New Zealand Herald 17th May 2007

The budget speech I hope to hear from Dr Cullen

Dr Susan St John
Economics Department
Business School, University of Auckland

Madam Speaker,

The expected cash deficit of $1.5 billion for this year has become a $2 billion cash surplus. In light of the sound fiscal position I am delighted to deliver further on core Labour policy objectives of social inclusion and investment in social capital and set the direction for the next decade of prosperity for all New Zealanders.

Nevertheless ours is a difficult balancing act: we are mindful of the constraints imposed by the external economic environment, our high international indebtedness, high real interest rates, uncomfortable inflationary pressures and a galloping real estate market.

I warned this budget will have some surprises. At this time, the priority is not for a cut in the company tax rate. This would be expensive, and a very indirect, uncertain way to encourage more productive investment. Businesses will benefit much more from higher net wages for employees and the lower interest and exchange rates that will arise from today's budget.

In times past New Zealand was widely regarded as a world leader in tax. Following the recommendations of the 2007 OECD report we will again make tax policy on a consistent basis. There will therefore be no distortionary tax deductions such as for R&D, or tax breaks for KiwiSaver including any already announced. While flat-rate bonuses may be paid from time to time to all KiwiSaver accounts as the economy permits, tax breaks are highly inequitable and costly. They are also completely ineffective in solving our real saving problem, which is a national one not a retirement income one.

To significantly take the pressure off interest rates and the exchange rate we must act decisively to remove serious distortions in the housing market. To allow tax losses on property eventually sold for untaxed capital gain is totally unacceptable. We will follow the thinking of the 2001 McLeod Tax Review and, subject to $1million exemption for owner occupied dwellings, all equity held in residential property will be taxed as if that equity had been placed in an interest bearing account at 4%.

In the past two decades New Zealand experienced the fastest growth in inequality in the OECD. The bottom 50% of the population holds only 5% of the wealth while the top 10% holds 50%. For social cohesion the forces behind these trends must be reversed.

Inflation has been cruel in producing rising average tax rates for low income workers. The first tax bracket has not been adjusted for inflation since it was set in the late 1980s. It is very important that inflation adjustments are carried our regularly as in Australia. The first bracket (15%) will move out to $18,000 and the other brackets will be adjusted for inflation since 2000 as a recent NZIER report has calculated. The cost will be about $1.5 Billion offset by saving from lower tax evasion and avoidance.

As I said last year “the most important contributor to economic growth in a modern economy is human capital”. I am announcing today a very substantial improvement in the funding formula for low decile schools. It is imperative that we build social capital by strengthening schools as the focus of the local community and in turn they will strengthen their local communities. To reduce the impact of poor health on the development of our children we will ensure free medical care for all children including out of hours and dental care.

This government has already achieved substantial redistribution to families in paid work. We expect this to have a significant impact on child poverty, but far too many children have been left behind. Pre-election 2005, we vastly improved the work incentive aspect of Working for Families by raising the threshold before families begin to lose tax credits and reducing the rate of loss for extra income. The complex, expensive ‘In Work Tax Credit’ is therefore not needed as a work incentive and will be abolished. Instead we will add $60 to Family Tax Credits for the first child in all families at a net cost of $400m thereby returning to an important principle of treating all children the same. Twenty dollars for each child aged under 5 will become fully universal at a cost of approximately $100m.

Many aspects of our welfare system were designed for the 1950s and must be rethought for the needs of a modern technological age of flexible labour markets and fluid family relationships. While we have recently rewritten the Social Security Act to enshrine paid work as the only source well-being in society, a consensus is needed about these issues. Today I announce a high profile Royal Commission to design a system that fits the reality of modern life, suitably values unpaid work and offers adequate protection from the new risks of the 21st century. I am hopeful, for example, that we will move to individual entitlement for sickness and invalids benefits. In the meantime, in line with the policy to inflation-adjust tax thresholds, the income that can be earned by beneficiaries before their benefit is cut is increased from $80 to $160 to allow for inflation of the past 20 years.

849 words