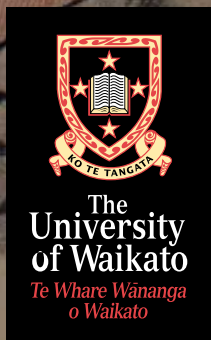


AUGUST 2000

Regional
Economic
Bulletin

THE
LEADING
EDGE
IN
MANAGEMENT

New Zealand –
Is there a
prosperous
future?



WAIKATO MANAGEMENT SCHOOL
Te Raupapa

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New Zealand – Is There a Prosperous Future?

Warren Hughes

The start of a new millennium is an opportune time to assess past economic performance allowing some perspective on the recent fall in the value of the NZ dollar. The plunge in the NZ dollar, against both the US and Australian dollars, has clearly raised some serious questions about NZ's economic future. The absence of any informed political debate reflects either a lack of understanding of the importance of this problem or a conscious political strategy of denial in the face of mounting evidence that full-on Rogernomics may have been a better bet after all.

The following table shows real per capita GDP levels in 1990 US dollars and annual growth rates in per capita real GDP for a variety of countries, including NZ, over the last 100 years.

TABLE 1: PER CAPITA GDP LEVELS (1990 US DOLLARS) & GROWTH 1900 – 2000

REGION & COUNTRY	<i>Year 1900 1990 US \$</i>	<i>1900 Rank</i>	<i>Year 2000 1990 US \$</i>	<i>2000 Rank</i>	<i>Growth Rate Percent p.a.</i>
ASIA					
China	652	18	6283	18	2.3
Japan	1135	14	20616	4	2.9
Korea/South Korea	850	15	14293	15	2.9
Taiwan	759	17	16854	13	3.2
SOUTH AMERICA					
Argentina	2756	9	9122	16	1.2
Venezuela	821	16	7643	17	2.3
EUROPE					
Finland	1621	13	19655	9	2.5
France	2849	7	20377	6	2.0
Germany	3134	6	19119	11	1.8
Ireland	2495	11	19511	10	2.1
Italy	1717	12	18416	12	2.4
Sweden	2561	10	19968	7	2.1
Switzerland	3531	5	21601	3	1.8
ENGLISH SPEAKING					
Australia	4299	3	20609	5	1.6
Canada	2758	8	22401	2	2.1
New Zealand	4320	2	16072	14	1.3
United Kingdom (U.K.)	4593	1	19704	8	1.5
United States (U.S.)	4096	4	27272	1	1.9

Source: World Economic Outlook, International Monetary Fund, May 2000.

Minor movements in rankings up and down can be safely ignored in Table 1, but the biggest winner and loser are easily identified. Japan from 14 to 4 in year 2000 is the big winner. NZ from 2 to 14 over the century is just as clearly the big loser. Compared to NZ, Australia has done extremely well; better than the U.K. but not quite as good as Canada. Starkly rendered is the value of the seemingly trivial difference of a 0.3% per annum growth rate advantage enjoyed by Australia over NZ for the past 100 years. This should be a loud wake-up call for those politicians who claim that economic growth should not be an important focus of government policy. How many social problems could today have been cured in NZ

if our current per capita GDP level was 28% higher, matching that of Australia? Even small gains in economic performance can be extremely valuable, affording a country more options to cure social ills.

