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GST, the cost of living and wages

Many people will be thinking about the effect of GST on the cost of living. The following must be somewhat speculative as the government has not yet finally said it will raise GST (though it seems highly likely it will go up by 20% from 12.5 percent to 15 percent), nor when that might happen. We don't know how changes to Working for Families, income tax cuts, or other measures will offset the increase. This will only become clear in the Budget on 20 May.

GST is likely to rise from 12.5 percent to 15.0 percent – 2.5 percentage points. That does not mean the cost of living will go up by 2.5 percent however. Firstly, the 2.5 percent increase is on goods whose prices are already at 12.5 percent above their GST-exclusive price, and secondly, some goods (such as rent, financial services, school donations and international travel) do not have GST charged directly on them. An example of the first issue: Groceries worth $100 ex-GST at present cost $112.50 including GST ($12.50 in GST). Taking GST to 15 percent makes that $115.00 – a 2.2 percent increase.

Statistics New Zealand estimates the net effect on average of a 2.5 percent increase in GST will be an increase of "about" 2.0 percent in the Consumer Price Index (CPI). However the exact effect will depend on whether businesses feel they can maintain profits if they pass through the full increase – or whether they take the opportunity to increase prices further. According to NZIER, forecasts for CPI for the year to the end of March 2011 range between 1.8 and 4.1 percent, averaging 3.1 percent, but forecasters are speculating as to timing of the introduction of the GST increase.

Even the estimated increase of 2.0 percent is only an average. We know that people on low incomes face a higher rate of GST increase on their incomes than people on high incomes because they can save less (and may in fact be spending more than they earn), they spend more on necessities, which mostly are liable to GST, and spend less on items that don't attract GST. We go into this in more detail below. So an argument can be mounted that low income workers require more than 2.0 percent compensation.

The Prime Minister has stated "I expect that the vast bulk of New Zealanders will be better off under a tax switch that comprises an increase in the rate of GST to 15 percent, together with a reduction in personal income taxes across the board and upfront increases in benefits, New Zealand superannuation, and Working for Families payments." The exact effects of course remain to be seen, and the likely outcome is that low income workers will be only just compensated, while those on high incomes receive significant net cuts in tax unless they are rental or commercial property owners affected by anticipated changes in the tax treatment of property (which may affect some middle income people too).

The timing of the anticipated increase in GST is a political decision. If the government wants to "compensate" for it immediately, it may be difficult to implement before 1 April 2011. If it wants to avoid the rise in GST being fresh in voters' memories in the 2011 election, it may introduce it in October this year. The CPI will obviously not reflect the increase in GST until after its introduction. The effect of GST on CPI-linked agreements will therefore depend very much on their timing.

