



# Progressive thinking



ten perspectives  
on tax



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# Contents



## 3 Foreword

**7** Talking tax, with  
context and all that

Morgan Godfery

**11** History of tax policy in  
New Zealand

Dr Lisa Marriott

**16** What my parents taught  
me about tax (and fairness)

Max Rashbrooke

**19** Taxing wealth

Bill Rosenberg

**23** Four tax myths that  
might pop up this year

Keith Ng

**25** Tax and the  
Social Contract

Bob Stephens

**28** Climate change  
and tax policy

Paul Young

**32** New Zealand's tax  
settings in an  
international context

Terry Baucher

**36** Tax and family assistance

Susan St John

**39** A light touch on foreign  
trusts and companies

Shamubeel Eaqub

## 42 Author bios



# Foreword



Erin Polaczuk  
and  
Glenn Barclay

National secretaries  
for the New Zealand  
Public Service  
Association  
Te Pūkenga Here  
Tikanga Mahi

## Kia ora koutou,

We need to talk about tax.

Not like we have been, either. Not exclusively in terms of ‘tax burdens’ and ‘tax relief’, and not in terms that assume all taxation is bad and all tax cuts are good. It’s simplistic, and it’s making us forget the reasons we pay tax in the first place. This kind of individualistic language is also dividing us when we need more than ever to be standing together for strong public services.

## Talking about tax

There are two enduring progressive perspectives on rethinking our public dialogue around tax. The first uses the analogy of a club membership; where tax is a subscription fee we all pay to fund a place that offers all of the personalised services we need, but it requires upkeep, staff, equipment... you may only have joined the club to use the gymnasium once a week, but your subscription also helps to clean the bathrooms, to pay the reception staff, to fix a leaking roof. Without yours and others’ subscription fees, the whole place would fall apart and no one would get to use the services they joined the club for in the first place.

The second idea is that we ought to be talking about tax like it’s a long-term savings account where we each deposit weekly, knowing that one day, we may well need to withdraw the money to pay for our healthcare costs, even if we’re

healthy for now. In that sense, paying tax is a pragmatic decision – what it funds may not always be of immediate use to us, but it likely will be in the future. Of course, most of the things our taxes pay for *are* useful to us every day – roads, schools, hospitals – and many of those things are funded by the taxes of those who came before us. If we talk about tax in this way, our parents and grandparents invested in the New Zealand that we now live in, and we are reaping the rewards of their labour.

These analogies are of some use in illustrating why we – the Public Service Association Te Pūkenga Here Tikanga Mahi – have produced this book. We’re uncomfortable with the fact that tax only seems to be discussed by ordinary people when they’re talking about tax cuts during election year; that timeless promise of governments seeking votes through what is essentially an over-the-table bribe – *vote for us and we’ll give you some extra money in the pocket*.

As we see it, our present situation in New Zealand as considered through the two perspectives described above is: a club whose management is so obsessed with offering membership discounts that they’ve been overlooking the severely degraded quality of the equipment on offer, or a long-term savings account with diminishing contributions that is incapable of producing the kind of return on investment that we as depositors have been promised.

# Foreword



## What metaphor fails to capture

Here at the PSA, we have an acute sense of what tax pays for. Representing over 63,000 workers in the public service, the state sector, local government, the community public sector and district health boards, we see what our taxes fund every day. We see the Department of Conservation ranger who looks after our native wildlife and protects endangered species from extinction. We see the library staff, tirelessly working at the centre of their communities to bring information to life for all New Zealanders. We see the border control agents working to keep our borders secure, the Ministry staff processing Official Information Requests to make our society more transparent, the home and disability support workers looking after the most vulnerable people in New Zealand.

All of these services are the result of the taxes that we and others before us have paid for – they are not *nice-to-have* add-ons for a prosperous society; they are the necessary foundations for any well-functioning nation.

At present, it is clear that many of the public services we maintain through our taxes have been neglected and underfunded since this Government took office in 2008: health, housing and education are the most visible casualties, but support for families, people made redundant, funding for

fair equal pay settlements and the protection of our natural environment are all at risk. The Government urgently needs to redress these funding deficits before tax cuts are dangled in front of voters yet again.

In fact, it could be argued that a third perspective on tax has implicitly emerged over the last nine years – in it, New Zealand is a large business that has been through some very tough economic times. We're all investors in this great big corporation, and after eight years of hardship, we're finally due a dividend from our CEO for our ongoing faith in the great belt-tightening of the nation. This perspective is pervasive, and it is unhelpful. It is even more unhelpful that all of our major political parties now seem to have bought in to this rhetorical approach to some extent, signalling their 'fiscal responsibility' by promising to cap spending on critically underfunded public services at an arbitrary threshold while assuming that current tax settings and levels are optimal.

New Zealand is not a membership-only club; it is not a long-term savings account; it is not a corporation moving from red ink to black. It is a diverse South Pacific nation of over 4.5 million people who should rightly be able to expect that paying tax affords them and their whānau access to good quality, timely and reliable public services. Currently, they cannot.

“At present, it is clear that many of the public services we fund with our taxes have been neglected and underfunded since this Government took office in 2008...”



“Consistently, it has been demonstrated that public services can be provided much more efficiently and effectively by the state than by the market alone. Again: New Zealand is not a business.”

Proper state investment in these services is not a burden on the market economy, contrary to the popular myth – as David Hall (Director of the Public Services International Research Unit at the University of Greenwich) noted in a 2009 paper, strong economic growth has gone hand-in-hand with rising public expenditure since the mid- 19th century, at least. Consistently, it has been demonstrated that public services can be provided much more efficiently and effectively by the state than by the market alone. Again: New Zealand is not a business.

### Having the conversation

In this book, we’ve collected together ten of our country’s best writers, academics and campaigners to consider the different elements of tax policy in theory and practice. In these ten chapters, our contributors consider everything from tax myths and political promises to specific measures for taxation on wealth and carbon emissions; from family assistance and inequality to social contract theory and tax avoidance. We also include primers on New Zealand’s history of tax policy and our relative taxation in an international context.

We’re not advocating for specific taxes nor fiscal policies in this book; this is not a manifesto. Some consistent themes do emerge over the ten articles here – New Zealand’s lack of a comprehensive Capital Gains Tax, for example, or the regressive status of Goods and Services Tax in practice

since its implementation. Several authors identify the problem of major tax avoidance by multinational companies, and several want to see income tax arrangements re-evaluated for a more progressive and fairer system that doesn’t over-burden the worst-off in our society. Inequality, over-politicisation and fairness are also recurrent themes.

As we write this, we’re coming up to the current Government’s ninth Budget. We hope that around this time, you will enjoy reading and considering the perspectives on offer here, and that you will break all social conventions and talk about tax – loudly and unashamedly! – with your friends, families and colleagues. Tax is not just the prerogative of governments to discuss – it is paid by the people for the people, and consequently, we should all have a significant say in how it operates.

We hope you will join us in this conversation.

Ngā mihi nui,

Erin Polaczuk

Glenn Barclay





# Talking tax, with context and all that



Morgan Godfery

Morgan (Te Pahipoto) is a writer and trade unionist based in Wellington.

He's also a non-fiction judge for the Ockham New Zealand Book Awards and sits on the Legal Issues Centre board at the University of Otago.

He tweets at @morgangodfery.

Here's some advice, a truism from years of talking and writing about te ao Māori: never mention the Treaty of Waitangi in polite company. People shift in their seats, their bellies tighten, and they think you're accusing them of something sinister.

"I'm not a racist" – this is the necessary qualifier – "but". Sometimes I wish the same were true when talking about tax. Instead of standing to attention, people's eyelids droop, their shoulders slump and they sink back in their chairs. "Tax sucks." It's not the subject you'd discuss in any sort of company.

In one way you can sympathise with this. When politicians discuss tax like they do data, all millions and billions, a thing existing in a privileged realm somewhere above politics and people's lives, the first reaction is to switch off. Tax talk becomes about "thresholds" and "efficiency" instead of the schools it might pay for, the hospitals it might improve and the houses it might build.

In a government green paper titled, ironically, *Making Tax Simpler*<sup>1</sup>, people are referred to as "customers" and the findings revolve around bureaucratic buzzwords like "flexibility" or vague platitudes like "modernising the tax administration system".

On this understanding of tax-as-technical-pursuit, most New Zealanders would willingly hand it over to technocrats and pointy-heads. It's a neat trick for conservative or centre left politicians who want to encourage people to understand tax as a "burden": here's this bad and complex thing – tax – and we're the only ones with the knowledge, skills and willingness to offer "relief."

"We've had no tax relief for seven years, going on eight now," ACT leader David Seymour told RNZ in March. "It's time for the government to actually look after the people who pay the bill." This is a cute soundbite, and typical of conservative and centre right politicians, but it leaves the most important things unsaid.

If there is a tax reduction there must be a corresponding reduction in spending or a corresponding increase in debt. This is what's at stake with talk of reducing the country's tax income. Except no one mentions schools that might

1. "Making Tax Simpler: A Government Green Paper on Tax Administration", Hon. Bill English and Hon. Todd McClay, accessed 17 April 2017.  
URL: <https://goo.gl/UJEoQc>



# Talking tax, with context and all that



go without teacher aids, hospitals that might keep fewer patients in overnight and additional homes that go unbuilt if there isn't enough tax income to either keep things going as they are or to improve things. Instead the emphasis is on what "I" might gain, like a "block of cheese," to borrow former Labour Party Finance Minister Michael Cullen's talking point from 2008.

