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Taxes

The Tax Working Group (TWG) report which was made public this month has been widely discussed. There are some positive aspects of its recommendations, and some disappointments.

To begin with the disappointments: it limited its view of the taxation system largely to its revenue gathering purpose. Yet there are other purposes for the taxation system, notably to redistribute income in an unequal society. Given the substantial rise in inequality and poverty in New Zealand, particularly over the 1980's and 90's, this review was an ideal opportunity to look for ways to use the taxation system for this important social purpose – what is called a progressive tax system. Instead the TWG took the view that this was a job for the social welfare system. That is a narrow view, and leads to other problems including some which the TWG complained about. Benefits to be affordable and of sufficient size to make a difference generally need to be means tested. This leads to high "effective marginal tax rates" – the rate of deduction from the last dollar earned – for people on welfare benefits. The problem is probably exaggerated – relatively few families are affected and most would rather have the additional income and put up with the marginal rates, but it is a problem nonetheless. Working for Families has this problem as the TWG notes, because it abates once the wage earner reaches a certain income level. It would be much better to build a more progressive taxation system from the ground up.

Officials did a good job of testing different proposals for their effect on income inequality and poverty, but the results were used to maintain the inequality status quo rather than improve things. It is notable that Australia has a considerably more progressive tax system than New Zealand. Susan St John summarised this in a presentation to the public conference held by the TWG: it has a top personal income tax rate of 45 percent (ours is 38 percent) and a broader base (including capital gains tax). It is much kinder to lower income people, being tax-free up to $15,000 rising to $16,000 for low income families. Yet the focus was on preparing to lower our corporate tax rates to compete with Australia rather than direct benefits to workers.

On the other hand, the proposals the TWG brought forward for broadening the tax base need serious consideration. One we should reject immediately:

increasing GST to 15 percent or more would hit low income households hardest. Even if they were compensated through higher benefits, changes in Working for Families or lower tax rates (negating much of the revenue gains) they would always be at risk of these being eroded in future.

However the TWG has placed firmly on the agenda taxes on capital which should (if properly designed) increase the progressivity of the overall taxation system, and which will broaden the sources of revenue to the government. These are being eroded through globalisation: the ability particularly of multinational companies and high income individuals to avoid high personal and corporate income taxes or (in the case of multinationals) to threaten not to invest. Threat of withdrawal of investment may also be exaggerated: many companies which invest in New Zealand do so because their dominance in a particular sector allows them to extract an "economic rent": higher than average returns on their assets. Telecommunications and finance are examples. We should claw that back through the company tax system and companies are unlikely to withdraw their investment because they have to be here to obtain these higher profits. In addition, the corporate tax rate is not the whole story. A recent PricewaterhouseCoopers/World Bank study, "Paying Taxes 2010", rated New Zealand as having the seventh lowest "total tax rate" in the OECD. Australia was 20th lowest.

The forms of taxes on capital suggested by the TWG are a Capital Gains Tax, a "Risk Free Rate of Return Method" (RFRM) tax, and a Land Tax. A capital gains tax would probably exempt owner-occupied housing and would regard an increase in the value of an asset as income to be taxed. It would after a transitional period raise up to $4.5 billion per year. RFRM deems the owner of an asset to have earned a "risk-free rate of return" – probably around 6 percent – on its net value. The owner is taxed on that as part of their normal income. The TWG suggests that if this applied only to rental property it would increase revenue by up to $850 million per year. A land tax would levy a small tax (perhaps 0.5 percent) on the value of land. There could be a value per hectare which is exempt in order to exempt most farm land and forestry, and reduce the effect on low income earners, though this is unlikely to be very effective given high urban land values. It could raise up to $2.3 billion a year.

The TWG also made suggestions for reduced depreciation allowances which would raise up to $1.6 billion per year and changes to rules which catch transnational corporations trying to avoid taxes by carrying high levels of debt in their local subsidiaries ("thin capitalisation"). These would raise up to $200 million and are also worth consideration.

On the face of it, all of these would tax more wealthy individuals and corporations at a higher rate than low income people. However it is not straightforward: retired people on low incomes but owning a mortgage-free house could be hard hit by a land tax for example. More detailed investigation is needed. But these are promising sources of further tax revenue which are more difficult for corporations and the wealthy to avoid. The present government would like to use this tax revenue to reduce tax rates on high incomes. A more progressive use would be to fund strong public services.

