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Editorial

Welcome to the spring issue of the New Zealand Public Finance newsletter. The last quarter has been very exciting for us here at the Chair in Public Finance.

From 1 October 2015, the New Zealand Productivity Commission has come on board as a co-sponsor of the Chair in Public Finance at Victoria University of Wellington. One of the key projects that the Chair will be working on alongside the New Zealand Productivity Commission, and Treasury, is an investigation into the determinants of productivity growth in the public sector.



We have a brief report from the New Zealand Productivity Commission on their recent inquiry *More Effective Social Services* on [page 3](#).

Norman also had the pleasure of spending some time researching in the UK, meeting with, and presenting to, various organisations and conferences – including the IIPF Annual congress in Dublin (read about it on [page 10](#)). More recently, he was invited to attend the presentations by the finalists of the [2015 Tax Policy Competition](#) held by the [Tax Policy Scholarships](#) Charitable Trust. It was a fun night, highlighting a number of really innovative ideas from the finalists. Jeremy Beckham proposed a [schedular tax base to promote savings and growth](#); Matthew Griffin presented [GST on imports using software and behavioural economics](#); Peter North discussed his [different approach to the treatment of houses under a capital gains tax](#). Special congratulations to Caleb McConnell, who was judged the winner of the competition with his proposal for the [purchase and sale of company tax losses](#). We are sure we will see more of these bright young minds in the future.

This issue also features a report from David Snell at EY on their recently released imputation study on [page 15](#), a profile on Lilla Csorgo, Chief Economist of the Competition branch at the Commerce Commission ([page 8](#)) and a discussion on retirement income from one of our research associates, Alison O’Connell ([page 11](#)).

There are also lots more exciting events coming up (see [page 18](#)). If you are local, make sure to catch the [GEN Conference](#) on 30 November, with two key themes: emerging issues that economists in the public sector should be aware of, and the key skills that economists will need over the next 5 years. Register by 23 October to take advantage of the early bird rate.

Finally, this week’s big economics news is the announcement from Sweden of the award of the 2015 Nobel prize in economics to Angus Deaton, professor at Princeton University “for his analysis of consumption, poverty and welfare”.

Libby Wight
Editor, NZPF Newsletter

Norman Gemmell
Chair in Public Finance, VUW

New Zealand Public Finance (NZPF) www.nzpublicfinance.com is an apolitical website dedicated to promoting research and informed policy debate on public finance issues in New Zealand. The NZPF Newsletter is an extension of the website promoting recent public finance research, news and events. To contribute to the website or the newsletter, please contact the [editor](#)

Feature

Pooled budgets come with strings attached

James Soligo and Dave Heatley, New Zealand Productivity Commission

Central government spends about \$34 billion a year on health, education and other social services. Most of this spending is on services provided directly by Crown entities, such as schools, universities and District Health Boards (DHBs). Government agencies use the rest to provide services directly or to pay non-government providers for supplying services. For example, the Ministry of Social Development had around 3,700 social services contracts with some 2,155 providers in 2014/15.

The Government asked the Productivity Commission in June 2014 to investigate how better outcomes can be achieved from the services it purchases. The investigation was to focus on improving commissioning and purchasing and on the institutional arrangement that would support such improvements.

The Commission published its final inquiry report in September 2015. The report describes a system attempting to meet very diverse needs within a wide range of social and cultural circumstances. But the system suffers from an overly one-size-fits-all design and uses a narrow set of commissioning tools. The result is a fragmented system that works well for the majority of New Zealanders, but badly lets down the most disadvantaged.

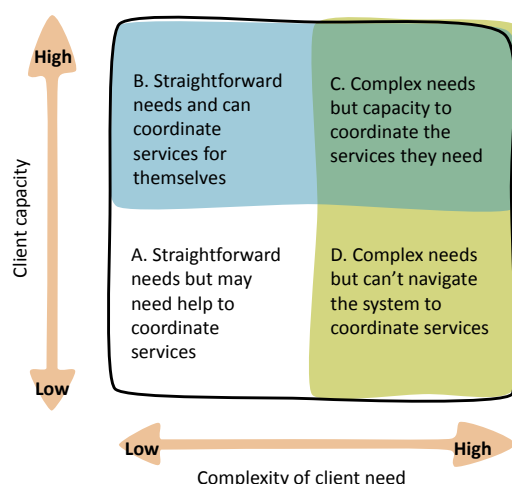
Different needs, one system

Broadly speaking, people's needs occur on a spectrum – from relatively straightforward to highly complex. People with complex needs often require services from multiple government agencies, and their needs are often interrelated so that addressing one problem in isolation will have little lasting impact on the person's wellbeing. For example, a person may have mental health problems alongside alcohol dependence and unemployment. Finding the person a job without addressing the alcohol or mental health issues is likely to result in a quick return to unemployment.

People also differ in their capacity to access and sequence the services they require. For example, some people may have natural supports that help them work their way through the system. Others may not. Figure 1 segments service users according to the complexity of their needs and their capacity to extract the services they need from the system.



Figure 1. Characteristics of clients of the social services system



The system works relatively well for people in quadrants A and B – the majority of New Zealanders. But it struggles to help those with complex needs; particularly those that find it difficult navigate the system (quadrant D).

It is in quadrant D that the Commission believes the greatest gains from reform are possible. Yet, to assist those people requires an understanding of why the system struggles to deal with complexity.

Struggling with complexity

New Zealand's political system is one of the most open, transparent and accountable in the world. The Constitution Act 1986 makes it unlawful for the Crown to spend any public money unless the expenditure is authorised by an Act of Parliament (s 22).

Other Acts contain further accountability provisions. The Public Finance Act 1989 provides the legislative framework for parliamentary scrutiny of government spending. The State Sector Act 1988 devolves responsibility to departmental chief executives for running their departments and for managing the resources allocated to those departments. And the Public Audit Act 2001 established the Controller and Auditor-General to provide independent assurance that public sector organisations are operating and accounting for their performance, in line with Parliament's intentions. These Acts set up strong vertical budgeting and accountability arrangements.

In addition to the responsibilities specified in legislation, officials must follow Cabinet directives and government rules. For example, the Government Rules of Sourcing set out standards for procurement planning, approaching the market and contracting. These rules inform departmental operating processes and accountability structures.

Clearly, transparent and accountable government has economic and social benefits – such as reducing corruption and acting as a check on the use of the State's coercive powers. Yet current arrangements for promoting accountability create side effects for the delivery of social services to people with complex needs.

