Tax Working Group Public Submissions Information Release

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NZ Tax Working Group
Secretariat for Submissions
30 April 2018

To the Secretariat:

I am offering my input on the subject of New Zealand's tax system for consideration by the Tax Working Group in this submission. Points raised in this document are intended to provoke discussion on matters which I realise are technically outside the formal ambit and terms of reference of the TWG; however, it is impossible to have a conversation about the role of taxation in political economy without raising issues of money, banking, and social good which are intrinsically linked. I am willing to appear before the group and speak to my submission.

Framing of tax in monetary terms

Before we consider how best to refashion our tax system, it would be beneficial to consider just what tax is – or more precisely, how the definition of tax shapes our thinking about its purposes. For any tax which is levied by a sovereign state, it is best to view its functions through the lens of Modern Monetary Theory (MMT)[i], an accounting framework in which money is issued by the sovereign (the Crown in this instance), goes into circulation in the broader economy, and at some point is removed from circulation by the issuing entity (the Crown once again). This view of money treats tax as either a payment for services provided by the Crown, or as an extinguishment of money which completes the circuit and maintains its value...but, importantly, not as revenue. In MMT terms, a sovereign spends first and taxes later. Tax types and amounts in MMT are set to achieve societal and economic outcomes, so Pigouvian taxes and wealth taxes can be used to provide market signals, influence behaviours, and ward off gross inequality.

Of course, in the present system 98 percent of our money supply is not issued by the Crown[ii], but instead comes into existence via lending by commercial banks and is extinguished when the principal of a loan is repaid[iii]. This has led to the curious phenomenon of the Crown borrowing its own currency from banks, at interest, and to the commonly perceived requirements that governments both 1) fund their spending by raising revenue in the form of tax or through borrowing; and 2) keep their levels of expenditure and indebtedness within the "means" provided by available revenue, in much the same way a household or business would balance its bank account. This requires us to overlook the ability of the Crown to create money by issuing notes and coins, and in our present-day reality of electronic banking this is easy to do. However, there has also been a concerted and ideologically-motivated effort to promote and entrench the notion of budgetary restraint among politicians, commentators, and the public. The reason for MMT's existence within the discipline of political economy is precisely to counter the omissions and distortions of discourse which arise in blind acceptance of the orthodox view.

Endogenous money creation and asset price inflation

Another problem is present in the creation of money through lending, and it is profoundly evident in its effect on the NZ housing market. The largest portion of our domestic private sector credit, and hence the main component of our money supply, is residential mortgages ($250 billion), and because a growth in aggregate lending requires economic growth to service the repayment, even more lending is required to create the money to support the larger economy. Axiomatically, this means credit must grow exponentially for GDP growth to take place and at some stage the leveraging of households becomes unsupportable. This precipitates defaults, writedowns, bank weakness or failure, and deflation due to the sudden decrease in the money supply. A period of recession or even depression is required to unwind and deleverage before the next cycle begins[iv]. Prof Steve Keen refers to the ratio of private debt to GDP (and its rate of growth) as the bellwether for a national economic collapse, and considers anything greater than 100 percent to be cause for concern. Ours is presently in the neighbourhood of 180 percent[v].

Because the mortgages are used to buy houses, a growing market in credit places upward pressure on home prices. Keen and other economists link the credit impulse with asset price inflation, and it is this combination which has both driven NZ property values to levels which cannot be supported by the incomes of most households, as well as given us a dangerous exposure to economic collapse driven by debt deflation. Unsurprisingly, the politically obvious solution of capital gains taxes has been trotted out. A capital gains tax looks superficially fit for purpose, but in real life often encourages property owners to sit tight, creating market distortions such as supply restriction and inefficient resource utilisation (think of empty nesters in four bedroom houses, while extended families cram into two-bedroom flats). And for the parameters of this exercise, the TWG's terms of reference explicitly rule out a tax on owner-occupied housing. Painting a profit-derived target on landlords and property speculators is politically expedient but won't fix the underlying problem.

Taxing the asset, not the effect

The solution lies not in taxing the family home, but rather the land underneath. The capital appreciation in home prices is in reality the value of the land, not the improvements. An increase in land values is an expression of a place's desirability in a multivariate assessment: proximity to schools, shops, transportation, amenities, and the social cohesion of the neighbourhood are strong drivers. These qualities feed into the intrinsic value, while the market places extrinsic signals on price and in times of credit expansion can create bubbles. Asset price inflation, especially that of land, in turn drives rent-seeking and as such is responsible for a feedback loop which increases socioeconomic inequality. By putting an appropriate tax rate on land, we can create a market signal which reverses or levels incipient bubbles, tamps down speculative incentives, and encourages full utilisation of urban residential sections subject to appropriate council planning.