Against the idea of paying the same or more tax for better schools, hospitals and homes, the idea of gaining another block of cheese each week seems petty. What use is personal "relief" if others go without? It's worth pointing out that this is more than hypothetical.

In the last budget Vote Health was, on a conservative estimate, \$248 million short of what it needed to cover inflation, population growth – including the effects of an ageing population – and the new services the government announced<sup>2</sup>. If we only wanted to maintain current health services there are three options: "reallocating" funding – perhaps the government could keep school operation grants frozen – debt (though the government says it wants to reduce debt) or tax changes.

The problem, at least as far as this government is concerned, is that its hands are tied. Income tax increases

appear to be off the table. New wealth taxes also appear to be a no-no. The first issue here is ideological – conservative and centre right politicians consider tax a barrier to economic growth – and the second is discursive.

In the prevailing discourse, the economy is like a living, breathing person. It gets "jittery", "confident" and it rewards "risk-takers" and punishes scroungers. News programmes cross to bank economists who read the tarots, consult the heavens and deliver their findings about how the economy is feeling. Will it punish exporters? Should consumers lift their retail spending to appease it?

Dressed in their tailored navy suits, bank economists are like the priests of old, holy garb and all, and they and their colleagues pronounce on the vagaries of The Economy. Are government taxes "hurting" it? The answer is almost always yes.

In this economic discourse, The Economy feels things like you and I. Now it seems so obvious it's almost redundant, but it's worth stating for the record: The Economy isn't a person. It cannot feel – it certainly isn't bestowed with intention or consciousness. Instead it's the name we give to the sum of our decisions about production, consumption and money.

“The Economy isn't a person. It cannot feel - it certainly isn't bestowed with intention or consciousness.”

2. Bill Rosenberg, "Did the Budget Provide Enough for Health?", Council of Trade Unions, accessed 18 April 2017. URL: <https://goo.gl/lh8PBA>



## Talking tax, with context and all that

“It’s an exhausted truism, but it seems apt here: “taxes are the price we pay for civilization”.”

In fact, tax is what makes the economy possible in the first place, not the thing “hurting” it.

US Senator Elizabeth Warren put it best in an iconic speech that was (predictably) vilified by her opponents:<sup>3</sup>

“There is nobody in this country who got rich on his own — nobody. You built a factory out there? Good for you. But I want to be clear. You moved your goods to market on the roads the rest of us paid for. You hired workers the rest of us paid to educate. You were safe in your factory because of police-forces and fire-forces that the rest of us paid for. You didn’t have to worry that marauding bands would come and seize everything at your factory — and hire someone to protect against this — because of the work the rest of us did.”

It’s an exhausted truism, but it seems apt here: “taxes are the price we pay for civilization,” as former US Supreme Court Justice Oliver Wendell Holmes famously said. At this point my chapter might read like a polemic. In one sense, I suppose it is, but in another sense it’s more than that: this is a plea to understand taxation in context. Tax isn’t a weapon politicians use against the

economy. Tax is what we use to pool our resources and secure the things we need: schools, hospitals, homes and more.

Perhaps talking about tax in context is easier said than done. Everywhere you look and listen, tax is talked about as something holding us down.

Even the Greens, the most progressive Parliamentary party on tax, sometimes fall into the trap with former co-leader Russel Norman telling media in 2014 that National’s research and development policies “hurt the economy,”<sup>4</sup> again as if it feels like we do. I go on television and radio and sometimes lapse into talking about the “healthy” or “unhealthy” economy, again as if it were like you and I.

The ‘vile maxim’ to which the ‘masters of mankind’ adhere, wrote Adam Smith in the *Wealth of Nations*, is ‘all for ourselves and nothing for other people.’ The doctrine is better known as class warfare, waged not in the streets but in governments and parliaments. The battles are often fought over tax. How much and from whom? How much and to whom?

These questions determine whether a child in Moerewa attends a well-resourced school, whether a patient Tauranga receives the best possible

3. Tiffany Gabbay, “Elizabeth Warren on Class Warfare”, The Blaze, accessed 17 April 2017.

URL: <https://goo.gl/9i5CNd>

4. Russel Norman, “National’s Cuts to R&D Will Hurt The Economy”, Scoop, accessed 17 April 2017.

URL: <https://goo.gl/vzfBot>

# Talking tax, with context and all that



care and whether the pot holes on the Desert Road are filled. Taxation is not the realm of technocrats. It's not something we should cede to politicians. It's the thing that helps us to determine the kind of life we might lead. ❖





# History of tax policy in New Zealand



Dr Lisa Marriott

Lisa Marriott is an Associate Professor of Taxation at Victoria University of Wellington's School of Accounting and Commercial Law.

Lisa's research interests include social justice and inequality, crime and the tax system, and the behavioural impacts of taxation.

This chapter provides a brief history of some of the tax policy changes in New Zealand's recent history. It examines the three primary forms of taxing: income, consumption and capital. The deliberate trend of tax changes in recent years has been to broaden the tax base and lower the tax rates and is visible in much – but not all – of New Zealand's extant tax policy.

Moreover, tax policy has become less complex in recent decades, with the removal of personal and company tax concessions.

## Individual income taxes

New Zealand has a history of progressive income taxes, whereby income taxes are structured on an individual's ability to pay. Rates for 1981 and 2017 are outlined in Table 1. Table 1 shows how rates have become less progressive over time: rates have reduced across all income thresholds and the thresholds have also reduced. While the tax rates are higher in 1981, the effective tax rates were frequently lower than those

shown, due to the rebates that were available to taxpayers.

New Zealand is unusual in taxing from the first dollar earned. Most OECD countries have a tax-free threshold, whereby no tax is paid until income exceeds a certain threshold. Instead, New Zealand targets low-income earners through the Working for Families package of tax credits. This is discussed further on page 34.

Table 1: Income Tax Rates 1981 and 2017

1981			2017	
Taxable income (1981 dollars)	Equivalent (2017 dollars)	Tax rate	Taxable income	Tax rate
\$1-\$5,000	\$1-\$21,404	14.5%	\$1-14,000	10.5%
\$5,000-\$11,683	\$21,405-\$50,013	35%	\$14,001-\$48,000	17.5%
\$11,684-\$16,266	\$50,014-\$69,632	48%	\$48,001-\$70,000	30%
\$16,267-\$22,000	\$69,633-\$94,178	55%	Over \$70,001	33%
Over \$22,000	Over \$94,179	60%		

# History of tax policy in New Zealand

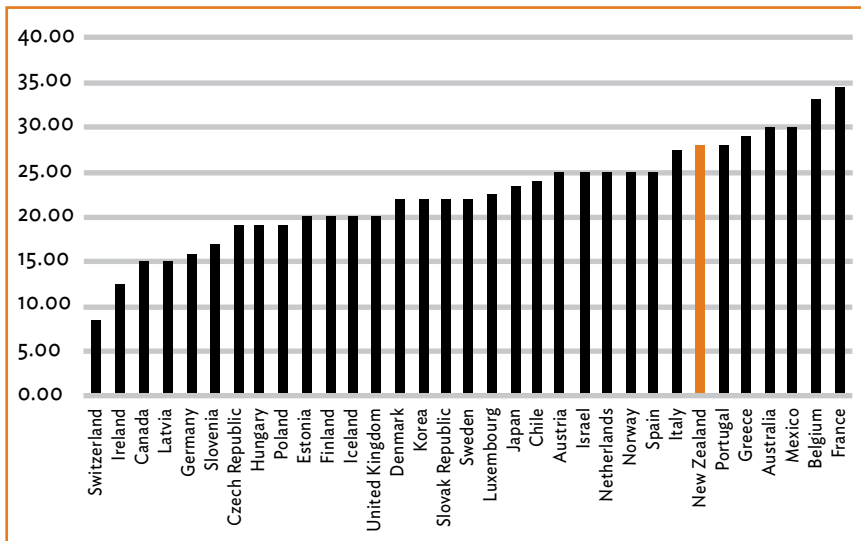


## Company taxes

Like individual income taxes, company taxes have also reduced in recent decades from 48% (1986-1988) to the current rate of 28%. Company tax rates have been relatively stable, remaining at 33% from 1989 to 2007, before commencing the decline to the 28% rate where it remains today. However, the 28% rate is not low

by OECD standards. Reference to Figure 1 outlines corporate income tax rates across OECD countries. This shows New Zealand's current company tax rate of 28% is now one of the higher rates among OECD countries. While New Zealand has followed the trend of other countries in reducing its company tax rate, other countries have continued to reduce their rates while New Zealand's rate stabilised.

Figure 1: Corporate Income Tax Rates (%) – OECD countries (2016)<sup>1</sup>



“...New Zealand's current company tax rate of 28% is now one of the higher rates among OECD countries.”

1. OECD.Stat, Table II.1, retrieved from <https://goo.gl/DWTVCM> 9 April 2017.



# History of tax policy in New Zealand

## GST

New Zealand's goods and services (GST) regime is admired globally. GST replaced the wholesale sales tax system that was known for its multiple rates and exclusions, which limited its ability to effectively contribute to government revenue.