TABLE 2: COMPARATIVE GROWTH RATES IN REAL GDP PER CAPITA 1981 – 2001

	81-90 Ave.	Years 1991 – 1999									91-99 Ave.	Forecasts	
		91	92	93	94	95	96	97	98	99		2000	2001
U.S.	2.9	-0.9	2.7	2.3	3.5	2.3	3.4	3.9	4.3	4.2	2.9	3.3	2.7
Japan	4.0	3.8	1.0	0.3	0.6	1.5	5.0	1.4	-2.5	0.3	1.3	0.9	1.8
Germany	2.3	5.0	2.2	-1.2	2.7	1.2	1.3	2.2	2.2	1.5	1.9	2.8	3.3
France	2.4	0.8	1.2	-1.3	2.8	2.1	1.6	2.3	3.4	2.7	1.7	3.5	3.1
Italy	2.2	1.1	0.6	-1.2	2.2	2.9	0.9	1.5	1.5	1.4	1.2	2.7	2.8
U.K.	2.7	-1.5	0.1	2.3	4.4	2.8	2.6	3.5	2.2	2.0	2.0	2.2	2.0
Canada	2.8	-1.9	0.9	2.3	4.7	2.6	1.2	3.8	3.1	4.2	2.3	3.7	2.7
Finland	3.1	-7.1	-3.6	-1.2	4.5	5.1	3.6	6.0	5.0	3.6	1.8	4.1	3.5
Ireland	3.9	2.0	4.2	3.1	7.3	11.1	7.4	9.8	8.9	8.4	6.9	7.4	7.2
Sweden	1.9	-1.4	-1.4	-2.2	3.3	3.9	1.3	1.8	3.0	3.8	1.3	3.9	3.2
Switzerland	2.1	-0.8	-0.1	-0.5	0.5	0.6	n/a	1.7	2.1	1.7	0.7	2.1	2.1
South Korea	9.1	9.1	5.1	5.8	8.6	8.9	7.1	5.5	-6.7	10.7	6.0	7.0	6.5
Australia	3.3	-1.0	2.6	3.8	5.1	4.2	3.6	3.6	5.1	4.4	3.5	3.9	3.5
New Zealand	1.6	-1.7	0.9	5.1	6.0	4.0	3.1	2.1	-0.3	3.0	2.5	3.9	3.4
Taiwan	7.9	7.6	6.8	6.3	6.5	6.0	5.7	6.8	4.7	5.5	6.2	5.9	6.0
Hong Kong	6.5	5.1	6.3	6.1	5.4	3.9	4.5	5.3	-5.1	2.9	3.8	6.0	4.7
Singapore	7.3	7.3	6.2	10.4	10.5	8.9	7.5	8.0	0.4	5.4	7.2	5.4	6.0

Source: World Economic Outlook, International Monetary Fund, May 2000.

Moving to the last 20 years, economic performance in terms of real GDP growth rates is shown in Table 2. NZ's performance is comparatively disastrous. Over 1981-90, only Sweden and NZ averaged below a 2% p.a. growth rate with NZ's 1.6% corroborating the low 100 year equivalent rate of Table 1. The effect of Rogernomics (reaffirmed in the early 1990s by National's Finance Minister Ruth Richardson) becomes apparent in 1993-95 with 1996-97 still good, but now the trend is clearly down. The comparison with Finland after 1993 is all too obvious. The 1991-99 average of 2.5% for NZ results from some very good and very bad years. In contrast, Australia's 3.5% exhibits a more uniform performance over the decade of the 90s. Against Australia, the NZ dollar has fallen from 93c Australian in mid-1995 to around 75c today – a 20% decline in five years.

In her book *Making a Difference*, Ruth Richardson identified a major anomaly in the reform programmes initiated by Roger Douglas and continued by her in the National government that followed. This anomaly was the continued existence of producer boards overseeing business in NZ's major agricultural sectors. One of NZ's better known economic commentators recently characterised farmer politicians managing dairy firms as "simpleton peasant politicians who would better serve making the tea". Although Richardson did her best to rid NZ of such Mickey Mouse management (also known as farmer control), she failed to get the support of Bolger, Birch, Falloon and other cabinet colleagues at that time. These relics of Soviet planning still handicap NZ's economic performance today.

The dismal performance of the traditional agricultural sectors stands in stark contrast to one of NZ's more successful sectors, the wine industry. In the face of intense international competition and a world wine glut and without a producer board in sight, the NZ wine industry has performed spectacularly in recent years. Unfortunately, the currently low NZ dollar has exposed this sector to opportunistic take-overs from countries with stronger currencies. However, the ingenuity of our winegrowers has led to the development of unique wines that are accepted internationally and this should secure a sound future for a NZ-based wine industry for many years.

NZ's wine industry has demonstrated what is possible with modern management practices. However, unless there is a major restructuring of our large, traditional agricultural exporting sectors in the very near future, NZ's dismal economic performance documented above will continue well into the new millennium.

Regional Survey of Waikato and the Bay of Plenty

Stuart Locke¹

Introduction

In early 1999 the Waikato Management School commenced a project to monitor both the performance and issues relating to small-to-medium size enterprises (SMEs). A quarterly survey has been undertaken on a nationwide basis collecting a range of data which is compiled to provide a SME Performance Index. The model is based on an Australian index known as the small business health index. Professor Neville Norman of the University of Melbourne's Economics Department originally designed weightings for the index which has been compiled and published by the Australian Society of Certified Practising Accountants for over ten years.

