DISCUSSION PAPERS

PAPERS PRESENTED TO THE
CONSUMPTION TAX CONFERENCE
24-25 February 1992

NEW ZEALAND'S EXPERIENCE WITH
CONSUMPTION TAX
Alan Bollard

and

LESSONS FROM NEW ZEALAND
Alan Wood

DISCUSSION PAPER NO. 268
June 1992

G.P.O. Box 4, Canberra 2601, Australia
NEW ZEALAND'S EXPERIENCE WITH CONSUMPTION TAX*

Alan Bollard
NZ Institute of Economic Research

and

LESSONS FROM NEW ZEALAND

Alan Wood
Economics Editor
The Australian

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CENTRE FOR ECONOMIC POLICY RESEARCH
CONSUMPTION TAX CONFERENCE
Monday/Tuesday, 24 and 25 February 1992
Convener: Dr. John Quiggin

PROGRAM OUTLINE

Opening Address: Mr Peter Reith
Deputy Leader of the Opposition and Shadow Treasurer

SESSION 1: Paper 1: Consumption Tax: A Solution or New Problems?
Terry Dwyer, Economic Consultant

Paper 2: Economic Arguments for a New Consumption Tax
John Freebairn, Monash University
Discussant (Papers 1 and 2): Fred Gruen, ANU

SESSION 2: Paper 3: Borrowing, Saving and Taxation
John Quiggin, ANU
Discussant: Robert Albon, ANU

PANEL DISCUSSION I:
What Can We Learn From The New Zealand Experience with the GST, Micron
economic Reform and Macroeconomic Policy?
Speakers: Alan Wood, The Australian
Alan Bollard,
NZ Institute of Economic Research

SESSION 3: Paper 4: Tax Reform and the Distribution of Income
Anne Harding,
Centre of Economic & Social Modelling
Dept of Health, Housing & Community Services

SESSION 4: Paper 5: National Savings Policy for Australia
Speaker: David Chessell, Access Economics

PANEL DISCUSSION II:
1. GST and the Size of Government
Geoff Brennan, Australian National University
2. GST and the Inflation Rate
Chris Murphy, Access Economics and ANU

SUMMARY SESSION
Opening Speaker: John Piggott
University of New South Wales
Open Discussion

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NEW ZEALAND'S EXPERIENCE WITH CONSUMPTION TAX

1. The Setting

In 1984 New Zealand commenced down a path of radical structural economic reform. A number of factors contributed to the decision to do this:

- New Zealand’s poor productivity and growth performance since the mid-1970s (see figure 1);
- an increasingly ad hoc and restrictive set of regulatory interventions by government in the 1970s;
- the record of devaluation, inflation, and mistimed stabilisation attempts during the 1970s, and a realisation of the structural problems facing the country;
- a Western world increasingly embracing the theory and practice of economic liberalisation; and the more recent economic breakup of centrally planned economies;
- a new government relatively free from interest group pressures;
- a thin political system (single chamber, two party, no significant splinter groups, no important state or local government economic policies, no written constitution, no proportional representation, and a three year term) which accelerated reform;

Figure 1: New Zealand and Trading Partners' Growth

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I wish to thank Peter Cough, David Grimmond and Brendan O'Donovan of NZIER for assistance.
- evidence of the failures of direct government intervention during major public investment programmes in the 1970s, which alienated many civil servants from wanting a direct role in commercial activity.
- the rapid dissemination of some recent microeconomic theoretical developments (including public choice, contestability and transactions cost theories).

It is a feature of New Zealand economic deregulations in comparison with other countries, that starting in 1984, radical changes were made across a wide range of fronts rapidly and simultaneously. The Appendix table lists the major reforms that took place.2

The regulatory reform programme was built on a number of strands:
- factor markets were a key area for reform, including financial sector deregulation, reform of energy and transport, and more recently labour market deregulation;
- product market reform was secondary: in particular price support on agricultural products and exports was terminated;
- industry regulatory reform was carried out, including business law reform, and the end of price and entry controls;
- the exchange rate was floated, international capital controls removed, foreign investment liberalised, import licences abolished, and tariffs reduced;
- government trading activities were commercialised.

The reforms were heavily microeconomic in character. On the macroeconomic side a tight monetary policy was put in place to target price stability, and the tax revenue system was restructured on a broader base with rates flattened. However, government spending, especially on social services, remained high and a persistent fiscal deficit was incurred.

2. The Tax Reform Programme

An important part of this liberalisation programme was to reform both the revenue and expenditure sides of the government accounts. In the 1970s and early 1980s most New Zealand government revenue was from direct tax, primarily income taxes. A high proportion of this came from personal income taxes. This was partly a result of a highly progressive scale of marginal tax rates during a period of inflation. The rates prevailing before 1983 can be seen in table 1. With a mean household income of about $27,000 in 1983, a high proportion of tax payers were paying marginal rates of 45% and above. This situation had been exacerbated by inflation-induced fiscal drag through the 1970s. Against this the corporate tax take was relatively low and narrow-based. A particularly high burden was placed on wage and salary earners compared to other income earners due to the frequency of tax avoidance and evasion.

