ISSUEANALYSIS

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Are New Zealanders paying too much tax?

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- The ever increasing tax burden has become a heated issue in New Zealand. At the 2005 election, over-taxation was hotly debated with the Government arguing that high taxation is a myth despite clear indications to the contrary.
- New Zealand's taxation burden is high by world standards. It is higher than Australia and the dynamic economies of Asia and America, and only slightly lower than the stagnant European economies.
- Anyone earning under $180,000 is likely to pay more personal income tax in New Zealand than in Australia.
- While our top tax rate (39%) is one of the lowest in the world, its application is one of the most inequitable. New Zealanders pay the top rate at 1.4 times the average wage compared to the weighted average for OECD countries of 5.6. This affects professionals such as teachers, nurses and police and, ironically, some families that also qualify for Government assistance.
- In nominal terms, New Zealanders pay 50% more tax than they did in 2000. The Government's tax revenue has increased at twice the rate of inflation and well ahead of all predictions.
- The Government is taking far more revenue than it needs. We have record budget surpluses which present a once-in-a-generation chance to cut taxes significantly without even touching spending.
- By changing accounting methods, the Government has been able to argue that the cash surplus (as opposed to the operating surplus) is, in fact, relatively minor and will go into deficit in coming years. While this is fiscally conservative and a commendable way to manage the accounts, it also indicates the very strong condition of the nation's economy. In such a healthy environment it defies comprehension that tax relief is not on the Government's agenda.
- Much of the increase in revenue has gone unnoticed because of 'bracket creep'. Our tax thresholds haven't changed in ten years, but the average worker is earning more and therefore paying tax at a higher rate.
- As a first step our income tax thresholds should be indexed to inflation, as is done for welfare benefits. Otherwise the Government is increasing taxation by stealth.

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Introduction

The question of whether New Zealand is over-taxed was a heated election issue in 2005 with strongly conflicting opinions. Critics argue that the Government can afford tax relief, but in response the Minister of Finance, Michael Cullen, has attacked what he calls the 'myth of high tax':

> First and foremost is the misperception that taxes are too high … and that New Zealanders pay far more tax than other countries. There is simply no truth to this.[1]

This paper looks at some of the main arguments and indicators for and against the proposition that New Zealand is a highly taxed nation. It examines how we compare to other countries, including Australia, our top rate, the problem of bracket creep, and how much tax revenue has increased in recent years.

Before deciding if New Zealanders are paying too much tax, we need to ask: what do we actually pay tax for?

A popular slogan is that 'taxation is the price we pay for living in a civilised society'. But this is too simplistic. If this were true, then we could raise taxes to 100% and have the most civilised country in the world. The optimal level of taxation is arguable, and higher taxes are no guarantee for a civil society.

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Most experts agree that the point of tax is to raise enough money to cover spending in a fair way ('fairness' being open to debate) with the least distortion possible.[2] This paper argues that the Government has gone well beyond this brief.

How much tax do we pay?

According to the most recent update, the Government's core crown tax revenue for 2006 will be $49.7 billion, which is 31.3% of Gross Domestic Product (GDP).[3]

With local Government taxes and rates added on, the OECD has estimated our total tax burden at 35.4% of GDP for 2004 (the most recent available year).[4] This means that over a third of all wealth produced in New Zealand is taken by government.

To make these numbers more comprehensible, based on these figures every man, woman and child pays an average of $262 in tax every week.[5]

Another way of expressing the tax burden is with Tax Freedom Day, the symbolic day when workers have paid their share to government and can finally start working for themselves. In New Zealand's case, Tax Freedom day for 2006 was on 10 May.[6]

While personal income tax is the most visible form of taxation, it makes up less than half (43%) of the Government's tax revenue. New Zealand has a relatively broad tax base so that much of our revenue is collected in other ways, such as GST, corporate tax, and excise tax on things like petrol, alcohol and tobacco.

How do we compare with other countries?