In New Zealand the survey is conducted nationwide and, in addition, a sample has been drawn for the Waikato and Bay of Plenty regions over the last three quarters. The Benchmark Index consists of a direct survey of SMEs and five statistical aggregates compiled by government agencies:

a.	SME survey	40%
b.	Retail sales	20%
c.	Motor vehicle registrations	10%
d.	Housing commencements	10%
e.	Hourly earnings	10%
f.	Interest rate on smaller loans	10%

In addition to the benchmarking questions, a number of specific topic issues are addressed for both the national and regional samples. Specifically, these focus on topics which are of current interest. The results reported can distinguish the regions from the national position thus highlighting local political economy issues.

Previous Surveys

December 1999

Three specific questions were asked concerning aspects of government policy in the developing the SME sector. The responses in Figure 1 indicated that there was little awareness of the Crown's policy and an absent of endorsement of roles for local government in the SME development area.

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FIGURE 1:

1. How do you believe local government in your area impacts upon small business in your area?			
Positive impact	26.18% (nationally)	30% (BOP)	15.2% (Waikato)
2. Do you think that local government should have an expanded role in developing small businesses?			
No	19.70% (nationally)	32.0% (BOP)	37.0% (Waikato)
3. Do businesses understand the Labour Government's SME policies?			
The answer was a resounding NO with 92% of the region and nationwide businesses saying they didn't have an understanding of what the policy was if there was one.			

March 2000

Attention turned to the areas of E-commerce and compliance costs. It is apparent from the responses shown in Figure 2 that there is a significant divergence between computer usage and access to the internet. Subsequent research indicated that there was low national usage of the internet for purchasing or selling by SMEs and in the Waikato this was below 15% of those that had internet connections.

FIGURE 2:

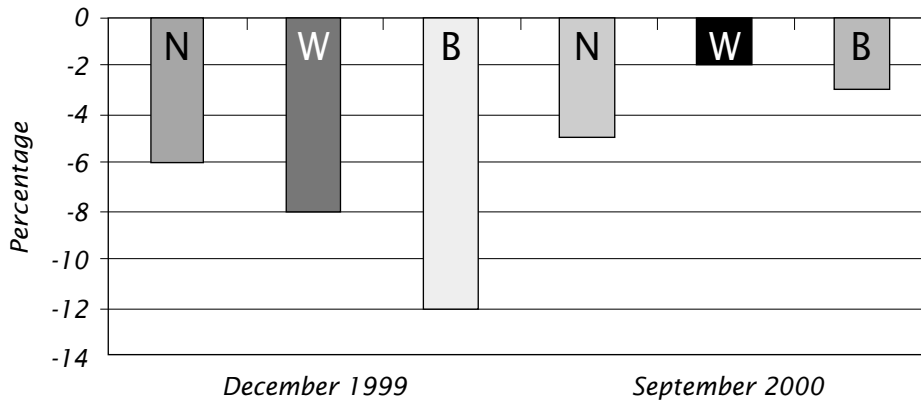
Nationwide	
1. Does your business have a computer?	Yes 75.7%
2. Is your business connected to internet?	Yes 73.1%
3. For businesses that are not presently connected would the internet be useful?	Yes 50.5%
Waikato	
1. Does your business have a computer?	Yes 61.1%
2. Is your business connected to internet?	Yes 47.7%
3. For businesses that are not presently connected would the internet be useful?	Yes 33.3%

Business Activity

Each quarterly survey addresses the two questions gauging the assessment of the SMEs: how the level of activity compares with 12 months previously, and their expectations for the outlook in 12 months time. The responses for the nation as a whole and the two regions of Waikato and Bay of Plenty often differ. The results of the survey for December 1999 and September 2000 are shown in Figure 3 and 4.

