

Review of fiscal impact of Green Party policies

for Green Party

August 2014

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1. INTRODUCTION

The Green Party commissioned Infometrics to review the fiscal impact of their policy proposals. The estimation of the expense and revenue impacts of individual policies has been conducted independently of the current project. Our objective here has been to ensure that the sum fiscal impact of the policies are accounted for correctly. This has entailed ensuring that policy impacts are correctly allocated between expense, revenue and capital impacts. The data has then been entered as adjustments to the Treasury Fiscal Strategy Model and results have been compared with the 2014 Budget Economic and Fiscal Update fiscal projections (BEFU) and the Pre-election Economic and Fiscal Update 2014 (PREFU).

Although our analysis indicates that the Green Party's policies would alter the fiscal outlook, our calculations do not incorporate any second round impacts. That is, no allowance is made for the economic consequences of the projected larger operating surplus and lower crown debt positions, nor of the resulting fiscal impacts of these economic changes. Such calculations would entail a much larger analytical project than undertaken here. The results would also be subject to the judgement of the analyst. Ultimately we consider that such additional analysis would add nuances rather than drastically alter the fiscal estimates.

The analysis is based on information provided by the Green Party as at 19 August 2014.

Below we present the summary of the fiscal impact of the Green Party policies. In the next section we describe the allocation of Green Party Policies between expenses, revenue and capital items. Finally in section 3 we present some tests of the sensitivity of the fiscal outcomes to assumptions about impacts of proposed tax changes.

Summary

A comparison of the fiscal impact of the Green Party Policies with the BEFU and PREFU forecasts for key summary fiscal indicators are presented in Table 1. The implication is that the proposed Green Party policies lead to moderately higher operating balances, lower debt and higher net worth outcomes than forecast in the BEFU. The critical factors leading to this outcome are that Green Party extra spending plans are typically below the BEFU operating allowance for extra spending and that the Green Party policies also include revenue raising initiatives (see Table 2).

The estimates of the revenue impacts of proposed changes to the top tax rate appear optimistic. However, sensitivity tests reported in the final section indicate that using lower revenue impacts does not materially alter the conclusion of the previous paragraph.