Since its inception in 1986, GST has collected a large proportion of government revenue at a relatively low cost. It commenced at the rate of 10%, increased to 12.5% in 1989 and 15% in 2010. New Zealand's GST system is relatively simple

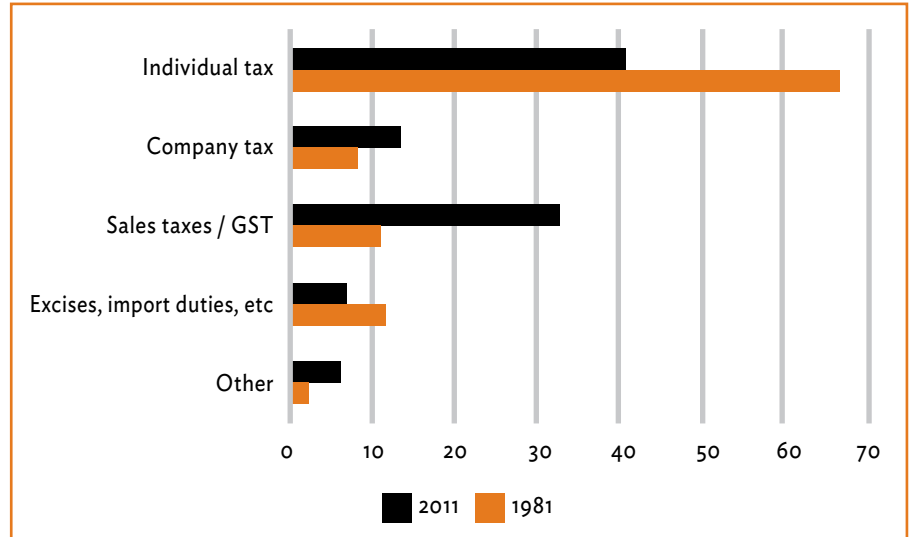
and benefits from having limited exemptions. At the present time, GST accounts for over 25% of New Zealand's tax revenue collected.

The efficacy of the GST regime can be seen in Figure 2. In 1981, approximately 11% of government revenue was collected from sales taxes, while nearly 66% was collected from individual income tax.

Some 30 years later, GST was collecting 32% of government revenue, while individual income tax had reduced to 41%. While GST is highly effective from the perspective

“While GST is highly effective from the perspective of revenue collection, it lacks the ability to capture an individual's ability to pay..”

Figure 2: Proportion of Tax Collected 1981 and 2011<sup>2</sup>



2. McLeod, R., Patterson, D., Jones, S., Chatterjee, S., and Sieper, E. (2001). Tax Review 2001: Final Report. Wellington: New Zealand Treasury and Inland Revenue (2015) Tax Policy Introduction Template, Policy Advice Division.

# History of tax policy in New Zealand



of revenue collection, it lacks the ability to capture an individual's ability to pay, that is, it is regressive – those on lower incomes pay a higher proportion of their incomes in GST than those on higher incomes. This is because those on lower incomes will typically spend a higher proportion (often all) of their incomes, whereas people on higher incomes will save a higher proportion of their incomes.

## Wealth Taxes

In the present time, New Zealand has few taxes that would typically be considered as wealth taxes. However, this has not always been the case. Death duties and gift duties were introduced in 1866 and 1885, respectively. The initial objective of these taxes was revenue generation and redistribution.

Gift duties had the additional aim of limiting the opportunity for people to avoid death duties by gifting their assets prior to their death.

In their early days, these taxes collected a moderate amount of revenue, but this deteriorated over time as avoidance measures became commonplace.

There appeared to be little political appetite to strengthen these forms of taxes, which contributed to their eventual demise. Estate taxes were repealed in 1992 and there has been no further attempt to introduce a similar tax. Gift duties were repealed from 2011.

Historically, New Zealand had a land tax that operated from 1878 to 1992.<sup>1</sup> In a similar way to death duties and gift taxes, it eventually collected little tax – 0.2% of tax revenue by 1980.<sup>2</sup> However, there has never been a comprehensive capital gains tax in New Zealand.

There are some components of capital gains that are taxed as they are explicitly included in the *Income Tax Act 2007*. But in the absence of such an inclusion, capital gains are not taxed in New Zealand.

This provides a tax advantage to those who have capital assets and has the potential to distort decision-making towards investment in capital assets due to their tax-preferred status. This approach is unusual among OECD countries and has generated much debate. While it is generally accepted that the New Zealand income tax base is effective, it is

“In the present time, New Zealand has few taxes that would typically be considered as wealth taxes.”

3. Barrett, Jonathan and Veal, John. (2012). “Land Taxation: A New Zealand perspective”, *eJournal of Tax Research*, 10(3):573-588.
4. McCaw, P.K., Schmitt, G.J., Kean, J.A., Phillips, R.T., Thompson, E.G., Titter, H.M., Tyler, B.H.C., Vautier, K.M., and Wright, A. (1982). Report of the Task Force on Tax Reform. Wellington: Government Printer.



# History of tax policy in New Zealand

“The most obvious gap is the absence of taxes on capital in New Zealand. It is notable that the primary group benefitting from this is the wealthy who own capital assists.”

also recognised that the absence of capital gain taxation is a gap that undermines the overall

philosophy adopted to tax policy in New Zealand.<sup>3</sup> This topic is covered in more detail on page 17.

## Conclusion

New Zealand has adopted a ‘broad-base, low-rate’ philosophy to tax policy. The concept of this approach is that taxing across a broader base provides for overall lower tax rates.

While some tax policy adheres to this approach, there are some significant gaps that challenge the coherence of the approach.

The most obvious gap is the almost complete absence of taxes on capital in New Zealand.

It is notable that the primary group benefitting from this absence of taxes on capital is the wealthy who own capital assets.

By way of contrast, the group most disadvantaged from increases in rates of GST are those who have the lowest incomes.

The political sensitivity of taxing capital gains is acknowledged, but it must also be acknowledged that a broad-base, low-rate tax regime cannot be achieved when a key component of the tax base is excluded. ❖

5. McLeod, R., Patterson, D., Jones, S., Chatterjee, S., and Sieper, E. (2001). Tax Review 2001: Final Report. Wellington: New Zealand Treasury





# What my parents taught me about tax (and fairness)



When I was a child, I remember often complaining, as all children do, that certain things weren't fair. My exasperated parents must have responded, as all parents do at least once, that life often isn't fair. But the larger lesson they taught me, across the whole of my upbringing, is that it doesn't have to be that way.

What they meant, in essence, is that a good society is one that pushes back against unfairness wherever it can. It knows that our rewards in life should reflect our own efforts but in practice are affected by dozens of things outside of our control, and that society must find ways to compensate for that.

Tax matters enormously to this discussion, because it is one of the main ways to tilt the balance back towards fairness. If people's income and wealth truly reflected their own decisions and nothing else, there would be far fewer reasons for taxation. And of course many high-earning people do work hard.

But people often succeed for myriad other reasons. They get help from their parents, or they are born with talents they have done nothing to deserve, or they happen to be in the right place at the right time.

Anyone who has made money in New Zealand has also done so by drawing on a common pool of resources: the public roads they drive on, the taxpayer-funded education

of themselves and their employees, the government's health systems, telecommunications networks and so on.

The most respected political philosopher of the twenty-first century, John Rawls, argued that even people's talents, being drawn out of the genetic pool, should be seen as "a common asset" and that while we should encourage people to use those talents to the full, we should also all "share in the benefits of this distribution whatever it turns out to be".

Tax exists in part to fulfil these demands. It holds onto the portion of people's incomes and wealth that has derived from luck, inheritance and the common pool of assets, and uses it both to top up the incomes of people who have been less lucky (via the benefits system) and to replenish the common pool. (Like any natural resource, the pool has to be continually filled up, otherwise it won't be there for the next generation to draw on.)



Max Rashbrooke

Max Rashbrooke is a research associate at the Institute for Governance and Policy Studies, and the author of *Wealth and New Zealand*.

He has written extensively on income and wealth inequality, and has worked as a journalist in both the UK and New Zealand.



## What my parents taught me about tax (and fairness)

“Currently New Zealand does not ask much of its richest citizens ...the poorest New Zealanders pay just under 30% of their income in tax, and the richest pay 34%.”

In this sense, tax pushes back against unfairness, which sometimes goes by the name of unjustified inequality. The material forms of inequality – imbalances of income and wealth – have increased significantly in New Zealand in recent decades. In fact, income imbalances increased more here than in any other developed country<sup>1</sup> between 1985 and 2005 – a major shift in New Zealand’s economy and culture.

Since the mid-1980s, the typical rich person (the mean equivalised household in decile 10, in technical terms) has seen their annual income (after-tax and inflation-adjusted) grow by around \$60,000, while the typical poor person has only seen a roughly \$2,000 increase.<sup>2</sup>

Stored-up wealth, meanwhile, is very unevenly distributed: the wealthiest 1% of individuals have one-fifth of all household wealth,<sup>3</sup> while the poorest half of the country have almost nothing.

But there is little evidence that the richest New Zealanders have suddenly become harder-working or are making a much greater contribution than they used to, and equally little evidence that poorer New Zealanders are less hard-

working or motivated than formerly. Indeed the hundreds of people who apply for every new supermarket check-out position tend to suggest otherwise. So there is good reason to think that the increases in income and wealth imbalances of recent decades have not been entirely deserved, and that the tax and benefit system should do more to tilt the balance back towards fairness.

Currently New Zealand does not ask much of its richest citizens. Rob Salmond’s 2011 book *The New New Zealand Tax System*<sup>4</sup> showed that the poorest New Zealanders pay just under 30% of their income in tax, and the richest pay 34%.

And this excludes money made selling assets, which, if we could measure it, would almost certainly drop the tax rate of the rich *below* that of the poor, since it gives them lots of extra income but attracts essentially no tax.

So we don’t ask much, proportionately, from people who have often had enormous advantages and who can afford to pay more, compared to what we ask of those who’ve often had very difficult upbringings and have nothing left over once their bills are paid.