The minimum wage – bad news
The minimal increase in the minimum wage announced this week by the Government is a step backwards. The minimum wage is one of the few remaining regulatory measures available to the government to reduce income inequality through the wages system and ensure low paid workers don't fall too far behind. Raising it by only 25 cents an hour to $12.75 from 1 April is an increase of only 2 percent. That is barely enough to compensate for inflation, and may not be enough even for that: NZIER's consensus inflation forecast for the year to 31 March 2010 is 2.3 percent.

The increase in the average wage will be considerably more than 2 percent. It rose 2.8 percent in the 6 months to September 2009 alone. NZIER's consensus forecast for increases in private sector wages to March 2010 is 3.5 percent. It is likely that as a result the minimum wage will actually fall as a percentage of the average wage.

Many workers are locked into minimum wage rates or rates closely tied to them. 123,000 workers were predicted to experience gains from the 2009 increase in the minimum wage according to the Regulatory Impact Statement for the 2009 Minimum Wage Order.

Bill Rosenberg

NZIER Consensus Forecasts[1]

These consensus forecasts were published on 15th December 2009.

March Year *Percent Change*	**2009/2010**	**2010/2011**	**2011/2012**
GDP	-0.4	2.8	3.0
CPI	2.3	2.1	2.3
Private Sector Wages[2]	3.5	2.2	2.4
Employment	-1.8	1.3	2.1
Unemployment	7.0	7.0	6.3

Although many forecasters are saying that the recession was shallower than had been expected, workers will still be feeling the pinch as unemployment rates are expected to remain at high levels for the next two to three years. This pessimism is mirrored in the recently released Treasury forecast which predicts unemployment to sit at 7.0 percent in 2010, 6.9 percent in 2011 and 6.0 percent in 2012. Private sector wage forecasts are also pessimistic,

[1] The consensus is made up of the average of forecasts from NZIER, Berl, ANZ- National Bank, ASB Bank, BNZ Bank, First New Zealand Capital, Deutsche Bank, UBS, Westpac, Reserve Bank of New Zealand and Treasury. Because the consensus forecasts are done only every 3 months, some of the more recent forecasts will be more accurate.
[2] As measured by Statistics New Zealand's Quarterly Employment Survey.

(forecasting a dip to a 2.2 percent increase in the average wage by March next year), though still ahead of inflation.

Economic Snapshot

- **GDP** increased by 0.2 percent for the September 2009 quarter. In annual terms GDP declined 2.2 percent.
- The **Consumer Price Index** (CPI) rose by 2.0 percent for the year to December 2009, although it declined by 0.2 percent for the quarter.
- **Food prices** rose 0.9 percent for the year to December 2009 but fell 0.3 percent during the month.
- **Unemployment** was sitting at 6.5 percent in September 2009. Maori unemployment was 14.2 percent, Pacific unemployment was 12.3 percent, Asian unemployment was 8.5 percent and European/Pakeha unemployment was 4.5 percent. Youth unemployment (15-19 year olds) was 25.1 percent. In December 2009, 66,300 people were on unemployment benefits.
- The total number of people in **employment** decreased in the year to September by 1.8 percent to a total of 2,154,000.
- The **minimum wage** is $12.75 an hour and $10.20 an hour for new entrants aged 16 or 17 in their first 3 months or 200 hours, whichever ends first.
- **Ordinary time hourly wages**, as measured by the Quarterly Employment Survey (QES) for September 2009, were up 5.1 percent in annual terms (4.4 percent in the private sector and 5.9 percent in the public sector). The average hourly wage is now $25.42 ($23.55 in the private sector and $32.07 in the public sector). The average female wage is $23.59 which is 87.4 percent of the male equivalent of $26.98. The Labour Cost Index (LCI) shows that ordinary time wages went up by 2.1 percent in the September 2009 year (1.9 percent in the private sector and 2.9 percent in the public sector). For those workers who received a pay rise in the year, the median increase was 4.0 percent and the average increase was 4.8 percent.
- On 28 January, the Reserve Bank left the **official cash rate** at 2.5 percent for the sixth consecutive review.

