

Budget 2010: Combating Government Waste

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I Background

Tackling Government waste is not easy. The main reason it is difficult is because most Government waste is channelled to special interest groups, which kick up a fuss whenever the legitimacy of their benefits is questioned. For example, when the Government moved to reduce taxpayer subsidies for night classes – many of which taught things like Moroccan cooking and kite making – we heard a lot from the course administrators and some of the students from those classes about how beneficial they thought they were.

Of course, the group that receives Government money will only ever have one complaint: they want more money. Every week my office is showered in mail from special interest groups asking me to help them receive more in Government handouts. Their interest is concentrated – they will be vocal, they will protest, they will write letters to the editor. The cost of Government waste, on the other hand, is spread amongst millions of taxpayers. Therefore, whenever the Government tackles Government waste, it will seem that they are harming many and helping few. The reality, however, is the reverse. They will be taking resources away from concentrated special interest groups and returning them to taxpayers.

The fact that special interest groups will complain does not change the reality that a lot of Government expenditure is wasteful. Most New Zealanders would like their money back. If we are unwilling to root out and cut Government waste, then taxes will remain high. High taxes discourage hard-work, entrepreneurship, and thrift. If the Government continues to be profligate with taxpayer money, then we will slip even further behind the nations which are willing to reduce waste and cut taxes.

Budget 2010 offers a real opportunity to unwind the wasteful expenditure which ballooned under Labour. Cutting this waste also gives us the opportunity to cut taxes, restoring the incentives to work and save. We can set New Zealand up to rapidly expand the size of its economy through private enterprise.

II Government Waste

I have identified and attached as **Appendix One** areas of Government expenditure which are wasteful, unnecessary, or do not return as much value as they cost. I have identified \$3.1 billion of Government waste. I want you to look through this list and seriously consider if it is worth the tax you are forced to pay to fund it. For example, the Ministry of Economic Development advises corporations on how to grow their company through leveraging environmental development. Given that companies care about their bottom lines, we can leave it up to them to figure out how to make profit. Some bureaucrat sitting in Wellington dreaming up ways for companies to increase their profits is not necessary, and nor is it likely to be successful.

Most of the Government waste I have identified dates from Budget 2005 – during the worst period of Labour's spending binge. This suggests that there is likely to be more waste dating from earlier periods that should be pursued. Making reductions to Government spending allows us to reduce taxes. Tax cuts encourage economic growth, and when we finance them by cutting wasteful Government expenditure, we win twice. We win when we end the waste, and then we win again when we productively employ those resources by giving them back to individuals to spend as they choose.

If you look over the list of Government waste, it is abundantly clear that we live in a special interest state, where every special interest group attempts to get their share of the goodies. We have handouts for the racing industry and for corporations, we have massive subsidies for the arts, we pour money into the bureaucracy to sponsor Rockquests and implement “NZ Branding strategies.” Despite the lavish amounts of money dished out to special interests, they never seem content – always requiring more money for “Primary Growth Partnerships” in agriculture, or more money for the Families Commission to undertake a review of the meaning of “family.” New Zealanders, many of whom are struggling to make ends meet, do not get value for money out of the \$2 million a year spent on “International Cultural Development”; or the hundreds of thousands spent on maintaining the capability of the New Zealand Film Archive; or the \$20 million on the New Zealand Screen production incentive fund. This is Government waste, plain and simple, and if we get rid of it, we can cut taxes, leaving people to make their own decisions on how their money is spent.

Targeting Government waste is orthodox economic policy – and the overwhelming number of economists agree that it would pay dividends. Eighty-five percent of economists favour ending subsidies for sport and the arts. Eighty-three percent of economists agree that Government deficits are bad for the economy.¹ New Zealanders can keep pretending that we can expand our economy with high levels of Government expenditure, but it is simply not true. The reality is that the burden of Government is holding back our economic prospects. Hong Kong and Singapore did not go from being desperately poor countries just 60 years ago to having average incomes higher than New Zealand by heavily taxing work. Instead, they did it by restraining the growth in Government and rewarding individual effort and enterprise. We need to do the same.

I have identified more Government expenditure than it is necessary to cut in order to achieve the tax plan outlined below. This gives the National Government options – perhaps they view some of the waste as politically necessary, in which case they can leave it in place and focus on even lower-hanging fruit. A better idea would be to cut taxes further or reduce the level of Government borrowing.