1. <https://goo.gl/SBSyxE>
2. <https://goo.gl/9z4emh>
3. <https://goo.gl/brM9lo>
4. <https://goo.gl/l3S2HP>

# What my parents taught me about tax (and fairness)



A tax system that did more to address this unfairness and unjustified inequality would have several elements. The first would be a higher top rate for income tax, perhaps for those earning over \$100,000 or \$150,000 a year.

New Zealand's 33% top rate is extremely low internationally (the UK and Australia, for instance, both have a 45% top rate), and modelling<sup>5</sup> by economists Thomas Piketty, Emmanuel Saez and Stefanie Stantcheva shows that developed countries could increase top rates as high as 80% before losses from avoidance and reduced effort would outweigh the revenue gains.

But the most glaring hole in New Zealand's tax system, from a fairness point of view, is the failure to tax wealth in any form, except for the government's very minimal tax on houses sold within two years of purchase.

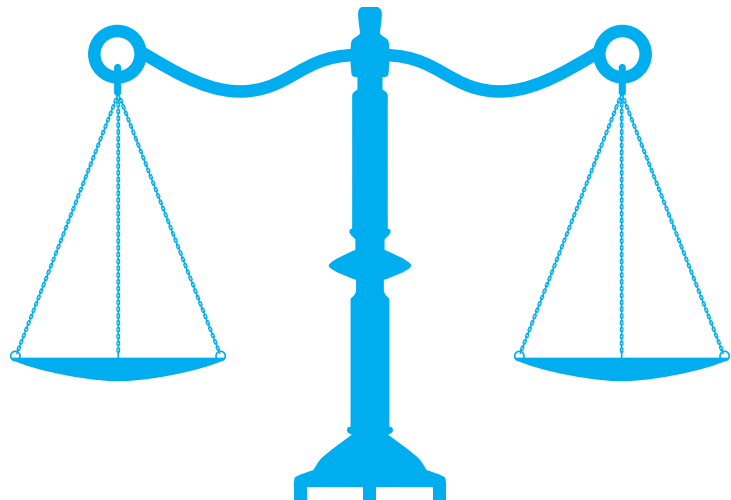
Like annual income, people's stored-up wealth can be earned through hard work, but it can also be inherited, gifted, or made by, say, flipping houses.

For this reason, most countries tax wealth in some form, and New Zealand could easily follow their lead. It could tax capital gains thoroughly, so that someone who

makes \$80,000 selling a house pays the same tax as someone who gets the same amount in salary. Or it could tax all wealth annually, as proposed by Piketty and (in different form) by New Zealand's own Gareth Morgan.

New Zealand could also institute a lifetime gifts tax, as proposed by the late Anthony Atkinson, a distinguished British economist. His idea was that the first, say, \$200,000 of gifts received in a lifetime could be tax-free, to allow uninterrupted inheritance of small(ish) amounts, but all further gifts should be taxed, so that those lucky enough to get these gifts could compensate those who don't. That's a kind of fairness that I think my parents would recognise. ❖

“...the most glaring hole in New Zealand's tax system, from a fairness point of view, is the failure to tax wealth in any form...”



5. <https://goo.gl/ITMnjF>



## Taxing wealth



Bill Rosenberg

Bill Rosenberg was appointed Economist and Director of Policy at the CTU in May 2009.

He holds a BCom in Economics, a BSc in Mathematics and a PhD in Mathematical Psychology.

Bill was previously Deputy Director, University Centre for Teaching and Learning at the University of Canterbury, a Commissioner on TEC, and a member of the Regional Land Transport Committee of Environment Canterbury.

Wealth is assets. They can be physical like land, buildings, plant and equipment, ‘intangible’ like trademarks, patents, and a firm’s reputation or brand, or financial like a bank account, shares, bonds or other securities. Companies and people own assets because they hope to get future benefits from them whether as income or capital gain or non-financial benefits such as having a house to live in.

### Why tax wealth?

Inequalities in wealth are much greater even than inequalities in income. The most recent data from Statistics New Zealand<sup>1</sup> showed that in the year to June 2015, the wealthiest one-fifth of households had almost 70% of household wealth and the top 1% alone had 18% of the wealth - more than the least wealthy 60% combined. The highest incomes tend to come from wealth, and can be much higher even than extreme chief executive salaries. Extremes of wealth concentrate power and influence and are therefore bad for social cohesion and a healthy democracy. If wealth can be passed on without limit between generations then those extremes worsen.

A large part of wealth is in housing. Home ownership can boost local communities and social stability. But fewer people live in their own homes, which are becoming increasingly unaffordable. Fixing that is a complex

issue beyond this discussion, but taxes on wealth are among the policies that need to change. They could help to reduce the likelihood of more housing bubbles and to rebalance the New Zealand economy if more investment moved out of buying and selling larger and more expensive houses into productive assets that supports good jobs.

Taxes on wealth also help to combat tax avoidance. Companies with operations around the world avoid taxes by using various tricks to shift profits to low tax countries. They undermine the revenue we need for good public services. Wealth taxes can be more difficult to avoid than income taxes.

### What taxes on wealth do we have?

New Zealand has few wealth taxes left. The only notable one is a weak capital gains tax. Income tax is payable on

1. Household Net Worth Statistics: Year ended June 2015, Available at <https://goo.gl/L8oz66>



## Taxing wealth

the profit made in reselling a property (not the owner's family home) within the first two years or if it was bought with the intention of resale at a profit.

Taxes on wealth used to be much more extensive. Until 1992 there was an estate duty of 40% on deceased estates over \$450,000 (\$730,000 in today's dollars). Gift duties (abolished only in 2011) discouraged avoidance of estate duties.

Stamp duties, abolished in 1999, taxed property sales. They are a form of transaction tax, and in many countries are also levied on share sales.

They are a close relative to financial transaction taxes which can reduce the flows of speculative international finance. These flows can at times have disastrous effects on financial stability and the value of exchange rates.

Land taxes were one of the earliest taxes in colonial New Zealand but were abolished in 1990. However there is still a property tax in the form of local government rates which are levied on the value of both land and buildings. Property registers make land and property taxes very efficient to collect.

Most of these taxes are common among other countries, including Australia. New Zealand is unusual in its weak taxation of wealth.

### What taxes on wealth would be useful for New Zealand?

It is important to head off growing extremes of wealth. Any form of progressive income or wealth tax would help with this, but the most direct would be to reinstate estate and gift duties. A simple and progressive structure for an estate duty would be to exempt an amount approximately equal to the median house price (\$550,000 at time of writing) and tax the remainder at the top income tax rate which is currently 33% but should be higher – at least 45%.

We should do what is possible through taxation to make housing more affordable, less subject to price bubbles and to encourage investment in other productive forms of assets. A full capital gains tax on property encourages investors to focus more on investment income than on rising asset prices. It may slow the formation of a price bubble, but it would need a tax that almost confiscates the capital gain to make speculation unattractive once rapid price rises are underway. Capital gains should be taxed like any other income. For public acceptance it would exempt the primary family home.

An alternative is a tax on a deemed 'risk-free rate of return' on the property (usually taken to be the interest rate at which Treasury can borrow). Again the primary family

“ We should do what is possible through taxation to make housing more affordable, less subject to price bubbles and to encourage investment in other productive forms of assets.”



## Taxing wealth

“Assistance to low to middle income first-home buyers must avoid the risk of pushing prices up further.”

home should be exempted or low income home owners compensated by reductions in other taxes. This would have the benefit of being a more reliable source of revenue than a capital gains tax, but the disadvantage of being less responsive to downturns in the economy. It removes much of the advantage that housing currently has over other forms of investment. A capital gains tax should be retained for other forms of wealth (such as shares) and on property if price bubbles recur.

There is concern that overseas residents push up house prices, particularly during a bubble. We could copy the Australian ban on non-resident purchases of existing houses. Alternatively we could levy a hefty stamp duty on property purchases by non-residents: for example British Columbia in Canada introduced a 15% property transfer tax on foreign real estate buyers in 2016.<sup>2</sup>

Assistance to low to middle income first-home buyers must avoid the risk of pushing prices up further. We could couple concessionary interest rates or a contribution to their deposit (paid for by the above taxes) with a requirement that they buy new houses. At the same time the government should be building or requiring developers to provide good

quality low cost starter houses for which first-home buyers get priority.

Finally, we should be designing an international financial transaction tax to help manage the exchange rate of the New Zealand dollar and during financial crises. Cooperation with other governments would make this more effective. ❖

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2. Canada tax targets foreign house buyers, 26 July 2016, available at <https://goo.gl/eqWno9>





## Four tax myths that might pop up this year



Keith Ng

Keith Ng is a data visualisation consultant by day and data journalist by night, using data to understand and explain complex issues and policies.

He also has the prettiest tax spreadsheets you've ever seen.

### Myth 1: “40% of households pay no ‘net taxes’”

Since 2011, Bill English has been pushing<sup>1</sup> the idea that around 40% of NZ households don't pay any “net tax”.

In its first iteration, the claim was very technical and specific. English said that these households “receive more in **income support** than they pay in **income tax**” [emphasis added]. But by 2016, it's mutated into a wildly inaccurate claim in the media:<sup>2</sup> that these households are “contributing nothing to New Zealand's tax take” and that the whole tax system is propped up by “a small number of taxpayers [who] bear the brunt of New Zealand tax bill”.

The problem with “net taxes” is that it excludes GST, which accounts for 32% of all taxes. Not quite as much as income tax (38% of all taxes), but it's a whopping big heap not to count. It also only counts cash transfers - so if you get cash from the government, that gets counted, but if you get a service from the government (such as education, or healthcare) that does not.