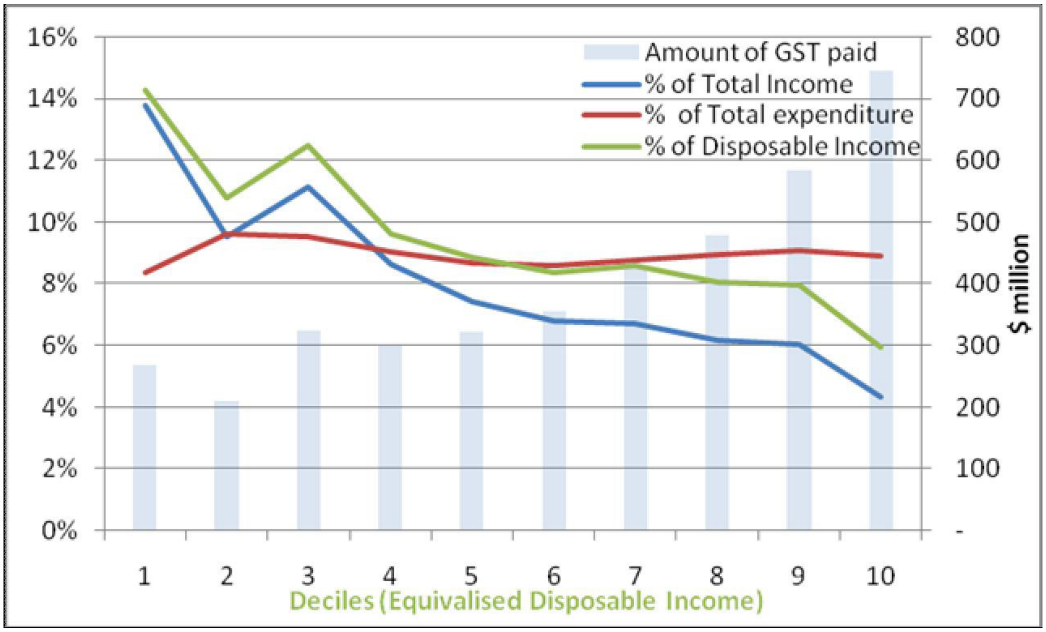
But very little attention has been given to the effect of a rise in GST has on wage increases via CPI increases. Employers may argue that they do not need to compensate for GST increases in wages because the tax changes include compensation. Some unions may argue that income tax is not a wages issue, and some collective agreements have a built in CPI adjustment, so workers covered by those agreements will automatically get compensation for GST in their wages at some point. But workers are bound to argue that if wage do not match CPI increases, then real wages are decreasing. The link between CPI and wage increases is arguably stronger now than when GST was introduced. And the increases in CPI due to GST is likely to coincide with deepening skill shortages.

Watch this space.

Some more detail on how GST affects low and high income people: The graph below comes from research carried out for the Tax Working Group ("Changing the rate of GST: fiscal, efficiency and equity considerations", available at http://www.victoria.ac.nz/sacl/cagtr/twg/Publications/GST_paper.pdf). It shows the proportion of both income and expenditure that is paid out in GST for each income group in the country.

On the far left is the 10 percent of households ("decile") with the lowest annual disposable incomes, corrected ("equivalised") for the number of people in the household. "Disposable income" means income after income tax and credits such as Working for Families have been taken into account. On the far right is the 10 percent of households with the highest such incomes.

The two downward sloping lines show the percentage of *income* that is paid in GST. The higher one (in green) shows it for disposable income, the lower one (in blue) for gross income. For the lowest income households, it is as much as 14 percent of their income. How can it be more than the 12.5 percent GST rate? Because many low income households are spending more than their income – getting further into debt, living on gifts from relatives, or using up their savings. For the highest 10 percent of households, only 4 percent of their total income or 6 percent of their disposable income goes on GST.



The third, much more gently sloping, line (in red) shows the percentage of *expenditure* that is paid in GST. It is still higher for lower income households, and even if it was perfectly level across the income range doesn't reflect ability to pay. It is much more painful for a low income household to go without $10 than it is for a high income household.

So beware of arguments that GST actually affects those on higher incomes more, or to the same extent, as those on low incomes because they pay more in dollar terms or because people at any level of income spend everything they earn over their lifetimes. That assumes wealthy people eventually consume all their income.

There are many other issues in the likely tax package that we will analyse. For instance, we also need to reject the notion that it is fair enough to drop the top income tax rate if there is to be a higher level of tax on property because those that own property are more likely to be on high incomes. But this commentary is mainly about the impact of GST on the cost of living, on CPI and therefore on wage bargaining. Those modelling the tax changes have done very little analysis of the relationship between a GST rise and wages: but it is a big mistake to assume that the relationship is insignificant.

Bill Rosenberg

NZIER Consensus Forecasts[1]

These consensus forecasts were published on 23rd March 2010.