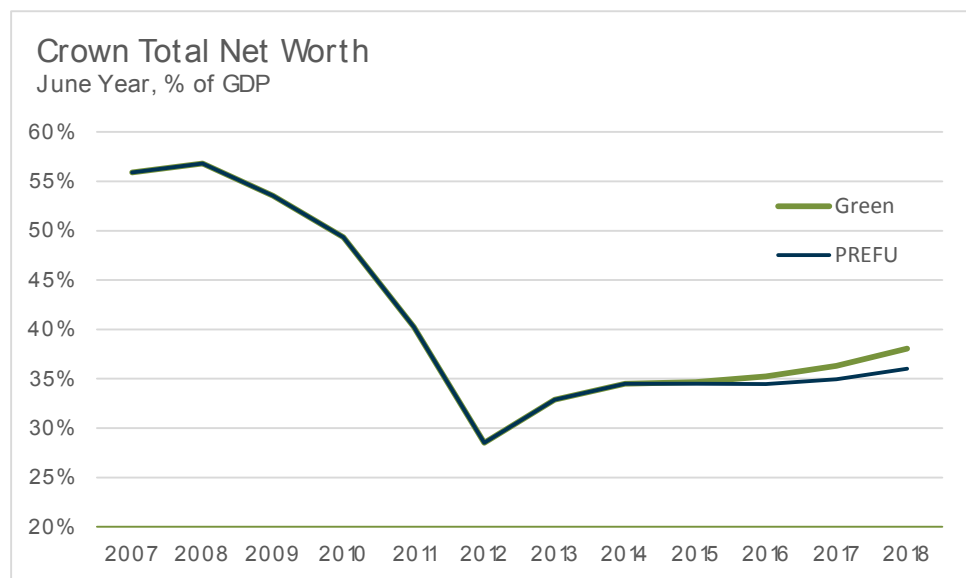
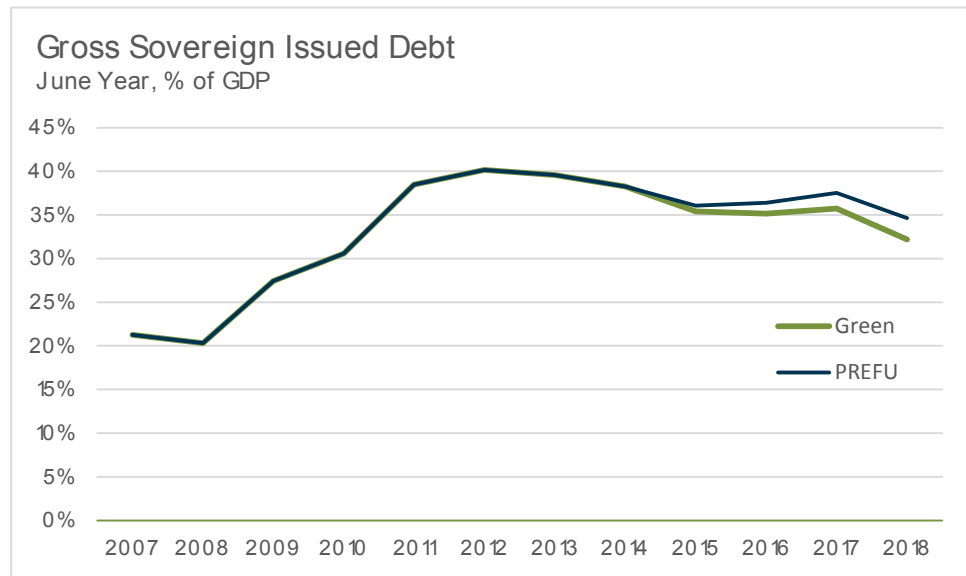
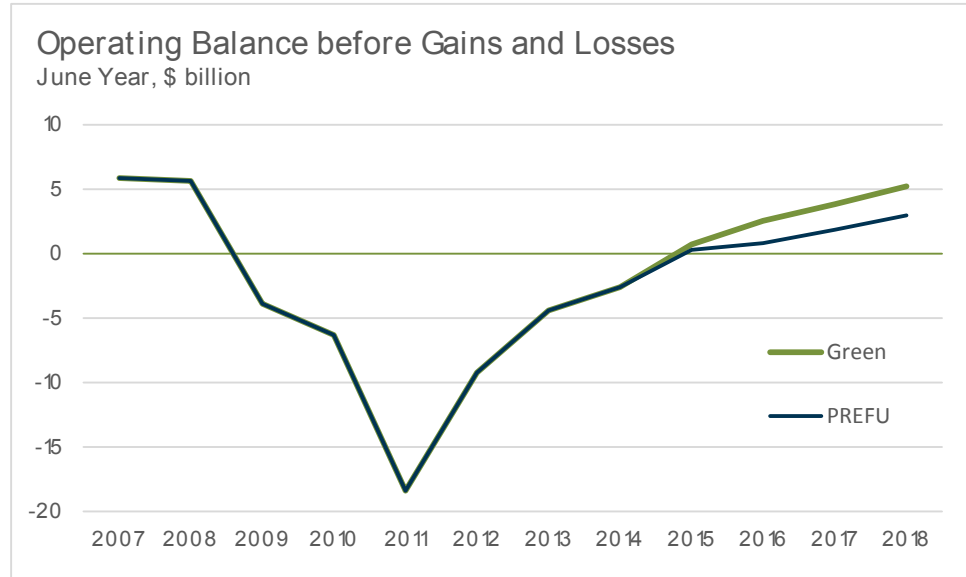
Table 1: Summary fiscal impact of costed Green Party policies

Fiscal Year	2014/15	2015/16	2016/17	2017/18
<i>OBEGAL (Operating Balance before Gains and Losses), \$ billion</i>				
Green	0.722	2.548	3.843	5.213
2014 PREFU	0.297	0.818	1.851	2.964
2014 BEFU	0.372	1.262	2.369	3.485
<i>OBEGAL (Operating Balance before Gains and Losses), % of GDP</i>				
Green	0.3%	1.0%	1.5%	1.9%
2014 PREFU	0.1%	0.3%	0.7%	1.1%
2014 BEFU	0.2%	0.5%	0.9%	1.3%
<i>Gross Sovereign-issued Debt (GSID), \$ billion</i>				
Green	85.027	88.211	93.494	87.267
2014 PREFU	86.647	91.348	98.271	93.896
2014 BEFU	85.479	90.318	97.193	92.799
<i>Gross Sovereign-issued Debt (GSID), % of GDP</i>				
Green	35.4%	35.1%	35.7%	32.2%
2014 PREFU	36.1%	36.4%	37.5%	34.6%
2014 BEFU	35.5%	35.8%	37.0%	34.0%
<i>Net Core Crown debt (excluding NZS Fund), \$ billion</i>				
Green	62.655	63.904	62.758	61.236
2014 PREFU	64.275	67.041	67.535	67.865
2014 BEFU	63.567	65.321	65.484	64.867
<i>Net Core Crown debt (excluding NZS Fund), % of GDP</i>				
Green	26.1%	25.5%	24.0%	22.6%
2014 PREFU	26.8%	26.7%	25.8%	25.0%
2014 BEFU	26.4%	25.9%	24.9%	23.8%
<i>Crown Total Net Worth, \$ billion</i>				
Green	83.254	88.490	95.068	103.189
2014 PREFU	82.829	86.548	91.449	97.654
2014 BEFU	78.633	82.838	88.314	95.121
<i>Crown Total Net Worth, % of GDP</i>				
Green	34.7%	35.2%	36.3%	38.1%
2014 PREFU	34.5%	34.5%	34.9%	36.0%
2014 BEFU	32.6%	32.8%	33.6%	34.9%

