

RIGHT BACK AT THE BACKGROUNDER

(A Reply to the 'Backgrounder' on Alliance Revenue Policy.)

By Charles Pigden

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Dear Comrades,

On Saturday the 18th of September, I received what purports to be a 'backgrounder' on Alliance revenue policy. I say 'purports' because as a backgrounder it leaves a lot to be desired. a) Anyone not already familiar with the issues would have considerable difficulty working out what the dispute is all about. b) You would expect a REAL backgrounder on what is a controversial matter within the federal Party to present BOTH sides of the question. This 'backgrounder' is a one-sided polemic in favour of one option, an option which breaks with previous Alliance policy and which is vehemently opposed by at least ONE of the federated parties (the NLP). It is true that the document is a badly argued and not very convincing polemic, but its defects as a polemic don't add up to virtues as a backgrounder. This reply is an attempt a) to explain the issues, b) to argue for the alternative option and c) to respond to the backgrounder. It is a labour I perform with some reluctance and not a little difficulty since I don't have access to much of the relevant data. I resent the fact that I have had to spend so much time on this task when a more even-handed backgrounder or a companion piece explaining the NLP's alternative would have saved me the trouble. Undemocratic attempts to manipulate the debate - which is what this backgrounder seems to be - are not just shabby in themselves: they tend to waste the time and the energy of party workers.

THE ISSUE.

In the past the Alliance has been in favor of a progressive income tax regime, that is a tax regime which requires the rich to pay a much higher *proportion* of their income in income tax than the poor. We have opposed the move by successive governments to what is very nearly a 'flat tax' system, that is a tax regime in which the rich and the poor pay roughly the same *percentage* of their income in income taxes. Why is this? Well, although capitalism is the goose that lays the golden eggs and most of us have no desire to kill it, if left to itself the capitalist goose tends to distribute those eggs very unevenly. Socialists and social democrats believe that the goose must be

disciplined. To this end they want to use the tax system to a) to raise revenue for various kinds of public goods (free health, free education, decent superannuation etc) and b) to redistribute wealth from the rich to the poor, thus producing a fairer and more equal society. (A TOTALLY equal society is impracticable under capitalism and may even be undesirable). A progressive income tax is a compromise policy which allows us to approximate the socialist ideal ('From each according to his ability; to each according to his need') whilst allowing enough *inequality* to provide an incentive to enterprise. Progressive income tax has proved, in the past, a very successful policy. Some of the richest and most go-ahead economies in the world are characterized by steep progressive income taxes which help to finance a generous welfare state in which real poverty is more or less abolished and nobody need feel excluded from participation in society. (Sweden, Ireland.)

Under Labour and National tax rates for the rich have been slashed. In Labour's case (we hope) this was not simply due to a desire to pander to the top ten per cent of the population. They honestly believed that if the rich were allowed to keep more of their commercially gotten gains, this would provide a greater incentive to enterprise. Labour came to agree with Gordon Gekko that 'greed is good'. They hoped that the entrepreneurs and managers of New Zealand would be fired by greed to produce flourishing businesses which would lift the country out of the economic doldrums. If the goose of capitalism were left to itself (or lightly disciplined), it would produce so many golden eggs that it would not matter if they were distributed unevenly. After all, would inequality really be an issue if the lowest paid earned \$60, 000 a year? At the same time the burden of taxation was shifted from direct taxes (such as income tax) to indirect taxes such as GST. These taxes tend to be *regressive*, that is, instead of redistributing wealth from the rich to the poor, they fall especially heavily on the poor thus making society *more* unequal rather than less.

In one respect this policy has been a success. It has greatly benefited National's core constituency and the constituency adopted by ACT - that of the top ten percent, and especially the top five per cent, of income earners. In every other respect it has been a miserable, wretched, abject failure. Instead of an abundance of golden eggs, we have low growth, low productivity, a massive foreign debt and a

huge balance of payments deficit. New Zealand has become an extremely unequal society but without the general prosperity which might have mitigated the effects of inequality. Just why the policy has failed is a moot point, but it is clear that the entrepreneurial classes have not been fired by creative greed to undertake the right kind of productive endeavour.