First, New Zealand's budget process fragments expenditure into appropriations that seek separate outcomes – health, housing, education, justice, social development etc. Yet in reality, these outcomes are interdependent for people with complex needs – housing

outcomes can affect health outcomes, health outcomes can affect education outcomes, education outcomes can affect social outcomes and so on.

Second, separate, specialised agencies administer these appropriations. Each agency views a client with complex needs through their own “professional” lens. No one agency has authority, accountability or incentive to view the individual (or their family/whānau) as a whole, and to respond to their needs accordingly. For example, health agencies rarely invest in better housing even though to do so may mean treating fewer people with respiratory problems. Corrections rarely invest in primary education, even though such investments might pay off through smaller prison populations.

Adding to this, Ministers operate in a highly contested and adversarial environment. Government contracts are under persistent scrutiny by groups with an interest in discrediting government policies. The threat of opportunistic scrutiny, coupled with strong vertical lines of accountability and legislation protecting the freedom of information, create powerful incentives for government agencies to use contracting mechanisms that minimise political risk – such as highly specified contracts, contracts of short duration and rigid monitoring of inputs.

Such contracting limits providers’ freedom to tailor services to individual circumstances. It also creates high transaction costs and works against innovation. None of which are conducive to the flexibility, and long-term, innovative thinking, needed to address complex social issues.

The pooling of budgets has proved elusive

Weaknesses in the current system have become more apparent over time, especially as hard-to-solve issues have persisted, despite efforts to tackle them. A commonly suggested solution to the problems created by fragmented budgets has been for the separate specialised agencies to work together better. The Commission found calls for greater cooperation and coordination between government agencies dating back to 1910!

One attractive approach is to combine budgets from multiple agencies into one flexible “pool” that can then be used to achieve outcomes that are broadly consistent with the outcomes sought under the separate appropriations.

Yet effective pooling of funds has been particularly elusive. Pooled budgets typically involve agencies relinquishing administrative control, yet retaining accountability for how funds are spent. This exposes them to risks should the funds be misused or ineffectively spent.

The result is that rather than contribute to the budget of an initiative under the control of another agency, agencies typically create initiatives under their own control. Where the pooling of budgets does occur, such as under the Government’s Enabling Good Lives initiative, the contributing agencies attach “strings” to their contributions. These strings reduce the flexibility in the use of “pooled” funds, often to the extent of undermining their purpose.

A different approach is needed

The Commission believes that to really make a difference for people that fall in quadrant D, it is not enough just to make the current system work better. A new approach is required that puts the needs of people and their families at the centre of decision-making. And puts

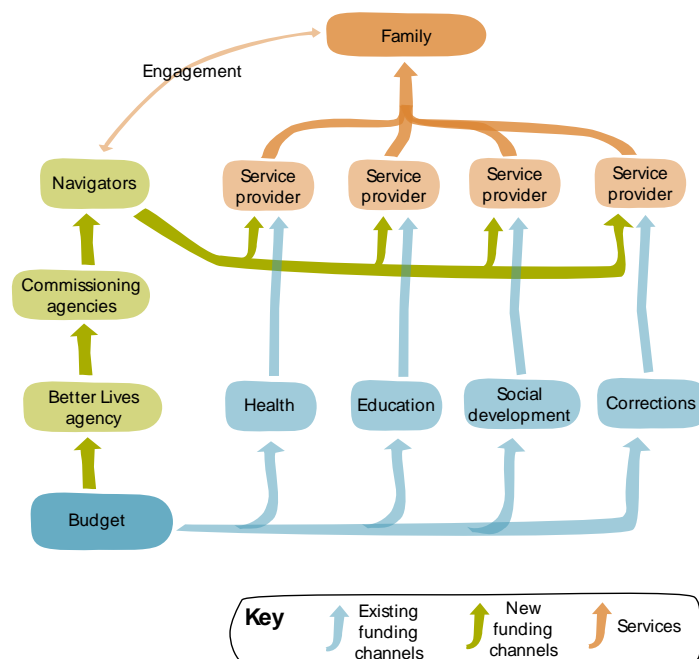
decision rights in the hands of those with the information and relationships needed to tailor a package of services to meet the person’s individual requirements.

The Commission had identified several conditions that need to be fulfilled to deliver an effective, integrated package of services to the most disadvantaged New Zealanders. These conditions include:

- a skilled, client-centred navigator who is close enough culturally and geographically to understand the client’s circumstances and to build a relationship of trust with them;
- clear responsibility of the navigator for achieving outcomes for the client that are agreed by both the client and the commissioner/funder – this will usually require the client to be “enrolled” with the navigator;
- a realistic allocation of funds to the navigator to provide the means and flexibility for an integrated package of services for the client to help them turn their life around;
- information systems and a decision-making framework that allocate funds to where they have the most effect; and
- devolved decision making that gives navigators the freedom to provide or purchase services in the way that will best help clients turn their lives around.

The Commission has developed two models that it believes could fulfil these conditions. One model would set up a “Better Lives” agency with dedicated funding and a mission to improve outcomes for the most disadvantaged New Zealanders. It would make use of devolved commissioning agencies that are closer to the clients. Some would be new organisations, and some could be existing ones (such as some not-for-profits and Whānau Ora commissioning agencies). Figure 2 depicts the Better Lives agency model.

Figure 2. The Better Lives agency model



The other model widens the role of DHBs into District Health and Social Boards (DHSBs). DHSBs would become commissioners of health and social services for the most

disadvantaged New Zealanders (quadrant D) in their districts. For instance, DHSBs could buy services from Primary Health Organisations and through them, GPs.

Both models include navigators who would engage with clients and have control over a budget to buy the services that best suit their clients' needs. They could purchase services from both mainstream agencies and non-government providers.

The Better Lives agency would be an independent Crown entity with its own appropriation. It would sit outside the mainstream agencies and have an outcomes-focused accountability. Improved data networks and analytics would help the agency better target those in need, and understand what's working and what's not. The combination of a single appropriation, a defined target population, and the ability to purchase services would overcome the problems of pooled budgets.

Implementing changes

The Commission is confident its recommendations would achieve a step up in performance of the social services system. The Government would need to take a strong lead to make reform happen and focus on the things that only it can do as system steward. Yet, for reform to succeed, it needs to collaborate with and unlock the potential of the many leaders across the system.