At first glance our tax burden might seem reasonable compared to other countries. In 2003 (the most recent comparable year) tax made up 34.9% of GDP, slightly lower than the OECD average of 36.3%.[7] This made us the 12th lowest taxing country in the OECD, with 18 countries above us—a fact often promoted by defenders of the status quo.[8]

But this kind of comparison doesn't give the true picture because it measures small countries like Luxembourg equally with the United States, Japan and other large economies. If we weight the OECD figures for the size of their economies the average is closer to 31%.[9]

There are also significant regional differences within these figures. European countries tend to be much more highly taxed (and economically stagnant), with an average ratio of 38.9%. This compares with 26.1% for the Americas and 29.3% for the Pacific, which includes Japan and Australia.[10] For English speaking countries, the weighted average is 28.7%.[11]

And the OECD is only a sample of 30 countries. Many of our regional trading partners have much lower ratios, like Singapore and Hong Kong, who were at 22% and 15% respectively in 2002.[12] Even in communist China, taxes account for just 19% of their GDP.[13]

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How do we compare with Australia?

Looking at the economies of New Zealand and Australia as a whole, there is no doubt that New Zealand collects a greater proportion of tax. OECD figures for 2003 (the most recent comparable year) show total tax revenue as a percentage of GDP as 34.9% for New Zealand and 31.6% for Australia.[14]

When it comes to basic personal income tax Australia's system is more progressive. It has a tax-free threshold of $6000 along with higher rates for top income earners, although these apply at higher thresholds than in New Zealand.

Using the basic rates, and adjusting for the respective Medicare and ACC levies, Australia will have a lower level of taxation for all incomes under $180,000 from July of this year. The tax free threshold of $6000 makes a big difference for lower incomes, but as incomes increase the gap narrows and is never more than 3%. For example, a person earning $50,000 in New Zealand will pay 23.9% of their income in tax compared to 21.3% in Australia.

New Zealand (does not include ACC earners levy)	
$0-$9,500	15c (with low income rebate; 19.5c without)
$9,501-$38,000	21c
$38,001-$60,000	33c
$60,001+	39c

Australia from 1st July 2006 (does not include Medicare levy)	
$0-$6000	0c
$6001-$25,000	15c
$25,001-$75,000	30c
$75,001-$150,000	40c
$150,001+	45c

There are some more important caveats though.

The above comparisons are only for single workers, but both countries have various schemes for giving tax credits and other forms of rebates to families with children.

There is also a difference in non-income taxes. Australia has capital gains and estate duties, compulsory superannuation (paid by the employer) and different indirect taxes.

Even though Australia is a lower taxing nation than New Zealand, it is still a highly taxed nation when compared to its trading partners and other similar countries. Like New Zealand there is strong public demand for tax cuts and reform.

How does our top tax rate compare?

Our top personal tax rate of 39% is one of the lowest in the world. Australia has a top rate of 46.5%,[15] while most European countries are between 40% and 50%.

New Zealand's major anomaly, though, is that our top rate kicks in at a very low level: at $60,000, which is just 1.4 times the average wage—one of the lowest ratios in the world. For the OECD, the weighted average is 5.6 times the average wage.[16]

New Zealand's major anomaly, though, is that our top rate kicks in at a very low level: at $60,000, which is just 1.4 times the average wage—one of the lowest ratios in the world. For the OECD, the weighted average is 5.6 times the average wage.[16]

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As a result our top rate affects people in professions like teaching, nursing and the police—a far cry from the 'tax the rich' calls of the 1990s. Ironically, many families paying the top rate now also qualify for Government assistance as part of the Working for Families scheme.

In hindsight, the increase in the top tax rate in 2000 to 39% for incomes over $60,000 was completely unnecessary. The original goal was to raise an additional $450 million a year[17], which pales in comparison with the total increased revenue since then. In fact the Government could have *cut* income tax and still be receiving far more revenue than it ever expected. This will be discussed in more detail below.

What about the tax wedge?

