



New Developments in Public Policy Formulation

Tax Working Group: What lessons for policy development?

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Conditions for successful reform

- The OECD sets out the following conditions for successful reform:
 - an electoral mandate;
 - policy design needs to be underpinned by solid research and analysis;
 - successful structural reforms take time;
 - government cohesion is critical;
 - the condition of the policy regime to be reformed also matter.
- Given the Tax Working Group process and the tax reforms in Budget 2010 do we agree with the OECD?

The fate of tax reviews

Sandford (1993) suggests three criteria by which to judge successful tax reform:

- extent to which tax reforms met the objectives the reviewers set themselves;
- sustainability of the reforms;
- extent to which the tax reforms had desirable or undesirable by-products.

The outcome has not always been favourable

“Experience suggests that tax reviews in Australia rarely lead to successful tax reform.”

Evans and Krever, 2009

John Head’s (2009) assessment of Canadian and US tax reviews suggests a similar experience.

New Zealand offers exceptions

“it is the NZ reform package of the mid-1980s which offers the only really optimistic prognosis.”

“The proposals of the McCaw Report (1982)were vigorously followed up, further refined and successfully introduced by the politically dominant Lange/Douglas government....”

John Head, 2009

NZ Government Budget, 2010

“Tax reform is a centrepiece of this Budget.”

Hon. Bill English, 2010 Budget

The Budget 2010 tax package

- (a) **Tax switching** - reducing reliance on taxing incomes, increasing taxation of spending and property, variety of base-broadening measures;
- (b) **Compensation** of “vulnerable individuals” for GST increase;
- (c) **Promise** of measures to reduce opportunities for families to structure their financial affairs to qualify for social assistance (WfF);
- (d) **Partially funded** by borrowing in the short-term with an expectation of self-funding in medium-term.

Embraced reform options suggested by the TWG – give or take some of the base-broadening options proposed.

Fast –reverse 12 months...

- Despite concerns with integrity and fairness of the tax system, and implications of globalisation and population ageing.....IRD and Tsy Briefings had not persuaded new Government that tax reform was a priority.
- Tax not a media issue.
- 2009 was a year of intense activity on taxation (IRD/Tsy/CAGTR conference NZ Tax reform: Where to next; NZAE conference: Tax Reform Symposium; TWG process).
- ShapeNZ poll in January 2010:
 - 79% considered tax system needed reforming;
 - 65% thought system unfair;
 - 56% favoured tax switching and base-broadening.

Fast –reverse further...

- 2005 BIM: the “ideological burp”
- Treasury working papers:
 - 2003: The excess burden of taxation
 - 2004: Equity and efficiency measures of tax-transfer systems
 - 2008: Roles of fiscal policy in New Zealand
- Based on prior work and research by Treasury and Inland Revenue
 - 2008 BIMs and associated research papers
 - Tax policy conference in February 2009

Foundation of the Tax Working Group

- Composition of group - experts, people who challenge, and not representatives of beltway lobbies.
- Supported by Victoria University, Treasury and Inland Revenue
- All meeting topics, papers and minutes published online
- Timeframe:
 - Formed June 2009:
 - 6 substantive sessions;
 - Public conference on 1 December 2009;
 - Report published 20 January 2010.
- Aim to provide medium-term direction of tax reform in New Zealand and to inform public debate about tax reform
- Process, nature, and outcomes fluid and responsive