The Commission recommends the establishment of a Ministerial Committee for Social Services Reform to create a reform plan, oversee its implementation and adjust it in light of experience. The Commission also recommends that the Government establish a Transition Office to focus the effort of agencies and to support the Ministerial Committee. An Advisory Board of system participants would provide the Ministerial Committee with independent expert advice on system design and reform progress.

Further information about the [*More effective social services*](#) inquiry and copies of its final report are available at <http://www.productivity.govt.nz/>.

The New Zealand Productivity Commission is an independent Crown Entity that provides advice to the Government on improving productivity, with the aspirational vision of productivity growth for maximum wellbeing for New Zealanders. The commission undertakes inquiries on topics referred by the government, productivity-related research that assists the improvement in productivity over time and promotes understanding of productivity issues.

Public Finance People

Dr Lilla Csorgo

A brief profile of contributors to public finance in New Zealand. This issue we focus on Dr Lilla Csorgo who is the Chief Economist in the Competition Branch of the New Zealand Commerce Commission

My career has been a mix of competition economics in both the public and private sectors. I started off my career at the Canadian equivalent of the Commerce Commission, later returning as a Special Economic adviser to the Canadian Competition Commissioner. I was also the economic member of the Canadian Competition Tribunal, the body that adjudicates the civil provisions of Canadian competition law, and spent years working at an economic consulting company before coming to New Zealand.

This type of varied exposure I think provides great insight to the machinations of the competition process. I remember the very first matter I worked on in the private sector. It was a particularly contentious hostile merge, with the target firm playing the odds, trying to bid up the purchase price. This meant it was, let us say, “flexible” about its views on whether the merger itself would raise competition issues. It was at this juncture that the lawyer we were working for, an older fellow on the verge of retirement, imparted these words of wisdom, “Remember, Lilla, the client always lies.”

While I hardly think this is always, or perhaps even often, the case, it does underscore that competition economics operates in an environment with a lot of self-interested behaviour. I don’t say that in any judgemental way, and very much applaud the entrepreneurial spirit that gives rise to the underlying profit-motive, but it does mean that a competition authority has its work cut out for it.

There is a lot of government interest worldwide in demonstrably establishing the value that a competition authority brings to an economy. The truth is that it is really hard to isolate and measure given that as there is at any time so many other things going on. But I am nonetheless a strong believer in the value of competition law. We only have to look at why that law was developed to understand why.

Canada was the first country with competition law – it is a little known fact that it beat the United States by two years. The history goes back, further, however, to the British Statute of Monopolies, which was an attempt to put an end to the monarchy’s practice of assigning private monopolies to royal favourites. There too the motive was self-interest, with a growing bourgeoisie wanting in on the high profits to be had in products like salt and glass, but the result was lower prices and increased access to these products by all. These types of laws as we



know them today, however, did not really take hold until late 1800s, and even then only in North America. There they were a direct response to the questionable practices of the 'robber barons' – the Rockefellers, the Astors, the Carnagies and the like, people who made their money in oil, real estate, steel, through hard work, good fortune, and price-fixing (among other unscrupulous practices).

The last 25 years or so has been a competition law renaissance: in 1990, less than 20 countries had competition laws; in 2015, more than 125 do.

This is a proud legacy to the work we are doing today and a recognition that there is real risk in not having some constraint on anti-competitive exercises of market power.

To correct a common misconception: this is not about seeking to level the playing field amongst market participants but rather setting the rules for how the game is played.

I came to the Commerce Commission four years ago because I happened to notice an ad in *The Economist* and thought that it might be fun for a while.

The economics are certainly the same, and the laws and the approach to enforcement are fundamentally so, but there are still a lot of devils in the details. As much as I don't want to say this as an economist, being in both the public and private sectors, and working across jurisdictions, has shown me that the process does really matter in terms of the outcome.

In New Zealand, one of the things I very much applaud is the publication of merger determinations and the accessibility of investigation reports. Having a written piece of work subject to public scrutiny engenders a commendable rigour.

One of the things that I personally like about my area of work is that it's good if you don't have a long attention span. Investigations and mergers are generally done within a couple of months and so you are constantly moving from one market to another. I'm always learning new things and it's surprising how interesting certain markets can be.

Those markets can also be surprisingly indicative of the country you are in. In Canada, matters I was involved in included hockey sticks and the National Hockey League. In New Zealand, I have worked on wool scouring and dairy.

Generally my work is focussed on ensuring high quality economic rigour in all of our work, not just investigations. Competition law matters and you want to make sure you enforce it in a way that is economically cogent. We need to recognise conduct which is an outcome of market forces versus that which is anticompetitive. Our role is to understand that difference and to act on it in a way that best benefits New Zealanders.

Dr Lilla Csorgo works at the Commerce Commission, New Zealand as Chief Economist in the Competition Branch. Her previous positions include Vice President at Charles River Associates, Economist Member of the Canadian Competition Tribunal, and Special Economic Advisor to the Canadian Competition Commissioner. She possesses a comprehensive knowledge of the theory and application of industrial organization, including antitrust, damages, and intellectual property. Dr Csorgo has conducted quantitative and qualitative analyses in a wide array of industries, including software, telecommunications, broadcasting, movie exhibition and distribution, retail, banking, and media. She has a PhD in economics from the University of Toronto.

Conference report

International Institute of Public Finance Annual Congress, Dublin, Ireland, 20-23 August 2015

Norman Gemmell

This year's IIPF conference took place in Dublin - a city much lauded for its rapid development during the '90s and 2000s but which seemed, to me at least, a somewhat tired-looking, marginal tourist-attractor. Maybe the GFC has taken its toll on Dublin in recent years, but I suspect it is more than this.

All the more reason, then, to spend time in the conference hall, and this certainly was worthwhile! As usual, keynote speakers were recognised experts and generally worth listening to - Rosanne Altshuler (Rutgers); Ruud de Mooij (IMF); Mihir Desai (Harvard) and Mike Devereux (Oxford).

From a personal point of view it was good to see a number of papers on the subject of measuring elasticities of taxable income – a favourite research topic of mine. An early session on this featured two particularly interesting papers on 'The Polish business "Flat" tax and its effects on reported incomes: a Pareto improving reform?' by Wojciech Kopczuk and 'The elasticity of taxable income and income shifting [in Finland]: what is real and what is not?' by Jarrko Harju and Tuomas Matikka. Conference paper abstracts are available on the [website](#).

Two keynotes in particular delivered interesting reviews of the literature in their areas of expertise.