Since the Labour/National tax policy has visibly failed, *now* is surely the time to strong-arm Labour back towards a progressive taxation policy. This would not only raise the money needed for our social program, but would in itself redistribute income from the rich to the poor. So what we must be proposing is a radical scheme for progressive income tax. We don't expect to *implement* it of course in the context of coalition politics but we do hope to edge Labour a little closer towards reversing its income tax policy; a policy we have regularly denounced as pernicious. The obvious strategy is to develop a strong maximum program so that the minimum we are prepared to put up with when we go into coalition with Labour goes at least *some* way towards meeting our objectives. In other words, our tax policy for 1999 ought to be minor variant of the policy we proposed in 1993 and again in 1996, right?

WRONG! For just at the moment that our policy has been vindicated, just when we have the chance to push for it in a new Coalition Government, we have chosen to abandon it in favour of an income tax regime which is LESS progressive than Labour's! We are only raising the tax rate above 33 cents in the dollar for those with incomes of over \$75,000 per annum, about 3% of the population! (Labour's top tax rate at least cuts in at \$60, 000!) The motive apparently is to curry favour with the upper middle classes and those who aspire to an upper middle-class income and resent, in advance, the taxes they would have to pay. (This, in plain terms, is what the 'backgrounder' means when it denounces the NLP's alternative as a 'tax on aspirations'.) Instead 'the Alliance' proposes to finance our policies with a range of indirect taxes and 'wealth' taxes: a Land Tax, a Stamp Duty, Tariffs, a Pollution Tax and a Gaming Duty. *This* is what is at issue between 'the Alliance' (actually the tiny committee which devised the tax policy) and the NLP Executive. The NLP, of course, has no particular objection to the taxes proposed. But they - I should say 'we' for I am at one with my party's Executive - *do* object to the abandonment of a progressive income tax. By abandoning this policy we have given up any serious hope of

reducing social inequality. At best we can hope to ameliorate its effects. But if the NLP's proposals (or something like the previous Alliance policy) were put into effect, it might actually *cut* income taxes for the poor, our core constituency. And not just the poor either. Even in the course of rubbishing the NLP's policy, the backgrounder admits that the NLP's tax scales would *benefit* those with incomes of under \$45, 000 a year, that is 90 PER CENT OF THE TAX-PAYING POPULATION. Apparently we should reject this policy because although it will *in fact* benefit most New Zealanders, a significant proportion of them have a fantasy life in which they have much higher incomes and in consequence will reject the real benefits we can offer for fear of an imaginary cost. What a peculiar set of people they must be!

These are issues of *substance*. But there is also an issue of *process*. The proposed 'Alliance' tax scheme represents a major shift in policy. As such it should have been debated openly within the Party not foisted on us at the last moment as the result of the secret deliberations of a cabal. Even if it were heaven-born wisdom (which it certainly is not) this would still be an objectionable procedure. In the 1996 Manifesto the top tax rate cuts in at \$28, 000. According to the Manifesto this means that 30% of New Zealanders would have to pay more income tax. Under the new regime the higher tax rate (43 cents in the dollar) cuts in at \$75, 000 a year, which means that about 3% of New Zealanders would have to pay more income tax. This is not just a difference of degree, or if it is, it is a difference of degree so large as to constitute a difference in kind. Now, nobody objects to the *details* of our tax policy being sorted out by a committee. Tax policy is a technical business requiring complex calculations and expert input. Whether a higher tax rate should cut in at \$28,000 or \$35, 000 per annum is perhaps best settled by a small group not thrashed out on the floor at Conference. But if we believe in democracy at all, we must believe that the *broad outlines* of our tax strategy should be determined democratically. This has not been done. If a major change in strategy was necessary (or was thought to be necessary) it should have been discussed and voted on much earlier, in 1998 for instance, when we devoted so much time and effort to improving our policies. We were told then to take existing (1996) policy as a template and to update and improve it in the light of altered circumstances. But the general idea was that we were not supposed to drastically revise existing policy. There was no need to re-invent the policy wheel. Since I was generally happy with the 1996 tax policy, and

since I did not expect a major change I devoted my energies to other areas; topics which mattered less in the great scheme of things but which made a lot of difference to me. (As an academic I was bothered by the threats to academic freedom and rather hoped that the Alliance might do something about it.) In short, I did what I have been repeatedly asked to do - I 'trusted the leadership', in this case on tax policy. Apparently this was a mistake. For now a major change in policy is being foisted on us without the opportunity for consultation and democratic debate. (Under the circumstances the meetings proposed will be little better than charades unless *both* sides are given the opportunity to put their case.) This is being done at the behest of a small committee which, to put it mildly, has exceeded its brief. It is hard to resist the suspicion that this tactic is deliberate, i.e. that the new policy is being introduced at this late stage to *forestall* democratic debate, since any attempt at resistance risks electoral disaster. This looks like moral blackmail to me, and I must confess, I don't like it.

