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Welcome from Professor Norman Gemmell and Dr Nazila Alinaghi

Welcome to the May/June 2020 CPF Newsletter. The coronavirus crisis has enforced a number of changes in the work of the CPF in recent months, not least the closure of Statistics New Zealand's IDI DataLabs, and the requirement to work from home. This has curtailed lab work on our 'Measuring income inequality and mobility' project, but has also allowed us to complete and progress a number of other projects.

Some highlights in this Newsletter edition are:

- Completion of two working papers reporting on estimates of the elasticity of taxable income (ETI) in New Zealand for personal taxpayers based on 'bunching' of taxpayers at the two main 'kinks' in the tax schedule at $48,000 and $70,000.
- The first ETI estimates for couple households that explicitly allow for income sharing. As might be expected, but has remained untested till now, individual taxpayers who have a partner display a greater degree of bunching around the two main tax kinks, capturing their greater incentive, and willingness, to adjust their behaviour to reduce tax liabilities.
- Commentary on the recent 2020 Budget from an economic and public financial management perspective by Professors Norman Gemmell and Ian Ball respectively.
- A new working paper from Norman documenting evidence of tax sheltering in New Zealand and how it changed in response to two major tax reforms.
- Lots of 'covid economics' from around the world, much of it from a public finance perspective, as economists rush to measure and analyse the fiscal stimulus and public debt consequences of the crisis.
- The New Zealand Productivity Commission has set up a 'Pandemic Economics blog' and released an issues paper, 'New Zealand Firms: reaching for the frontier'.

- Treasury are providing weekly updates available on their website and making some weekly and monthly data available quickly.

We also provide a short bio, and belated congratulations, to Phil Whittington, appointed to Inland Revenue's Chief Economist role permanently late last year.

Finally, CPF events have inevitably been curtailed so far this year due to Covid-19 restrictions. But we provide some pointers below to recent webinars, and hope to have our first 2020 Public Economics Research Day soon, now that we have moved to Covid Alert Level 2, and perhaps soon at Level 1. Details will be emailed out soon.

Hopefully, like us, you are now enjoying the greater freedoms that Level 2 brings, and looking forward to more professional face-to-face contact that doesn't rely on Wi-Fi quality! Technology to facilitate remote working and engagement has certainly improved enormously during this pandemic crisis, but also seems to have some way to go.

Norman Gemmell and Nazila Alinaghi

Media Articles

Recent featured media articles are as follows:

Budget 2020: Emperor Robertson's New Clothes

By Norman Gemmell

The popular phrase 'the Emperor has no clothes' comes from Hans Christian Anderson's moral tale for children in which, as a crowd of on-lookers deferentially applaud the naïve Emperor in his new invisible clothes, a young child is the only one to call out the Emperor's true sartorial state.

Strangely, with an election happening in just four months, hardly anyone in the media (and certainly not in government) seems to be calling out last week's Budget as an 'Election Budget'. After all, we're in the midst of a health pandemic and unique economic crisis when surely everyone agrees that a large increase in Budget spending is called for? Indeed most economists, myself included, have been broadly supportive of the government's Covid-19 fiscal responses so far and calling for more in the Budget.

Budget 2020 may not be the proverbial pre-election 'lolly-scramble' so often on journalists lips at this time in an election year. But pre-election sweetener it surely is. A canny Emperor knows exactly what 'invisible' electioneering clothes he's wearing.

How so?

If this is a recovery budget, how much extra spending is required? $30 billion? $50 billion? … These are huge numbers: Total core Crown spending in 2019 was only around $90 billion. But no-one knows right now how much spending is required to cushion New Zealanders through the coming recession.

And that's my point – for once almost any big number can be presented as necessary for recovery at this stage before the recession bites. So why not make sure that the government taps into all the pre-election benefits associated with maximum apparent generosity now?

There are, however, some clues to this excess generosity hidden beyond the budget headlines.