Firstly, Ruud de Mooij presented on the corporate 'tax bias towards debt in the global economy'. While this might appear less of an issue for New Zealand – where our corporate tax regime arguably avoids this distortion for domestically-owned firms, global developments clearly also have spill-over effects here. De Mooij produced a particularly interesting chart plotting, for a cross-country sample, bank leverage ratios (liabilities/assets) against the 'increased probability of crisis due to debt'. This showed the expected positive relationship – more debt is associated with greater risk of a crisis. Comfortingly (perhaps?) for New Zealand, though our leverage ratio is relatively high, it is associated with a particularly low risk of crises due to debt.

Secondly, Mike Devereux addressed the question: 'is a sustainable tax on international profit feasible?' Anyone familiar with Devereux's work will be aware of his doubts regarding the sustainability of corporate profit taxation due to increasing international mobility of capital and profit-shifting opportunities for multinational firms. But, in a balanced and thought-provoking presentation, he provided a clear exposition of the issues, whilst demonstrating convincingly (to me at least) why the OECD's proposed BEPS (base erosion & profit shifting) solutions are a long way from a first-best approach. Greater recognition of the need to tackle corporate incentives is required if international profit taxation is to remain feasible.

For further information see the [conference website](#), complete with slides from [keynote speakers](#).

Feature

Retirement income: all about annuities?

Alison O'Connell

Retirement is an uncertain phase of life. The risk of not having enough income can loom large for people no longer able or willing to keep earning. Some commentators recommend the Crown should shoulder some of this risk - a suggestion examined by a recent paper from the New Zealand Society of Actuaries (NZSA)¹.

As the "investment approach" is showing its value in welfare policy, and the Crown's balance sheet is getting more attention, here is another example of adding actuarial insight to a public policy issue.

Retirement: what is the problem?

Every developed country is facing up to how people should manage their money in retirement. There will be more than 1 million New Zealanders reaching age 65 over the next twenty years. Already most New Zealanders reaching their 65th birthday can expect to live for at least a further twenty years. People in their twenties can expect to live nearer to thirty years after age 65.

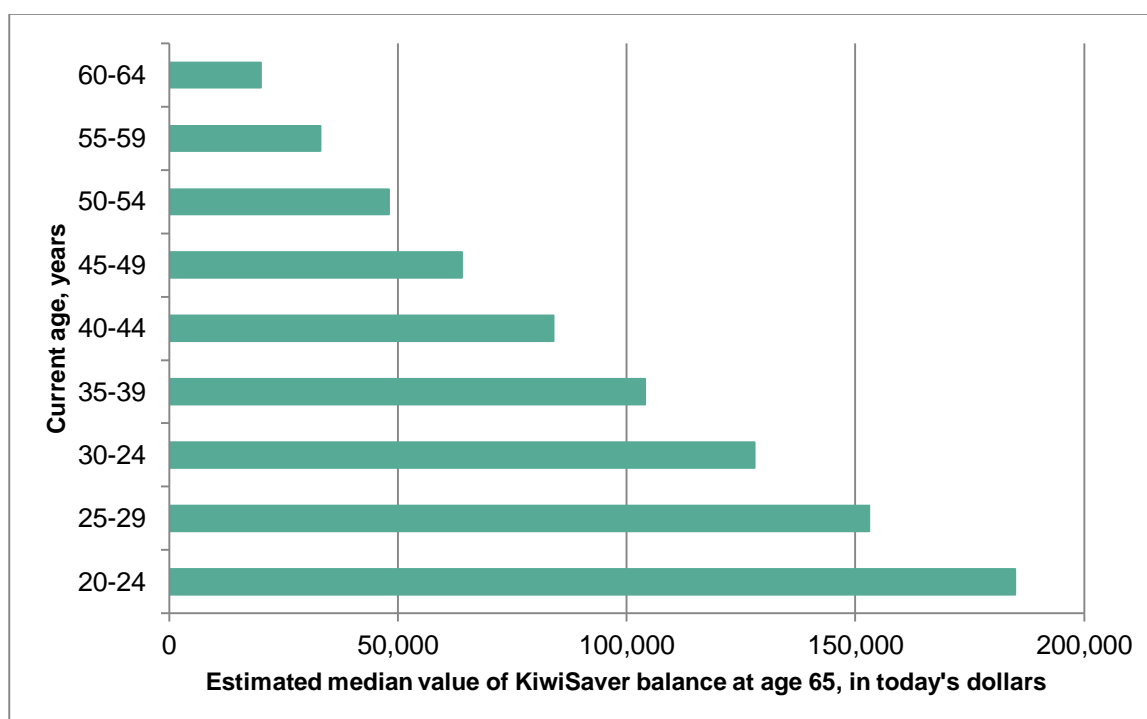
Of course, 65 is not really a useful marker any more. Retirement is diverse, with different work, financial and health experiences. Financial requirements change throughout retirement, critically depending on home ownership, health and activity. People are likely to live longer than they expect. Investment and inflation risks continue. Unexpected costs may arise at any time. The probability of needing long-term care increases with age.

KiwiSaver, introduced in 2007, is changing the retirement landscape. Nearly three-quarters of the population aged 18-65 are KiwiSaver members. KiwiSaver balances are available from age 65. It is estimated that on current savings patterns, about half of the KiwiSaver members reaching age 65 in twenty-five years' time will have a KiwiSaver balance of \$100,000 or more in real terms. The median maturing KiwiSaver balance will be below \$50,000 in today's dollars for those aged 50-54 now, with at least ten years to go before funds can be accessed.

The problem with this situation is often stated as one of New Zealand having no open annuity market. A few previously established funds do offer an annuity-type option. However, KiwiSavers cannot convert their balances into a guaranteed income for life, and so may suffer longevity risk - running out of money before dying.

¹ Alison O'Connell, Catherine Edgar, Christine Ormrod, Daniel Mussett, Janet Shirley, Joe Benbow, Jonathan Eriksen and Mark Channon (2015) *Income Streaming in Retirement: Options for New Zealand*. New Zealand Society of Actuaries. www.actuaries.org.nz.

Figure 1: Estimated distribution of maturing KiwiSaver balances available at age 65, by current age group, in real \$'000²



Will the market provide?

The market is providing products to help the growing numbers of retirees manage their money in later life. More innovation is expected as KiwiSaver balances grow. Currently, most KiwiSaver products have a drawdown option, home equity products are available, and a new provider is said to be close to launching a variable annuity. A variable annuity provides some protection against longevity risk, and may retain some flexibility to withdraw capital, but is not risk-free.