A number of indirect taxes were in place prior to 1984, including a customs duty, a road tax, beer tax, and a wholesale sales tax. These taxes had arisen haphazardly. The wholesale sales tax had acquired many modifications: 60% of wholesale goods and all services were exempt, and rates on remaining taxable goods varied from 10-60%. This was recognised to be arbitrary and distortionary. Capital gains were largely untaxed.

The 1987 Budget noted some of these problems:

"The tax system was unable to provide adequate revenue because it relied too heavily on the income base... The narrowness of the income base combined with the lack of another broad tax base, resulted in highly uneven effective rates of tax [which] biased behaviour by altering the prices of goods and services and imposing differential wedges between pre- and post-tax earnings and returns on investment... The tax system was also widely believed to be unfair with erosion of the income tax base by concessions and by the exploitation of loopholes. High marginal rates of income tax encouraged the growth of non-taxable forms of income." (Part II, page 28-29)

In seeking to reform this tax system, the Government focused on a regime based on several criteria. Most importantly it should be as neutral as possible in terms of its impact on spending and investment decisions. In addition it should be broad-based in terms of coverage and efficient in terms of reducing the incentives to tax avoidance. There was also an intention to reduce taxation on income which was seen as a disincentive to work effort and the instrument by which government had become larger and (arguably) less efficient in its provision of services. These arguments were broadly in line with the guiding principles behind the wider reform programme.4

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2Note that the National Government in the late 1970s did put in place some deregulatory reforms, and it is a generalisation to suggest the process started with the 1984 Labour Government.

3This paper builds on the analysis of P. Creigh, A Study of New Zealand's Experience with the Goods and Services Tax, NZ Institute of Economic Research, 1986.

4For a detailed discussion on this, see A Bullard, New Zealand Economic Reforms 1984-93, Country Study No 9, International Center for Economic Growth, 1992.
It can be seen from figure 2 that some of these aims were largely achieved. In 1981 income tax represented 75% of total tax receipts, and a decade later this had been reduced to 63%. By that time GST was providing 24% of tax receipts.

![Figure 2: Contributions to Tax Revenue](image)

The move to reform taxation was spear-headed by the Treasury with the support of the Finance Ministers. During the period 1984-1986 a programme of tax-related research was funded by Treasury and carried out at the Institute of Policy Studies. This recommended a redesigned tax system based on a goods and services tax.

The main elements of tax reform consisted of:

- personal income tax gradually moving on to a flatter rate, at lower levels.
- reductions in tax concessions available to personal income tax payers (five income bands reducing to two, with the top rate dropping from 66% to 33%);
- compensating social security benefits including a family support scheme and rebates designed to target support on the lowest income earners;
- the reform of existing indirect and wholesale sales taxes to be replaced by the goods and services tax;

- some additional taxes such as fringe benefit tax to plug gaps in the system;
- the revamp of company taxation levels to integrate them with the top personal income tax rates, to reduce tax avoidance, and to neutralise the various company treatments.

There was some further intended reforms that did not eventuate. In 1986 the finance minister proposed a single step income tax, but received inefficient political support. In addition, it was intended to tax capital gains on an equivalent basis to other income, but this was never achieved.

<table>
<thead>
<tr>
<th>Table 1: Income Tax Reform (cents per dollar of taxable Income)</th>
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<tbody>
<tr>
<td>(1) Personal Tax</td>
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<tr>
<td>Taxable Income ($)</td>
</tr>
<tr>
<td>0 - 6,000</td>
</tr>
<tr>
<td>6 - 9,000</td>
</tr>
<tr>
<td>9.5 - 24,000</td>
</tr>
<tr>
<td>25 - 30,000</td>
</tr>
<tr>
<td>30 - 36,000</td>
</tr>
<tr>
<td>36,000 +</td>
</tr>
<tr>
<td>(11) Corporate Tax</td>
</tr>
<tr>
<td>Resident companies</td>
</tr>
<tr>
<td>(111) Goods &amp; Services Tax</td>
</tr>
<tr>
<td>Tax</td>
</tr>
</tbody>
</table>

Note: * A range of rebates are paid on the lowest income groups depending on household composition.
** Later raised to 33%. Non-resident company tax rate is 30%.
*** Increased to 10.5% on 1.7.89.

3. The Goods and Services Tax (GST)

GST is a broad-based tax of relatively simple design with almost no exemptions. It was originally levied at 10% of sales value on all transactions between companies and individuals involving the transfer of "taxable supplies". This is effectively a tax on value added, but with the major exception that there is no GST levied on the hire of labour. Supplies intended directly for export are zero rated.

The Government was especially reluctant to grant any exemptions but eventually a small number have been allowed. Financial services are exempted on the basis that the fees charged by banks do not correspond to the value of the service applied, in view of the return from interest differentials.
Life insurance is exempt GST because of the savings element which should not be the subject of a consumption tax; most insurance is subject to GST.