FIGURE 3:

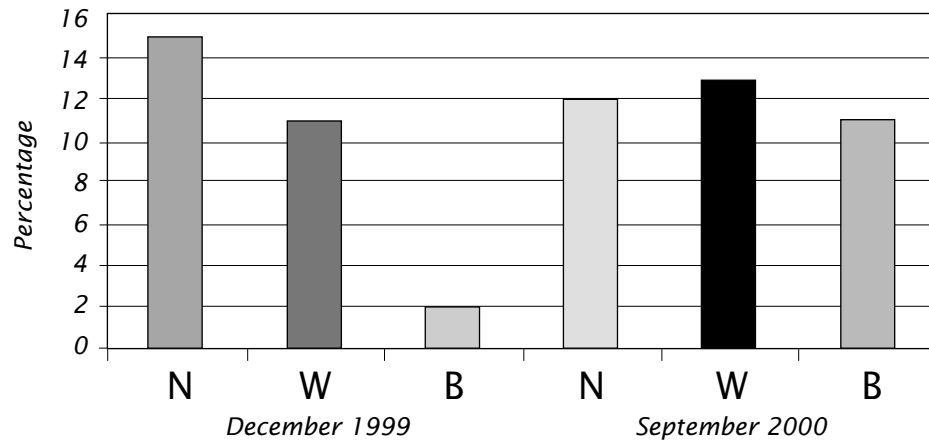
Business Strength Compared to 12 Months Previous



The designations N, W and B indicate Nationwide, Waikato and Bay of Plenty respectively.

FIGURE 4:

Business Strength Expected in 12 Months Time



The indicators point to a lower level of activity at present vis à vis 12 months previous, but the outlook for 12 months time is positive. The Waikato is more bullish than the national average but Bay of Plenty is slightly down on these two. Nevertheless, the outlook for the Bay of Plenty is far more positive than that being shown in December.

The hours of work anticipated is also surveyed and the most recent figures are shown in Figure 5.

FIGURE 5:

1. On average, how many working hours per week do you work?		
	<i>Waikato</i>	<i>Bay of Plenty</i>
Less than 24 hours per week	8.14%	3.70%
Between 25 – 40 hours per week	25.58%	16.05%
Between 41 – 60 hours per week	50.00%	58.02%
Between 61 – 70 hours per week	9.30%	20.00%
More than 70 hours per week	6.98%	1.23%

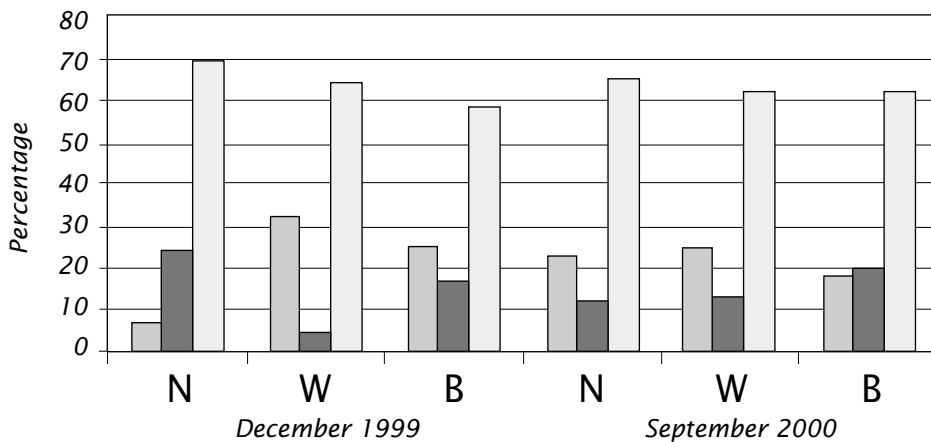
2. Over the past 12 months, have your working hours		
	<i>Waikato</i>	<i>Bay of Plenty</i>
Increased	22.58%	18.52%
Decreased	12.79%	19.75%
Stayed the same	61.63%	61.73%

The working hour figures do reveal a difference between Waikato and Bay of Plenty. It will be useful to monitor these on an ongoing basis to determine whether there is a different work ethic associated with a more strongly developing demographic region.

The increase in work hours in the most recent surveys is nationwide as shown in Figure 6.

FIGURE 6:

Change in Hours Worked on Previous Quarter



The specialist questions in the most recent survey enquired about business awards, the upcoming E-commerce summit, and the regional economic policy of the Crown. Responses are shown in Figure 7.

