

Newman Weekly

By Dr. Muriel Newman
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The New Zealand Centre for Political Debate

Time for a Flat Tax?

In 1990, my husband Frank and I co-authored the book *How to Grow Rich: secrets to better money management, a guide to financial independence*. It became a best seller, both here, in Australia, and interestingly, in Hong Kong.

One of the key steps to achieving personal financial independence is to find ways of boosting household cash flow. That means reducing outgoings and increasing income.

But, while individuals undoubtedly have a big part to play in increasing their incomes through gaining a promotion, taking on part-time work, and so on, wage rates are inextricably linked to a country's standard of living.

Back in the 1950s and 60s, New Zealand had one of the highest standards of living in the developed world. Today, because of government mismanagement, we rank amongst the lowest in the OECD.

According to Sir Roger Douglas, the driving force behind the economic reforms of the eighties, if New Zealand had succeeded in growing at the average rate of the OECD over the thirty-year period from 1960 to 1990, by 1990 our standard of living would have almost doubled.

Imagine how much easier it would be to achieve financial independence, if incomes were more than double their present level!

So why is it that successive governments have failed to manage our economy in a way that maintains high living standards? The answer of course, is politics: governments have a tendency to take their eye off strategies that drive economic growth, in favour of policies that will win them votes at the next election.

Having said that however, sometimes even when politicians try to do the right thing, they find that their efforts are frustrated by the powerful forces of the

status quo: in their book *The Tyranny of the Status Quo*, Milton and Rose Friedman describe it as an "Iron Triangle" made up of the beneficiaries of a particular policy who want it to remain, the bureaucrats who thrive on its very existence, and the politicians who introduced it and have a vested interest in its continuation.

A simple case in point is the promise made by successive governments, to reduce business compliance costs. Yet, in spite of all of the fine rhetoric, bureaucracy and red tape continue to grow unabated, fuelling a serious decline in business confidence and falling productivity growth.

In its briefing paper to the incoming government (<http://www.treasury.govt.nz/briefings/2005/>), Treasury sets out a plan for raising productivity and growth. Along with reducing compliance costs and improving infrastructure, central to their advice is the urgent need to lower tax rates, in order to boost economic growth and raise living standards.

According to Treasury: "high marginal tax rates on personal and company income are the most damaging to growth" since they discourage investment, hard work and entrepreneurship. They recommend prioritising tax reform: reducing the high marginal personal 33 percent and 39 percent tax rates, reducing the high 33 percent company tax rate, and reducing the high effective marginal tax rates (which Labour has made worse through its Working for Families package).

Tax reform is not unknown to New Zealand. In the 1980s the top rate of income tax was halved from 66 cents to 33 cents and within two years income tax receipts were higher. Reducing our company tax from 45 percent to 33 percent, created a distinct competitive advantage, ranking us well below the OECD average

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at the time, of 40 percent. However, other countries have now eclipsed us and New Zealand has the eighth highest top corporate income tax rate in the OECD.

In 1986, New Zealand was the first country in the world to introduce GST, a consumption tax with no exemptions (although with some zero rated supplies). This broadened our tax base away from a straight reliance on income tax, and it's underlying incentive - the more you consume, the more you pay - is widely regarded as "fairer" than income tax, which penalises hard work.

In light of the recommendation by Treasury that personal and company tax rates should be urgently reduced in order to boost New Zealand's growth rate, and with our long and trouble-free experience of having a flat consumption tax, surely it is now time to consider a flat income tax.

Richard Epstein, Professor of Law at Chicago University and our guest contributor in this week's NZCPD forum(www.nzcpd.com) in his book *The Case for a Flat Tax* puts it this way: "When the overall question of wealth production and wealth transfer are combined, the flat tax emerges as a very powerful, durable and simple institution".

The case for a flat tax is overwhelming: it draws job-creating capital, it cuts massive bureaucratic red tape and compliance costs, it rewards productivity, and it creates an enormously

strong incentive for hard work. A flat tax has unleashed an economic revolution in eight Eastern European countries including Estonia, Slovakia and Russia boosting economic growth and raising living standards at an unprecedented rate.

Having watched the incredible prosperity generated by Hong Kong's low tax structure, and now the example of the benefits to Russia of a 13 percent flat tax, it is rumoured that China is looking at adopting this simple pro-growth system as well.

The merits of a flat tax are now being debated by advanced industrial economies - Britain, Canada, USA, Germany countries looking for new ways to boost economic growth and raise living standards. Why not New Zealand?

If New Zealand adopted a flat income tax, to accompany our flat consumption tax, then we too could enjoy the unparalleled growth that it would bring. Financial independence would then become a realistic goal of every New Zealander. What's wrong with that?

This week's poll asks if you support the idea of a flat tax for New Zealand, and if so, what rate you think it should be.

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