Non-profit organisations are not required to collect GST on sales of goods they receive as donations.

Residential accommodation - rents for accommodation greater than 4 weeks are GST-exempt because owner-occupiers receive accommodation services exempt from GST and anything else would be inequitable treatment.

Existing house sales are GST-exempt because of the savings component of property holdings (although agents' fees are liable). Sales of new houses built by a GST-registered builder are subject to GST.

Second-hand goods transactions between private individuals are GST-exempt due to the infeasibility of tracking such transactions and because of the element of double taxation of goods where tax has been paid when new. Businesses dealing in second-hand goods paid GST at one-eleventh of the value of sales (for a 10% tax).

Central and local government services are subject to GST. Local authority rates (property taxes) are considered to be a payment for goods and services provided to the community and hence subject to GST. Note that tax-exempt entities are unable to reclaim the GST paid on inputs.

In contrast to the former wholesale sales tax which was collected by the Customs Department, administrative responsibility for the GST rests with the Inland Revenue Department, because of its close connection with both personal income tax and company tax.

It was understood that the tax reform process was to be viewed as an integrated whole. Indirect taxation was accompanied by a reduced personal income tax with fewer income brackets as shown in Table 1, a lower corporate income tax standardised to household rates, and removal of the wholesale sales tax and other indirect taxes. Some flattening of the income tax rate took place before the introduction of the Goods and Services Tax. When GST commenced on 1 October 1986 there was a further lowering of income tax rates across the board in compensation. GST was subsequently increased to 12 1/2% on 1 July 1988, and income tax went through some further readjustments.

While this tax reform was in process, the government appointed a Royal Commission on Social Policy to examine distributional questions associated with the whole programme of fiscal and regulatory changes. When the Commission reported in 1987 it was generally condemnatory of the reform process, arguing that insufficient account had been taken of equity issues, and prophesying that GST would be a regressive element in the tax system.

The capital gains tax, which was seen as an integral part of the tax reform process, never eventuated. By 1989 there was general consensus that the country had lost its taste for radical tax reform, as well as concern about the potential cost of administration and compliance. Consequently the tax was never implemented, leaving a conceptual gap in the coverage of taxation of income and consumption.

4. The Introduction of GST

The Goods and Services Tax was introduced on 1 October 1986, following a major advertising campaign and a series of business seminars. The actual implementation went relatively smoothly.

There was some disruption to the pattern of retail sales in the period. In the preceding quarter the real value of (seasonally adjusted) retail sales increased by 8%. In the following quarter sales dropped 13%. During the lead-up period, trade stock levels dropped noticeably and then grew for the period after, suggesting the unusual sales pattern had encouraged suppliers to increase their stocks in anticipation of a boom which did not eventuate. The disruption of sales was particularly noticeable for durable goods, which rose by over 30% on the previous year's figure. There was some confusion amongst consumers about the net effects of the removal of the wholesale sales tax and the imposition of GST on some items (-the pre-GST spending boom included items that were already subject to wholesale sales tax).

In July 1989 when the rate was increased from 10 to 12 1/2% this pre-sales effect was much less noticeable (- note there was no income gain from lower income taxes as in 1986).

In order to be able to claim back refunds, businesses had to register for GST if their annual turnover was above $24,000 (increased to $30,000 in 1990). Many self employed and some small traders in New Zealand who had successfully evaded paying income tax in the past, wished to claim GST refunds on purchases, and found it necessary to register to do this, hence exposing themselves to corporate income tax. The effect was to increase the corporate taxation coverage notably. A side effect was to yield very good business statistics data based on GST registrations and to increase the known population of firms in New Zealand. The Inland Revenue Department had anticipated 180,000 registrations in the first year of operation. Within six months registrations had reached 280,000.
The next year company income tax returns rose by 6,000 over the number filed the year before, and a further 4,000 the following year. This was an unexpected spin-off of GST registration and other elements of tax reform. Clough, using national accounting data, estimates that actual GST collections at that stage accounted for around 80% of potential GST.  

GST was intended to be a relatively simple and efficient tax. Its administration is conducted principally by the Inland Revenue Department which spent roughly $20 million extra per year in the early years on administration. Clough estimates that the average collection costs for GST are around 1.1 cent per dollar of revenue collected, comparing favourably with the overall average costs of tax collection of around 1.4 cents per dollar for income tax and 1.7 cents for excise tax.

What of compliance costs? There is no conclusive evidence here, but due to the few exemptions and simple rate structure, compliance should be less costly than for most European VAT systems (where estimates are that compliance costs may be four times as large as administration costs).

The neutrality of the tax is also difficult to judge. There has presumably been some inter-sectoral impact in a moving from an uneven, limited, indirect tax system to a more generalised consumption tax. But beyond some localised effects (e.g., stimulating computer demand) it has not been possible to identify these. The general belief has been that GST will lead to less distortionary and more efficient resource allocation (although a consumption tax with a standardised rate is not strictly neutral because it takes no account of differing demand elasticities).