Here's one way of looking at it. The Treasury's Budget forecasts show $62.1 billion of extra Covid-related government spending. They also forecast the loss in GDP expected as a result of the Covid downturn with, and without, the extra Covid spending. For the next two years (2020-21) the total GDP loss is $13 billion (with full Covid measures) and $18 billion (without full Covid measures) compared to GDP in 2019. That's an awful lot of extra spending to save $5 billion in GDP. Plus, by 2022 Treasury predicts GDP much higher (by 12%) than in 2019, even with no Covid-related spending.

Or look at it another way – Treasury estimates that the $62.1 billion Covid spending will save 140,000 jobs. That's nearly $450,000 per job saved for two years! Sounds like an expensive trade-off.

Before the Budget I called for a stimulating, but prudent, budget. That meant:

- moving away from universal, to more targeted, wage subsidies
- setting up flexible spending programmes now that respond to needs as they arise
- reprioritising spending away from short- and longer-term 'nice to haves' to essential recovery support
- presenting a credible future debt track beyond the immediate recovery.

What did the Budget deliver? Arguably none of the four.

Firstly, another two months of universal wage subsidies with slightly stricter conditions (a bigger fall in business revenue) doesn't make them 'targeted'. This is despite projections that the economy is already getting back to 80% or more of normal working with a few sectors likely to continue suffering. And when we're two months closer to that election the $20+ billions of 'unallocated' Recovery Fund' can be strategically dropped into the election battle as further subsidy extensions and other vote-targeting sweeteners.

Secondly, there's 'flexibility'. Surely a $50 billion Recovery Fund with much of it as yet unallocated is exactly that? Not when there are no 'quick response' schemes being put in place now to deliver it. I suspect that, contrary to Simon Bridge's assertion ("Grant Robertson doesn't even know today how he will spend it all"), the Finance Minister knows very well how he'll spend it – wherever media-sensitive groups 'need our support' between now and September.

Thirdly – what of 'reprioritising' spending? There is negligible evidence of the Minster's pre-Budget promise that some spending would be 'put on ice'. On the contrary, almost every spending 'vote' (or should that be ‘special interest group’?) gets a boost over 2020-24 including making sure that future inflationary costs are covered. Sweeteners everywhere, from arts and culture to conservation to $75 million for MSD’s office re-fit programme. No fiscal constraints here, no public sector pay restraint or postponing ‘nice to have’ project for a year of two.

Do we really need those new Inter-Islander ferries right now when we have massive, more urgent spending needs? And an extra $1.6 billion for ‘re-training’ and apprenticeships. How many Air New Zealand flight attendants or Queenstown tour guides does he think are up for retraining to move onto farms?

Why are we paying $3 billion (up from $0.4 billion ‘prescribed by formula’) to the NZ Super Fund in 2021-22 to pre-fund future pension spending, while we also borrow massively to fund today’s crisis? Answer: Labour in opposition criticised the National government for precisely this after the GFC. It dare not be seen now to be doing the same, even though suspending payment makes more financial sense!

So, there is recovery spending, and there is wasteful spending – I fear there is rather too much of the latter in this Budget. Of course, any funds unallocated from the $50 billion come September 20th provide a convenient nest-egg to buy agreement in coalition negotiations while maintaining the fiction that no ‘extra’ spending commitments have been made.

Fourthly – perhaps the biggest give-away of this Budget’s imprudence is hidden away in the Fiscal Strategy Report (FSR). This shows projections to 2034 in the government’s indebtedness and ‘net worth’ (a more comprehensive measure of the financial sustainability of the Crown’s activities: its total assets minus liabilities), based on the fiscal consequences of this years’ budgetary choices.

From a healthy Crown net worth of 43% of GDP at the time of last year’s Budget, this FSR forecasts net worth at 34% in 2020. Fair enough – we are coping with extra crisis spending and lower revenues. But, following the Budget, Crown net worth is projected to drop to just 9% of GDP by 2024 and only get back to 12% by 2030. In other words, a decade from now, during which time another serious crisis could easily have hit us, the government’s plans for net worth are so diminished that we would be woefully unprepared financially for another fiscal bail-out of the economy.