March Year *Percent Change*	**2009/2010**	**2010/2011**	**2011/2012**
GDP	-0.4	3.1	3.2
CPI	2.2	2.4	2.4
Private Sector Wages[2]	3.3	1.9	2.6
Employment	-1.4	1.6	2.3
Unemployment	7.2	7.0	6.2

Economic Snapshot

- **GDP** increased by 0.8 percent for the December 2009 quarter. In annual terms GDP declined 1.6 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 0.7 percent for the year to February 2010 and were down 1.3 percent for the month.
- **Unemployment** was at 7.3 percent in December 2009. Maori unemployment was 15.4 percent, Pacific unemployment was 14.0 percent, Asian unemployment was 9.2 percent and European/Pakeha unemployment was 4.6 percent. Youth unemployment (15-19 year olds) was 26.5 percent. In December 2009, 66,328 people were on unemployment benefit.
- The total number of people in **employment** decreased in the year to December 2009 by 2.5 percent to a total of 2,152,000.
- The **minimum wage** is $12.50 an hour and $10.00 an hour for new entrants aged 16 or 17 in their first 3 months or 200 hours, whichever ends first. The rates will rise to $12.75 and $10.20 respectively from 1 April.
- **Ordinary time hourly wages**, as measured by the Quarterly Employment Survey (QES) for December 2009, were up 4.0 percent in annual terms (3.1 percent in the private sector and 5.7 percent in the public sector). The average hourly wage is now $25.37 ($23.45 in the private sector and $32.30 in the public sector). The average female wage is $23.50 which is 87.1 percent of the male wage of $26.98. The Labour Cost Index (LCI) shows that ordinary time wages went up by 1.8 percent in the December 2009 year (1.5 percent in the private sector and 2.4 percent in the public sector). For those workers who received a pay rise in the year, the median increase was 3.7 percent and the average increase was 4.4 percent.
- On 11 March, the Reserve Bank left the **official cash rate** at 2.5 percent for the eighth consecutive review.

[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.

Economic Growth

GDP increased by 0.8 percent in the December 2009 quarter. However, despite three quarters of growth, GDP in annual terms still shrank 1.6 percent. After 7 consecutive quarters of decline in manufacturing activity, there was a turnaround in the December 2009 quarter with growth of 4.5 percent. This rise was driven by food, beverage, and tobacco manufacturing (up 5.4 percent), petroleum, chemical, plastic, and rubber manufacturing (up 6.1 percent) and metal product manufacturing (up 8.1 percent). However, in annual terms GDP for manufacturing was still down 10.4 percent. Overall goods producing industries were up 3.0 percent for the quarter but were still being weighed down by contraction of the construction sector, down 0.6 percent. The service sector, led by a 2.7 percent increase in wholesale trade (the first rise for nearly two years), grew 0.4 percent for the quarter. After 3 quarters of positive growth, activity in the primary producing industries was down 1.3 percent in the December quarter, led by a 5.1 decrease in fishing, forestry and mining activity. In expenditure terms, GDP increased 0.8 for the quarter but declined 0.5 percent in the year to December 2009.

Online Job Vacancies

The Department of Labour's job tracking tool, Jobs Online, reported a 6.6 percent rise in vacancies over the three months to February 2010, with a 4.6 percent increase occurring in skilled vacancies. In the North Island, advertising for skilled vacancies has increased markedly with Wellington up 6.2 percent, Auckland up 5.4 percent, and the rest of the North Island up 6.2 percent. However, job advertisements in Christchurch over the three months to February were down 1.1 percent and the rest of the South Island was down 1.5 percent. Since November 2009, vacancies have risen 5.1 percent for managers, 5.6 percent for technicians and trades and 3.5 percent for professionals. Since November, the biggest increase in advertising occurred in retail and marketing (up 12.0 percent) and the biggest decline occurred in health and medical sector (down 6.9 percent). Although statistics for skilled vacancies are improving, advertisements are still down 43 percent from the peak in March 2008 and the Department of Labour says that unemployment has yet to peak.