It will be difficult to develop a viable commercial market for lifetime guaranteed annuities at reasonable cost in New Zealand. Even if the Government offered bonds suited to match annuity terms, and made the basis of taxation on annuities similar to that on investment products, annuities would remain relatively poor value for money because the small size of the market implies high risk, marketing and administration costs for insurers which will be passed on to consumers.

Annuity markets exist in many countries, mostly where they are encouraged or supported by tax incentives or policy settings, including means-testing. If the public pension is means-tested then there is a strong public finance driver to encourage or mandate annuitisation. A key defining characteristic here is New Zealand Superannuation (NZS). Nearly all New Zealanders have Crown-guaranteed, non-means-tested lifetime income from NZS, at a more generous level than the public pensions in countries which have annuity markets.

² Projections based on a sample of actual balances. See NZSA paper for more detail.

Should the Crown provide?

Some commentators think that the New Zealand Government should provide annuities, so that everyone could buy one. In setting out the difficulties with the market providing traditional guaranteed annuities at reasonable cost, the NZSA agreed that government provision might be the only way for all New Zealanders to have access to such a product. Indeed, the Government may be the best provider of annuities: no credit risk, no profit loadings or solvency requirements, the greatest economies of scale for cost, the largest risk pool across which to mitigate actuarial risks and some ability to manage inflation risk.

But that does not mean government provision is necessary or desirable. Largely because of NZS, not everyone needs or wants an annuity. The Crown already takes on longevity risk for NZS, the Government Superannuation Fund and the National Provident Fund. Even if using reasonable prices that anticipate longevity risk, the Crown will bear residual risks. The provision of annuities will therefore not be cost-free to the Crown. How equitable to all New Zealanders would be the costs and benefits of the Government providing an annuity to those who would want it?

It is critical to understand who needs, or might want, an annuity. Retirement planners urge us to think in terms of income, not value of investments, in retirement. Adopting the three income tiers recommended by, among others, Robert Merton³, suggests:

- First, secure a minimum guaranteed income. NZS does this.
- Second, generate conservatively flexible income, from a liquid fund which can also be used for unexpected capital calls. This could be achieved by a portfolio of term deposits and savings accounts with some drawdown from a conservatively invested KiwiSaver. This capital would be subject to longevity risk, but the amount of income taken can be trimmed to suit longevity expectations. Benchmarks suggest around \$100,000 would be a minimum amount to hold in this way.
- Third, aim for desired additional income. People with enough assets to reach this tier can invest for higher risk and return and, if concerned about longevity risk, might be interested in using some capital to buy an annuity.

Experience from overseas and from the specific funds with annuity-type options in New Zealand suggests that annuities might be attractive to, roughly, 20 to 40 per cent of people. This is quite consistent with the framework above and the distribution of KiwiSaver balances that could be expected. It means that the need or desire for an annuity on top of NZS would generally be found in a wealthier minority.

This is not to say there is no foreseeable role for Government. The important roles for Government in the short term are two-fold:

- Ensuring the population can anticipate and rely on NZS, health care and long-term care.
- Balancing market innovation with consumer protection: prudential regulators being responsive to new products and conduct regulators designing an advice system for older people looking to decumulate their savings.

³ Robert C. Merton (2014) *The Crisis in Retirement Planning* Harvard Business Review, July-August 2014

Practical solutions

Product needs would be expected to change for an individual during retirement as the potential impacts of - and preferences towards - risks change. The key risks are inflation, investment, credit (security), longevity and its opposite, mortality (dying too young to enjoy savings). People vary in ways which are fundamental to what the appropriate product(s) is for them, and market conditions change. So, it is not possible to give a universal rule, for example, for when an annuity would be better value for money than drawing down income from invested assets.

This means a standard decumulation product is not the answer, but practical and relevant financial "guidance" or a new form of advice will become ever more critical. The NZSA paper suggested two approaches worth developing:

- Simple, approved "rules of thumb" for how much to draw down from savings, suitable for many people with modest KiwiSaver balances.
- A simple form of approved independent financial guidance, available at suitable moments during retirement. Taking the logic of behavioural economics, with the contention that an advice focus is more appropriate than a product solution, perhaps KiwiSavers with significant balances could be auto-enrolled to (and able to opt-out of) a guidance scheme.

A range of experts should be involved in developing rules of thumb and guidance. There are examples emerging around the world but a New Zealand version has to meet our market and policy environment. Actuaries are concerned, in particular, to ensure that individuals are informed about longevity, mortality, credit, inflation and investment risks and uncertainties around costs including medical and long-term care needs.

Dr Alison O'Connell is a Research Associate of New Zealand Public Finance and an actuary, researcher and policy adviser. She writes in a personal capacity. Alison blogs at www.longlifepensions.com/.

Feature

Imputation and the New Zealand dividend psyche: An analysis of corporate and investor attitudes

Andy Archer and David Snell

New Zealand is one of only a few countries to use dividend imputation as a part of its tax system, along with Australia. Both sides of the Tasman also share a high dividend culture.

Introduced in 1988, New Zealand's imputation regime removes double taxation on distributions by attributing to shareholders a credit for the tax borne on profits at the company level. Benefits include a single layer of tax, a reduced cost of capital for local businesses and their investors, and a relatively high rate of domestic corporate tax for the government.

Imputation's effect on corporate and investor behaviour under-researched

Given the apparent significance of imputation in this country, there have been surprisingly few studies examining its effect on corporate and investor behaviour. EY wanted to get behind the raw data to understand first-hand how companies think about imputation when setting their dividend policies. To what extent does imputation influence corporate and investor attitudes and behaviour?

The resulting research presents the findings of in-depth interviews with a cross section of 25 New Zealand corporates and 12 investor groups. It explores the extent to which imputation drives high dividend flows from New Zealand corporates, and it also unearths particular tax induced behaviours.

This study is particularly relevant now because the Australian government is considering whether or not it keeps its imputation system. Change in Australia would inevitably lead to questions being asked here about our own system, since we would be virtually on our own.

New Zealand corporate dividend policies

New Zealand corporates pay out more in dividends than any of our competitor countries, an average of 77 per cent of post-tax income in 2014. Australia follows closely behind but the global norm is only around 40 – 50 per cent. We found that imputation plays a strong hand in New Zealand's dividend psyche.