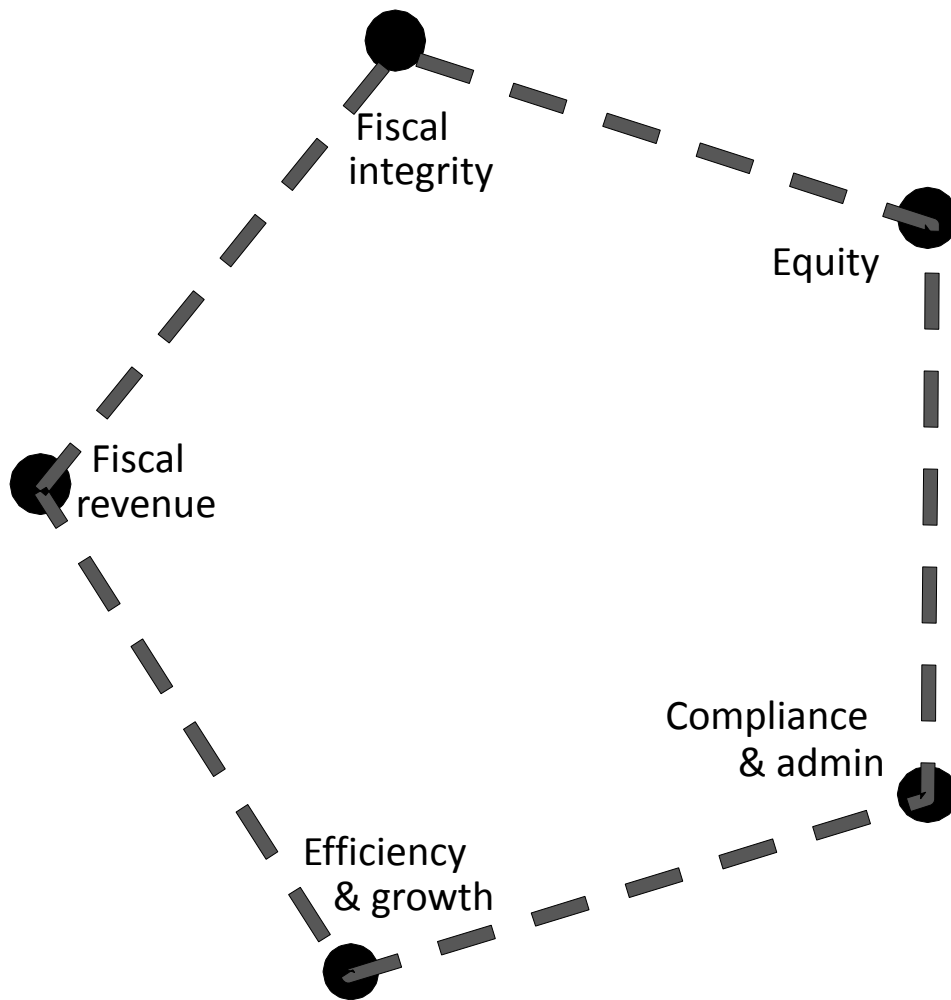
...any lessons for future reviews?

6 lessons:

- The power of “rational policy analysis”;
- Sound research and ‘real time’ analysis;
- Involve experts;
- Helps to have solid grounds for a review;
- Communication, Communication, Communication;
- Review report should support the process of promoting reform.

L1: Rational policy analysis

- Agree on a set of principles for a good tax system (the TWG pentagon);
- Identify options for reform;
- Point out pros and cons of options to help inform Government and public of the implications of adopting different values.
- How do the options impact on the pentagon?



L2: Sound research and 'real time' analysis

- Assess the effect of tax options in terms of the principles
 - TWG benefited from NZ Tax reform: Where to next; NZAE conference: Tax Reform Symposium; commissioned research, specialist knowledge around the table;
- A secretariat prepared and capable of 'getting hands dirty'
 - New work on distributional and efficiency effects of tax options; fiscal costs of tax reform packages; reviews of proposals, etc);
- Ensure specific reform options combine to provide a coherent reform package.

L3: Involve experts

- Consultation and collaboration with ‘experts’ has been a feature of the NZ tax policy processes, at least over last 25 years.
 - TWG members experts in tax law, accounting, economics
 - Use of external experts as advisers on particular topics
- TWG was a variant on a strong NZ tradition.

“Much of the success of the mid-1980s NZ tax reform must be attributed to innovative consultation and policy review procedures featuring close and effective interdisciplinary collaboration between lawyers, accountants and economists from the public and private sectors.”