III Tax Changes

The National Government is promising to reduce personal tax rates. With the cuts to Government waste indicated in **Appendix One**, we can heavily reduce taxes. National has indicated that they will increase GST to 15 percent. They have also indicated that they are seriously considering removing depreciation allowances for buildings and depreciation loading on new assets. Although I believe that this is unnecessary, the following plan is based on expected changes. I expect that GST will be increased to 15 percent, that depreciation loading on new assets will be scrapped, and I also expect that the rates of depreciation will be reduced (but not scrapped) for buildings.

Below I outline a tax plan that large cuts in wasteful spending would allow – but the point is that targeting Government waste suddenly leads to a lot of possible tax changes. This is the sort of plan that the National government, if a little more adventurous, could easily achieve.

This tax plan costs approximately \$4.8 billion. It is funded by increasing GST (\$1.9 billion), reducing the rate of depreciation on buildings (\$900 million), removing depreciation loading on new assets (\$300 million), and axing approximately \$3.1 billion in wasteful expenditure. The package also includes, as per National’s promise, compensation to low-income families, with benefit increases to superannuitants, beneficiaries, and those receiving Working for Families (estimated to cost just over \$300 million). The \$3.1 billion of wasteful expenditure is attached as

¹ See Greg Mankiw, Principles of Economics, Chapter 2.

Appendix One.

In summary, then, the equation is as follows:

| Increases/savings in Government Revenue: | | (\$ million) |
|--|----------------------------|--------------|
| | GST to 15% | 1,900 |
| | Reduced depreciation | 900 |
| | No depreciation loading | 300 |
| | Reducing waste | 3,100 |
| | Total | 6,200 |
| | | |
| Cost of Tax Changes: | | |
| | 38% rate to 24% | 1,414 |
| | 33% rate to 24% | 828 |
| | 21% rate to 18% | 1,170 |
| | Company rate to 24% | 1,080 |
| | Compensation to low income | 336 |
| | Total | 4,828 |
| | | |
| | Net position | 1,372 |

As is clear, the Government would actually have almost \$1.4 billion dollars extra to play with in the above scenario. This could be used to further reduce the deficit or to deliver greater tax cuts. The above scenario indicates how much room the Government actually has, so long as it is willing to scrutinise Government expenditure. If it continues to only look at one side of the ledger, then the only tax cuts they deliver will be funded by tax increases elsewhere.

The table below summarises the current structure of tax rates and their thresholds, as well as what I believe a National Government could introduce relatively easily:

| Tax Threshold | Current Tax Rate | Proposed Rate |
|---------------------------|-------------------------|----------------------|
| \$0 - \$14,000 | 12.50% | 12.50% |
| \$14,001 - \$48,000 | 21.00% | 18.00% |
| \$48,001 - \$70,000 | 33.00% | 24.00% |
| \$70,001 – over | 38.00% | 24.00% |
| Corporate income tax rate | 30.00% | 24.00% |
| Trustee income tax rate | 33.00% | 24.00% |

This substantially flattens the tax scale. By reducing the top tax rates significantly, we increase the incentive to work and save. Interest on savings will now be taxed at a much lower level, encouraging investment and economic growth. Income will be taxed at a lower level, encouraging people to remain active in the workforce. As Prime Minister John Key has repeatedly said, he “believes in the power of tax cuts.” If he really believes in the power of tax cuts, then the bigger the better.

Moreover, when tax rates are low, people have little incentive to devise complex tax planning

structures in order to avoid income tax. After all, why bother paying expensive legal or accounting fees when it would be cheaper to declare the income and pay tax on it? Hiding income in trusts and companies will also no longer be profitable, because the tax rates for these structures have also been reduced to 24%.

Some will point out that those with the highest incomes will significantly gain from this tax structure. That is true. However, it should be noted that it is essentially impossible to design a tax cut where the highest earners do not benefit the most. This is because those on the highest incomes pay the most in taxation, and therefore any reduction will return the most to them. When the top 10 percent of income earners pay 70 percent of all income tax, tax cuts will necessarily favour them.

Moreover, viewing tax cuts through this mindset is mistaken. Viewing taxes in a static context completely misses the point of incentives. Generally people start on low incomes, which rise as they gain education, skills and experience. The point of a low flat tax is to incentivise people to acquire valuable skills, and not penalise them for doing so. A low flat tax adds dynamism to an economy. This dynamism is invaluable, and ultimately benefits all members of society.

Moreover, the people who earn the highest incomes are also the most productive members of society. Because incentives matter at the margins, we lose a significant amount of economic growth by taxing those with high incomes so disproportionately. Those skilled workers are the most likely to flee high tax rates and work in countries like Australia, Singapore, or Hong Kong. Taxes on those at the top reduce job growth and investment significantly, meaning that high taxes on the wealthy flow through and affect those on low incomes too. With increasingly mobile labour and capital, the idea that you can tax the rich as much as you want with no bad effects is nonsense.