Table 2: Fiscal impact of Green Party policies relative to BEFU, \$ billion

Fiscal Year	2014/15	2015/16	2016/17	2017/18
<i>New Revenue</i>	0.634	1.506	1.957	2.298
<i>Green Party Election Priority Spending</i>	0.245	1.852	3.204	4.228
<i>Net impact</i>	0.389	-0.346	-1.247	-1.929
<i>Less existing Budget provisions for new spending</i>	0.000	1.349	2.980	4.504
<i>New revenues less new spending over baseline</i>	0.389	1.003	1.733	2.575
<i>Impact on OBEGAL</i>	0.425	1.730	1.992	2.249

CONFIDENCE



2. APPROACH

The data provided by the Green Party has been re-sorted so that data is grouped into expenses, revenue, and capital items. In particular data provided by the Party was grouped in policy areas. In some cases the policy included both revenue and expense items. For example, proposed tax cuts associated with the climate protection plan were included as costs, but more correctly should be treated as revenue reductions. Likewise, some prospective expense savings were grouped with revenue initiatives. These have been reclassified as reductions in expenses.

The summary of these reclassifications are presented in Table 3. New expenses have been split between expenses associated with announced policies and expenses that have yet to be announced.

Table 3: Summary allocation of Green Party policies, \$m

Fiscal Year	2014/15	2015/16	2016/17	2017/18
<i>Additional expenses</i>				
Associated with announced policies	216	1,531	2,821	3,779
Policies yet to be announced	70	527	653	748
<i>Less expense savings</i>	41	206	269	300
<i>Total new expenses</i>	245	1,852	3,204	4,228
<i>Additional revenue</i>				
New tax revenue	60	145	1,541	1,831
Non-tax revenue	0	212	312	324
<i>Less tax reductions</i>	0	0	1,077	1,077
<i>Total new revenue</i>	60	357	776	1,078
<i>Net contribution to operating balance</i>	-185	-1,495	-2,428	-3,150
<i>Capital items</i>				
Additional assets	0	37	64	151
Additional liabilities	1,195	37	27	87

The next step was to allocate fiscal items into classifications that conform with those used in the Treasury Fiscal Strategy Model. The items are then input as adjustments to the fiscal model. No adjustments were made to the economic settings underpinning the model. This means that the fiscal impacts of the Green Party proposals can be compared to those of the Budget on a like-for-like basis.

The one other adjustment made was to subtract the Budget provisions for new spending (ie the fourth row in Table 2) from the "Additions to expenses via operating allowance". To illustrate, the Green Party provision for new proposals in 2017/18 is \$748m, while the provision in the PREFU for new proposals is \$4,504m. So the net impact of these two factors is a reduction in spending of \$3,756m (= 748 – 4,504).

The implication is that the fiscal impact of the Green Party policies presented here do not allow for any additional new policies except for those incorporated in the second row of Table 3.

3. SENSITIVITY OF RESULTS TO REVENUE ASSUMPTIONS

The Green Party is proposing to increase the top tax rate to 40% for marginal income over \$140,000, and to also align the tax rates applying to trusts to this change in personal income tax rates. Estimates of the revenue impact of these policy proposals were prepared by the Parliamentary Library for the Green Party (see Table 4).