Let’s be clear. New Zealand economists are not calling for future ‘austerity’ to get the government’s books back into balance within a few years. Instead, there is widespread support for suitable, not profligate, spending to assist faster growth of the economy to reduce the debt burden to previous levels over, say, a decade or more.

But the Crown’s projected financial vulnerability a decade on reflects Minister Robertson’s failure to offer any credible plan to raise net worth through fiscal prudence down the line. This is despite official forecasts of quick economic improvement: real GDP growth is forecast to be massively positive at 8.6% in 2022, and 4.6% in 2023.

‘Recovery’ is, of course, a much better slogan for a pre-election Budget than ‘sustainable public finances’, and what political opponent is going to fight an election claiming ‘the government is helping recovery too much’?

So, the Emperor’s clothes may indeed be invisible and it seems the crowd is still applauding. Both he and the Empress will be hoping that continues to September 19th. If Mr Robertson wasn’t so nice (not to mention politically savvy), he might be tempted to paraphrase the previous Labour

Finance Minister's arrogant taunt at a National opposition: "We will win, you will lose, eat that"!

This article was originally published on **Newsroom**.

Budget Must Plan to Restore Its Buffer

By Ian Ball

Going into the global financial crisis in 2007-2008, the New Zealand government had a very strong balance sheet. Its net worth was equivalent to approximately 55 percent of gross domestic product (GDP). Following the crisis, and then the Canterbury earthquakes, net worth dropped substantially, to under 30 percent of GDP.

The Public Finance Act 1989 (PFA) requires the Government to "pursue its policy objectives in accordance with the … principles of responsible fiscal management". One of the principles is "achieving and maintaining levels of total net worth that provide a buffer against factors that may impact adversely on total net worth in the future".

Net worth, the difference between total assets and total liabilities, is a more comprehensive and realistic measure of fiscal position than debt, because debt takes no account of either non-debt liabilities, such as those of ACC, or of assets – debt ignores the asset side of the Government's balance sheet altogether. In fact, debt represents only 20 percent of the total assets and liabilities the Government must manage.

Since 2008, governments clearly complied with this legislative requirement to build a net worth buffer. After only four years of decline, a very short period by international standards, the Government's net worth resumed its upward path, reaching just under 50 percent of GDP by 2019.

And then Covid-19 struck. Finance Minister Grant Robertson attributed the Government's ability to "go early, go hard" to, among other things, the Government's strong balance sheet. Prior to this week's Budget, the Government has already committed very large sums both to fighting the virus and to providing economic support to individuals and companies adversely affected. It is likely there will be more measures in the Budget.

At the time of writing, it appears Covid-19 has been eliminated and the buffer has served its purpose. But the economic pain is not over for citizens, for businesses and for the Government's balance sheet.

So what am I looking for in the Budget?

Clearly, measures to continue containing the pandemic and restore the economy will need to be financed. But, even though the impact of Covid-19 will take some years to dissipate, I will still be looking for evidence the Government plans to restore the buffer net worth provides.

There are a number of reasons for this.

First, and most obviously, this will not be the last serious economic shock the country will face, and we will be better placed to deal with future shocks if the Government's balance sheet is strong. In both the current crisis and the global financial crisis, the value of the buffer has been demonstrated. So, with a number of crises just waiting in the wings, we need to rebuild that buffer.

Second, if we care about intergenerational equity, as the current Government explicitly does, then restoring net worth reduces the burden being passed to future generations. The Treasury's estimates of the net worth impact of an ageing population already tell us maintaining the buffer will be a huge challenge, so we should not make that situation worse.

Third, recent work by the International Monetary Fund (IMF) points to a number of advantages that accrue to governments with strong net worth positions – they have lower interest expenses, lower yields on their debt and greater fiscal flexibility. The IMF also finds these countries are more resilient to economic downturns and grow, on average, three times faster following a recession. This is a good place to be.

Finally, in its own Budget Responsibility Rules, the Government does not mention this legislatively required buffer, which calls into question its commitment to maintaining a strong balance sheet.

Very few governments globally have balance sheets as strong as New Zealand's. In the current crisis, that strength is a real advantage. So where will I look to see if the Government plans to maintain that advantage?