“Net tax” is an arbitrary and meaningless way to count who is “contributing” and who isn't. It exists as a political tool. Although it is produced by Treasury, Treasury themselves have never published it. It has only ever been

released by the Minister of Finance's office, and usually its first public appearance<sup>3</sup> is on David Farrar's blog.<sup>4</sup>

### Myth 2: The top 10% of taxpayers paying 46% of taxes proves they're overtaxed

It's true - the top 10% of taxpayers pay 46% of all income tax - but that's only half the picture.

How much tax you pay depends on two things: a) the tax rate, and b) your income. It's pretty straightforward, so it's incredible how often people blame “high amount of tax paid” on the tax rate being too high, and completely ignore the income effect.

The top 10% of taxpayers make around 34% of all taxable income, nearly as much as the bottom 70% combined. So while they pay a lot of tax, they also make a lot of money.

But the critical part is that they pay a higher **tax rate**, and that's where any debate about tax fairness ought to start. The top 10% of taxpayers have an average income of \$140,000 per year, and pay 26.5% of that in income tax. The next 10% down from them have an average income of \$73,000, and pay 20.4% of that in income tax.

The defining factor of a progressive income tax system is that people

1. <https://goo.gl/HokdW>
2. <https://goo.gl/ycpUOj>
3. <https://goo.gl/DDAOyo>
4. <https://goo.gl/3K4Dxk>



# Four tax myths that might pop up this year



on higher incomes pay a greater **percentage** of their income in taxes. Whether you think that's fair is a matter of values, not fact. But looking at the "total tax paid" or "proportion of tax paid" without looking at income or tax rate is just plain misleading, and tells us nothing about progressiveness or fairness.

## Myth 3: Bracket creep has reversed the effects of the 2010 tax cuts

Bracket creep refers to the effect of inflation on the tax rate. As our incomes grow (due to inflation), we move into higher tax brackets and a pay higher tax rate, even though the growth due to inflation isn't really making us richer.

Before the 2010 tax cut, the average tax rate for all taxable income was 21.4%. Immediately after the tax cut kicked in, at its lowest point in 2012, the average tax rate fell to 18.9%. That's the impact of the tax cuts.

By 2015 (the latest year for which data is publicly available), it crept back up to 19.5%. That 0.6% increase is partly the result of bracket creep. It's not nothing - and it disproportionately affects people earning around \$50,000 per year - but people are still paying less income tax than they did in 2010.

While bracket creep is rightly characterised as "a tax increase by stealth", successive governments - left and right - have kept it as a handy political tool. It's a mechanism that automatically raises taxes a tiny bit each year; over time, it gives governments the option to increase spending or to tweak the tax system.

## Myth 4: Tax cuts pay for themselves

Here's an idea: If everyone gave the government less money, the government would receive **more** money. This is not a joke. The 2010 tax cuts<sup>5</sup> were estimated to cost around \$1.1b over four years. But by 2014, the tax cut was supposed to result in the government receiving an extra \$175m a year in taxes.

The magical part is a single line in the budget called "Adjustment for macroeconomic effects". Treasury includes this because they believe that tax cuts will help the economy grow faster, and a bigger economy means more taxes.

It's a sound idea in theory, except it's a bit like a rain-dance. If it rains more than average after I do a rain-dance, then clearly it was very effective. If it rains less than average after I do a rain-dance, then you're lucky I did it, because it would've been much worse if I didn't!

And that's what happened. By the time 2014 rolled around, the economy grew slower than expected and tax revenue was \$4b less than the 2010 forecast. Did the tax cut fail to stimulate growth? Or was the economy worse because of the Christchurch earthquake and other factors, and the tax cut helped soften the blow?

“The defining factor of a progressive income tax system is that people on higher incomes pay a greater percentage of their income in taxes.”

Even with the benefit of hindsight, it's impossible to prove or disprove. That's a pretty lousy way for an "evidence-based" government to justify spending a billion dollars. ❖

5. <https://goo.gl/hRGxWG>



## Tax and the Social Contract



Bob Stephens

Bob Stephens retired from being an Associate Professor in the School of Government in 2010.

While at Victoria University he published widely in the areas of taxation, social policy, including co-establishing the NZ Poverty Measurement Project, and income distribution.

He is still involved in these areas at the Institute of Governance and Policy Studies.

Contrary to the opinion of the New Right, the payment of tax is a measure of citizenship, of being a member of society. Taxation is not theft of one's market income, but is the method of payment for the services that government provides.

Tax, along with government expenditure, also permits the redistribution of income from the current well-off to the current less well-off; from those without dependents, to those with dependents, especially children; for individuals throughout their lifetime; and between generations.

Some will be net gainers from the interactions of taxation and government expenditure, most will roughly break-even, while those who are better-off are more likely to pay more in taxes than they receive from government expenditures.

Taxation is part of a social contract, developed and endorsed via the political system, which links all members of society through the interaction of all government expenditures and the payment for those services. Taxation is not just personal income tax, but covers GST, company taxation, excise duties, tax on fringe benefits, as well as ACC levies and road user charges.

Profits from state-owned enterprises and government deficits are other ways of financing

government expenditures. Government spending includes social security, pensions, health care, education, infrastructure, defence, police, environmental protection and the operation of the state itself. Taxation must be considered along with the benefits that accrue from government spending.

For this social contract to be acceptable to society, it must be seen as fair. Fairness is multi-faceted. Fairness covers both horizontal and vertical equity, and incorporates inter-temporal and inter-generational equity.

Horizontal equity requires that individuals in similar economic and social circumstances pay the same level of taxation. Vertical equity is the appropriate amount of tax (and receipt of government services) that the rich pay relative to the poor. Without horizontal equity, attempts at ensuring vertical equity are a random lottery. Overcoming flawed policy from the past creates winners and losers, but this is a way of increasing fairness and thus enhances the social contract.

# Tax and the Social Contract



Unlike the market, a major problem for taxation is the separation of a direct link between payment and receipt of government services. This separation is not just today, but also occurs on a temporal basis: today's government funds school children who are tomorrow's workers and taxpayers, and these people subsequently become recipients of pensions. The current fall in the number of taxpayers relative to pensioners is seen as unfair to the younger generations who will need to foot a larger tax bill to maintain existing level of services. However, today's pensioners paid taxes in the past in the expectation that they would receive a pension. The social contract applies over the life-cycle.

Radical tax reform, changes in the degree of provision and payment for government services, or significant changes in demographic structures, can easily change inter-temporal notions of fairness. The social contract cannot be seen in isolation from wider changes in economic and social conditions, such as increasing market income inequality, market liberalisation, changes in family formation with sole parenting, longer life expectancy and higher divorce rates.

It is seen as unfair that multinational companies can use tax havens to avoid tax on New Zealand derived profits, or that

some individuals can structure their financial affairs to permit tax avoidance and tax evasion. Tax rules allow some sources of income to be treated differently. Those who receive income from tax-advantaged second housing, or capital gains, face far lower effective tax rates than wage earners. Housing is a preferred investment to other assets which raises house prices and imposes a burden on current and future generations. Issues of horizontal inequity led to the 1986 tax reform, with the uniform GST replacing a wholesale tax with rates ranging from zero to 60%.

Some sources of income such as fringe benefits were tax free whilst others had a marginal tax rate of up to 66%. Horizontal equity is also the level playing field, allowing resources to go to their most efficient use.

The degree of vertical equity is a social judgement, to be determined, in part, by the political process. The substantial widening of market income inequality is hard for government to counter, but in New Zealand income inequality has been exacerbated by the lowering of personal income tax rates, especially at the upper end of earnings, with the top tax rate now being 33%.

Over the last 30 years the personal income tax system has become far

“Taxes are paid at one stage of the lifecycle in the expectation that you will receive a benefit at a later stage: a redistribution of one's own wealth.”



## Tax and the Social Contract

“Taxation is part of a social contract... which links all members of society through the interaction of all government expenditures and the payment for those services.”

less progressive: for someone on average earnings, the tax rate has fallen from 23% to 19%, while at 3 times average earnings the average tax rate has gone down from 38% to under 30%. The targeted nature of family assistance (a tax credit) has led to a fall in the inequality of the tax system for those with dependent children.

Much income redistribution occurs throughout one's lifecycle, between periods of relative 'want' and relative 'plenty'. Market incomes rise during the early periods of employment, flatten, and then drop dramatically when retired. In a family there is often a shift from a one-income to a two-income.

This combination of benefits and tax payments smooth out variations in living standards over the lifecycle, with people contributing when the incomes are relatively high and receiving net benefits when incomes are relatively low. Taxes are paid at one stage of the lifecycle in the expectation that you will receive a benefit at a later stage: a redistribution of one's own wealth. Most households pay roughly the same amount in tax as they receive in benefits, but that there is some redistribution from lifetime rich to lifetime poor.

With the ageing of the population, younger taxpayers may contribute more taxes to the welfare state than they will receive from it,

while the baby-boomers will be net beneficiaries. For fiscal balance, when today's young retire, the smaller tax base will require a cut in benefits (especially superannuation), or higher taxes. The development of the New Zealand Superannuation (Cullen) Fund was designed to offset this intergenerational inequity: government payments into the fund increase current tax payments; drawing down the fund, post 2040, tax payments for superannuation need not increase. This lifecycle redistribution would permit future payment of pensions, limiting the spectre of intergenerational inequity.

The social contract is thus multi-faceted: taxes pay for current government spending; taxes allow for income redistribution between current rich and poor; they are an effective method of redistributing income and expenditure over one's lifetime; and they can show whether different generations are treated equitably by the state. ❖

# Climate change and tax policy



For as long as the world has been earnestly attempting to tackle climate change, economists have advocated a price on greenhouse gas emissions as the best way to do it.

