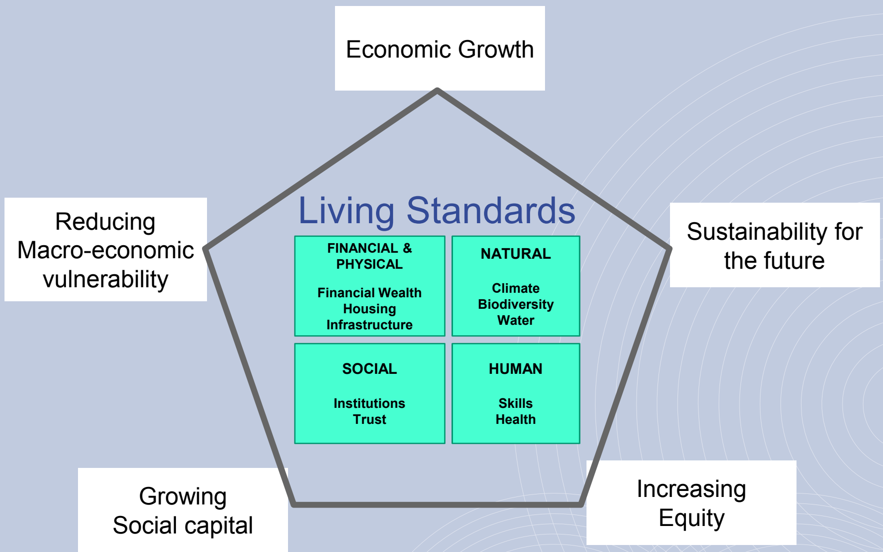
We want something that is

- Practical
- Focused
- Measureable

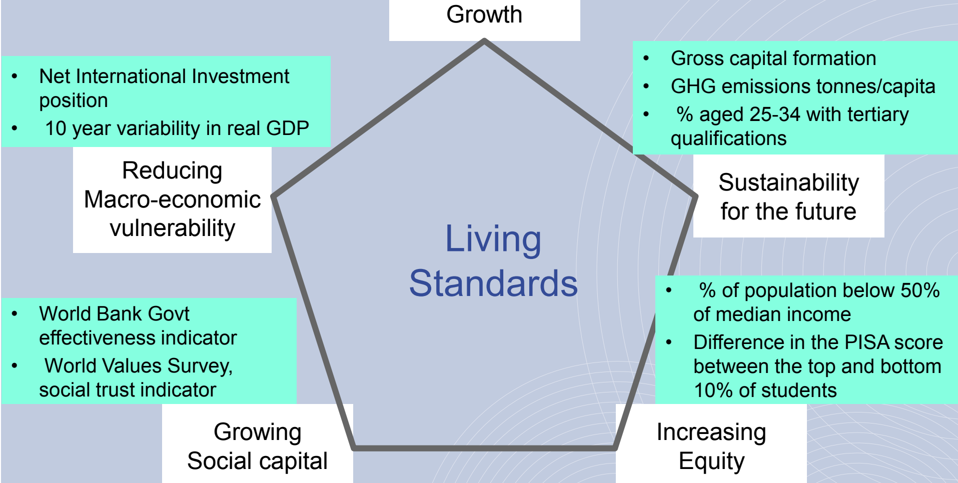


Objective: **Higher Living Standards for all New Zealanders**

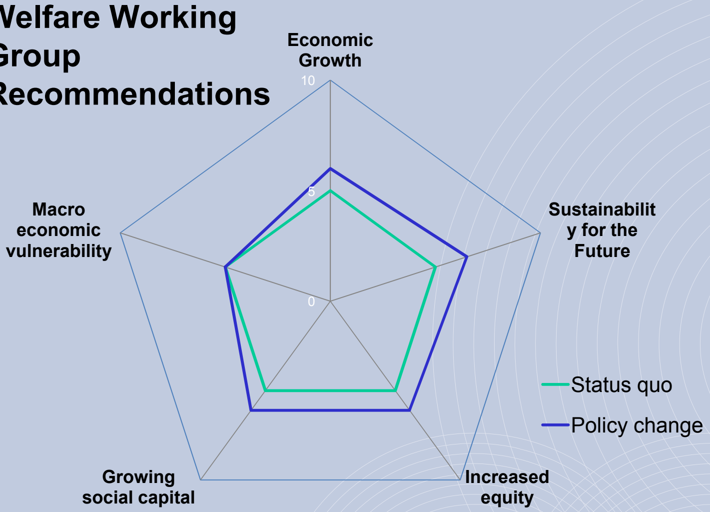
Method: Increasing the freedoms of individuals to enjoy desired lifestyles