A recent report by the OECD *Taxing Wages* (March 2006) looked at the size of the 'tax wedge' in various countries, by calculating the tax and social security contributions (if any) paid by employees and employers, minus any cash benefits received from the Government.

For a single person on the average wage, New Zealand's rate is 20.5%, while for the average family with two children the rate is 14.5%. This is the third lowest rate in the OECD for the average worker, and one of the few positive signs regarding New Zealand's tax burden.

Again there is an important disclaimer to this study. As noted before, New Zealand has a relatively broad tax base which means that personal income tax is not the Government's biggest source of revenue. Personal income tax makes up just 43% of the Government's revenue, which is lower than the OECD average of 49.6%.[18] Therefore this study doesn't give the full picture because it doesn't include indirect taxes (which are substantial in New Zealand).

The recent trend

Comparing the tax take to GDP is not the sole measure of how big a Government is, and it can even be misleading. It is a relative measure, so that increases in taxes can be hidden by increases in GDP.

For example, at first glance it might seem that New Zealand's tax burden has only gradually increased since 2000, up from 33.9% of GDP to 34.5% by 2004.[19]

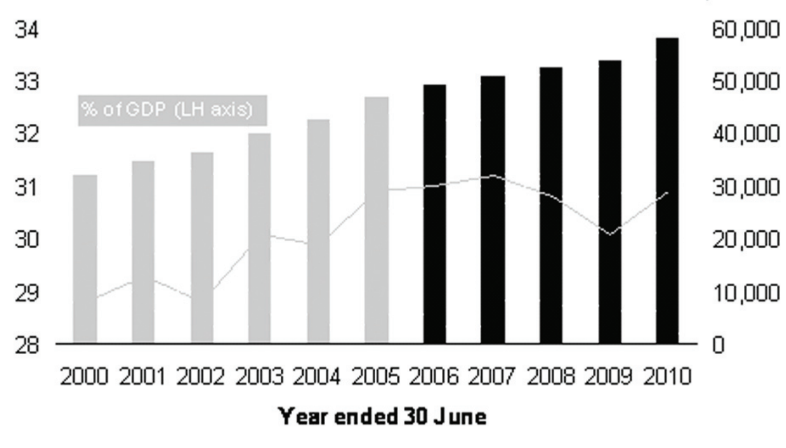
Looking at the *actual* amount of tax revenue gives a very different view. It has increased massively: from $32.2 billion in 2000[20] to a forecast $49.2 billion in 2006. By 2010 it will reach $58 billion .[21]

New Zealanders are now paying over 50% more tax than they were in 2000.

New Zealanders are now paying over 50% more tax than they were in 2000. If tax revenue growth had followed the inflation rate of 3% a year it would only have increased by half that amount.

Treasury's own graph below clearly shows the massive increase.

Tax revenue forecasts



Source: The Treasury[22]

This decade has been a boom time for the Government's coffers. Last year alone, tax revenue increased by 9.6%, or $4 billion.[23]

Much of this windfall has been unexpected, with tax revenue consistently ahead of all forecasts. For 2007 the forecast revenue is nearly $5 billion ahead of what was originally predicted in 2002.[24]

Why are we paying so much more?

Since 2000, the Government has done little to visibly increase taxes, apart from increasing the top personal rate to 39% for incomes over $60,000. This now raises an estimated $780 million a year in extra revenue.[25]

The National Party calculates that there have been 41 new taxes or increases to existing taxes, levies and fees since 2000. Many of these have been minor, with only four increases generating significant revenue:

- tobacco excise;
- petrol excise (several times);
- road user charges for light diesel vehicles; and
- ACC motor vehicle levies.

By 2005, these had raised an extra $415 million a year in revenue, so new and increased taxes don't really explain the Government's surge in tax revenue.[26]

Table 1: Contributing factors to the growth in total direct tax between 1999 and 2004[27]

Contributing factor	Contribution
Corporate tax growth	34%
Personal income growth	34%
Employment growth	24%
39 per cent top personal income tax rate	8%

The Treasury has determined the four main factors why tax revenue has increased so much in recent years, all of which are due to strong economic growth:

New Zealand's unemployment has halved since 1998 and a large number of new employees have entered the workforce. More people in employment obviously mean more taxpayers and more tax.