There is also a *credibility* issue. Believing that the 1999 revenue policy would be a slightly watered down version of 1996 policy, we in Dunedin have been conducting a campaign in the letters pages of the local paper on behalf of progressive taxation. The idea was to disarm opposition come election time by refuting our opponents *in advance*. Their arguments would have been stated and answered and they themselves would have acquired a healthy fear of our polemical pens. (The Dunedin Alliance boasts some excellent and indefatigable letter-writers.) Now all our propagandistic efforts have gone to waste and we will either have to keep silent or devise a set of sophistries to defend a policy in which we do not believe. But it is not just that this policy belies the propaganda of the Dunedin Alliance. (After all, we don't matter that much. in the great scheme of things.) The new policy makes a mockery of Alliance propaganda for the last ten years. Haven't we repeatedly argued that the successive income tax cuts were wrong? Wasn't Jim Anderton saying just this in Dunedin a couple of weeks ago? Well, the test of whether you really believe something is wrong is whether you are prepared to put it right when you get the chance. If we adopt this policy we will have failed this test. We will be no better than the Labour Party which sometimes makes apologetic noises about Rogernomics but shows no desire to reverse Roger's reforms. If we adopt this policy it will look as if we are a set of unscrupulous opportunists

prepared to sacrifice our most important policies for the sake of a few extra votes. And the reason it will look like that is that that is the way it will be.

Finally there is the *tactical* issue. The fact is that we won't be allowed to implement *either* of these policies. For if we are in government at all we will be the junior partners in a Coalition with Labour and the senior partner will not agree to either the tariff (which finances the 'Alliance' scheme) or a progressive income tax (which is the financial motor of the NLP's scheme). So why make a fuss? The answer is that the policy we are elected on is the policy we are bound by for the next Parliament. It represents the *most* we can argue in our negotiations with Labour, a maximum program for that period. If we accept the 'Alliance' proposal then we won't even be able to *argue* for progressive taxation until 2002! We rule progressive taxation off the agenda for the NEXT THREE YEARS. And it will be very difficult to argue for it 2002 given that we will have kept mum about it for so long. 'If progressive income tax is so important to you,' our Coalition partners will ask 'why have you kept quiet about it for all this time? It seems you were happy enough to give it away when you thought that would get you a few extra votes'. What will we answer but 'That was then: this is now'? So let us be clear about this. If we agree to this proposal we will have given up progressive taxation for *at least* the next three years and we will be somewhat discredited when we try to pick it up again.

My object in joining the NLP and later the Alliance was a simple one. I wanted to keep alive a social democratic option in New Zealand politics with a view to reconquering the Left (and ultimately the centre) for social democracy. I think in terms of a two-track strategy: we can win by winning or win by losing. If we win by winning we gradually replace Labour as the chief party of the Centre Left. If we win by losing we force Labour to the Left in an effort to compete with us so that eventually they are compelled to steal all our policies though we dwindle into insignificance. Either way we require a vigorous and confident social democratic program. If we give that up we will neither win by winning nor win by losing. We will simply LOSE and all our efforts will have been in vain.

PROBLEMS WITH THE 'ALLIANCE' POLICY

In this section I criticize the 'Alliance' policy in more detail. I am not trying to argue that the taxes proposed should be dropped. Most of them are at least worth a try. But I AM trying to argue that there are costs as well as benefits and that this particular mix of indirect taxes does not add up to a reliable source of revenue in the long term. Thus the 'Alliance' policy should at least be *supplemented* with a progressive income tax simply to ensure that we can continue to meet our commitments. Several of the taxes are regressive in themselves and likely to exacerbate existing inequalities. One (the tariff) is something of a one-off - it cannot be relied upon to continue generating revenue in the long term. Another represents a leap in the dark. Can we really be sure that the FTT will generate sufficient revenue to do away with GST? The honest answer has to be 'No'. Finally the policy omits one of the most widely used wealth taxes in the world, namely capital gains tax. I shall discuss these taxes in turn.