Elements:	Physical Capital	Human Capital	Social Capital	Natural Capital
Risks e.g.	Earthquakes Floods Eruptions Infrastructure disrepair White elephants	Crime Ill health Skill Deficiency	Welfare dependency Economic crises Education failure Civic society failure	Climate Change Biodiversity risks Erosion
Mitigations	Insurance	Education Policy	Welfare Reform	Emissions Trading

How might we measure progress for New Zealand?



Welfare Working Group Recommendations



Note: This is intended to demonstrate how the diagram could be used, rather than a Treasury view of the recommendations

Changing the rate of GST

Description

- This summary examines the impact of a possible increase in the GST rate to either 15%, 17.5% or 20%;
- GST was introduced at 10% on 1 October 1986. It was increased to 12.5% from 1 July 1989;
- This measure should be seen as a possible revenue positive input to a broader package of reform, and the impacts of the overall package on revenue, efficiency, integrity, equity, and compliance should be assessed.

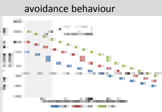
Fiscal revenue

Mechanical effect of an increase (per year):

($ billion)	2007/08 GST	Estimated Additional Revenue at:		
Rate	12.5%	15%	17.5%	20%
Private sector revenue	11.115	2.150	4.200	6.170
Automatic Benefit Adjustment	N/A	(0.250)	(0.480)	(0.720)

Behavioural effect of an increase:
The mechanical effect of an increase in the rate could decrease as a result of behavioural changes if :

- Consumers alter the mix of their expenditure toward non-GST items;
- Consumers decrease expenditure as a proportion of income;
- There is an increase in avoidance behaviour



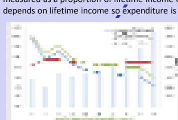
$ billion		15%	17.5%	20%
Additional revenue		+2.150	+4.200	+6.170
Behavioural effect leading to a reduction in GST base of:	0%	0	0	0
	5%	-0.65	- 0.74	- 0.82
	10%	-1.29	- 1.47	- 1.65
	15%	-1.94	- 2.21	- 2.47
	20%	-2.58	- 2.94	- 3.29
	25%	-3.23	- 3.68	- 4.11
	30%	-3.87	- 4.41	- 4.94
	35%	-4.52	- 5.15	- 5.76
	40%	-5.16	- 5.88	- 6.58
	45%	-5.81	- 6.62	- 7.40
	50%	-6.03	-6.89	-7.71

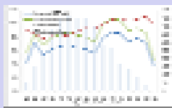
Fiscal integrity

- Risk of fraud, such as carousel fraud, increases as a higher rate of tax provides a greater return.
- Risks associated with GST refunds increases.
- Increased incentive for private or recreational activities to try to register for GST to remove the legal incidence of GST.
- Additional pressure for special or reduced rates.
- Higher rates of GST may lead to households substituting spending toward non-taxable providers (such as, low value imported goods) or "self-supplying" (e.g growing their own vegetables)
- May improve integrity if part of broader reform, e.g. lower top personal rate.

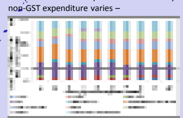
Equity

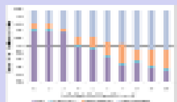
GST appears more regressive if measured as a proportion of annual income; equity effects should be measured relative to disposable income, or expenditure. GST is less regressive if measured as a proportion of lifetime income or expenditure …this is because consumption depends on lifetime income so expenditure is more stable across lifetimes than income…



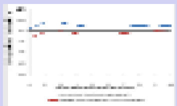


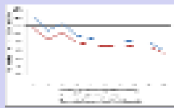
…The ratio of GST to non-GST expenditure is also relatively constant across deciles. The composition of GST expenditure is relatively stable across deciles; but the composition of non-GST expenditure varies –