If we are to curb the alarming rise in inequality and deprivation that is underway in New Zealand we need to have a policy handbrake that inhibits wealth accumulation. The disparity putting a wedge into our society is wealth, not income, and a tax response needs to target assets because this is where wealth goes and from assets rents are derived. Placing a meaningful tax on land could be done at a level that removes the need for GST, and ideally income and company tax as well. In doing this, we would see individuals and families on the bottom rungs of the economic ladder reap an immediate windfall in disposable income by eliminating GST, while the effects on middle income families would be mostly neutral as long as they were not on unusually high value sections.

Capturing the appreciation in value

In the year ending March 2018, average house prices in New Zealand went from $631,432 to $677,618, an increase of slightly over seven percent[vi]. We can safely assume that virtually the entire appreciation was in land and not improvements. Across the whole-of-country portfolio of 1.8 million homes[vii], that represents an increase in market value of over $82 billion. No one worked to earn that; it was an effect of credit-driven demand for location, and location is a value created by the public. A reasonable setting of a land tax which captured that increase could therefore "fund" (in non MMT terms) all the expenditure items in the present Budget with a considerable amount remaining for discretionary spending and at the same time render all other taxes unnecessary, and this example does not even consider commercial or industrial property, let alone rural lands.

The example cited above highlights what good could come of the upward surge in values observed as the persisent bubble in the housing market refuses to abate. What goes up must come down, though, and one of the outcomes of a well-executed land value tax is a stable market in which asset speculation is difficult by design. I offer the scenario merely as a talking point to demonstrate what might be possible. If commercial and industrial land were put into the mix the tax levels across the board could be quite modest, perhaps 2-3 percent annually or less, and council rates could be paid from that instead of being billed separately by local and regional authorities.

Taxing what we take and the messes we make

The other taxes that should be in effect under a new, fairer system would comprise a meaningful price on externalities. These are resource and emission taxes or levies, and Pigouvian taxes. We can start with the biggest externality and market failure in human history: climate change. To create the appropriate signal across all sectors, a carbon tax must be put into place and the amount should be no lower than $20/tonne, with $50 an achievable target that could replace excise taxes on refined fuels. We can use similar measures to pay for the cost of cleaning up waterways with taxes on the abstraction of water and on the emission of pollutants.

Closing the monetary circuit

Returning to the concept of money in MMT, if we look at the various ways the state would be taking money out of the economy in the form of tax, it makes sense that this be done as a formal extinguishment instead of a way station along the path to a bank's loan balance being repaid. Ideally, the state should be putting money directly into the economy. To put the principle into application, a universal basic income could be implemented alongside the new tax regime, using a public bank established under Crown auspices solely for this purpose. UBI payments would be electronically created under the Crown's account in this bank, with the deposits (the liability in banking terms) immediately transferred to each resident's own account, and the aggregate asset remaining with the Crown until such time as tax in that amount is paid. By creating some money this way, we take the edge off the moral hazard of having too much of our shared economic well-being subject to the vagaries of boom and bust in credit cycles. In addition, a UBI could supplant some forms of welfare, currently the single largest line item in the Budget. The other mechanism for non-bank money to be introduced would be direct spending by the Crown on public infrastructure and services. The ripple effect induced by an injection of debt-free money into the system would go a long distance and contribute to a new wave of egalitarianism and well-being in New Zealand, and would provide a model for the rest of the world to follow.

Phil Stevens

[1]

i For thorough discussions of MMT, refer to the works of L. Randall Wray, Stephanie Kelton, Bill Mitchell, and many others.

ii Reserve Bank of New Zealand, https://www.rbnz.govt.nz/statistics product C50 for March 2018 yields a figure of 98.06 percent.

iii Kumhof, Michael and Zoltan Jakab “Banks are not intermediaries of loanable funds - and why this matters” https://www.bankofengland.co.uk/working-paper/2015/banks-are-not-intermediaries-of-loanable-funds-and-why-this-matters

iv Steve Keen, *Debunking Economics*, Ch. 13

v RBNZ, composite of C50.D. and M5 products.

vi Quotable Value https://www.qv.co.nz/property-trends/residential-house-values

vii 2013 Census identified 1.77 million residential properties.