Productivity

Statistics New Zealand released its provisional productivity statistics for 2009, which showed that labour productivity in the measured sector[3] dropped 1.5 percent over the year to March 2009. This compares to 1.8 percent growth in labour productivity recorded in the March 2008 year. The recession has influenced productivity as a result of GDP outputs (down 2.2 percent) falling more quickly than labour inputs (down 0.7 percent). Capital productivity (measured by output per unit of capital) dropped 5.3 percent in the year. Multifactor productivity (output per unit of inputs that cannot be attributed to

[3] This excludes government administration and defence, health, education, and commercial and residential property services, which account for approximately 23 percent of the economy.

either labour or capital) fell 3.1 percent. There was a 4.0 percent increase in the ratio of capital to labour in the year to March 2009, indicating capital deepening over this period.

Retail Sales

Seasonally adjusted retail sales values for the January 2010 were up 0.8 percent (or $42 million) from December 2009 figures and up 2.3 percent (or $121 million) compared to January 2009. The biggest proportional gains in annual terms were seen in motor vehicle retailing (up 9.8 percent or $48 million), takeaway food retailing (up 9.4 percent or $9 million) and automotive fuel retailing (up 8.1 percent or $41 million), whilst the biggest declines were seen in personal and household goods hiring (down 15 percent or $3 million) and liquor retailing (down 8.7 percent or $9 million).

Manufacturing Sector

After 4 consecutive quarters of decline, including a 9 year low in the previous quarter, the volume of manufacturing sales rose by 3.1 percent in the December 2009 quarter according to the Economic Survey of Manufacturing. Sales volumes rose in most sectors, with the most substantial increases recorded in meat manufacturing and dairy manufacturing (up 4.6 percent), other food retailing (up 5.8 percent) and structural, sheet and fabricated metal (up 7.9 percent). Manufacturing sales values rose 0.7 percent ($139 million) for the quarter but declined 10.0 percent ($1.85 billion) when compared to the December 2008 quarter. Although meat and dairy manufacturing sales volumes were up, sales values were down 2.1 percent ($113 million) following a fall of 15.4 percent in the September 2009 quarter. However, the biggest fall in sales was recorded in basic metal manufacturing, which in unadjusted terms was down 19.1 percent ($128 million). The survey also showed that since December 2008, the expenditure on wages and salaries across the sector has declined by 4.5 percent.

Another manufacturing survey, the Performance of Manufacturing Index (PMI), continued to show expansion with an index of 53.3[4] for February 2010. The employment index was in positive territory in February with an index of 51.8. Metal product manufacture (54.9) and machinery and equipment manufacture (52.4) both had positive indices. In regional terms Canterbury and Westland showed growth with a PMI of 59.2, whilst all other regions showed slight contraction with PMI's values between 48-50.

Service Sector

The Performance of Services Index (PSI) was 53.7[4] in February 2010, marking seven continuous months of expansion. The employment index fell from the 52.7 recorded in January to sit at 50.6. All regions, apart from Canterbury and Westland (46.8) recorded expansion in February. The greatest expansion in the service sectors occurred in health and community

[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 (58.8), wholesale trade (54.2), accommodation, cafes and restaurants (52.6) and property and business services (52.4). However, retail trade (47.6) and transport and storage (47.8) experienced contraction.

Food Prices

For the month of February 2010 food prices were down 1.3 percent after a 2.1 percent rise in January. All subgroups recorded decreases as fruit and vegetable prices fell 3.5 percent, meat, poultry and fish fell 2.4 percent, grocery foods fell 0.8 percent, and non-alcoholic beverages fell 1.9 percent. In the year to February 2010, food prices rose 0.7 percent.

Housing and Property prices

The Real Estate Institute of New Zealand's (REINZ) Monthly Housing Price Index showed that stratified median house prices decreased from $360,700 in January 2010 to $360,150 in February 2010. House prices have increased 5.3 percent since February 2009. After an 18 year low of 3,666 residential sales in January 2010, the number sales returned to more customary figure of 5,029 in February.