The rationale is simple: emissions impose a cost on society, and exposing polluters to this cost will incentivise change. ‘Internalising’ the cost through carbon taxes<sup>1</sup> or emissions trading will reduce demand for carbon-intensive products, make cleaner alternatives more competitive, and spur low-carbon innovation.

Beginning with Finland’s carbon tax in 1990, pricing schemes have expanded to cover 13 percent of global emissions.<sup>2</sup>

In New Zealand, following a tortuous and ultimately unsuccessful effort to put in a carbon tax, the Fifth Labour Government passed the Emissions Trading Scheme (ETS) late in its reign in 2008.

The failure so far to deliver a strong and reliable price, and to reduce New Zealand’s emissions,<sup>3</sup> has eroded support and led to calls to start over with a carbon tax.

In this chapter, I discuss where to from here and argue three main points. First, that a reformed ETS can deliver results with the right political intent. Second, that New Zealand’s overall level of carbon pricing is low. And third, that higher carbon prices – if done right – can not only reduce our emissions, but help us build a fairer and more prosperous country.

## A big fat price on carbon

“The appropriate price is what I call very scientifically ‘A Big Fat Price’ on carbon. You have to give very strong signals about the fact that you want to push out carbon.”

- OECD Secretary-General, Ángel Gurría<sup>4</sup>

What price do we need? One approach is to determine a ‘social cost of carbon’, which the OECD argues can be “very conservatively” set at EUR 30 (NZ\$45) per tonne of emissions.<sup>5</sup> These assessments are contentious and values-laden; some studies find



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Paul has worked voluntarily and professionally on climate change issues for eight years, and co-founded Generation Zero in 2011.

Paul holds a MSc in physics.

1. I use ‘carbon’ throughout to refer to all greenhouse gases.
2. World Bank, Ecofys and Vivid Economics (2016). State and Trends of Carbon Pricing 2016. World Bank, Washington, DC. P.22. Accessible at <https://goo.gl/6WeaXC>
3. Ministry for the Environment (2015). New Zealand Emissions Trading Scheme Review 2015/16: Discussion document and call for written submissions. Ministry for the Environment, Wellington. Accessible at: <https://goo.gl/OP6vkB>
4. Accessible at: <https://goo.gl/L54SZY>
5. OECD (2016). Effective Carbon Rates: Pricing CO<sub>2</sub> through Taxes and Emissions Trading Systems. OECD Publishing, Paris. Accessible at: <https://goo.gl/Sy7NMZ>



## Climate change and tax policy

“The price level is key, but so too are price reliability and predictability. Furthermore, even a strong carbon price will not be sufficient alone; it must be part of a broader policy package.”

costs exceeding US\$200.<sup>6</sup> A second approach estimates the price needed to reduce emissions in line with agreed global temperature goals. A recent International Energy Agency study found CO<sub>2</sub> prices should rise to US\$120 (NZ\$170) by 2030 in OECD countries for a reasonable chance of keeping global warming under two degrees.<sup>7</sup>

The price level is key, but so too are price reliability and predictability. Furthermore, even a strong carbon price will not be sufficient alone; it must be part of a broader policy package.

### Reforming the ETS

The ETS has delivered neither strong, reliable nor predictable prices to date. This sorry tale has been told elsewhere.<sup>8</sup> But the root of the problems has been political decisions, not the tool itself.

Most critical was the lack of limits on the quantity of foreign carbon credits participants could use. Since New Zealand was cut off from Kyoto Protocol carbon markets in mid-2015, the ETS has been recovering. With the

phase-out of the “one-for-two” subsidy underway, polluters currently face a price around NZ\$11.50 per tonne.<sup>9</sup>

Further change is needed. The ETS could be reconfigured as follows to deliver stronger prices and greater predictability, while retaining key advantages of trading:

1. Keep it closed from other markets for the foreseeable future;<sup>10</sup>
2. Introduce government auctioning of emissions units up to a fixed cap;
3. Introduce a price corridor with lower and upper limits (managed through auction reserves);
4. Set levels for the cap and price corridor several years in advance, with an indicative range extending further.

In this model, the government, not ETS participants, would lead any purchase of international carbon credits to help meet New Zealand’s commitments.

This model would establish a transparent, shrinking cap on New

6. <https://goo.gl/mdKzkX>. Accessed 19 April 2017.

7. OECD/IEA (2017). Chapter 2 of Perspectives for the energy transition – investment needs for a low-carbon energy system. Accessible at: <https://goo.gl/qOiclx>

8. Simmons, Geoff and Paul Young (2016). Climate Cheats. The Morgan Foundation, Wellington. Accessible at: <https://goo.gl/CmVYxz> and Leining, Catherine and Suzi Kerr (2016). Lessons Learned from the New Zealand Emissions Trading Scheme; Motu Working Paper 16-06. Motu Economic and Public Policy Research, Wellington. Accessible at: <https://goo.gl/OMkWB>

9. Unit price from [www.comtrade.co.nz](http://www.comtrade.co.nz) with 67% surrender obligations.

10. I acknowledge the participants in Motu’s ETS Dialogue for helpful ideas and discussion on options for reform of the NZ ETS.



Zealand's emissions. It would give clear future price signals to guide low-carbon investments. Finally, it would generate revenue for the government, who could add it to the public purse, recycle it through rebates or reductions in other taxes, or invest it in targeted low-carbon infrastructure and programmes.

## A broader view on carbon prices

Most developed countries have a range of specific taxes on energy use (for example, fuel taxes). Regardless of the reason for implementation, these impose an effective price on carbon.

In all but a few countries, energy taxes currently vastly outweigh explicit carbon prices.<sup>11</sup> Overall, New Zealand has among the lowest effective carbon prices in the OECD. This strengthens the case for increasing our carbon price, and for considering a broader range of pricing instruments than just the ETS, such as the following.

Unlike a fuel tax, our unique road user charge system for diesel vehicles doesn't penalise less efficient vehicles. The OECD has recommended introducing an excise duty on diesel.<sup>12</sup>

It is particularly urgent to avoid investments in long-lived, carbon-intensive assets, such as coal boilers. In the absence of a sufficient ETS price, one idea is a targeted levy on new boilers equivalent to, say, a carbon price of at least \$100 per tonne.

While debate rages on about whether and how to include biological emissions in the ETS, we could start with a simple tax on nitrogen fertilisers with revenue used to fund native revegetation.

I would even make the case – at least in the short-term – for a fossil fuel levy on top of the ETS. This could be done relatively easily by charging a 'surrender fee' on each emissions unit.

## Smoothing the transition

Concerns around rising carbon prices tend to gravitate around two poles: impacts on low-income households and impacts on trade-exposed businesses. Both are legitimate issues, and both can be managed through careful policy design. Current ETS settings are overly generous on the latter, while doing nothing about the former.

Emissions-intensive, trade-exposed activities get a free allocation

“With wise implementation, we have nothing to fear and much to gain from higher carbon prices. They can make our tax system fairer and more progressive, while tackling the urgent crisis of climate change.”

11. OECD (2016). Effective Carbon Rates: Pricing CO<sub>2</sub> through Taxes and Emissions Trading Systems. OECD Publishing, Paris. Accessible at: <https://goo.gl/TS8HMw>

12. OECD (2017). OECD Environmental Performance Reviews: New Zealand 2017. OECD Publishing, Paris. Accessible at: <https://goo.gl/wpHmK1>



## Climate change and tax policy

“The ETS has delivered neither strong, reliable nor predictable prices to date. But the root of the problems has been political decisions, not the tool itself.”

of emissions units, reducing companies' price exposure by up to 90%. There are problems with how this is done, but the biggest issue is opportunity cost: free allocation represents foregone revenue. While there is a case for transitional assistance, this must be weighed up against other uses of the money.

Elsewhere, carbon revenues are commonly recycled through rebates or tax reductions targeted at low-income households. Many governments also use a portion of the revenue to invest in a low carbon future. This too can be targeted towards those most vulnerable to the impacts of climate policies – for example, home insulation subsidies for low-income households, and retraining programmes for workers in carbon-intensive industries.

Depending on how the revenue is used, carbon pricing may even boost GDP growth.<sup>13</sup> Research shows that environmental regulation has significant positive effects on long-run productivity.

With wise implementation, we have nothing to fear and much to gain from higher carbon prices. They can make our tax system fairer and more progressive, while tackling the urgent crisis of climate change. ❖



13. OECD (2016). Effective Carbon Rates: Pricing CO<sub>2</sub> through Taxes and Emissions Trading Systems. OECD Publishing, Paris. Accessible at: <https://goo.gl/NAsqGW>



# New Zealand's tax settings in an international context



During the year ended 30th June 2016, the Government collected nearly \$70 billion in tax revenue, or about \$14,900 from every person in the country.<sup>1</sup> That sounds like a fair sum of money, but how does New Zealand's tax burden compare internationally?

Very well it appears, based on the 2017 edition of the OECD's annual Taxing Wages report.<sup>2</sup> According to the OECD, a childless single New Zealand worker earning the average wage had the second lowest "tax wedge" in the OECD's 35 member countries. One-earner families with two children had the lowest tax wedge in the OECD.

## Behind the headlines

The low tax wedge is a combination of relatively low income tax rates, no social security taxes and transfers for social assistance, such as Working for Families (WFF) tax credits.