The Budget contains a section on the Government's fiscal strategy, which outlines long-term intentions (a minimum of 10 years) for total net worth, as well as for a number of other factors. Also included in the Budget papers is the Budget Economic and Fiscal Update, which includes forecast financial statements through until the 2024 financial year.

Between the long-term projections and the forecast financial statements, we should get a clear view of the timeframe over which the buffer will be restored. As a reference point, last year's Budget projected net worth would stabilise around 47 percent of GDP by 2026.

With the significant uncertainties of the present situation, there are real difficulties in producing forecast financial statements and long-term projections. We know things will not turn out exactly as forecast. Nevertheless, these documents provide us with the clearest picture of how quickly the net worth buffer will be restored, the shock of future crises mitigated, and the wellbeing of future generations protected.

This article was originally published on **Newsroom**.

Monetary Policy and Deficit Financing

Follow the link below to an interesting, and perhaps controversial, interview on ‘interest.co.nz’ with Reserve Bank Governor, Adrian Orr, in which he addresses questions over how Reserve Bank monetary policy, and fiscal stimulus actions by the government, might interact.
Adrian Orr: More QE would be the 'simple' way for the Reserve Bank to boost the economy; Going further and getting the Bank to directly finance government initiatives would be ‘achievable’ (**here is the link**).

Back to the Future for Fiscal Policy?

In **a recent piece** published in the Public Finance Focus, Professor Ian Ball argues for greater use of accrual accounting in government to better reflect the state of government assets and liabilities. Ian says:

“Governments are operating off an information set that is partial, easy to manipulate, and in no way adequately reflects the complexity of the financial operations of a modern government.”

New Research

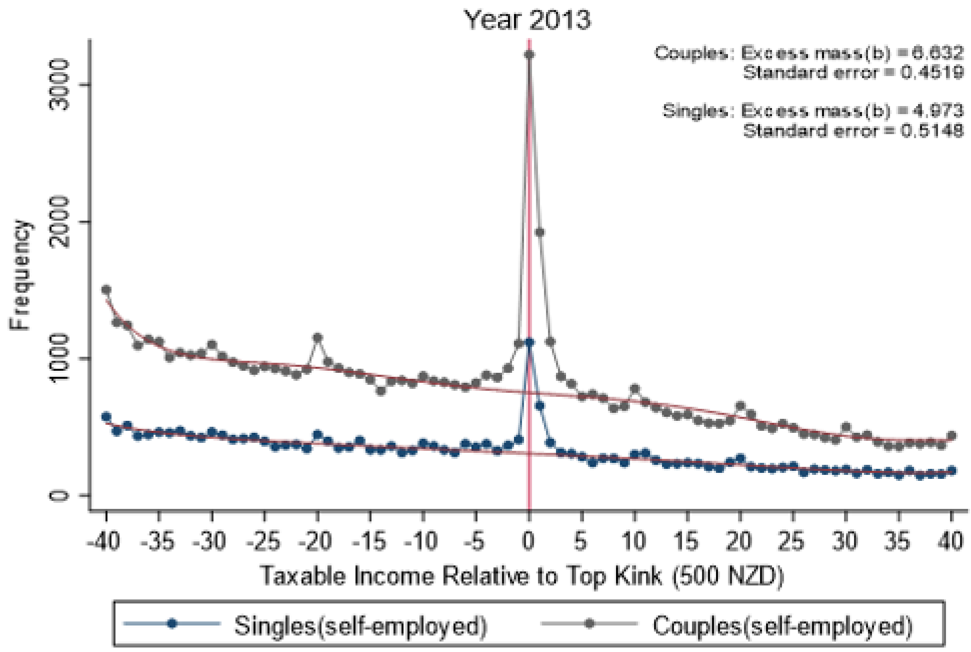
Do Couples Bunch More? Evidence from Partnered and Single Taxpayers in New Zealand

By Nazila Alinaghi, John Creedy and Norman Gemmell

Recent papers hypothesise that estimates of the elasticity of taxable income (ETI) for individuals may be biased where those individuals are taxed separately but are part of a couple family. This study investigates that issue by applying the ‘bunching at tax kinks’ approach to estimate separate ETIs for partnered and single individuals. It shows that there are opportunities for, and constraints on, bunching specific to partnered individuals. Using administrative taxable income data for the New Zealand taxpayer population over the period, 2000 to 2017, individual taxpayers are matched to their partners using population census data. Results provide strong support for the hypotheses that ETIs are larger for individuals in couples than for single individuals, and for couples where both partners are located in the same income tax bracket. Self-employed individuals in couple families reveal especially large ETIs.