GST effectively involves the business as a tax collector on behalf of government, and there were initial complaints about how onerous this could be. It has involved extra spending on accounting systems for many small businesses; this may have had a side effect of improving their short term monitoring systems.

The introduction of GST was reasonably well received. Small scale retailers were opposed to compliance requirements, but large scale business interests generally supported GST. This was in contrast to the proposed capital gains tax which received a broadly hostile response.

5. Price Effects

During the years leading up to the introduction of GST, New Zealand had experienced high price inflation, followed by a price/wage freeze which was lifted in 1983 with a subsequent rebounding in levels of inflation to around 18%. By 1986 inflation was beginning to respond to a deflationary monetary policy. It was therefore of some concern as to what effect the introduction of GST might have on prices. The inflationary effect of the whole package of tax and income support measures had a number of components:

- the direct effect on retail prices caused by GST at 10%, partially offset by changes in suppliers' margins and on some products by the removal of wholesale sales tax at a higher rate;
- the effect of direct tax reductions and increasing disposable incomes leading to increasing demand;
- cross-price effects of different goods and services with varying degrees of substitutability;
- the negative effects of the removal of the wholesale sales tax;
- long term indirect effects as the economy adjusted to changing consumption patterns;
- the impact on inflation expectations (money illusion).

In the event, the introduction of GST and related tax reform clearly had an inflationary effect. This may partially be measured by a tax and price index which estimates the change in gross income required for the taxpayer to maintain a given standard of living. The change in CPI of 9% over the first year of GST's introduction implied the net effect of direct and indirect tax reform, was to raise the real disposable income of the average income earner by 2.5%. In the quarter following the introduction of GST there was a marked effect on the CPI which translated into an increase in the annual rate of inflation from 13 to 18%.

Grimmond has used the NZ Institute of Economic Research price forecasting model to estimate the consumers price index excluding GST effects. He notes that 70% of the effects of the GST imposition and the GST increase passed through the CPI in the following quarter, and most of the effects were evident after another six months. The estimated effects are shown in table 2. 

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6 Clough, ibid.

Table 2. Approximate Impact of GST on CPI

<table>
<thead>
<tr>
<th>GST Introduction</th>
<th>GST Increase</th>
<th>CPI Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.10.86</td>
<td>10%</td>
<td>7.4%</td>
</tr>
<tr>
<td>GST Increase</td>
<td>1.789</td>
<td>1.9%</td>
</tr>
</tbody>
</table>

The first GST shock came at a time when there was some underlying increase in producer prices, not subject to GST. One explanation for this might be that businesses made some attempt to increase margins at this time. During the second GST shock there is less evidence of this.

Figure 3 shows the estimated impact of the introduction of GST on the consumer price index in 1986 and its increase in 1989.

Figure 3: GST Effects on Consumer Inflation
Annual Percent Change

GST has had a number of more subtle effects on prices. For example, there was a small rise in the price indices in the period following its introduction due to GST on inputs being absorbed into the cost structures of GST-exempt and unregistered businesses. In addition, the imposition of the tax changed some relative prices in such a way as to prompt a change in consumer behaviour. Moreover GST presumably raised inflationary expectations which could have had the effect of slowing down the deflationary process. The resurgence of demand caused by the pre-GST sales boom would also have added to inflationary expectations.

Legally retailers were required to either price inclusive of GST, or make it clear that price labels were exclusive, but there may have been some confusion here. There were also probably some examples of retailers using the introduction of GST as an excuse to build in margin increases.

It should be noted that from about 1987 the Reserve Bank was running a tight monetary policy. The government set up the Reserve Bank on an independent contractual basis, and formally charged it with achieving a price stability (defined as 0-2% inflation) by 1992 (subsequently extended to 1993). Consequently there was strong underlying pressure on the money supply and on inflationary expectations which must have impinged on the price response.

6. Distributional Effects

In the early discussions of GST and other tax reforms, most attention was paid to the neutrality and efficiency of the tax, rather than to its distributional effects. Even today several years after the event, the impact is not completely clear. On the one hand, GST broadened the tax base considerably and extracted tax payments from many who had paid less before. On the other hand, the introduction of a consumption tax together with the reduction of personal income tax to a lower flatter structure made the overall tax structure markedly less progressive. Analysis of real disposable income changes may be obscured by inclusion of the (GST-inclusive) CPI in their deflators. The conclusion of commentators like Clough are that the introduction of GST and related income transfer measures did not improve the position of low income households in New Zealand. In addition the failure to introduce a capital gains tax affected the planned overall outcome.

Figure 4 shows the rate of growth in real disposable incomes of households of full time wage and salary earners by quintile. The 1986 reforms (mainly GST) triggered a broad improvement in income, whereas the 1988 reforms (flattening the income tax scale) noticeably favoured the higher income groups. (Note however that these results should be interpreted with caution as the figure does not include households without a full-time wage or salary earner.)
Given the vast amount of industry reform, tariff change, price changes, and government reorganisations over this period, one must obviously be cautious about attributing causes. However it is likely that the tax changes were the major factor in realigning income distribution in the early period, though during 1990-92 government spending changes are likely to have a more dominant effect.