Building Consents

In February 2010, building consents were up 10 percent on January 2010 figures. There were 1,362 new building consents (excluding apartments) worth $484 million. The value of consents for the year to February was down 8.2 percent (or $471 million).

Government Accounts and Debt

Government accounts for the 7 months ending in January 2010 showed that tax revenue was $72 million higher than was forecast in the Half Year Economic and Fiscal Update (HYEFU). After taking into account the tax repayments from the big four banks' tax evasion ("structured financial transactions"), corporate tax receipts were $150 million below forecast, indicating that business profitability is still being affected by the recession. GST revenue was up $258 million on HYEFU and personal tax was $251 million below forecast reflecting lower personal incomes. Core government expenditure was $678 million lower than forecast. As a result of these more favourable fiscal conditions, the operating balance before gains and losses (OBEGAL), although still in deficit by $3.36 billion, was $883 million smaller than forecast. The operating deficit was $1.43 billion smaller than forecast with better than forecasted net gains of from ACC's investment portfolio (up $222 million) and the New Zealand Superannuation Fund investment portfolio (up $122 million) and actuarial gains from ACC ($342 million more than expected). ACC is spending $201 million less than forecast on compensation and rehabilitation. Net debt, the Government's main debt indicator, was in line with forecasts at $22.8 billion or 12.3 percent of GDP and gross debt was $2.9 billion lower than forecast at $48.8 billion (or 26.4 percent of GDP).

Migration

Statistics NZ released international migration statistics for both January and February this month. On a seasonally adjusted basis permanent and long-term (PLT) arrivals exceeded departures by 1,860 in the month of January 2010 and by 1,050 in the month of February. For the year to January 2010 there were 86,010 PLT arrivals and 63,422 departures meaning that there was a net annual gain of 22,588 migrants. There was a net PLT outflow of 16,019 migrants to Australia, which compares to almost double the amount (35,400) in the previous January year. Statistics for February 2010 year showed that arrivals exceeded departures by 21,618, up considerably from the 6,160 recorded in the February 2009 year. This came about due to fewer departures (down 23.3 percent or 19,208) as well as fewer arrivals (down 4.2 or 3,750). In the year to February, 21,000 people arrived on work permits - 3,000 fewer than the previous February year.

Current Account

The current account (the difference between what New Zealand earns and spends abroad) returned to a deficit of $3.1 billion for the December 2009 quarter after recording a $39 million surplus in the previous quarter. This change was driven by a record $2.7 billion rise in the investment income deficit which stood at $3.4 billion after five consecutive quarterly declines. Net international liabilities were $167.5 billion (90.3 percent of GDP) for the December 2009 year, which is a $5.3 billion improvement on the September 2009 quarter. However, banks are still borrowing heavily in short term loans from overseas and bank debt drove a $6.5 billion flow of foreign investment into New Zealand. Outward investment of $5.4 billion was itself in large part also driven by the banks. Liabilities due within 12 months have risen from 41 percent in September to 44 percent in December 2009. The balance on goods was $237 million which was a $405 million smaller surplus than the September figure. There was a $55 million smaller surplus in the balance on transfers and a $33 million fall in the services balance. The deficit for the year to December 2009 was $5.5 billion (or 2.9 percent of GDP), which compares to a $16.0 billion deficit (or 8.7 percent of GDP) recorded in December 2008.

Overseas Goods Trade

In the year to February 2010, there was a trade deficit of $347 million (or 0.9 percent of exports) and in the month of February 2010 there was a surplus of $321 million (or 9.7 percent of exports). The deficit reflects a pattern of imports increasing at the same time as exports are either falling or not rising as fast as imports. Compared to February 2009, imports in February 2010 rose 1.3 percent (or $37 million) to $3.0 billion and the value of exports fell 3.6 percent (or $124 million) to $3.3 billion. Although export data is still showing declines in activity compared to the previous year, it is beginning to improve, having risen 4.4 percent since October 2009.

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