Participants consistently told us that many of the drivers behind this corporate dividend psyche - capital management, the need to meet pay-out targets, credit rating considerations and cash flow management - are entirely commercial. But those targets are set in the knowledge that New Zealand has an imputation system, and they can only be met once tax is factored in. The message which did come through is that imputation allows directors to act on these drivers. Imputation supports and encourages corporates to return funds to shareholders, whereas other tax systems throw sand in the works.

Strong support for imputation

Both corporates and investors were of the view that dividend imputation is a good system which has served New Zealand well.

We found strong support for imputation from the New Zealand corporate and investor community. Though a number of regime improvements were suggested, there was one constant call for change. Ninety-seven per cent of our sample favoured mutual recognition of New Zealand imputation and Australian franking credits by our two governments to make trans-Tasman investment flows more efficient.

Mutual recognition was always thought to be too expensive for the Australian government to contemplate. However, recent modelling by the [Australia New Zealand Leadership Forum](#) has cast doubt on that issue. Nevertheless, participants remained sceptical around the prospects for reform.

Corporates and investor attitudes did not always match

Our study revealed some gaps in corporate and investor attitudes, most notably in the value of imputation credits and the extent to which imputation underscores a share price premium. But directors generally view an imputed dividend as the optimal dividend strategy regardless of shareholders' utilisation of the tax credit. Imputation credits generate up to a 39 per cent increase in an investor's post-tax return, meaning that fully imputed dividends do carry value. This, however, depends on the tax position of the individual shareholder, and for many shareholders imputation credits carry less value than most directors believe.

Tax induced strategies adopted

We found that because corporates place such a high value on imputation, they apply a number of strategies to increase the available pool of credits.

These include prepaying tax, transfer pricing to pay New Zealand tax, and the use of alternative distribution tools such as special dividends and share buy-backs. Some companies adopted a greater range of behaviours than others.

The most common practice is prepaying tax. Making smaller, short term prepayments to manage the timing of imputation tax credits and dividend pay-outs is common, and sums tend to be in the \$2 million — \$8 million range. At the extreme, a small number of companies (three out of 25) reported pre-paying significant amounts of tax in the tens of millions to feed their imputation pool, thus allowing consistency of imputed dividends.

The second most common strategy reported was transfer-pricing foreign earnings to New Zealand on a pre-tax basis to maximise the proportion of domestic tax paid and consequent imputable credits generated. This approach represents a win-win for both domestic shareholders and for the New Zealand government.

Survey methodology

The study was initiated following our observations over many years of how companies adopted different approaches to the question of delivering shareholder value. We reviewed corporate dividend and imputation research, primarily from Australian sources, but also New Zealand. Supporting data was also sourced from Inland Revenue and the NZX (with thanks to both organisations).

Primary data collection was undertaken during the second half of 2014 and the beginning of 2015, with two groups of informants:

1. Corporates - participants included directors and/or chief financial officers from 25 New Zealand companies, including large NZX-listed enterprises, closely held corporates and co-operatives. The industries represented were utilities, manufacturing, telecommunications, entertainment, building and infrastructure, agriculture, transportation and financial services.
2. Investors – these 12 participants included equity analysts and advisers, and fund managers (as proxies for the investor community).

A survey questionnaire was devised for each of the two groups, utilising open-ended and yes/no questions, and rating scales. Questions explored dividend policies, special distributions, investment advice, investor preferences, the impact of New Zealand's imputation regime on decision-making, the real value of imputation credits, possible regime improvements, and the implications of change.

The survey questionnaire was sent to each participant prior to a face-to-face interview and discussion (typically lasting 60 minutes) with a key EY staff member.

Data was then collated and analysed to show trends within and between groups. All responses were anonymised.

Andy Archer is an EY tax partner and David Snell an EY executive director specialising in tax policy.

Read more about the study at <http://www.ey.com/NZ/en/Services/Tax/ey-imputations-big-play-in-dividend-culture-in-new-zealand>

EY and the Chair in Public Finance will be hosting a seminar discussing the study's finding on 23 November at 4.30pm. More details to follow.

Upcoming Events

27-29 October 2015

[CAPA Seoul 2015](#)

Seoul, Korea

6-7 November 2015

[9th Norwegian-German Seminar on Public Economics](#)

CEifo Group Munich
Munich, Germany

13-14 November 2015

[Symposium on Business and Economics in Times of Crisis 2015](#)

Lisbon, Portugal

23 November 2015

[Effect of trial periods in employment on the hiring behaviour of firms](#)

Te Punaha Seminar – Ministry of Business, Innovation and Employment
Wellington, New Zealand

26-27 November 2015

[Imperative of Economic Growth in the Eurozone: Competitiveness, Capital Flows and Structural Reforms](#)

Faculty of Business and Economics – Mendel University in Brno
Brno, Czech Republic

30 November 2015

[GEN Annual Conference](#)

Wellington, New Zealand

7-8 December 2015

[OFCE - Workshop on Empirical Monetary Economics 2015](#)

Paris, France

17-18 December 2015

[11th International Scientific Conference on Economic and Social Development](#)

Zagreb, Croatia

18-29 January 2016

[Local Economic Development](#)

[The Hague Academy for Local Governance](#)
The Netherlands

16 February 2016

[2016 Texas WPF Annual State-wide Conference](#)

Women in Public Finance
Texas, USA

25-26 April 2016

[Fiscal Equalisation in Europe - 2016 ZEW Public Finance Conference](#)

Centre for European Economic Research
Mannheim, Germany

13-15 June 2016

[ZEW/NBER Trans-Atlantic Public Economics Seminar](#)

National Bureau of Economic Research (NBER) and the Centre for European Economic Research (ZEW)
Mannheim, Germany

11-13 July 2016

[PET 16 Rio](#)

Association for Public Economic Theory
Rio de Janeiro, Brazil

25-26 July 2016

[Global Health Economics Summit](#)

Berlin, Germany

9-11 August 2016

[Entrepreneurship, Innovation and Public Policy - 2016 IIPF Annual Congress](#)