It could be argued that this issue must be viewed in its overall context. Some of the reduced progressivity from tax reform may be restored by the revamped government spending currently under way. The government’s spending reforms have been through a number of versions recently and until health, superannuation, and other reforms are finalised, it will be impossible to judge their overall distributional effect. In the meantime we lack the up to date household income and expenditure data necessary to properly model this issue.

7. Macroeconomic Effects

The tax reforms initially yielded a higher than expected tax take, because of their success in reducing tax avoidance and evasion. This success in government revenue reform probably had the interim effect of taking pressure off the programme of government expenditure reform. If this is true, it has been an expensive outcome.

New Zealand has continued to run a structural fiscal deficit, and the attempts to reduce the size of government have brought a very slow response as is evident in figure 5. In 1990/91 the government was forced to take evasive action, cutting transfer spending at a time when the economy was stagnant, terms of trade were falling and household income declining. Ideally such expenditure reform would have taken place earlier. Expenditure had increased from 28% of GDP in 1984/85 to 44% by 1990/91. Sieper and Wells argue that this allowed important government expenditure reform to be postponed.

It is clear that with a broad-based tax like GST the government has a powerful instrument affecting aggregate demand. The effects during the introduction of GST in 1989 were blunted by the promised compensating...

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9 This figure must be interpreted with caution because historically this measure of real disposable income has diverged markedly from measures of total household real disposable income.
reductions in income tax. But in 1989 when GST was increased to 12 1/2%, the effect on retail sales and subsequently on growth was marked; after experiencing signs of a pick-up the economy dropped back to recession the following year. This tax will always be vulnerable to politicians using it as an easy way to significantly increase revenue. It also demonstrates the dangers of using a structural instrument for short term cyclical factors.

In seeking to assess the overall effects of the consumption tax in New Zealand it must be remembered that it was introduced during a period when:
- there was widespread economic reform in progress, and GST was therefore not the single focus of attention that it might otherwise have been;
- there was a tight monetary policy, low or negative growth and rising unemployment during the period of tax reform which minimised subsequent inflationary pressures but led to other problems.

Taking these factors into account, I conclude that GST was introduced without major disruption, and has proved to be a broad-based neutral tax that raised revenue relatively efficiently for government and shifted the tax burden from income to indirect taxes. Weighed against this, has been a substantial one-off increase in the consumer price index spread over 9 months, some sales disruptions, transfer of compliance burdens to businesses, an increase in regressivity of indirect taxes and overall net transfers, powerful effects on aggregate demand, and the indirect effect of allowing government to delay important expenditure reforms.

### APPENDIX: Economic Reforms in New Zealand

<table>
<thead>
<tr>
<th>1. FACTOR MARKETS</th>
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<tbody>
<tr>
<td><strong>Financial Industry</strong></td>
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<tr>
<td>Addition of credit growth guidelines</td>
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<tr>
<td>Removal of separate requirements for trustee banks, building societies, finance houses, stock brokers</td>
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<tr>
<td>Removal of quantity restrictions and other entry barriers to banking</td>
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<tr>
<td>End of formal financial controls (reserve ratio requirements, sector lending priorities)</td>
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<tr>
<td>Removal of interest rate controls</td>
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<tr>
<td>Abolition of export credit guarantees</td>
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<tr>
<td>Removal of ownership restrictions on financial institutions</td>
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<tr>
<td>Liberalisation of Stock Exchange</td>
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<tr>
<td><strong>Energy Industry</strong></td>
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<tr>
<td>Corporatisation of State Coal Mines</td>
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<tr>
<td>Financial restructuring of oil refinery</td>
</tr>
<tr>
<td>Legalisation of oil company ownership of service stations</td>
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<tr>
<td>End of price controls (except on gas)</td>
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<tr>
<td>Sale of Crown gas exploitation/distribution interests</td>
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<tr>
<td>Sale of other Crown energy holdings</td>
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<tr>
<td>Corporatisation and restructuring of electricity generation, transmission and distribution</td>
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<tr>
<td><strong>Transport Industry</strong></td>
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<tr>
<td>Removal of restrictions on road/rail carriage</td>
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<tr>
<td>End of quantity licensing of trucking</td>
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<tr>
<td>Corporatisation of state rail, air and bus services</td>
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<tr>
<td>Tendering of local authority bus services and liberalisation of licensing requirements</td>
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<tr>
<td>Deregulation of airline industry</td>
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<tr>
<td>Opening up of domestic aviation industry</td>
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<tr>
<td>Granting of number of land and on-flying rights to foreign airlines in NZ</td>
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<tr>
<td>Corporatisation/sale of airports and Airports Corporation</td>
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<tr>
<td>Corporatisation of ports</td>
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<tr>
<td>Deregulation of stevedoring industry</td>
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<tr>
<td>Removal of cabotage on coastal shipping</td>
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<tr>
<td>Research and Development</td>
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<tr>
<td>Removal of concessions for research and development to put on equal footing with all investment</td>
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<tr>
<td>Cost-recovery of public R &amp; D work</td>
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<tr>
<td>Establishment of a contestable pool of public funds (Foundation of Research Science &amp; Technology)</td>
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<tr>
<td>Corporatisation of government research bodies (Crown Research Institutes)</td>
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<tr>
<td><strong>Labour Market</strong></td>
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<tr>
<td>Introduction of voluntary unionism</td>
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<tr>
<td>More market-based bargaining under Industrial Relations Act</td>
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<tr>
<td>Amendment: compulsory unionism reinstated</td>
</tr>
<tr>
<td>Some contestability in union coverage under Labour Relations Act</td>
</tr>
<tr>
<td>Radical reform via Employment Contracts Act (= voluntary unionism, contestable union of any size, any arrangements for employee/employer bargaining at 2000 or individual level).</td>
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2. INDUSTRY DEREGULATIONS