The extent of bunching for self-employed taxpayers (single and coupled individuals) is illustrated in the following chart for 2013, the most recent year where census family relationship data yield an exact match with taxpayer data for the same year. The main feature is that bunching is relatively larger by couples compared to singles (it is also larger for self-employed compared to all taxpayers combined, the figure can be found in the paper). Another feature is that there is some evidence of round-number bunching, discussed by other researchers. That is, there is some evidence of small positive excess mass at ±10 (±$5,000) intervals around the $70,000 top tax kink.

The full working paper can be found **here**.

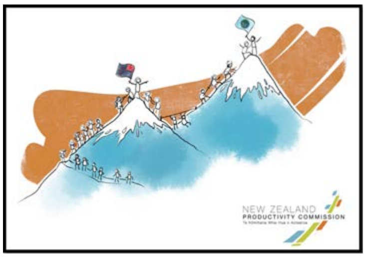


Bunching by Self-employed Taxpayers, 2013

News from Sponsors

Productivity Commission

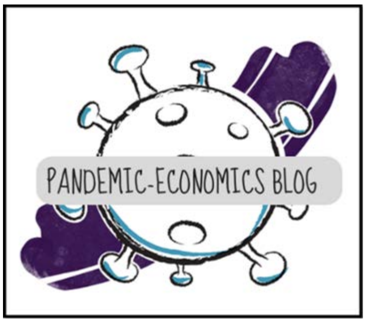
Helping Kiwi firms reach the productivity frontier



New Zealand is facing the prospect of a significant economic shock from the spread of COVID-19. Helping more Kiwi firms reach the productivity frontier would be a valuable step towards the economy reaching its full potential once the immediate effects of COVID-19 have passed.

The Government has asked the Productivity Commission to undertake an inquiry into New Zealand's "frontier firms" (the most productive firms in the economy). The Government wants to know how the economic contribution of these firms can be maximised, through their own performance and the way they diffuse new technologies and business practices to other domestic firms.

The Commission has released an **issues paper** seeking submissions on the New Zealand situation. Submissions will help the Commission identify relevant policies for the Government to help lift productivity. Following the issues paper, a report with the Commission's draft findings and recommendations will be released in November 2020. A final report will be presented to Government in March 2021.



Pandemic-economics blog

The Productivity Commission has started a **Pandemic-economics blog** to share ideas and discuss policy issues to COVID-19. With new posts every few days the Commission is covering everything from **education** to **legislation** and **the future of work**. Authors are writing in an individual capacity. There is no 'house' view. The Commission welcomes comments and guest posts!

The Treasury

Budget 2020

Budget 2020 has been recently released.
Budget-relevant materials can be found both on the **Treasury website** and on the **Budget website**.

Covid-19 economic response

The Treasury is also leading work across the whole of government to support the Government's COVID-19 economic response package. Various documents are available **here**.

Overseas Investment Regime changes

Earlier this month, the government announced changes to strengthen the Overseas Investment regime in response to the COVID-19 pandemic. Relevant documents including a Fact sheet are available **here**.

Reserve Bank Act Review – Public consultation (3rd round)

The third round of public consultation for phase 2 of the Review of the Reserve Bank of the New Zealand Act is extended for 6 months due mainly to the challenges COVID-19 caused. The new deadline for submission is now 23rd October 2020. Read more **here**.

Ministry of Education

Who exercises school choice? An analysis of out-of-zone students

Andrew Weber, Chief Economist at the Ministry of Education has recently authored **a study of families' school choices in New Zealand** using administrative data.