On top of this, the more people earn the more they spend, which leads to an increase in GST and other indirect tax revenue.

Corporate tax returns have also been well ahead of all forecasts and are a sure sign of a strong economy. Corporate tax now constitutes 17% of the total tax take, up from 12% in 2000, while the share of income and indirect taxes in the total tax take has slightly declined.[28]

The problem of bracket creep

People's wages and salaries tend to increase over time, be it from promotions, new jobs, working extra hours, or from regular pay rises to meet the cost of living. This is especially the case in a tight labour market like New Zealand, where there is a shortage of workers in many industries.

Higher wages mean that people move into higher tax brackets. This is the problem of 'bracket creep': wages naturally rise over time, but the tax levels don't. In real terms, our tax rates increase subtly every year.

For example, in 1999 an annual income of $60,000 only applied to the top 5% of taxpayers. This has now doubled to 11% of taxpayers, or 20% of full-time workers, affecting 330,000 people.[29]

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The problem of bracket creep applies to nearly all taxpayers, not just the higher income earners. In 1996 (the last time the thresholds were changed) a person on the average wage paid a top marginal rate of 21 cents in the dollar, but now a good chunk of their income is taxed at 33%.

These marginal rates—the amount of tax a person pays on the next dollar they earn—are hugely important because they influence people's behaviour, such as whether to return to the workforce, work more hours, or invest in education and training.

This taxation by stealth is particularly unfair given that welfare benefits are adjusted on 1 April every year to match inflation. Why are workers—people who actually earn their money—treated differently?

Even more galling for taxpayers is the fact that excise duty on petrol, tobacco and alcohol is also increased every year in line with inflation.

Bracket creep is one of the most insidious ways a government can increase the tax take with no debate or public acknowledgement. Westpac chief economist, Brendan O'Donovan, labels it 'theft by fiscal creep … an increasing proportion of people pushed into higher tax thresholds.'

> The Government's had a choice—to pay down debt, to decrease taxes or increase spending. What they've done is paid down debt, increased spending and actually increased taxes [by not adjusting tax thresholds to keep pace with wage movement].[30]

Belatedly, the Government announced in the Budget last year that tax thresholds will be adjusted for inflation on a three-yearly basis, but not until 2008. In the wait for adjustment O'Donovan says the Government 'will collectively rob us of another $1.4 billion'.

After widespread derision (the media labelled it the 'chewing gum tax cuts'), Dr Cullen has now signalled the adjustments may not go ahead after all: 'There is no final decision on that', he told the finance select committee in February.[31]

Bracket creep will always be a problem with progressive tax rates. Ultimately, lower and flatter tax rates (as recommended by the Government Tax Review of 2001) are preferable, and this will be covered in future papers.

A surplus of riches?

> *'Surpluses deny people their reward from work through over-taxing.'*
> Gareth Morgan, Infometrics.[32]

The big increase in tax revenue has led to a subsequent increase in budget surpluses, again well ahead of all forecasts. Tax revenue is rising faster than the Government can spend it.

Perhaps the ultimate sign that a government is taking more than it needs is the budget surplus—the gap between what it collects and what it spends.

The big increase in tax revenue has led to a subsequent increase in budget surpluses, again well ahead of all forecasts. Tax revenue is rising faster than the Government can spend it.

Last year the operating balance was $6.2 billion, about $500 million ahead of what was forecast and equivalent to 4% of GDP.[33] In effect, one eighth of the Government's tax take is left over after spending is accounted for.

The trend looks set to continue in 2006. In the nine months to March, the operating balance had already reached $9.4 billion, $3.5 billion higher than forecast.[34]

This is an absolutely enormous amount of over-taxation, unprecedented in New Zealand history. It works out at $1600 per year for every New Zealander, or around $30 each a week.