<table>
<thead>
<tr>
<th>Product Markets</th>
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<tbody>
<tr>
<td>Termination of Supplementary Minimum Prices on agricultural products</td>
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<tr>
<td>Agricultural tax concessions removed</td>
</tr>
<tr>
<td>Termination of concessional financing of primary producer stocks held by producer boards</td>
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<tr>
<td>Review of compulsory producer marketing board arrangements</td>
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</tbody>
</table>
Economic Reforms (continued)

Termination of domestic boards for eggs, milk, wheat 1994-98
Termination of export market development incentive schemes 1994
Phasing out of export performance tax incentives 1994-97

Industry Reforms

End of wage/price freeze 1994
Termination of price control, and replacement by (unused) price surveillance powers under Commerz Act 1984-98
Removal of a number of licensing on almost all industries, and end of government regulations on new industrial enterprises 1984-98
Removal of all state regulated monopoly rights (except letter post, air traffic control, and milk distribution) 1984-98
Removal of some occupational licensing 1985-90
Removal of producer cooperative tax advantages 1989
Termination of restrictions on shop trading hours 1989

Business Law Reform

Establishment of Commerz Act as liberal efficiency-based regime 1986 to govern mergers and trade practices
Fair trading Act governs consumer rights 1995
Review of securities legislation and takeover law (extent of efficiency approach still under discussion) 1988-91
Review of whole intellectual property regime (Patent, Copyright, Trademarks and Designs Acts) 1990-91
Review of Town and Country Planning Act 1997-98
Resource Management Act to govern more liberal planning and environmental legislation 1991
Crow Minerals Act to clarify property rights to mineral resources 1991

3. INTERNATIONAL TRADE AND MONETARY REFORMS

Currency Protection

Phasing out of export licensing requirements 1983-89
Reduction of export tariffs on Swiss Formula from average 25% to 10% 1986-92
Further one third reduction in export tariffs planned 1992-96
Removal of all protection features for 18 specific "industry " 1994-92
Plant" sectors and incorporation into general tariff reform programme 1996-97
Slowing down of reduction in special "industrial sectors 1987-96
Motor vehicles/components and textiles/clothing/footwear 1987-96

International Capital Controls

Removal of dual capital inflows for investments (rubberstamped by Overseas Investment Commission, except for farming, offshore islands and fishing) 1985
Very liberal regime for portfolio investment/repatriation of profits 1985

Exchange Rate

Domestic foreign exchange trading 1984
Devaluation 1984 2.5% against basket of currencies 1994
Free float of currency on foreign exchange markets with direct control 1985

Monetary Policy

Devolution of monetary policy instruments to deflation, with target of "price stability" (0-2% price increase) by 1992/93.
Tight monetary policy (ND below rate of inflation) 1987-
Independence of Reserve Bank from government, formalised through Reserve Bank Act 1989

4. GOVERNMENT SECTOR REFORMS

State Trading Operations

Removal of almost all state regulated monopoly rights 1984-98
Corporatisation of 24 state owned enterprises (in transport, finance, tourism, forestry, broadcasting, utilities and service industries) 1987-98
Restructuring to include national monopoly elements of SEZs 1989-91
Full operational privatisation of Air NZ, Bank of NZ, Petroleum Corporation, Tourism Hotel Corporation, Shipping Corporation, Rural Bank, Government Life, Forestry Corporation, Post Office Bank, Telecom Corporation and others 1987-91
Further privatisation planned via divestment of state ownership, sale of minority interests, share sales, etc. 1991
Requirements for local authorities to corporatise Local Authority Trading Enterprises (LATEs) and tender out services 1990-91
Encouragement to local authorities to sell holdings in airports, port companies and local utilities 1991
Sale of other assets e.g. irrigation schemes, fishing rights 1983-98

Taxation Reforms

Broadening tax base through "Goods and Services Tax" on virtually all final domestic consumption without exception (now 12.5%)
Flattening and lowering of personal income tax rate, with top rate standardised to corporate tax rates, and aimed to minimise poverty traps 1998