Exempting food (but not takeaways/restaurant meals) from the base does not substantially improve equity; and would cost 15% of GST revenue:





Most benefits have a built in adjustment to reflect price increases; although these may be delayed. Providing adequate compensation is not straightforward; but an approximation of the amount of revenue needed to compensate for the increase is:

Quintile	WFF	NZS	Benefit	No assistance	Total
1	1.31	3.93	4.13	1.83	8.38
2	5.02	5.58	3.6	4.86	13.37
3	9.33	3.58	3.8	7.23	17.70
4	8.24	1.79	2.46	16.32	23.53
5	3.29	3.39	2.27	36.13	37.03

Efficiency & growth

GST can be broadly described as a tax on spending by households - an indirect tax on labour

Relative to income taxes, broad-based consumption taxes are :

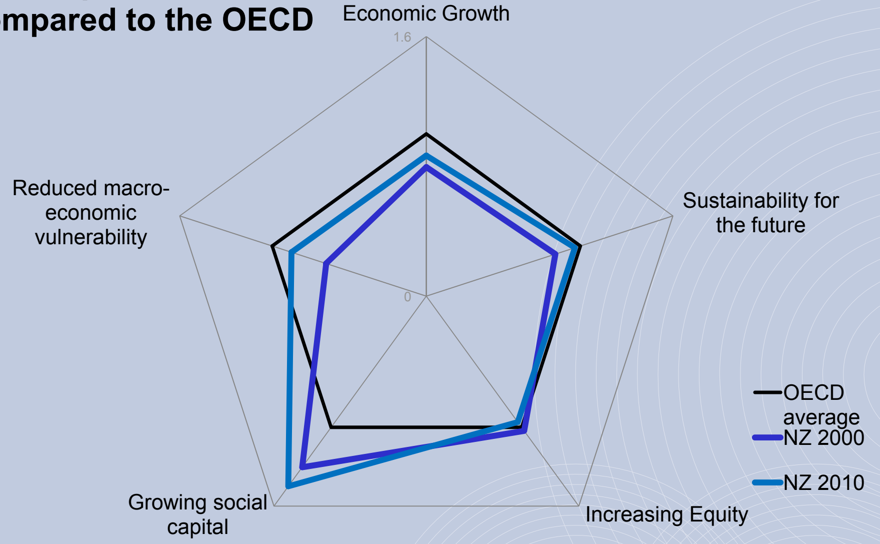
- Less distorting to
  - firm and household decisions, and thus to GDP;
  - saving or investment decisions;
  - households' employment participation;
- Less progressive, as there is less scope for a progressive rate structure, or targeting to specific groups;
- Broad base and few exemptions reduce the deadweight cost connected with raising GST revenue and make avoidance more difficult.

	Possible short-run economic impact
Inflation	Introduction of GST, and previous increase had one-off price level impact. The price level impact would be dependent on Reserve bank response, wage settings, incidence of tax, consumers' response (e.g. changes in consumption patterns).
Consumption	Likely increase in quarter preceding increase, with fall in quarter following increase.
GDP	Impact on GDP is dependent on nature of consumer response, and on use of revenue: fiscal consolidation may be contractionary; expenditure or tax reforms may be neutral or expansionary.

Compliance & administration

- Tax simplification measures such as the "tax fraction" (e.g. 12.5% = 1/8th and 1/9th) and the payments basis of accounting become more difficult to use if the rate of GST is 15% or 17.5%.
- If special rates of GST are introduced, administration and compliance costs will rise in response to the new boundary.
- Higher rates of GST will have an impact on the profitability and operation of taxpayers that supply exempt goods and services, such as financial services providers (banks).

NZ's performance compared to the OECD



Note: This is only intended to indicate how the diagram may be used. The data involved and the methodology for constructing the indices needs significant further work. It does not therefore represent Treasury's view of what has happened over the ten years concerned.

Questions

- Does the proposed approach resonate with you – does it represent progress in policy thinking and design?
- Are the main indicators used the right ones?
- Do the measures make sense – are they appropriate as starters?
- Is the way we are suggesting to use the framework to guide policy advice OK?
- Is the suggested way of using the framework to collaborate across public sector agencies OK?