Consumer Price Index (CPI)

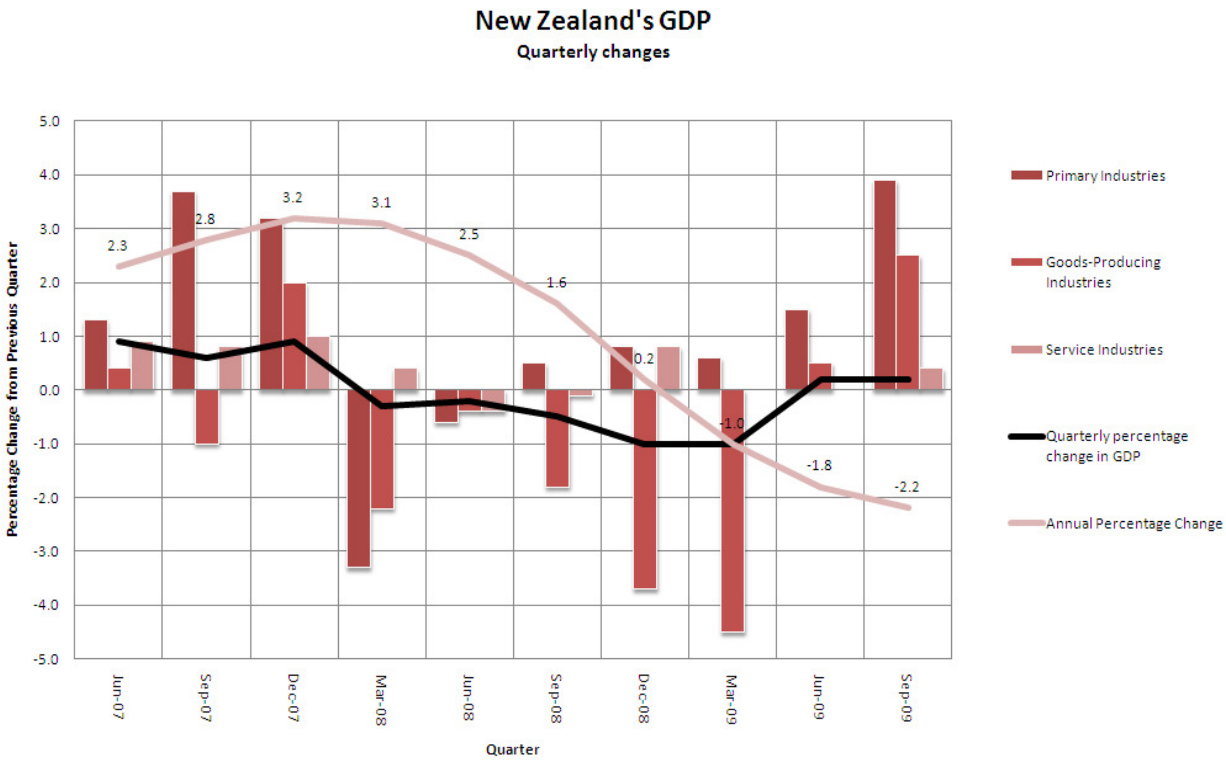
The CPI declined by 0.2 percent between the September 2009 and December 2009 quarters. This fall is mainly attributed to the fall in food prices (down 2.4 percent) for the quarter. Prices for the transport group were up 1.5 percent and clothing and footwear prices were up 1.8 percent. Between December 2008 and December 2009 CPI rose 2.0 percent. The majority of groups experienced annual price increases; the largest of these were from education (up 4.2 percent), transport (up 3.7 percent), health (up 3.7 percent) and clothing and footwear (up 2.9 percent). The only downward movements were observed in the communication group (down 0.2 percent) and the recreation and culture group (down 0.5 percent). The biggest subgroup movements over the year were from vehicles (up 11.4 percent), non-alcoholic beverages (up 7.7 percent) and personal effects (up 7.3 percent). The biggest price falls came from package holidays (down 9.9 percent), audio-visual and computer equipment (down 10.0 percent), and telecommunications equipment (down 7.0 percent).

Food Prices

In the month of December 2009, the food price index fell 0.3 percent - the fifth monthly fall in a row. Fruit and vegetable prices rose by 1.8 percent in December after falling markedly in the previous months (down 2.0 percent in November, 4.6 percent in October, and 8.4 percent in September). Meat poultry and fish prices also decreased (down 1.2 percent), as did non-alcoholic beverages (down 1.2 percent). From December 2008 to December 2009 food prices increased 0.9 percent. Leading this annual change were non-alcoholic food and beverages (up 6.6 percent) and restaurant and ready to eat meals (up 2.8). Fruit and vegetables prices were down 2.1 percent. The biggest individual annual changes came from poultry (down 8.5 percent), cheese (down 11.6 percent), soft drinks, juices and waters (up 7.4 percent) and food additives and condiments (up 8.6 percent).