Table 4: Parliamentary Library estimates of revenue impact of proposed tax changes

Fiscal Year	2014/15	2015/16	2016/17	2017/18
New top tax rate of 40% on income over \$140K	264	528	558	591
Trust tax rate aligned with 40% top tax rate	310	620	620	620

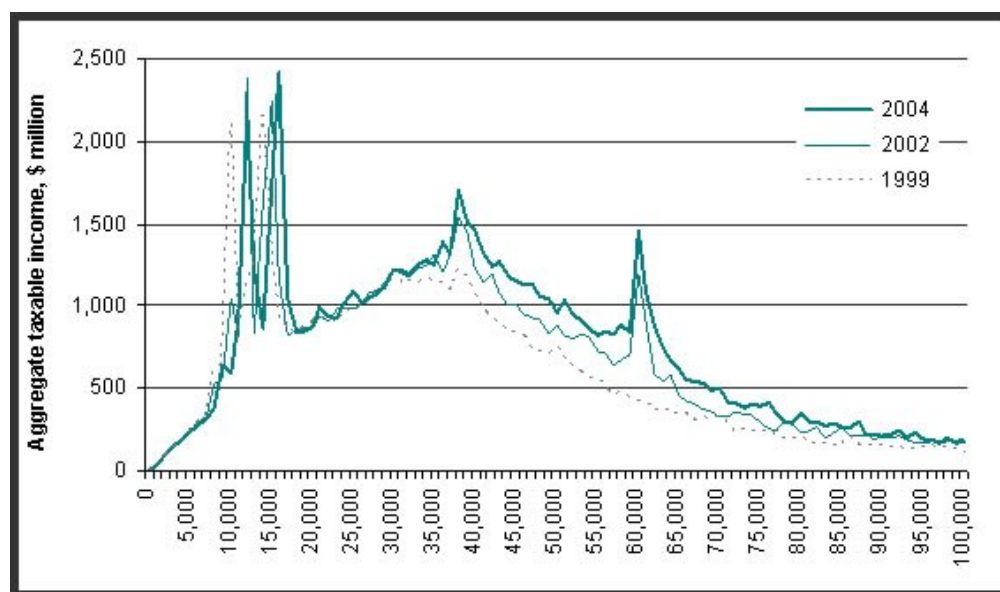
We have briefly reviewed the estimate for the top tax rate change and this appears to be based on ready reckoner information provided by Treasury (see <http://www.treasury.govt.nz/government/revenue/estimatesrevenueeffects>). Although the calculations made for the Green Party appear consistent with the information provided by Treasury we think that on balance the estimates provided are likely to overstate the revenue impacts of the proposed tax changes. Our first minor concern is that we think that the estimates are overly optimistic about the implementation time of the proposed tax changes. The estimates presume that following a 20 September election that the tax changes will be fully implemented by 1 January. Although this is certainly feasible, it may be more prudent to presume some delay in the revenue calculations.

Our second more substantial concern is that the estimates make no allowance for behavioural responses to the tax change. The type of impact is demonstrated in Figure 1, which presents the way that declared income evolved following the introduction of a 39% tax for incomes over \$60,000 in the early 2000s. The majority of post 1999 income growth occurs at income levels below \$60,000. In particular there is the development of an income spike precisely at \$60,000 – a spike that did not exist prior to the tax change in 1999.

If the incentive is large enough people will rearrange their affairs to reduce their tax exposure. The Green Party proposals to change the tax rate for trusts and to increase tax enforcement activities reflect an awareness of this propensity, but the revenue estimates do not reflect this awareness. Tax avoidance is not necessarily illegal, but usually reflects a combination of people perceiving that the system is not equitable and an overly complex tax system. The former creates the incentive, the latter the means, for tax avoidance. Taxpayers will be surprisingly fast at changing their affairs, and most changes will be quite legal.

The Green Party tax revenue estimates take no allowance for a decline in the tax base and as such must be viewed as high-end estimates. We think it would be prudent to base fiscal estimates on considerably lower revenue estimates.

Figure 1: Developments in taxable income, 1999 - 2004



Source: (Inland Revenue Department, 2005)

The implication of different revenue assumptions on operating balance projections are presented in Table 5. The top line presents the 2014 PREFU projections. The second line presents the projections based on Green Party assumptions. The third line delays revenue impacts from proposed tax changes until 2015/16 (as well as proposed extensions to family tax credits). The fourth line also assumes that the revenue from proposed changes to the top tax rate and trust tax rates are 50% of that projected by the Parliamentary Library.

Table 5: Impact of different revenue assumptions on operating balance projections

Fiscal Year	2014/15	2015/16	2016/17	2017/18
<i>OBEGAL (Operating Balance before Gains and Losses), \$ billion</i>				
2014 PREFU	0.297	0.818	1.851	2.964
Base estimate	0.722	2.548	3.843	5.213
Tax changes commence from 1 July 2015	0.278	2.527	3.819	5.188
and revenue from top tax rate changes reduced to 50%	0.278	1.938	3.185	4.503

Although the lower revenue assumptions obviously reduce projections of the operating balance, the reduction is not sufficient to reduce fiscal projections based on Green Party policies to below the PREFU projections. The projected operating balance for 2017/18 of \$4.503 bn is still \$1.539 bn above the BEFU projection.