Among key findings, he reports: *"Students who attend out-of-zone schools are substantially more advantaged than their peers in the same neighbourhoods who attend the local in-zone school, on most dimensions we examine", and "the effect of school choice appears to be to concentrate disadvantage in the schools that students are opting out of, but potentially increase socio-economic diversity in the schools that students are opting into."*

People news

Phil Whittington: Chief Economist, Inland Revenue

Phil graduated Victoria University with a double major Bachelor of Arts in Economics and English, and a law degree in 2007.

He started his career as a tax lawyer working for Inland Revenue, but moved to the Treasury tax team after 3 years. There he concentrated much more on economics as compared with law, and found that he enjoyed it much more.

While at the Treasury he completed the three Chartered Financial Advisor exams, which he says he found very useful and significantly improved his statistical, mathematical, and financial economics knowledge.

After two years in the Treasury tax team and moving around a few other teams in Treasury (Housing, Macro) he moved into a Senior Policy Advisor role in the Policy and Strategy unit back at Inland Revenue in 2016. In common with various other officials, Phil spent almost all of 2018 working as part of the secretariat to the Tax Working Group.

Phil became acting Chief Economist last year and was appointed to the permanent role in November of 2019. He comments that 'having a solid background in tax law has definitely been a strong complement to economics, and does let me delve into the detail of tricky policy issues'.

As Chief Economist Phil manages the economics and stewardship team in Policy and Strategy. There are seven members of the team with a variety of backgrounds but all have a solid grounding in economics. As one might expect, the last few months have been focused solely on COVID-19 and the tax system's response to the crisis.

When he is not working, Phil likes to spend time with his wife and two young children, go out for a run or go to the gym.

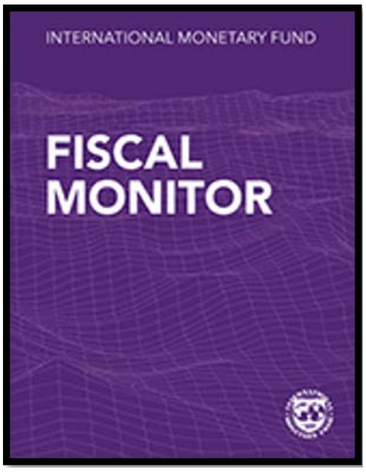
Public Finance News from Overseas

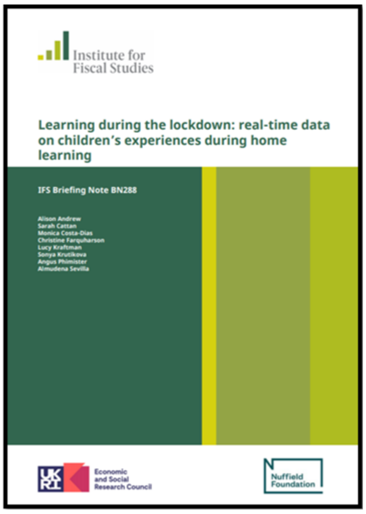
OECD: Taxes and Fiscal Policy in Response to the Coronavirus Crisis

This report from the OECD discusses how tax and fiscal policy can cushion the impact of continued containment and mitigation policies and subsequently support economic recovery. It outlines the major policy reforms that they suggest will be required to prepare for restoration of public finances.

IMF: Fiscal Monitor

The latest **Fiscal Monitor** aims to help policy makers choose how to invest for the future in a fiscally prudent way, adopt well-planned discretionary policies to stimulate demand, and enhance social safety nets and unemployment benefits.





Institute for Fiscal Studies

The IFS in London offers numerous contributions on the UK's fiscal responses to the coronavirus pandemic. This includes a **Briefing Note** on educational impacts via home learning.

Other Media and Commentary

Harvard's Economic Tracker: real time data to address real time problems

From the Opportunity Insights team at Harvard University. An interactive **tool** that uses real time data to measure the depth of the economic downturn and give evidence of any recovery was launched by Opportunity Insights. By providing valuable information on the state of the economy in different regions of the U.S., this tool will help policymakers to make evidence-based decisions. Full paper by Raj Chetty and colleagues is available **here**.