Economic Growth

In the 3 months to September 2009, Gross Domestic Product (GDP) rose 0.2 percent, following 0.2 percent growth (revised up from 0.1 percent) in the June 2009 quarter. In annual terms, GDP shrank 2.2 percent. The primary producing industries (up 3.9 percent) fared better than the goods-producing industries (down 2.5 percent) and the service industries (up 0.4 percent) for the year. Finance, insurance and business services grew 7.1 percent and fishing, forestry and mining grew 8.5 percent compared to the same quarter in 2008.



Manufacturing production – now sitting at June 1999 levels – fell 1.9 percent in the quarter and 11.9 percent from September 2008. Construction fell 10.0 percent from September 2008 and 4.4 percent in the quarter, and residential building investment (down 5.0 percent) had its eighth consecutive quarter of falling production. Investment in fixed assets was down 1.8 percent due in part to low business expenditure in machinery, and equipment (down 8.0 percent) and other construction (down 9.3 percent) whilst household spending was up 0.8 percent for the September quarter.

Government Accounts and Debt

Government accounts for the 5 months ending in November 2009, showed that tax revenue was $0.3 billion (1.4 percent) higher than was forecast in the Half Year Economic and Fiscal Update (HYEFU). This was due to higher than forecast corporate tax receipts (up $0.1 billion or 7.0 percent) and GST receipts, (up $0.3 billion or 7.4 percent) which were partly offset by personal tax deductions that were $0.2 billion (2.3 percent) below forecast. Core government spending was $0.3 billion lower than forecast. As a result of these more favourable fiscal conditions, the operating balance before gains and losses (OBEGAL) though still in deficit was $0.7 billion better than forecast. The operating deficit (including gains and losses) was $1.1 billion better than forecast, with net gains of $0.4 billion mainly in the Crown's investment portfolio, notably including ACC's investment fund and the New Zealand Superannuation Fund. Net debt, the Government's main debt indicator, was close to its target at $22.7 billion or 12.3 percent of GDP, which is a considerably better position than the UK's government debt which was at 55.5

percent of GDP in March and is still rising. Gross debt was $2.6 billion lower than forecast at $48.1 billion (or 26.0 percent of GDP).

We have been investigating the issue of the level of public debt in New Zealand and in particular the $240 million a week that Ministers regularly mention in interviews (including in the Minister of Finance's media release on the November Government Accounts). Our question has been: is the $240 million a week a gross or net figure? We have now been advised that the $240 million gross issuance per week converts to $130 million net and $110 million in repayments when it is averaged over four years from July 2009 to June 2013. Because there are repayments on occasions (including the next 18 months) there will be periods when it could be said that $240 million is being borrowed but averaged out over 4 years it appears that the true net figure is $130 million.

In response to this being made public before Christmas, Ministers stated that a further $70 million a week on average is being raised through the sale of existing financial assets built up in past years, making a total fall in the Crown's net worth of $200 million per week on average. However we understand that this was not counted in the $240 million figure which is being used by Ministers and so the net borrowing figure of $130 million is still relevant. Neither is it clear how the $70 million is calculated. The Half Year Economic and Fiscal Update 2009, released with the October Financial Statements, forecasts Core Crown Operating Cash deficits to be financed in part from sales of financial assets averaging $53 million per week over the next four years. Greater clarity is needed in the size and financing of New Zealand's public debt.

Current Account

The seasonally adjusted current account (the difference between what New Zealand earns and spends abroad) for the September 2009 quarter was a surplus of $340 million, the first time in any three month period since December 1988. This compares with a deficit of $406 million in the three months to June 2009. The surplus was caused by a seasonally adjusted surplus in goods trade of $734 million which occurred due to imports (down $609 million to $8,877 million) having fallen to a level well below exports despite them also falling by $665 million to $9,611 million during the quarter. The surplus is a result of hard economic times and falling import prices rather than success in exports or the substitution of imported products with locally produced goods. The quarterly surplus was also assisted by a reduced deficit in payments to investors (down to $574 million) due in large part to further payments of tax by banks that were found by the Courts to have been involved in massive tax avoidance. Lower interest rates, lower corporate profits, and increased income from overseas subsidiaries of New Zealand companies also helped. For the September 2009 year, the current account deficit was $5.7 billion – only 3.1 percent of GDP, as opposed to 9.0 percent in recent years. Income paid to overseas investors created an $8.0 billion deficit on investment income, which is considerably greater than the current account deficit. New Zealand's international liabilities stood at 93.7 percent of

GDP compared to 88.3 percent at September 2008. These deficits are funded by international borrowing or foreign ownership of New Zealand assets.