Presented in **Appendix Two** is a tax table for those with no dependents. To calculate how much better off you would be, find your income on the left column, and follow it along the row. But note, these are just the static benefits. The real point is the incentive it gives people to get ahead from their own efforts.

III Working for Families

Labour's Working for Families scheme is particularly pernicious because of how it alters effective marginal tax rates. Effective marginal tax rates measure the impact of earning an extra dollar on your actual income. It therefore counts not only the tax paid on that dollar, but also the abatement of benefits. Working for Families makes many people feel like they rely on the Government in order to meet their needs – even when many recipients pay far more in tax than they receive in Working for Families benefits.

Working for Families needs to be replaced with a better family tax structure because its high effective marginal tax rates substantially undermine the incentives that people face to work hard to get ahead. Working for Families is destroying the dynamic incentives to seek promotions, to develop skills, and to seek a better job. As with the tax changes above, there are many different ways that the system can be unwound. One is by replacing it with a universal family allowance. Alternatively, you could have a combination of universal allowances and abating payments, in order to target those most in need.

I believe that the best way to begin the process is to replace the payouts with a tax credit. This means that the income people earn essentially goes untaxed until they reach a certain income threshold, at which point they will start being net contributors. No one will be better or worse off from the introduction of a tax credit scheme, but they will be better off as a result of the tax reductions. Moreover, all will be aware of the actual extent to which they are net payers or

recipients. The full details are contained in **Appendix Three**, but the point at which you will start paying tax on your income is indicated below:

| | |
|------------------|----------|
| One Dependent | \$41,600 |
| Two Dependents | \$49,400 |
| Three Dependents | \$57,240 |
| Four Dependents | \$66,000 |
| Five Dependents | \$73,000 |
| Six Dependents | \$81,000 |

Above the tax free income threshold, individuals will pay the new tax rate – that is, 18 or 24 cents. Below the tax free income threshold, they receive a tax credit equal to the difference between their current Working for Families payment less the tax they would pay under the new regime. For those who earn below that amount, they will be credited with income in their pay packets in accordance with the Working for Families formula. For those who earn above it, they will still receive a tax credit, but that will be offset by the tax they pay (as occurs presently). Importantly, the tax credit will reduce the need for administrative staff at the Ministry of Social Development, while also altering in a positive way the incentive to work.

V *What Next*

The ACT Party believes that a lot more is necessary to reverse New Zealand's economic fortunes and end the flight of New Zealand's best and brightest. We should remove tariffs on imported goods – taxes that New Zealanders are forced to pay for purchasing an iPod, an imported carpet, or imported footwear. We would also re-introduce lower minimum wages for youth, to deal with the fact that 39 percent of young Maori who are seeking work cannot find it. It is a tragedy that young people are not legally able to work for \$450 a week, and so instead are forced by the Government to receive \$180 on the unemployment benefit instead. These young people do not develop the skills or the work ethic that most develop during their first job.

To really address the failing health and education sectors, we do not need another Government review or still more tinkering: tinkering has not solved the problem for the last seventy years, and shows no new promise. Instead, we need to inject a substantial private sector element into the health and education sectors to drive performance. We rely on competition and the choice it brings to clothe us, to feed us, and to provide us shelter – it is ridiculous that we rely on central planning to educate our children and keep us healthy. Central planning, even when implemented with the best of intentions, has never worked. Our education and health are far too important to leave to a bureaucrat sitting at his desk in Wellington. Only choice and competition, which both promote human freedom, will allow us access to high quality health and education.

In addition, we should allow young people to opt out of the pyramid scheme that is New Zealand superannuation, as well as the state monopoly welfare schemes. They would face much lower taxes, but they would also be required to insure themselves against health, safety, and welfare risks. They would be required to save for their own retirement. That freedom would encourage many skilled people to move to New Zealand to work, live, and raise a family.

The above plan is a good first step – and a step that a National Government that was willing to do more than tinker would actually implement. If the National Party really believes in the power of tax cuts, then they should prove it. If we root out Government waste, cutting the unnecessary aspects of Government expenditure, then we can return that money to individuals who know how to spend it better. Lower taxes would ensure that all New Zealanders would be encouraged to work,

save, and invest. It would be that atmosphere of incentive which would turn around New Zealand's declining economic prospects, and transform us into a Pacific tiger.