Financial sectorisation of corporate taxation to eliminate exaction and cut administrative costs 1995
Removal of most other indirect taxes 1995-96
Removal of tax concessions for savings, etc. to put on neutral footing 1997

Expenditure Control

Attempts at reduction in government expenditure, especially in areas of administration and industry development 1995+
Assignment of proceeds of sale of state-owned enterprise assets to repay public debt 1997+
Public sector management reform through Public Finance Act 1999
Reform of core government departments on corporate lines through State Sector Act 1998 with separation of policy, provision and funding 1995+
User-pays principles for remaining state trading activity 1998+
Reduction of government accounts on more commercial lines, accrual accounting, output-based monitoring systems through Public Finance Act 1998
Abolition of 50 quango and quasi-governmental organisations 1987
Renewed attempt at reduction in social spending (education, health, social welfare, superannuation) 1991

Social Services Reform

Reform of compulsory education system, based on elected boards and of Trustees 1998-90
Quasi corporatisation and fee-paying for tertiary education institutions 1992
Integration of state housing assistance into private sector rental 1991
and mortgage provision 1990
Tightening of requirements and reduction of levels of unemployment benefits and other government social transfers 1990
Tightening of requirements, extension of age, and reduction of benefits for government funded old age pension scheme 1989-91
Separation of funding from provision of state health services, establishment of Crown Health Enterprises, and expectations of private sector growth 1992
Likely development of private funding arrangements for health provision 1992
LESSONS FROM NEW ZEALAND

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Bob Gregory has been good enough to give us quite a bit of room to move in the title of this session, and I intend to exploit it by not looking in detail at the New Zealand GST experience. Instead I want to take up the broader issues, including what we can learn from the New Zealand macro and micro policy experience. If you think this is a bit remiss, since this is, after all, billed as a consumption tax conference, let me reassure you that Alan Bollard will be looking at the New Zealand GST case in detail, and I can see little point in going over the ground he covers so competently in his paper.

I would nonetheless like to offer one or two general observations about the GST experience in New Zealand and its relevance, or lack of it. The thing that struck me most when I asked New Zealand bureaucrats, politicians, businessmen, unionists and economists about the impact of GST last year was the insouciance of the replies. Quite plainly, GST is now a non-issue for most New Zealanders.

One possible explanation is shell shock; so many painful reforms have taken place over such a relatively short time span that individual measures are simply not focused on. That doesn't stand up, however. There have been plenty of specific complaints directed at other measures. Instead I think it is clear that any adverse effects have had only a transitory impact on the New Zealand consciousness and, so far as I could see, on the New Zealand economy - although Alan Bollard raises one or two issues in the latter context that suggest this judgement may be too sanguine. However, I don't intend to anticipate his paper here. Various studies have noted that implementation of the GST was relatively smooth and operating problems seem to have been minor.

At the man-in-the-street level the only clear evidence I saw of resentment was the menu of an Auckland restaurant. It had two columns, one headed 'Our Price', the other 'What They Make Us Charge You'. But the normal practice was the GST to be added in without any specific identification except the generalised one about prices including GST.

What can we conclude from this (anecdotal) evidence about the introduction of a GST in Australia. We might conclude that if we handle its introduction as professionally as New Zealand, then it will be accepted relatively quickly. That is no doubt nice to know, but I suggest not very useful given where we are now. It is the transition we have to deal with, and there is reason to suspect this may prove rather more demanding in Australia.

There is, for example, the small matter of an election. In New Zealand the GST was introduced by a party in power after an extensive propaganda campaign. If it is introduced here it will be after a campaign against it by the party in power. Of course, if the Coalition wins government then John Hewson will have a mandate to introduce the GST. The larger his majority, the stronger he will presume that mandate to be, although this is not necessarily a valid assumption.

One group that has already made known its intention to continue to resist, regardless of the election outcome, is the ACTU. Does this matter? Well according to Hewson's strategists, no it doesn't. A coalition government would not propose to introduce its 15 per cent GST until October 1994. By then it expects to have its labour market policies bedded down, so that the two
issues do not overlap. This may turn out to be an optimistic assumption. As Hewson himself has recognised, labour market reform is going to be his government's primary task, and its most difficult.

Unfortunately for him, the New Zealand labour market experience offers lessons that cannot be directly applied to Australia. I say unfortunately in the sense that New Zealand's National Party Government has been able to introduce radical labour market reform through its Employment Contracts Act without any significant economic disruption. In one step the labour market has been deregulated and the hold of national unions broken. It is, of course, still too soon to offer an definitive view on how this Act is working, but I found some early signs encouraging. The crux issue will be whether employers use it constructively to establish genuine enterprise level bargaining or seek to exploit it in a confrontationist, cost-cutting way.

While I think more radical deregulation of our labour market is the target Australia should be aiming for if we are to get the sweeping productivity gains that will transform this economy, there are Constitutional and institutional barriers in the way that will make radical reform here much more difficult. Thus it is easily conceivable that the battle with the ACTU will drag on and become entangled with the GST issue as unions seek to make compensation for the price effects of GST part of their broader struggle with the Government.