Manufacturing Sector

In the September 2009 quarter, the Economic Survey of Manufacturing showed that seasonally adjusted manufacturing sales volumes were down 1.4 percent, after rising 1.5 percent in the June 2009 quarter. Sales volumes are down 5.2 on the September 2008 quarter. Seasonally adjusted manufacturing sales values were down 5.1 percent (or $1,004 million); the fourth consecutive quarter of declines and down 11.8 percent compared to the September 2008 quarter. After propping up the manufacturing industry results in previous surveys, meat and dairy were the main sub-sector weighing the industry down with sales volumes and values down 7.1 percent and 15.8 percent respectively since June 2009. If meat and dairy results are excluded then manufacturing volumes (up 1.0 percent) would be in positive territory whilst sales would remain negative (down 0.8 percent or $107 million). Other sectors experiencing marked declines included machinery and equipment manufacturing volumes (down 4.4 percent) and sales down 4.0 percent ($66 million) and petroleum and industrial chemical manufacturing sales, down 8.8 percent ($68 million). On a more positive note, encouraging manufacturing sales came from wood product manufacturing (volumes were up 9.1 percent), basic metal manufacturing (volumes were up 21.5 percent and values were up 14.6 percent or $85 million) and transport equipment manufacturing sales (values were up 11.7 percent or $65 million).

After recording 51.8[3] in November 2009, the Performance of Manufacturing Index (PMI) for December 2009 continued to show signs of expansion with a two-year high PMI of 52.9. Production and new orders also recorded two-year highs of 54.1 and 57.2 respectively. However, the employment index looked less healthy, contracting from 50.1 in November to 48.7 in December. The food manufacturing index (60.6) and petroleum, coal and chemical products (59.4) showed the greatest expansion, whilst metal product manufacture (48.2) and machinery and equipment manufacture (45.8) fell back into negative territory after showing signs of expansion in recent months.

Service Sector

The Performance Services Index (PSI) was 54.4[4] in December. This was a slight fall from the two-year high recorded in November of 56.0, but marks five continuous months of expansion nonetheless. Employment (51.1) remained steady, activity/sales (55.1) were down slightly, as were new orders (60.0). The best service sector results came from accommodation, cafes and restaurants (58.4), wholesale trade (56.1), health and community services (55.6) and transport and storage (54.7). The index for property and business

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[3] A figure under 50 shows the sector is contracting; above 50 shows that it is growing. The index is an early indicator of business activity

[4] A figure under 50 shows the sector is contracting; above 50 shows that it is growing. The index is an early indicator of business activity

services (48.7) was the least robust. In December all regions recorded expansion.

Retail Sales

Seasonally adjusted retail sales values for the month of November 2009 were up by 0.8 percent ($47 million). This followed a flat month in October 2009 when sales remained unchanged. From November 2008 to November 2009 retail sales increased by 2.4 percent ($151 million). This marks the first time since October 2008 when the annual retail sales (based on the change in sales compared to the same month in the previous year) have been positive. Core retail, which excludes sales in the auto industry increased 3.6 percent ($129 million) over the year and 0.8 percent ($34 million) for the month. Sales for the other retailing category, which includes antique and used goods, flowers, garden supplies, and watches and jewellery were up 7.3 percent (or $18 million) and automotive fuel retailing was up 3.8 percent (or $20 million) in the month of November. The biggest fall for the month was recorded in motor vehicle retailing sales (down 3.2 percent or $18 million).

Migration

On a seasonally adjusted basis, permanent and long-term (PLT) arrivals exceeded departures by 1,800 in the month of November 2009. For the year to November 2009 PLT arrivals (86,500) exceeded departures (66,500) by 20,000. This figure is up dramatically from the net gain of 3,600 recorded for the year to November 2008.

