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ViewPoint

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Is New Zealand Ready for a Capital Gains Tax

Whether the GDP figures for the June Quarter are a sign that the economy is improving or not may depend upon one's point of view, but the New Zealand economy remains beset by fiscal and monetary policies that appear to be at conflicting settings. Inflationary pressures (international oil prices) have eased in recent months and the volume of exports lifted in the recent quarter, yet inflationary pressure remains. For example the ever-burgeoning government sector spend may still push the Reserve Bank into tightening mode. This would drive up the exchange rate and strangle any hope of an export led improvement in the current account deficit.

While the Government has presented itself as a careful fiscal manager, it is also aware that there is an election to contest in just over two years. The clamour for cuts to the personal and business tax rate has not subsided since the last election. With a large surplus at its disposal, the Government may be inclined to roll out the chequebook and inject money into non-productive sectors of the economy in an effort to win votes – a personal tax cut (where the votes are) is the last thing an economy facing consumption driven inflation needs. Personal tax cuts might deliver that most desirable of political prizes, an election win, but in the long-run, it will drive economic imbalances, exacerbate inflationary pressures further, and create severe difficulties for those in the export sector. Particularly those dependent on elaborate transformation off the back of an overvalued and volatile New Zealand dollar. Productive earnings have not kept pace with property prices, inflation or interest rates. General tax cuts will not redress this trend and will only reduce the fiscal surplus and continue to fuel consumer borrowing and spending. A government intent on leadership and re-election needs to consider what options might encourage a more productive economy.

One option is the introduction of a capital gains tax (CGT) on the non-productive sectors of the economy, for example, investment property. Discussion of CGT is a near death experience in New Zealand politics. It is an understatement to say it would be unpopular, but leadership is like that. Those advocating such a tax, see it creating a better balance in the economy whereby the Government collects some revenue from the non-tradable sectors, and in doing so, offers support to the external sector, building a more productive economy and, over time, improving living standards and reducing the external deficit. It is worth noting that our major trading partners all have CGT.

We have seen the use of interest rates to curb inflationary pressure driven by domestic consumption fail. We have seen the export sector clubbed to its knees by the impact of interest rate differentials overvaluing our exchange rate. The blow out in the trade deficit and inflation stands as testament to this policy failure.

A more direct lever on the domestic consumption is the rate of GST. A variable 'variable GST' or a 'two-tier GST system', with an upper tier in control of the Reserve Bank and focused on controlling non-tradable sector inflation pressures may be a better answer. A 'two-tier GST' system would enable the Reserve Bank direct access to the domestic consumer, on investment property and consumer spending, on say electrical goods. Investment property purchases can legitimately be seen as providing a service, that is, of facilitating asset based revenue, the same as many other assets in businesses that are subject to GST.

Family homes would be exempt from both CGT and any variable GST element. Balancing reductions in revenue collected on income and profits tax balance the national accounts, an interesting side effect would be that inflation resisting revenues would accrue to Government replacing the inflation driving revenues accruing to the lending and financial institutions,

Using a broader taxation approach would remove direct pressure from interest rates with that better balance volatile currency fluctuations would no longer pressure the tradable sector. We would stop biting the hand that in the end must feed us.

Under this scenario, the Government would control the base rate of GST. Having factored this into its inflation control calculations, the Reserve Bank would have the authority to determine a marginal rate above this and potentially where it might be applied or removed in its efforts to manage inflation.

New Zealand's economic recovery will occur once its exporting sectors are strong and this requires a cohesive policy balance. CGT and variable rate GST approaches need serious consideration. Under the effects of mismatched policy and interest rate based inflation controls in place at the moment it approaches madness to try and build an export business from New Zealand. Competing against imports locally is more difficult as exchange rates erode competitiveness. The death of the trading sector is in prospect and with it the collapse of our living standards.

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