University of Nevada at Reno
Lake Tahoe, USA

Recent Public Finance News

New Zealand

- 15 October, [Bill English - New Zealand Economic and Fiscal Outlook](#), Scoop
- 12 October, [ASB economists say RBNZ has 'already come unstuck' with forecasts of a lower dollar](#), Interest.co.nz
- 10 October, [Growth big ask for new reserve bank boss](#), New Zealand Herald
- 6 October, [Ministry breaks down TPPA tariff gains; dairy, meat the biggest winners](#), Stuff
- 5 October, [HRC urges action over growing gender pay gap](#), Scoop
- 2 October, [Hourly wages rise, but gender gap back to six-year high](#), Stuff
- 29 September, [Auckland home affordability improves - Massey researchers](#), New Zealand Herald
- 28 September, [International forces remain major influence on economy](#), RBNZ
- 24 September, [The price is right: Land prices can help guide land use regulation](#), NZIER
- 22 September, [Changes to GST on the cards](#), Stuff.co.nz
- 16 September, [Minister cautious about rule changes for wealthy migrants](#), New Zealand Herald
- 15 September, [More effective social services](#), New Zealand Productivity Commission
- 14 September, [Fonterra cautious over higher prices](#), New Zealand Herald
- 14 September, [House prices dropping in Wellington and sky rocketing in Auckland](#), Stuff
- 10 September, [RBNZ's Wheeler says Auckland house price inflation over 25% in "dangerous territory" when price inflation should be 10% over 5 yrs "if RBNZ is doing its job"; Spencer says fast rise risks steep reversal](#), Interest.co.nz
- 9 September, [Reserve Bank cuts OCR to 2.75 per cent, banks follow suit](#), New Zealand Herald
- 2 September, [Auckland company given money laundering warning](#), Radio New Zealand
- 31 August, [Calls for Kiwis stuck in rent trap to be given incentives to save](#), Stuff
- 29 August, [Why world catches cold when China sneezes](#), New Zealand Herald
- 26 August, ['Auckland effect' keeps Hamilton housing market buoyant](#), Stuff
- 25 August, [KiwiSaver and the wealth of New Zealanders](#), NZIER
- 24 August, [Liz Koh: Fail to plan, plan to fail so get sorted now](#), Bay of Plenty Times
- 21 August, [Hard times behind the averages](#), New Zealand Herald
- 20 August, [Online shoppers not deterred by new GST rules](#), New Zealand Herald
- 17 August, [Gender pay gap still there: so what are we doing about it?](#), Stuff
- 14 August, [West Coast councils to receive millions in economic stimulus funding](#), Stuff
- 14 August, [Retail sales edge up as online buying grows](#), New Zealand Herald
- 13 August, [Tax amnesty on transferred pensions](#), Bay of Plenty Times
- 13 August, [House sales roar away both in and outside Auckland](#), Stuff
- 12 August, [Anti-TPP protest at Parliament](#), New Zealand Herald
- 8 August, [Kirkcaldies reflects decline of Wellington as business hub](#), New Zealand Herald
- 3 August, [It's time for rest of economy to shine](#), New Zealand Herald

World

- 12 October, [2015 Economics Nobel awarded to Angus Deaton \(Princeton\) “for his analysis of consumption, poverty and welfare”](#), nobelprize.org
- 11 October, [Key member of Swedish Academy of Sciences calls for immediate suspension of the “Nobel Prize for Economics”](#), Real-World Economics Review Blog
- 25 September, [OECD warns that government healthcare spending could become unsustainable](#), Public Finance International
- 24 September, [Social landlords must be wondering how much longer they can survive](#), The Guardian
- 18 September, [UK productivity lags behind rest of G7](#), BBC News
- 13 September, [China economy: New signs of economic slowdown](#), BBC News
- 09 September, [How sustainable are charity contracts for public services?](#), The Guardian
- 07 September, [Piketty was wrong. Seizing from the rich to help the poor won't solve inequality](#), The Telegraph
- 04 September, [German factories suffer shock export collapse](#), The Telegraph
- 03 September, [China poses threat to global growth, IMF warns](#). BBC News
- 01 September, [To solve the crisis in care for older people, think health, not ill health](#), The Guardian
- 27 August, [By Another Measure, U.S. Economic Growth Has Nearly Stalled This Year](#). The Wall Street Journal
- 26 August, ['Don't overburden central banks,' says India's Rajan](#), BBC News
- 25 August, [Home Buyers to Make Comeback in Next Decade, Mortgage Bankers Say](#), The Wall Street Journal
- 24 August, [What Market Swings Mean for Inequality](#), The Wall Street Journal
- 24 August, [How did Black Monday start?](#), The Telegraph
- 21 August, [UK income tax receipts reach surplus in July](#), The Guardian
- 20 August, [Greek PM Alexis Tsipras resigns and calls for snap election](#), The Telegraph
- 19 August, [Third bailout deal for Greece signed](#), Public Finance International
- 14 August, [CBA chief Ian Narev says upping GST, cutting taxes would fire the economy](#), Sydney Morning Herald
- 13 August, [China Seeks to Calm Markets as It Devalues Currency for 3rd Consecutive Day](#), The New York Times
- 13 August, [Europe in crisis: everyone from Putin to ordinary savers is stockpiling gold](#), The Telegraph
- 12 August, [Memorandum of understanding: what exactly has Greece signed up for?](#), The Guardian
- 4 August, [Anti-austerity unpopular with voters, finds inquiry into Labour's election loss](#), The Guardian
- 3 August, [IMF sends economic development funds to help Nepal rebuild](#), Public Finance International
- 28 July, [The uncertain relationship between national insurance and income tax](#), The Guardian
- 28 July, [UK PM pledges transparency drive to tackle corruption](#), Public Finance International
- 10 July, [Putting the Public Back in Public Finance](#), The New York Times

Public Finance Publications

Working Papers in Public Finance

This working paper series is published by the Chair in Public Finance, Victoria University of Wellington, in collaboration with researchers in New Zealand and overseas.

*NZPF Research associates in **bold***

WP10/2015

Creedy, J. and Scobie, G. '[Debt Projections and Fiscal Sustainability with Feedback Effects](#)'.

This paper analyses long-term fiscal sustainability with a model which incorporates a number of feedback effects. When fiscal policy responds to ensure long-term sustainability, these feedback effects can potentially modify the intended outcomes by either enhancing or dampening the results of the policy interventions. The feedbacks include the effect on labour supply in response to changes in tax rates, changes in the country risk premium in response to higher public debt ratios, and endogenous changes in the rate of productivity growth and savings that respond to interest rates. A model of government revenue, expenditure and public debt which incorporates these feedbacks is used to simulate the outcome of a range of fiscal policy responses. In addition the effects of population ageing and productivity growth are explored.

WP11/2015

Creedy, J. and Mok, P. '[Labour Supply in New Zealand and the 2010 Tax and Transfer Changes](#)'.