Student Loans and Allowances 2008

In 2008, 178,506 students (or 37.5 percent of those enrolled) were borrowing under the student loans scheme. There were 2.7 percent more borrowers in 2008 than 2007, with 69 percent of those who were eligible choosing to use the scheme. For students who had completed their studies at the end of 2007, the average loan balance amounted to $14,980 up 2.5 percent from 2006 figures. Most borrowers (63.1 percent) were aged 24 years and under. Those studying at a higher level were more likely to leave their studies with greater level of debt. After 5 years of completing their study, 35.5 percent or 15,150 of 42,654 borrowers had fully repaid their loan. Statistics New Zealand reports marked ethnic variations in the proportion of loans being repaid after 5 years, with European/Pakeha students having paid off 27.6 percent on average, while Maori students had repaid an average of 14.2 percent, Pacific Island students 9.4 percent and Asian students 18.0 percent. There was also a 5.1 percent increase in the number of students receiving allowances whilst the average allowance amount declined slightly from $6,580 to $6,550.

New Job Tracking Tool

The Department of Labour's Jobs Online, which measures the number of skilled vacancies posted online, replaces the former Job Vacancy Monitoring Programme, which measured job advertisements in printed media. The

December 2009 report indicates that from September to December 2009 the number of advertisements for skilled jobs increased by 5.0 percent. This is a notable increase from the 1.5 percent rise recorded in the 3 months to November 2009. For the December 2009 quarter vacancies for managers were up 6.4 percent, for technicians and trades they were up 6.3 percent and for professionals they were up 4.3 percent. However, skilled vacancies, although improving, were still down 23.0 percent compared to December 2008. The Wellington region fared the worst with a 31.4 percent drop in vacancies, followed by Auckland with a 26.3 percent fall. The December report shows that the only sector where online job advertisements grew in the past year was education (up 8.0 percent), whilst the biggest falls were for positions in design, engineering, science and transport (down 53 percent), farming (52 percent) and electrotechnology and telecommunications trades (down 43 percent).

Trade Oversees Merchandise Trade

In the December 2009 quarter, seasonally adjusted merchandise export values fell by 2.8 percent ($9.2 billion), the fourth quarterly decline in a row. The largest declines came from milk powder, butter, and cheese, down 10.1 percent ($198 million), crude oil, down 19.5 percent ($114 million) and casein products, down 33.1 percent (or $65 million). After two quarters of declines, meat exports recorded the largest increase, up 6.0 percent (or $66 million). For the fifth consecutive quarter there were significant declines in import values, down 3.2 percent or ($9.4 billion) in December. Significant contributors to this fall came from machinery and plant equipment, down 7.2 percent ($103 million) and transport equipment (which is unadjusted), down 26.5 percent (or $97 million). The largest rise was from passenger car imports, up 26.8 percent ($133 million). New Zealand's trade balance for the December quarter was a deficit of $170 million or 1.8 percent of exports. At 1.3 percent of exports or $517 million, the trade deficit for the December 2009 year, was well below the 11.3 percent average for the last 10 years.

Housing and Property

The Real Estate Institute of New Zealand's (REINZ) Monthly Housing Price Index showed that stratified median house prices decreased from $369,825 in November 2009 to $366,500 in December 2009. The December figure indicates a 6.0 percent increase in house prices since the same period in 2008. For the main centers, house prices increased by $2,000 to $416,167 in Wellington, decreased by $8,500 to $479,175 in Auckland, and in Christchurch prices decreased by $4,900 to $340,975. The non-stratified house price (which is considered less accurate than the stratified data) showed that median housing values increased from $355,000 in November to $360,000 in December 2009 and were up 9.6 percent since December 2008.

Building Consents

Statistics New Zealand reported that in December 2009, there were 1,260 residential building consents, excluding apartments. Building consents fell 1.4 percent for the month after rising 2.8 percent in November 2009. The number of consents has increased 45 percent since March 2009. Levels are still considerably lower than mid-2007, but trending upwards towards mid-2008. The number of consents issued in 2009 was the lowest issued for a calendar year since the series began in 1966, according to Statistics New Zealand.

Work Stoppages

In the year to September 2009, there were 18 work stoppages, comprising 15 full strikes and 3 partial strikes. This compares to 30 work stoppages in the September 2008 year and 29 in the September 2007 year. There were no lock outs in the year to September 2009. Statistics New Zealand said the stoppages concerned 2,010 employees, causing a loss of 1,382 days of work, and costing the workers an estimated average of $130 in wages, down considerably from the $500 average cost recorded in September 2008.

For further information contact Bill Rosenberg billr@nzctu.org.nz or Gemma Habens on gemmah@nzctu.org.nz