Fiscal Policies for the Recovery from COVID-19

The IMF Blog recently published a piece on how improved social safety nets and broad-based fiscal support can lead to a strong economic recovery that benefits everyone in the society. To read more visit **here**.

Wellbeing Amid Lockdown

Experts in wellbeing from 11 countries were asked about people's experience of lockdowns. **Key responses** are summarized by Arthur Grimes.

Wellbeing: When to End Lockdown

LSE experts from the Centre for Economic Performance released a wellbeing **framework** to determine when to release the COVID-19 lockdown in the UK.

Events

Forthcoming events

CPF Public Economics Research Day – June 2020

Provided we can run a research day within Covid-19 restrictions, we aim to hold one in late June at Rutherford House. Keep an eye on your email inbox for an invite. Please email **Anna Burnett** if you would like to be added to our invite list.

Past Events

With on-site events set to remain on hold for some time yet in many countries, organisations have been looking at new ways of connection such as virtual conferences and webinars. Here are a few interesting webinars.

The **Royal Economic Society** has launched a series of webinars focusing on the economic issue and policy solutions to the COVID-19 Crisis.

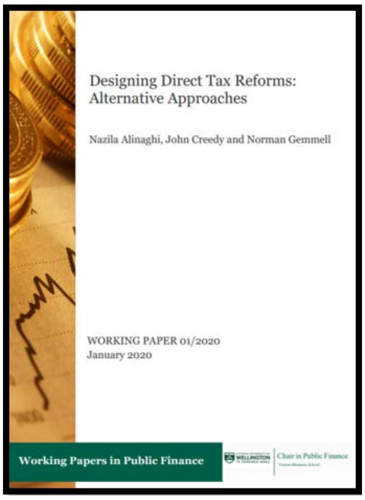
Here is a webinar on **"Inequalities and the COVID-19 Crisis"**.
Chair: Rachel Griffith
Speakers: Angus Deaton & Richard Blundell

The **Economic and Social Research institute** has also provided a series of webinars.

Here is a webinar on **"The Effect of the COVID-19 Pandemic on Consumption and Indirect Taxes in Ireland"**. A corresponding paper is also available **here**.

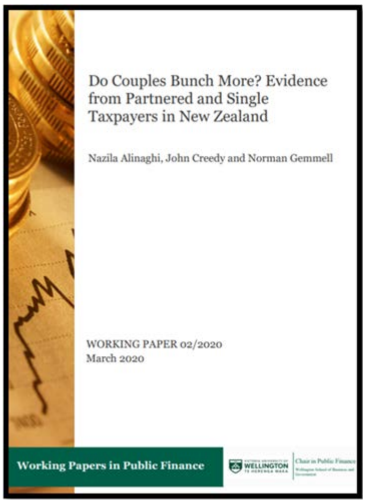
Recent working papers

Links to recent research and working papers from the chair in Public Finance.



A working paper by Alinaghi, Creedy and Gemmell discusses alternative approaches to design tax policy reforms.

Download this paper



A working paper by Alinaghi, Creedy and Gemmell examines whether behavioural responses to taxation are different for partnered and single individuals.

Download this paper

A working paper by Gemmell examines two New Zealand tax reform episodes (in 2000 and 2010) to investigate evidence of tax sheltering.

Download this paper

Recent published papers

Buckle, R. A. (2019) New Zealand's thirty-year experience with inflation targeting: the origins, evolution and impact of a monetary policy innovation. History of Economics Review, 73, 47-84.

Buckle, R.A., Creedy, J. and Gemmell, N. (2020) Is external research assessment associated with convergence or divergence of research quality across universities and disciplines? Applied Economics. Available at **https://doi.org/10.1080/00036846.2020.1725235**.

Cabral, A., Gemmell, N. and Alinaghi, N. (2020) Are survey-based self-employment income under-reporting estimates biased? New evidence from matched register and survey data. International Tax and Public Finance. Available at **https://link.springer.com/article/10.1007/s10797-020-09611-8**.

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