This paper examines the simulated labour supply responses to the personal tax and transfer policy changes introduced in New Zealand in 2010, and the implications for revenue and income distribution. The main changes examined are the increase in the GST rate from 12.5 to 15 per cent, along with reductions in personal income tax rates and increases in the main benefit payments and assistance to families with children, to compensate for the rise in GST. The simulated labour supply responses were obtained using the Treasury's behavioural microsimulation model, TaxWell-B. The 2009/10 Household Economic Survey (HES) was used. The combined effect of all policy changes is to increase average labour supply slightly for all demographic groups. Labour force participation of sole parents is simulated to increase by 0.86 percentage points. In considering separate components, the change in income tax rates is found to have the largest effect on labour supply. This is not surprising given that it affected a large proportion of the population while the changes to the benefit system and assistance to families with children apply only to certain groups. The reforms are found to be approximately distribution neutral, in terms of the Gini inequality measure of after-tax income per adult equivalent person.

WP12/2015

Ball, C., **Creedy, J.** and Scobie, G. ['Long-run Fiscal Projections under Uncertainty: The Case of New Zealand'](#).

This paper introduces uncertainty into a fiscal projection model which incorporates population ageing along with a number of feedback effects. When fiscal policy responds in order to achieve a target debt ratio, feedback effects modify the intended outcomes. The feedbacks include the effect on labour supply in response to changes in tax rates, changes in the country risk premium in response to higher public debt ratios, endogenous changes in the rate of productivity growth and savings. Stochastic projections of a range of policy responses are produced, allowing for uncertainty regarding the world interest rate, productivity growth and the growth rates of two components of per capita government expenditure. The probability of exceeding a given debt ratio in each projection year, using a particular tax or expenditure policy, can then be evaluated. Policy implications are briefly discussed.

Recent publications from NZPF research associates

*Research associates in **bold***

Gemmell, N and Morrissey, O., (2015), 'Distribution and Poverty Impacts of Tax Structure Reform in Developing Countries: How Little We Know', Chapter 16 in J. Alm and J. Martinez-Vazquez (eds.) *Tax Reform in Developing Countries*, Volume 1. Cheltenham: Edward Elgar.

Prebble, J. (2015) ['Kelsen, the Principle of Exclusion of Contradictions, and General Anti-Avoidance Rules in Tax Law'](#), *WU International Taxation Research Paper Series no 2015-23*.

White, D. (2015) 'Personal Capital Gains Taxation: Reflections on the Influence of Economic Theory on Tax Reform Proposals' *New Zealand Journal of Taxation Law and Policy* 21(1) p.18-50.

Public Finance Journals

1. [FinanzArchiv](#)
2. [Fiscal Studies](#)
3. [International Tax and Public Finance](#)
4. [Journal of Public Economics](#)
5. [Journal of Public Economic Theory](#)
6. [National Tax Journal](#)
7. [Public Budgeting and Finance](#)
8. [Public Finance Review](#)
9. [Public Finance and Management](#)
10. [Tax Notes International](#)

Institutions Working on Public Finance Research or Policy

New Zealand

[Centre for Accounting, Governance & Taxation Research \(CAGTR\)](#)

Victoria University of Wellington

The CAGTR was established within the School of Accounting and Commercial Law to advance and apply knowledge germane to the accounting and legal professions, commerce and industry and the public sector.

[Retirement Policy & Research Centre \(RPRC\)](#)

The University of Auckland

“The Retirement Policy and Research Centre (RPRC) is an academically focused centre specialising in the economic issues of demographic change.”

[Chair in Public Finance \(CPF\)](#)

Victoria University of Wellington

The Chair in Public Finance (CPF) is a joint venture between Victoria University and four sponsoring institutions with an interest in public finance The Treasury, the Inland Revenue Department, PricewaterhouseCoopers, and the Ministry of Social Development. The Chair conducts research and organises events to increase awareness and discussion around public finance issues.

World

[Tax and Transfer Policy Institute](#)

Canberra, Australia

“The Tax and Transfer Policy Institute (TTPI) carries out research on tax and transfer policy, law and implementation for public benefit in Australia.”

[CESifo Group Munich](#)

Munich, Germany

Centre for Economic Studies, the ifo Institute and the Munich Society for the Promotion of Economic Research in Germany.

[Institute for Fiscal Studies](#)

London, UK

The Institute for Fiscal Studies aims to promote effective economic and social policies by better understanding how policies affect individuals, families, businesses and the government's finances.

[London School of Economics Public Economics Programme \(PEP\)](#)

London, UK

The PEP's activities include “theoretical and empirical work on the economics of taxation, the provision of public goods, social insurance and the economics of income distribution.

Oxford University Centre for Business Taxation

Oxford, UK

“The Oxford University Centre for Business Taxation is an independent research centre which aims to promote effective policies for the taxation of business.”

University of Exeter, Tax Administration Research Centre

Exeter, UK

“The Tax Administration Research Centre undertakes research on tax administration in order to strengthen the theoretical and empirical understanding of tax operations and policies. The Centre is operated in partnership by the University of Exeter and the Institute for Fiscal Studies.”

Office of Tax Policy Research

Michigan, USA

The Office of Tax Policy Research (OTPR) is a research office at the Stephen M. Ross School of Business at the University of Michigan. OTPR supports and disseminates academic research on all aspects of the tax system, with the goal of informing discussion about the future course of policy.

OECD Centre for Tax Policy and Administration

Paris, France

The Centre for Tax Policy and Administration (CTPA) is the focal point for the OECD's work on all taxation issues, both international and domestic.

Congressional Budget Office

Washington, DC, USA

The Congressional Budget Office (CBO) has produced independent analyses of budgetary and economic issues to support the Congressional budget process. The agency is strictly nonpartisan and conducts objective, impartial analysis.

National Institute of Public Finance and Policy

New Delhi, India

The National Institute of Public Finance and Policy (NIPFP) is a centre for research in public economics and policies. The institute undertakes research, policy advocacy and capacity building in areas related to public economics.

Centre for Public Finance Research

Washington, DC, USA

The Center for Public Finance Research (CPFR) offers research and education in public budgeting and finance, public financial management, public economics, and benefit-cost analysis at the local, regional, national, and international levels.

National Institute of Economic and Social Research

London, UK

“NIESR aims to promote, through quantitative and qualitative research, a deeper understanding of the interaction of economic and social forces that affect people's lives, and the ways in which policies can improve them”.

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