The Tariff. The Tariff is temporary. Why? Because the various Free Trade treaties and agreements to which New Zealand is a subject only permit us to use tariffs to deal with a balance of payments deficit. Once New Zealand is in the black the tariff will have to be phased out. When exports reliably exceed imports this source of revenue will dry up. Since it represents a billion dollars of income, we will have to get the money from somewhere else. Nor is this all. The tax is regressive in its effects since it raises the price of imported goods and reduces the pressure on New Zealand enterprises to keep prices down. We are in fact replacing one GST type tax with another. The tariff is probably less regressive than GST since the poor spend a high proportion of their income on food which is mostly produced in New Zealand whereas the rich spend more of their money on imports. But a tax can be more progressive than GST and still pretty regressive since GST is one of the most regressive taxes there is. A final problem is that the tariff is a dual purpose tax and the two purposes are fundamentally at odds. It is designed both to raise revenue and to inhibit imports. If it succeeds in inhibiting imports the revenue raised will begin to drop off. For all these reasons it should be treated as a windfall tax and used to finance one-off expenditures (increasing the stock of state houses, buying back the railways, rebuilding rural hospitals etc). It should not be used to finance ongoing

expenditures such as health, education or superannuation. In the long term the tariff is not a reliable substitute for income tax. It should not be treated as if it is.

The Pollution Tax. Polluting industries are liable to pass on costs to the consumers. The tax, therefore, is regressive but only mildly so.

The Land Tax. So far as I can see the likely effect of the Land Tax will be to raise commercial rents. The companies concerned will endeavor to pass on this added cost to the consumer. The tax, therefore is regressive, though again only mildly so.

The Financial Transactions Tax (FTT). This tax is designed to replace the highly regressive GST and is thus a step in the right direction. But there are at least two problems. 1) Since the poor as well as the rich engage in financial transactions the FTT catches them too. It is likely to be a little more progressive than GST but maybe not all that much. 2) We don't know if it will work. When I said this once in discussion some Democrats took exception. But what I said was literally true. We do not *know* if it will work. Nobody, so far as I know, has attempted a financial transactions tax of the kind we propose and on such a massive scale. Hence it may well be that it will not raise the money we expect or that it will have unanticipated downside effects. This is not to say that it is not worth trying (I think it is). But it does mean that we cannot *rely* on it to replace GST. The obvious strategy therefore is to phase it in gradually and to phase out GST if and when FTT proves successful. But this means that we are likely to have the regressive tariff and the regressive GST running simultaneously. This is likely to raise the cost of living which again is more of a problem for those with insufficient funds to meet the costs. 3) Finally, FTT like the tariff is a dual purpose tax and the more it succeeds in meeting one objective - in this case deterring speculative transactions - the less it succeeds in meeting the other - raising revenue. For the speculative transactions that we have deterred (or driven overseas) will no longer be there to be taxed. Again this is not a reason for rejecting FTT but it *is* a reason for not relying on it as a major money -spinner.

The net effect of these taxes will be to raise the cost of living. Since we are making the poor pay more, it seems a little rough that we are not prepared to give them a tax break.

There is one tax that is inexplicably missing from this schedule - **Capital Gains Tax**. A Capital Gains Tax is a tax on gains in the value of capital. Since you have to have made the gains before you pay the tax it is a tax which it is difficult to pass on to the consumer. Thus it is a non-regressive wealth tax, the very thing that the 'Alliance' tax policy would appear to be in favor of. Moreover it is a tax that is widely employed (I believe most OECD countries have it) and something of a money spinner. And like FTT it taxes speculative activities (which typically result in capital gains when they succeed). Moreover it would be easy to implement since it would simply be a matter of copying the legislation that exists in other countries. I therefore suggest that it should be added not only to the 'Alliance' policy but to the policy of the Alliance.

BACK AT THE BACKGROUNDER

I now turn to the backgrounder itself. I can't answer all its 66 points, since I don't have the time, but I will try to deal with some of them.

1. The 'Alliance' Budget is based on four key ideas which have been discussed at length over the past three years.

Answer: The ideas may have been discussed individually, but they have not been agreed on nor have they been put together in this particular proposal. Thus the fact, if it be a fact, that they have been widely discussed does not mean that the 'Alliance' Budget has been democratically discussed or sanctioned.