This leads on to a related issue where the New Zealand experience does have direct relevance - monetary policy. New Zealand's Labour Government consistently paid more attention to control of inflation as an issue than did Australia's in the 1980s. One can argue that it had more reason to, or alternatively that it made a mistake in doing so. I don't want to pursue those arguments now. For those who do, on the first issue I suggest the paper on New Zealand and Australia in the Eighties by Ted Sieper and Graeme Wells of the ANU, which by happy coincidence is in a set of conference papers on Australian Economic Policy recently published by the Centre for Economic Policy Research.

On the second issue, if you happen to be one of the three or four economists in Australia who haven't yet been sent a copy of Jeff Schubert's paper on New Zealand, I am sure he would be happy to send you one. Jeff's at Hongkong Bank Australia.

Although we arrive via somewhat different paths, the fact is both countries now have low inflation. The issue is where we go from here in a policy sense. As most of you probably know, the New Zealand central bank has an inflation objective in its Act; that is to say, it is instructed to concentrate on price stability. The precise definition of what constitutes stability is in a written agreement between the Finance Minister and the RBNZ Governor - currently 0-2 per cent by the end of calendar 1993.

While this arrangement is not as inflexible as many of its critics seem to imagine, it is certainly much more explicit in its focus on inflation than the Australian legislation. The current Prime Minister and the head of the Reserve Bank of Australia are both opposed to a New Zealand-type target, although both are latter-day converts to low inflation as a policy objective - the former from expediency and the latter from experience. We can expect to hear a lot about the importance of preserving our inflation gains on Wednesday night, but not attempt to follow the New Zealand model.

Where this model becomes highly relevant is with a change of government. For a new government attempting to introduce both labour market reform and a GST, a credible anti-inflation policy is crucial. New Zealand experience shows that a legislated inflation objective is credible once the central bank's
commitment to it is demonstrated. I don’t believe there is any alternative policy that would be as effective in convincing both consumers and the unions to restrain their inflationary behaviour.

The introduction of a GST will, of course, also make running such a monetary policy more difficult. The RBNZ complained in its briefing paper to the incoming National Government that ‘these government influences on inflation, including the GST and its subsequent increase, have from time to time represented major sources of upward movement in the CPI, significantly aggravating the task of monetary policy in controlling and reducing inflation and inflationary expectations’.

Finally, I want to turn briefly to look at the big-picture issue of what lessons New Zealand’s experience with microeconomic reform and macroeconomic policy holds for Australia. An increasingly fashionable view is that it demonstrates the failure of economic rationalist policies and a warning to Australia. Australia’s current recession is seen as vindication by those who hold this view.

I don’t believe it does any such thing. What it does demonstrate is the failure of the policies of the preceding two decades and how long it takes to correct such policy mistakes. It also demonstrates, and here there is an obvious parallel with Australia, how long it takes to shift cultural attitudes. But drawing too many parallels with New Zealand is dangerous. Just as the economic performance of the two countries was very different in the 1980s, it could easily continue to diverge in the 1990s.

New Zealand started its reforms from a much worse economic position than Australia, has a much smaller resource base and population, a more limited range of exports and so on. The reality may be that it is adjusting to a permanently lower living standard now that the basis of its earlier wealth as ‘England’s fertile farm’ has disappeared. However, I think it is too early to reach such a pessimistic conclusion, and there is an alternative and more attractive possibility, namely that fundamental reforms take time to yield their benefits.

In its most recent report on New Zealand the OECD suggest that among the factors accounting for its disappointing output and employment performance were:

- Severity of initial conditions;
- Past inconsistency of policies;
- Obsolete resources;
- Skill shortages;
- Rising public spending;
- Imbalances in structural reforms;
- Political uncertainty and shocks.

For New Zealanders the task seems never ending. The new National Party Government come to power and had to tackle the two areas where Labour had fallen short - the labour market and fiscal policy. That has prolonged recession, as has the weakness of New Zealand’s external markets. It has also increased political pressure to abandon the existing policy orientation, as in Australia.

However, there are some encouraging signs emerging. The most encouraging is the extraordinary lift in business confidence since Christmas. But a considerable challenge still remains, which the Secretary to the New Zealand Treasury has identified as constructing a welfare system consistent with the open, competitive, trading economy. This is the essential task for fiscal policy, and it is an open question whether political support for reform can be
sustained long enough to complete this task, just as doubts hang over
Australia's capacity to sustain microeconomic reform.

I think the conclusion of the OECD report is appropriate for both countries:

"There could be a temptation to revert to large fiscal deficits and
government intervention to boost economic growth and job
creation. Such a policy reversal would be likely to yield at best only
short-run gains, while further retarding the necessary
transformation of the country's productive capacity in conformity
with world market prices. Such an approach should be firmly
resisted. New Zealand is now a considerable way through the
adjustment process... To build on the reforms of recent years and to
underpin the much-needed improvements in the country's
medium-term growth prospects, it is essential for New Zealand to
consolidate and extend the policy orientation pursued since the
mid-1980s".