What the bald statistics hide is the effect of the "abatement" provisions for those receiving social assistance when they earn extra income. Under the abatement provisions, the amount of WFF assistance is "abated" by 22.5 per cent for every extra dollar of income over \$36,350. This means that as income rises, the amount of assistance falls. This can have some

dramatic effects. According to one Inland Revenue report in 2015, there were 4,000 families with an effective marginal tax rate of 100%.

In other words, every additional dollar earned was effectively lost through the combination of benefit abatement and tax. It's conceivable that more families will face this welfare trap as the abatement rate is set to rise to 25 per cent in the near future, together with a corresponding reduction in the threshold to \$35,000.

The OECD survey looks at income tax, but what about GST? This made up \$18.2 billion, or 26.1 per cent, of the total tax collected in the 2016 year. GST's percentage of the overall tax take places New Zealand second overall in the OECD.<sup>3</sup>

On average, GST or value added taxes represent about 20 per cent of tax revenues in other OECD countries. New Zealand's higher GST take is because it has no exemptions or variable rates, making it the most comprehensive GST in the world.

This is the result of the "broad base, low rate" approach to tax policy that governments of both hues have followed since the mid-late 1980s. A broad base with no exemptions allows lower tax rates, and the GST system – which is regarded as a



Terry Baucher

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He has over 30 years' experience as a tax specialist in both Britain and New Zealand.

Terry is a frequent commentator on tax matters in the media and is the co-author with Deborah Russell of *Tax and Fairness* (Bridget Williams Books 2017)

1. Financial statements for the year ended 30th June 2016

<https://goo.gl/ixl91s>

2. <https://goo.gl/AZS5O1>

3. <https://goo.gl/SXfgpl>



# New Zealand's tax settings in an international context

“The absence of a CGT undermines the broad base low rate tax policy.”

model of this kind – best exemplifies this policy.

Countries seeking to introduce Goods and Services Taxes are encouraged to follow the New Zealand approach.

However, one problem with GST is that it is seen as a regressive tax for low income persons as they pay a greater proportion of their income in GST than higher income earners. This has prompted calls to zero-rate fresh food, for example, as a means of redressing this issue.

Such proposals address the symptoms, not the cause. Families struggling to meet the bills suffer from a lack of income, not over-taxation. Boosting incomes for low and middle income families would be far more effective than an ill-defined tax break.

The broad base low rate approach can also be seen with corporate income. Companies paid just over \$11 billion in corporate income tax for the 2016 year. At 4.4 per cent of GDP, this is in the top five of the OECD.

However, the base is perhaps not as broad as it appears. The four Australian owned banks paid \$1.65 billion between them in 2016, Air New Zealand \$200 million and the New Zealand Superannuation Fund \$538 million on profits of \$559 million; an effective tax of 96 per cent!

The New Zealand Superannuation Fund is consistently one of the largest taxpayers in the country, having paid more than \$4.6 billion in tax since its inception in 2003. More than \$3 billion of this tax has been paid since the government stopped contributions in 2009. The New Zealand Superannuation Fund was established to help meet future superannuation costs, but it pays so much tax that it's already covering almost five per cent of the current cost of New Zealand superannuation.

Its colossal tax bills are very largely down to the vagaries of the financial arrangements and foreign investment fund (FIF) regimes, which operate as de facto capital gains taxes.

## Social spending relative to the rest of the world

New Zealand's social spending on health, education and social security and payments including superannuation was \$52.8 billion during the June 2016 year. At an estimated 21 per cent of GDP, it is in line with the OECD average.

\$12.2 billion (4.9 per cent of GDP) of the total social spending represented New Zealand superannuation, with health costing \$15.6 billion (6.2 per cent of GDP).

Treasury expects superannuation and health costs to rise to 7.2 and 8.3 per cent of GDP respectively by 2045. Although these future costs would be

# New Zealand's tax settings in an international context



reasonable by comparison with other OECD countries, they still represent a 40 per cent increase from present levels.

Consequently, future governments will face mounting pressure to either raise taxes or cut services. Politically, cutting services or means-testing access to services and benefits has proved difficult – witness the abandonment of the New Zealand Superannuation Surcharge in the mid-1990s, and how the current National government retained popular social programmes such as WFF and interest-free student loans.

On the other hand, both Labour and National have successfully implemented increases in GST, and the Labour government was elected in 1999 with a specific promise to raise the top rate of income tax.

## Lessons from overseas

New Zealand's "broad base, low rate" approach to tax policy is seen as best practice. Nevertheless, are there lessons from overseas tax systems for New Zealand?

Yes, in the form of a comprehensive capital gains tax (CGT). This would apply without the need to determine a person's intent. Its introduction

should broaden the tax base to meet future health and superannuation demands and help address growing wealth inequality.

In a 2012 paper, Treasury saw "merit in a general capital gains tax...as possible revenue-raising reforms."<sup>4</sup> Inland Revenue, in the same 2012 paper, was less persuaded; arguing that evaluating a CGT "would be a very substantial exercise". For the moment the politicians are siding with Inland Revenue.

What's remarkable about this debate is that the experiences of other countries' CGTs are discounted, with the difficulties for a New Zealand CGT viewed in isolation.

CGT has its complications, but those already exist in New Zealand's tax system in the financial arrangements and FIF regimes; probably the two most complicated parts of the current tax system.

The FIF regime is arguably the most loathed part of the tax regime. In 2006, when the latest incarnation of the FIF regime was introduced, Parliament's Finance and Expenditure Select Committee received over 3,400 submissions.<sup>5</sup> Only two supported the changes.

“According to the OECD, a childless single New Zealand worker earning the average wage had the second lowest “tax wedge” in the OECD’s 35 member countries. One-earner families with two children had the lowest tax wedge in the OECD.”

4. Inland Revenue & Treasury Joint Report: Taxation of Savings and Investment Income September 2012 <https://goo.gl/Qp9gOy>

5. Volume 2 of the Officials' Report to the Finance and Expenditure Committee on Submissions regarding the Taxation (Annual Rates, Savings Investment, and Miscellaneous Provisions) Bill <https://goo.gl/wXasfq>



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“Families struggling to meet the bills suffer from a lack of income, not over-taxation. Boosting incomes for low and middle income families would be far more effective than an ill-defined tax break.”

New Zealand is practically alone in the OECD in not having a CGT. The United States has treated capital gains as income since it introduced a Federal income tax in 1913. The UK has had a separate CGT since 1965, Canada introduced its CGT in 1972 and Australia has taxed capital gains since 1985. There are decades of practical experience about the implementation and operation of a CGT available from other jurisdictions.

The absence of a CGT undermines the broad base low rate tax policy. If politicians and policy makers want to ensure New Zealand continues to have one of the lower tax burdens in the OECD, then this gap must be addressed. Otherwise future generations will face an unpalatable combination of higher taxes and reduced services. ❖



## Tax and family assistance



One of the least tractable concepts in tax is that of the effective marginal tax rate (EMTR). The official income tax rate applied to each dollar earned is not the only payment a family will make on that dollar.

There may be other losses and government imposts that look and feel like taxes. Families with children are particularly affected. The overall effect is a high EMTR that leaves a parent little to show for the effort of earning that extra dollar, constituting a strong disincentive to earn it in the first place. It is one of the major reasons that child poverty rates are high in low income working families.

Let's take the example of a parent on the minimum wage of \$15.75 per hour, earning \$36,350 per annum. There are some Working for Families and rent subsidies but increasingly this family relies on foodbanks and loan sharks.

Let's say there is an opportunity to earn another \$10,000. Once tax and ACC are paid (18.71%), Working for Families is abated (22.5%), student loan repayments are made (12%), Accommodation Supplement is reduced (25%) and KiwiSaver extracted (3%), the \$10,000 has been effectively taxed at 81.21%.

Furthermore, there may be a sudden drop in child care subsidies and child support payments of between 18-30%. Every family is in a different set of circumstances, and few

will understand what is actually happening. They will know that at the end of the year despite their extra work effort they are no better off, may actually be worse off and will undoubtedly feel despair.

The EMTR effect, arising from the tax-transfer interface, is always in the too hard basket. In 2010 the Tax Working Group felt it was outside their brief and passed the buck to a welfare working group. But when the Welfare Working Group (2011) was established, it was explicitly forbidden to examine this issue. Yet it is this interface that impacts intensely on the well-being of families with children, and their ability to work their way out of poverty.

It is important to understand how this debilitating problem has arisen. The high tax rates of the early 1980s were thought by economists to reduce the incentives of high income people to earn and save.

Enter Rogernomics and the low flat-tax broad base solution of the late 1980s. However, a comprehensive view of income was not achieved because the capital gains part of the package did not eventuate.



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## Tax and family assistance

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Nor did flat tax solve the high EMTR problem; it merely shifted it from the top end to low and middle income earners. Low flat tax under the ideology of the day was to be accompanied by more user pays of social provision. However a three-way iron rule applies.

The greater the amount of social assistance to be reduced as income rises, the longer the range of income before all assistance has been bled out unless a higher rate of abatement is imposed. Reducing the amount of assistance acts to intensify poverty, a long income range defeats the purpose of welfare only for the poor, while a high rate of abatement imposes severe disincentive effects.

In advice to the incoming government in 1990, Treasury warned:

*As a general rule, the more people facing higher effective marginal tax rates over longer ranges of potential income, the greater the costs to society and the greater the probable loss of output.<sup>1</sup>*

Treasury identified high levels of benefits as a major factor preventing a more gradual abatement system and benefits were cut significantly in 1991. The Change Team on Targeting Social

Assistance in 1991 was tasked with designing a new ‘integrated’ system of targeted social assistance. Thus the 1991 budget announced a complex system of Family accounts based on aggregated family assistance and a constant bleed-out or abatement rate.<sup>2</sup>

Unfortunately, while aggregating assistance onto a family-based smart card, abating at one rate worked in theory, but the technocrats could not make it work in practice. One of the problems was that the typical modern family did not resemble the assumed nuclear family model.