2. It is unrealistic for the Alliance to expect to solve all the ills that have accumulated over the last 15 years in lifetime of a single Parliament. So the Alliance should be modest since it does not know the full extent of the problems it has to face.

Answer: This is a non-sequitur. It is true that the Alliance cannot expect to solve all the ills that have accumulated over the last 15 years in the lifetime of a single Parliament. But this does not mean that we should be modest. On the contrary it suggests that we should make determined start. If we pussy-foot around we are not likely to get anywhere. It may be that we do not know the full extent of the problems

that we have to face but we have a pretty good idea of some of them and some fairly well-worked out solutions into the bargain. There was nothing particularly modest about the First Labour Government which faced similarly awesome problems. On the contrary they attacked those problems with vigour and self-confidence. Why not us?

3. *We can only indicate the policy directions we will campaign for since we will be in partnership with Labour.*

Answer: This is true and all the more reason to press for a radical program. We won't get everything that we DO ask for but we won't get anything that we DON'T ask for.

4, a) *Income Tax is a declining proportion of national income. b) This means that very little financial assistance can be afforded to the poorest without raising the rates for relatively low income earners. c) Therefore the decision has been taken to redistribute income via universal provision of health, education and housing.*

Answer: As to a), this is partly due to political decisions which it is our business to reverse. Thesis b) is misleading, bordering on the false. It is true that to give tax breaks to the poorest we would need to raise the rates for those with relatively low incomes i.e incomes which are minuscule in comparison with the income of a Don Brash or a Christine Rankin. But it is NOT true that we would have to set the rates at a level which would penalize the majority of the population. On the contrary, the majority would benefit. As for c) it is misleading to say the least. It is true that by providing universal healthcare, education and housing we redistribute benefits and even income, but in the 1996 policy we redistributed benefits and income through the provision of these services *and* we redistributed income by giving a tax break to the poor. Thus our present policy is *less* redistributive than our previous one. It is not (as the backgrounder repeatedly suggests) a choice between a policy which 'redistributes' through the provision of universal benefits and a policy which redistributes through a progressive income tax. It is a choice between a policy which 'redistributes' through the provision of universal benefits and a policy which redistributes through a progressive income tax *and also* 'redistributes' through the

provision of universal benefits. The NLP wants both kinds of 'redistribution'; the 'Alliance' only one. The British Labour Government of 1945 aimed to slay the giants of Ignorance, Disease, Want (or Poverty) and Squalor (or Lack of Housing). In the 1996 policy we too targeted all four giants. But now, it seems, we have put the giant of Want into the 'Too Hard' Basket. This does not look like progress to me.

5. The Alliance Budget represents the first stage in process that would last six years. It is not an absolute blueprint but it does contain the main policy planks for the upcoming election.

Answer: The Alliance Budget contains the policies to which we will be bound in the next Parliament. For that very reason it should contain a maximum rather than a minimum program and, in particular, a policy of progressive taxation.

18. Much as I deplore the absurd sums of money squandered on consultants by the present public service, is it sensible to eliminate consultants ALTOGETHER? Might there not be SOME cases in which consultants might be useful?

20-25. The argument of these sections is roughly as follows: Taxes are means not ends. They are tools for promoting social goods and for realizing the principles for which we stand. Therefore a given tax regime can never be a matter of principle. Indeed it is impious - a bit like farting in church - to put a tax regime on a par with such glorious goals as 'Freedom from Economic Oppression' and 'Social Justice'. Consequently it is absurd for the NLP to make a fuss because the 'Alliance' has raised the rate at which higher taxes cut in from \$28,000 per annum to \$75,000 and it is absurd and even impious to pretend that all this is a matter of principle.

Answer. This is nauseating twaddle. It is true that taxes are means not ends but it does not follow that they cannot be matters of principle. For the fact is that a tax can be the chief, if not the only, means to one of these glorious ends; so that if you give up the means you are much less likely to achieve the end. This is precisely the case with Progressive Income Tax and the twin goals of the reduction of inequality and the mitigation of poverty (which I think are comprehended under 'Social Justice'). Our present tax proposals do little or nothing to reduce inequality which is why the NLP objects to them and why they consider this a matter of principle. The

backgrounder appears to consider that 'Social Justice' is so precious a principle that it would be wrong to try and achieve it.

There is much more to say but it is 2 a.m. and time to stop. I hope this will be of use for the teleconferences on Wednesday night.

Yours in solidarity

Charles Pigden