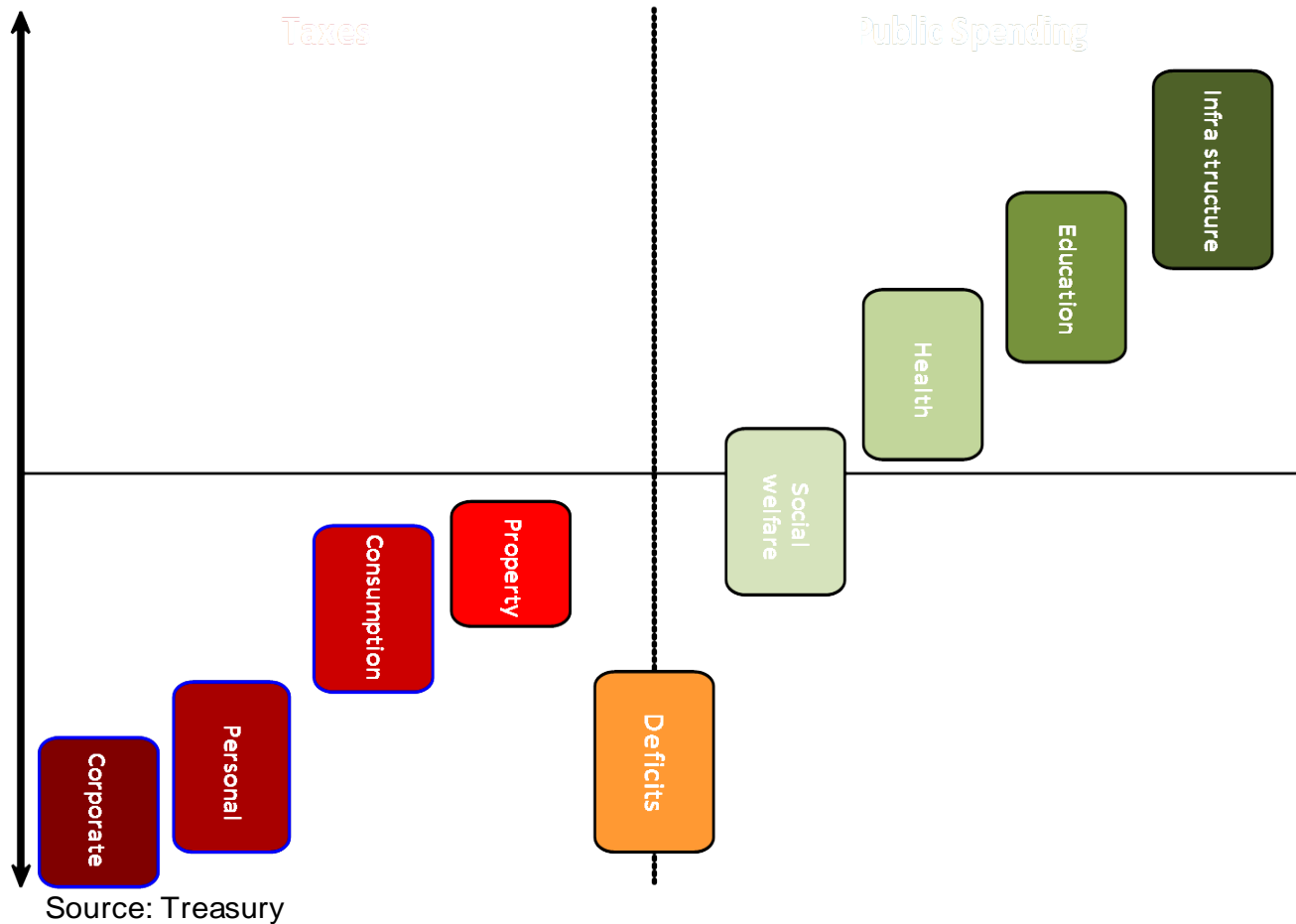
David White, 2009

L4: Helps to have solid grounds for a review

TWG able to draw on:

- Solid body of international research from preceding 15+ years on taxes and growth;
- Decade experience with piece-meal changes to NZ tax system and WfF showing clear adverse effects on integrity and fairness of NZ system;
- Housing price boom and bust underscored concerns over taxation of property;
- Perhaps environment faced by the TWG closer to that for the McCaw review than for Ross (1967) and McLeod (2001) reviews.