Another was that the scale of assistance to be targeted, even with the 1991 welfare benefit cuts, meant assistance would be paid well up the income scale even with a very high single rate of abatement.

The integrated solution that had been used to justify the low flat-tax user-pays approach had quietly disintegrated. Now all that was left was the welfare mess of a plethora of high and overlapping abatements.

While one might have expected a re-examination of the wisdom of the 1990s reforms, instead the welfare morass has been intensified

1. The Treasury (1990). Briefing to the incoming government. Wellington, The New Zealand Treasury: <https://goo.gl/YACrXO>
2. Shipley, J. (1991). Social assistance: welfare that works. Wellington, Government Printer

# Tax and family assistance



in the name of target efficiency.<sup>3</sup> Welfare ‘only for the poor’ and low top tax rates has been the means of achieving an implicit, if not explicit, objective: more wealth and income for the top earners and an ever-immiseration and indebtedness of low-income families.

An alarming part of this picture is way tax credits for children are treated. One of the requirements to moderate the regressivity of a flattish income tax system with a notably high GST on everything, is a well-designed set of family-based tax credits.

The New Zealand system, known as Working for Families (WFF) operates to offset taxes paid by the family, thus improving horizontal equity – at least for low income families – by acknowledging that children reduce the ability to pay tax. The progressivity of the overall tax structure is further enhanced because tax credits are ‘refundable’ when they exceed the taxes paid by a low income family.

WFF tax credits are a major mechanism to alleviate and prevent child poverty. Just as older people need tax-funded support, so do families, especially when on a low income. It is critical such child tax credits are understood, supported and enhanced. When policy confines

the tax credits ever more closely to low income families the EMTR problems are intensified.

If there is no will to revisit the ideology that drove the 1991 changes of flat low tax and user pays, then mitigation of high EMTRs is the urgent task. Unfortunately, current policy, based on increasing target efficiency, is going in quite the wrong direction.

For WFF, this sees the threshold for abatement heading back to \$35,000 – where it was in 2005 – and the rate of abatement going up to 25% over time. Student loans are replacing student allowances, so repayment of larger student loans applies for long periods of time, especially for women. The thresholds for loan repayment have been frozen, as has the threshold for the parental income test and the cap for the Accommodation Supplement.

An innovative set of policies that reverse the recent cuts and enhance the programmes that help families, including a debt forgiveness programme is urgently required. Better still, a revisiting of the low flat-tax broad-based dogma is well overdue. ❖

“ The EMTR effect, arising from the tax-transfer interface, is always in the too hard basket.”

3. St John, S. and K. Rankin (2002). Entrenching the welfare mess. Auckland, Economics Department Auckland University: <https://goo.gl/JxNjsN>



## A light touch on foreign trusts and companies



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New Zealand ranks highly in international rankings of transparency, low corruption and ease of doing business. For the most part, the praise is well deserved. But there are some parts of our rules and regulation that are not as transparent nor as fair as they should be.

The Panama Papers exposed how our light touch regulation of foreign trusts can be abused. The rise of global online businesses, but not the taxes paid, shows how our tax system is not keeping up with change. The UK and Australia have led the way in collecting taxes from multinationals like Google and Facebook, who generate significant revenues but don't pay much tax. New Zealand is approaching slowly alongside an OECD review.

A thorough review of the foreign trust regime by John Shewan highlighted the problems, and the need for greater regulation. This has not happened. Even when the problems are clearly highlighted and solutions proposed, policy change is slow.

There is a lethargy in improving the tax system in New Zealand. Like many policy issues – tax, housing or poverty, for example – political leaders are entranced by the tranquillising drug of gradualism.

### Transparency and Panama Papers

A massive leak of documents from law firm Mossack Fonseca sheds light on a

shadowy world of the rich hiding their money from prying eyes, tax evasion and money laundering by criminals.

For New Zealand to be caught up in it is, at face value, surprising. We are after all one of the least corrupt countries in the world. Our rules and regulations are meant to reflect our moral fortitude, based on principles of fairness and transparency.

But these are not always the case. Perceptions can mislead. The corruption and rot that we have – all countries have them – are much subtler and more white-collar than the most blatantly corrupt countries. Corruption cases here are often about nepotism, the subtle use of loopholes in rules and regulations, and the low numbers of prosecutions for white-collar crimes with lenient penalties.

New Zealand's role in the international scandal is real. Our offshore trusts have been used by those looking for anonymity, because if the beneficiaries and their incomes are offshore, there is no requirement for informational disclosure. By running money through various tax havens and vehicles like New Zealand trusts, the ultimate beneficiaries



# A light touch on foreign trusts and companies



are hidden, and their tax liabilities avoided. This very likely facilitates money laundering in some instances.

New Zealand doesn't demand a detailed and transparent register of these trusts because they wouldn't be paying tax in New Zealand anyway. So there is little threat to our tax base, but it would cost money to administer the register.

And so our foreign trust rules are firmly in a moral grey zone. Our own citizens are unlikely to be much affected by them, but we have a moral duty to ensure our rules and regulations do not facilitate dishonest practices by others.

These New Zealand rules have been in place for some time. So it is not the fault of any one particular political party. But the immediate reaction from our current government that there is no problem, that we have been cleared by the OECD (we haven't) and that there is little need for change – that's where the problem is. Our politics is incremental and the knee-jerk reaction is to stop, stymie and discredit criticism and maintain the status quo.

There is a glaring absence of leadership when it comes to tackling issues that are difficult. The Shewan report called for much greater transparency alongside upcoming changes to anti money laundering (AML) rules. While the AML umbrella is being widened from financial

institutions, even large banks are not well prepared for the AML duties. Expecting accountants and real estate agents to do so seems fanciful.

The reality is that we are soft on white-collar crime and we aren't good at regularly updating our rules and regulations.

Rules and regulation understandably take time to change. But the truth is that there's no 'finish line' when it comes to rules and regulations. The backdrop is always changing and very clever people are working hard to find ways to work around the rules all the time. Rules and regulations can never be perfect. We have to take a Kaizen approach to our regulatory approach – constant improvement.

## Multinational tax avoidance

Taxes – nobody likes paying them. But they are a useful way of co-ordinating and paying for things we value and would not otherwise happen: justice, health and education, for example. Making sure everyone pays their fair share means that the burden is spread across the many rather than the few.

But not everyone is paying their share. Perhaps the most galling are the large and highly profitable multinationals that book their revenue in other tax jurisdictions to reduce their tax payments. It has become known as a 'Google tax', as Google has been booking its ad revenues in low tax jurisdictions like

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Singapore to avoid paying higher taxes in places like New Zealand or Australia where they are selling these ads.

But some countries are fed up and want to crack down on it.

“Everyone has to pay their fair share of tax, especially large corporates and multinationals, on what they earn here in Australia,” said Scott Morrison, Australia's Treasurer, in his annual Budget speech. “Multinational corporations that attempt to avoid tax by shifting profits offshore will be subject to targeted anti-avoidance measures and high penalties.”

Australia follows a similar crackdown in the UK last year. The penalties for profit shifters will be more severe though – Australia will charge a penalty tax rate of 40 per cent, compared to 25 per cent in the UK.

The Treasurer believes that the new policy will net them nearly AU\$4 billion in revenue over four years. This is money they will not have to raise from other parts of the economy, or borrow, to fund planned spending.

Cracking down on multinational taxes isn't cheap, nor easy. They are investing in a 1,300 person and AU\$679 million funded taskforce to implement this. Perhaps we could throw some resources at this Australian taskforce and look at harmonising our approach, to leverage their investment. The gains would be large relative to the investment.

With our closest economic partner, Australia, and the historically connected UK cracking down on multinational tax avoidance, we are out of step.

Our approach to multinational corporate tax avoidance has been to persistently point to a review being done by the OECD, a club of rich countries. The reaction was the same to the initial release of the Panama Papers, which showed that our foreign trust rules were allowing foreigners to use New Zealand structures to flout their tax obligations.

Tax policy isn't sexy and often too complex to lend to pithy straplines. In poll-driven politics, this makes tax policy a low priority.

Tax policy is difficult and a measured approach makes sense. It also makes sense to act early, rather than wait for some consensus – which inevitably takes too long and gets too diluted by the time all the special interest groups are appeased. The Australian Budget has gotten on a jump on New Zealand on tax policy. It should be a catalyst for us to speed up tax reform in New Zealand and make it a pivotal issue for the election this year. ❖

# Our contributors



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Keith Ng is a data visualisation consultant by day and data journalist by night, using data to understand and explain complex issues and policies.

He also has the prettiest tax spreadsheets you've ever seen.



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Bob Stephens retired from being an Associate Professor in the School of Government in 2010.

While at Victoria University he published widely in the areas of taxation, social policy, including co-establishing the NZ Poverty Measurement Project, and income distribution.

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- *The Chief Executive as Employer: Reinforcing the New Public Management Silos* (paper presented by G. Barclay & B. Pilott in 2008 at the After the Reforms conference)
- *State of the Future – strong public services for tough times* (published in 2009 in response to the global financial crisis)
- *Why We Need Public Spending* (commissioned in 2010 from David Hall of Greenwich University)
- *Modern Public Services* (policy paper series published in 2011)
- *Rethinking the State Sector Act* (published in 2014 in collaboration with the New Zealand Fabian Society)





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