If we include the $1.9 billion allowance for unallocated spending as part of the surplus then the numbers get even bigger.[35] Remember, too, that all this is in the context of big increases in Government spending. If spending had increased at the rate of inflation (or even say 1–2% above) since 2000 then the amount of excess taxation would be enormous.

But is there really spare cash?

Minister of Finance, Michael Cullen, has consistently argued that the surplus is a misleading figure because most of the money has been already allocated. He has berated the media, saying:

> Unfortunately the media—and obviously political opponents, for purely tactical reasons—couldn't get it through their heads that the operating surplus wasn't the amount you could spend.[36]

Dr Cullen points out that much of the surplus has been allocated towards the Government Super Fund ($2.1 billion for 2006), for District Health Boards, and for buying land for schools and prisons. He argues that the cash surplus is the most appropriate figure, which is $3.1 billion for 2006 and will actually go into minor deficits in coming years.

Critics have argued that debt should be used for big capital projects because the benefits will last a long time and be enjoyed by future generations, rather than saddling the taxpayers of one year (ie, 2006) with the whole cost.

Putting arguments about definitions aside, the money for capital expenditure still has to come from somewhere and Dr Cullen has chosen to use the surplus.

Avoiding debt, and repaying it, is fiscally conservative and a commendable way to manage the accounts. But it beggars belief that room can't be found for tax relief when the accounts are so healthy.

Even using the cash surplus of $3.1 billion would allow for significant cuts. For example, the top, middle and corporate tax rates could all be dropped to 30% and the middle rate could be lowered to 18%, costing $3.15 billion, according to Treasury's estimates.[37] All this could be done without even touching current spending or debt repayment.

Conclusion

No matter how you look at it, tax revenue has increased massively in recent years. The Government is taking more revenue than it ever expected and more than it needs to cover spending and investment.

Some argue that New Zealanders have deliberately chosen higher taxes and spending. To some extent this is true—a Labour-led Government has been elected three times now with promises of higher spending. However there was only ever one specific tax increase promised, in 1999, and last year saw a strong groundswell for tax cuts.

Moreover, the amount of extra tax the Government now takes from us is so huge that it could be returned to taxpayers without even *touching* the issue of spending.

Even if the Government refuses to lower taxes, adjusting the tax brackets for inflation would be a small but important first step in reducing our tax burden to a fair level. It would change the presumption in favour of the state back towards the individual, and ensure that when the country does well the creators of that wealth get to keep a fair share of it. Countries such as Canada, the United States and Netherlands automatically index their national personal income tax thresholds, while many others have partial indexation.

Clearly New Zealand is a highly taxed nation by world standards and by our own standards. Future papers will look at why and how we could reduce our tax burden.

Tax, and over-taxation, is an issue that won't go away. The 2006 Budget provides a unique opportunity to do something about it.

...adjusting the tax brackets ...would change the presumption in favour of the state back towards the individual, and ensure that when the country does well the creators of that wealth get to keep a fair share of it.

Endnotes

[1] Hon Dr Michael Cullen, speech to PSA delegates, 8 September 2005.

[2] The McLeod Review 2001, 5: 'The key focus of tax policy is to enhance the overall economic wellbeing of New Zealanders by seeking ways to reduce the cost of imposing tax—or making the tax system more efficient—while promoting fairness and continuing to raise sufficient revenue.'

[3] Treasury's Half Year Economic and Fiscal Update, December 2005, ch 2, 3.http://www.treasury.govt.nz/forecasts/hyefu/2005/2revenue.asp.

[4] OECD Revenue Statistics 1965–2004, 2005 edition. Provisional forecast for 2004, the most recent year: http://www.oecd.org/dataoecd/18/23/35471773.pdf, 4.

[5] New Zealand's population is 4,126,613 (Statistics New Zealand), and the latest GDP forecast from Treasury's Half Year Economic and Fiscal Update December 2005 is $158,947,000,000. Using the OECD's figure of 35.4% of GDP, this works out to tax revenue of $56,267,238,000 and $13,635 per capita.