Growth effects of taxes and public expenditures



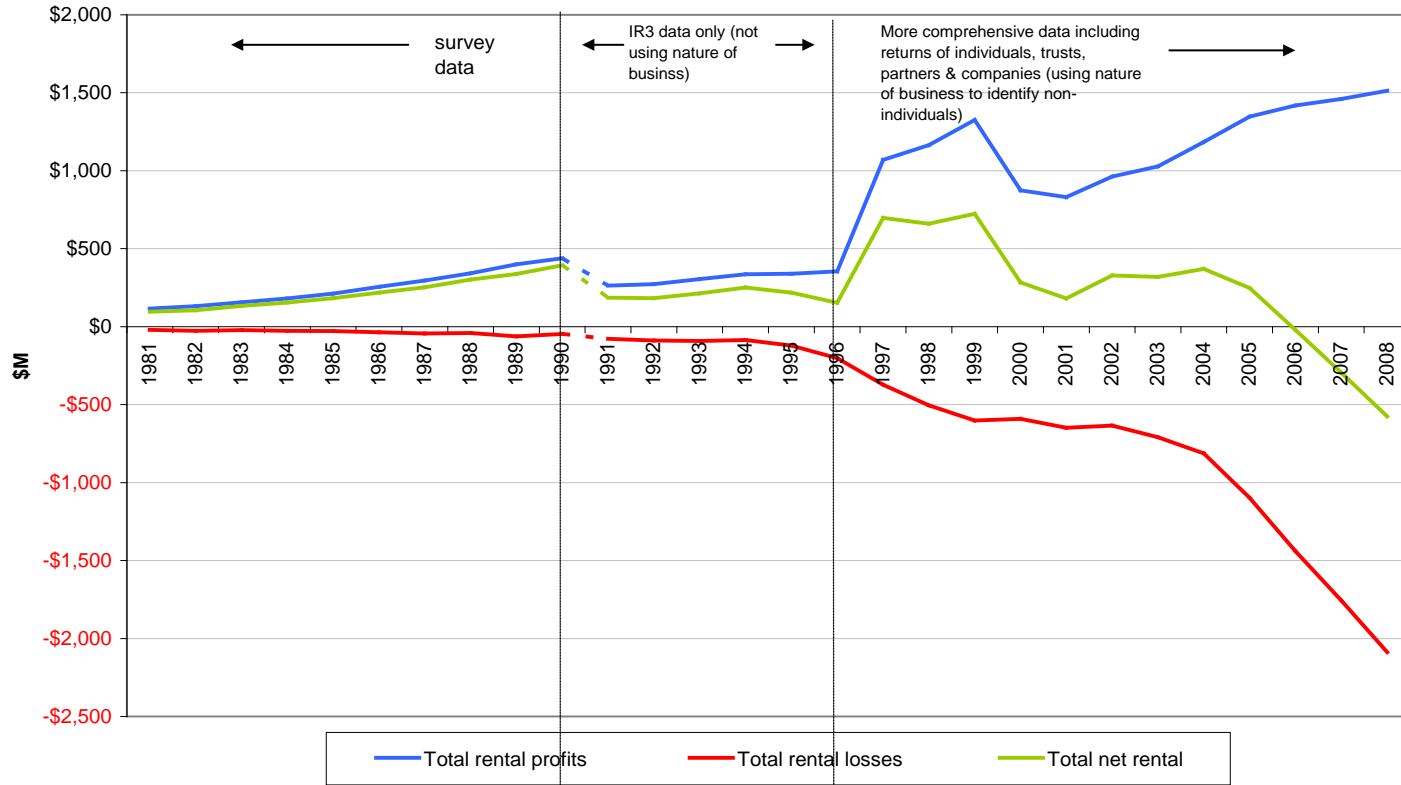
L5: Communication, Communication, Communication

Crucial for preparing ground for acceptance of recommendations:

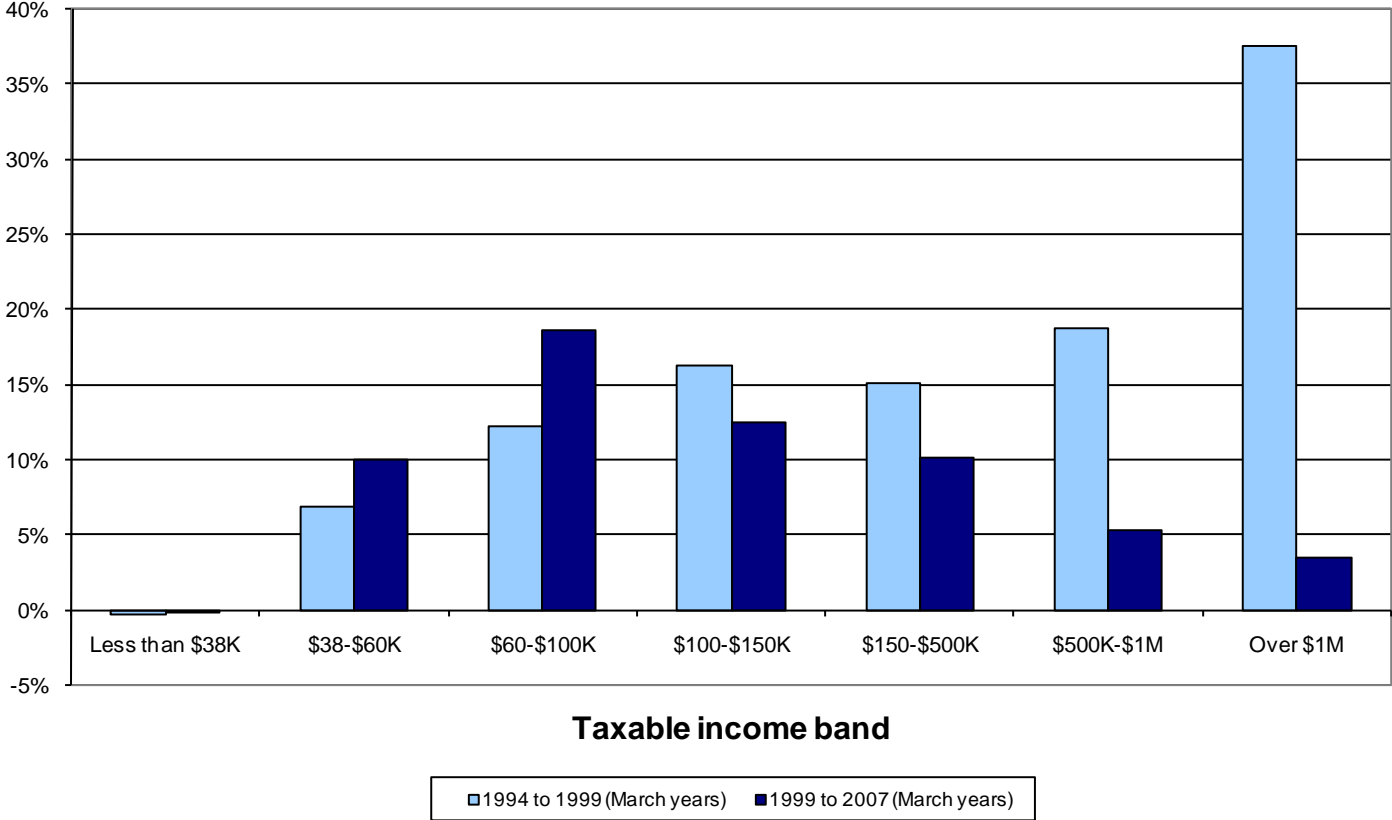
- Develop a communication strategy;
- Focus initially on ‘problems’ to create appetite for ‘solutions’;
- No surprises
- Fairness concerns created more interest than economic concerns:
 - Show stoppers - 9700 households with rental property losses claiming WfF;
 - Large diversion of higher incomes into trusts post 2001 - got media attention;
 - Tax switching tended to be viewed as a “money-go-round”.
- Important to get public “buy-in” to problem and that tradeoffs exist.