[6] CIS calculates Tax Freedom Day by dividing total per capita tax revenues by GDP per head. Applying the OECD tax figure of 35.4% of GDP for 2004 to the latest GDP figure of $158,947,000,000 (Treasury's Half Year Economic and Fiscal Update December 2005) and population of 4,126,613 (Statistics New Zealand), tax per capita is 35.4% of GDP per capita, or 129 days of the year. The 130th day of the year is May 10th.

[7] OECD Revenue Statistics 1965–2004, 2005 edition, tables and graphs, 4.

[8] Quoted by Dr Michael Cullen in 'National's tax policy will fire up election campaign', New Zealand Herald, 20 July 2005.

[9] IRD Briefing for the incoming Minister of Revenue, September 2005, 20.

[10] OECD Revenue Statistics 1965–2004, 2005 edition, tables and graphs, 4.

[11] Calculations by Sinclair Davidson, *Who Pays Income Tax in New Zealand and is Progressive Taxation Justified?,* New Zealand Business Roundtable March 2005, 5.

[12] IRD Briefing for the incoming Minister of Revenue, September 2005, 21.

[13] China Business News, 'Deputy director of the State Bureau of Taxation says income taxes for foreign-funded enterprises are not high', 10 January 2005.

[14] OECD Revenue Statistics 1965–2004.

[15] From 1 July 2006, including Medicare levy of 1.5%.

[16] The weighted average threshold is 5.6 times the average wage. *International Comparison of Australia's Taxes*, by Dick Warburton and Peter Hendry, published by the Australian Treasury, 12 April 2006, 70.

[17] 'Tax to spend: Cullen's billion-dollar gamble', New Zealand Herald, 30 March 2002

[18] This includes direct social security contributions on income, which have the same effect as tax. *Who Pays Income Tax in New Zealand and is Progressive Taxation Justified?, Sinclair Davidson,* New Zealand Business Roundtable, March 2005, 3.

[19] OECD Revenue Statistics 1965–2004, 2005 edition. Provisional forecast for 2004, the most recent year: http://www.oecd.org/dataoecd/18/23/35471773.pdf, 4.

[20] Core Crown tax revenue, Michael Cullen answer to written Parliamentary question 483, 15 February 2006.

[21] Treasury's Half Year Economic and Fiscal Update, December 2005, ch 2, 3.

[22] As above.

[23] Financial Statements of the Government of New Zealand for the year ended 30 June 2005, 4.

[24] Minister of Finance Dr Michael Cullen, answer to written parliamentary question 9020 (2005).

[25] Treasury's Ready Reckoner, http://www.treasury.govt.nz/readyreckoner/reckoner.asp.

[26] Parliamentary Question 18264 to Minister of Finance Dr Michael Cullen, 18 December 2004.

[27] Parliamentary Question 17311 to Minister of Finance Dr Michael Cullen, 29 November 2004.

[28] Key Facts for Taxpayers, NZ Treasury 2000 and 2005.

[29] As above, and Household Labour Force Survey December 2005.

[30] 'The Tax Wars', The Listener, June 11 2005.

[31] New Zealand Herald, 15 February 2006.

[32] Gareth Morgan, 'Would the real Government surplus please stand up', 27 July 2005, www.garethmorgan.com.

[33] Financial Statements of the Government of New Zealand for the year ended 30 June 2005, 7, http://www.treasury.govt.nz/financialstatements/year/jun05/4.asp.

[34] Financial Statements of the Government of New Zealand For the Nine Months ended 31 March 2006

[35] Budget Policy Statement 2006, 4. http://www.treasury.govt.nz/budgetpolicy/2006/intro.asp#budget

[36] Interview with Dr Michael Cullen by Keith Ng, http://www.publicaddress.net/default,2426.sm#post2426.

[37] Treasury's Ready Reckoner, http://www.treasury.govt.nz/readyreckoner/reckoner.asp.

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