SS 1: Net Taxable Rental Income

Rental income time series - Value \$M chart



SS 2: Average annual growth in individual taxpayers at different income levels



Source: : Inland Revenue Department

Communication, Communication, Communication

- Change in political environment from previous tax reform
 - Prior tax reform under FPP electoral system
 - Introduction of MMP and minority governments
- Needed to build a public mandate for tax change
- Political support for reform built throughout the process

L6: Review report should support the process of promoting reform

Two types of reports:

- Academic – tend to be prescriptive and educational for academics and tax policy specialists;
 - Policy focussed – directional and educational for public;
 - Accessibility and understandability important.
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- TWG Report intentionally the latter (with background technical papers assigned to the internet)
 - Don't force government to accept or deny recommendations

“The Report is refreshingly free of the kind of rhetoric which is so often a part of taxation debates... A Report which simply set out a dogmatic agenda for reform, using the kind of rhetoric that is familiar from the commentaries of special-interest groups, would have little value and would be read only by like-minded people.”

John Creedy, 2010

Outcome and impact on Budget 2010

- TWG process informed government thinking on nature of problem and options; e.g:
 - GST
 - Company tax and alignment
- Convinced Government of need for reform; and provided clear direction about the type of reform required.

“The Tax Working Group discussed a broad range of options for tax reform. The Government has considered all of these options closely... While the Government has ruled out some of the proposals discussed by the Tax Working Group, most of the options discussed by the Group still remain on the table.”

Hon. John Key, 9 February 2010

“Officials alone would not have delivered what the TWG did with its mix of views and expertise...”

John Whitehead, 2010

The fate of the TWG process

While tax reviews have often failed to satisfy Sandford's three criteria, there might be some useful lessons from the TWG process:

- Did the TWG process meet the objectives the reviewers set themselves?
 - Report considered medium-term direction; tax reform in Budget 2010 consistent with this; public debate enhanced
- Were the reforms sustainable?
 - Although early, seems to be political acceptance
 - Reforms broadly fiscally neutral- particularly in long-term
 - Growth effects positive from reforms.
- To what extent did the tax reform have desirable or undesirable by-products?
 - Significant progress was made in the 2010 Budget to restore the coherence and fairness of the tax system and to reduce its damaging effects on growth and efficiency

TWG process & OECD conditions for successful reform

- An electoral mandate;
 - Not necessarily- tax reforms in Budget 2010 not announced prior to election; TWG process built public and political mandate.
- Policy design needs to be underpinned by solid research and analysis
 - Framework and rational policy analysis approach critical to TWG process.
- Successful structural reforms take time
 - Although TWG and Budget process relatively quick, background work critical to success of both. The benefits of the reform will build up over time.
- Government cohesion is critical
 - Particularly important in an MMP environment; although the reform process itself can assist cohesion.
- The condition of the policy regime to be reformed also matters
 - Awareness of the policy regime's condition also important. TWG process created awareness of the condition of the tax system without which reform would not have happened.

Overall assessment?

The process underscores:

- Importance of well-informed policy-advisors prepared to try new approaches to policy reform;
- Payoff that can arise from the courage of Ministers to risk new and more public approaches to policy advice;
- Value that can be gained from collaboration between practitioners, academics and policy advisors.

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Growth effects of tax switching

- Subsequent IMF “modelling” results consistent with TWG claim that the tax mix matters.
- Werner Schule (2010) “Potential contribution of fiscal policy to rebalancing and growth in New Zealand”, IMF Working Paper:
 - Revenue-neutral shift in taxes from labour and capital to consumption using IMF’s Global Integrated Monetary and Fiscal Model (GIMF), increases real investment, employment, real exports (via increase in REER) and GDP and corporate and household wealth.

GST confusion

- Base for GST is expenditure - incidence is proportional in terms of expenditure and life-time income (but regressive in terms of current income). Nevertheless, some groups disadvantaged unless compensated.
- NZ GST is broad-based and efficiently designed. TWG recommended retaining broad-base – e.g. removing exemptions for “food” makes almost no difference to the distribution of the tax but loses 20% of GST revenue.
- Raising GST allows more revenue to be raised from non-residents (currently about 5% of private GST revenue), and
- Effective way to tax high income or high wealth individuals.
- Was recommended as part of a package of reforms.