FIGURE 7:

	Waikato	Bay of Plenty
1. Have you entered the local business awards this year?		
Yes	4.65%	3.70%
No	93.02%	96.30%
Don't know	2.33%	0.0
2. Do you think there are advantages for the business in participating in local business awards scheme in the future?		
Yes	43.02%	34.57%
No	38.37%	44.44%
Don't know	18.60%	20.99%
3. Were you aware that Government is planning to release its policy on E-commerce at a summit in November?		
Yes	27.91%	19.75%
No	62.79%	80.25%
Don't know	9.30%	0.0
4. Do you think that Government in big matters such as E-commerce policy is listening to business?		
Yes	13.95%	2.47%
No	59.30%	80.25%
Don't know	26.74%	17.28%
5. How do you feel about the progress being made with the establishment of regional development committees under Mr Anderton's business development policies?		
Positive impact	9.30%	2.47%
Negative impact	8.14%	6.17%
No impact	7.58%	91.36%
Don't know	6.98%	0.0

Findings

The Waikato, Bay of Plenty and Nationwide results are seldom the same. This observation is not surprising as the subeconomies and communities in these two regions are distinctly different. The nationwide aggregates reflect urban and rural centres from Invercargill to Whangarei. Key findings from the nationwide surveys², which were supported by the regional surveys over the last 18 months are:

1. Low level of satisfaction with government policies in respect to:

- Reducing compliance costs for SMEs
- Employment Relations Act
- Government listening to business
- Regional development matters
- Proposed People's Bank
- Reserve Bank monetary policy

² These are available at www.mngt.waikato.ac.nz/mrc and have been published in New Zealand Business magazine.

2. Lack of communication capacity by government in relation to:

- SME policy
- E-commerce summit

3. Low level of uptake of:

- E-commerce technology

4. Support for a common currency with Australia

Specific issues for the Waikato and Bay of Plenty regions were: the low level of computer/e-commerce strength and in the Waikato particularly, dissatisfaction with the role and potential role of local government in SME policy.

Implications

The policy implications of the regional results point to three important issues:

- 1 Government does not appear competent in determining regional economic impacts of significant policy matters. The lack of developed regional economic modelling will potentially prove costly to the economy overall. This is likely to be most pronounced in the current information, communication technology areas of research which need to address regional infrastructure and education if e-commerce potentials are to be gained.
- 2 Regional level consultation is not occurring. The Chambers of Commerce and other established business networks are not being integrated into consultative policy formulation and analysis. Unless SMEs see themselves as appreciated and essential stakeholders the expectation gap will continue, resulting in lost opportunity and negativity engendered dead weight losses for the economy.
- 3 Regional government is not in touch with their SME sectors for the Waikato and the Bay of Plenty. A real investment in open consultation and research is needed to unleash the growth potentials latent in the SMEs.

A final and striking implication of the research is that SME's consistently look forward to improved future prospects. While the past period may have slumped, there is typically a buoyant expectation for the outlook in twelve months time. Such good prospects inevitably lead to greater risk taking than a dismal outlook would indicate as prudent. It appears that SME's, in general, may be poor at assessing accurately future prospects. Such inaccurate forecasting is likely to put capital at risk. A little more conservatism in outlook, i.e. SME's removing the rose tinted glasses, may reduce the level of business failures associated with overforecasting potential revenue.

Tax Compliance, Self-Assessment and Tax Administration in New Zealand

*Simon James and Clinton Alley*³

Introduction

It has never been easy to persuade all taxpayers to comply with the requirements of a tax system and sometimes the methods used could be harsh. For instance, during the Roman Empire it seems that at one time the approach of the tax-collecting period would be characterised by the ‘tears and terrors of the citizens.’ It is not known just how ferocious the penalties were but Gibbon in *The History of the Decline and Fall of the Roman Empire* tells us that: “The cruel treatment of the insolvent debtors of the state is attested, and was perhaps mitigated, by a very humane edict of Constantine, who, disclaiming the use of racks and of scourges, allots a spacious and airy prison for their confinement”.

Even with the modern versions of racks, scourges and airy prisons, tax compliance is likely to become a significantly more important aspect of tax policy. Most of the old problems remain and some different considerations are raised by developments such as self-assessment, the emergence of the global economy and electronic commerce. These factors have policy implications concerning the way the tax system should be administered. In particular, one risk with self-assessment is the temptation to rely on a harsher enforcement regime. It will be suggested below that if the ultimate purpose of taxation is to benefit society, this does not appear to be consistent with a regime which generates ‘tears and terror’ among the citizens.

The purpose of this article, therefore, is to re-examine issues of tax compliance in the light of a changing environment for tax administration in New Zealand and, indeed, across the world. We examine the importance of compliance and some of the effects of non-compliance and suggest that existing definitions of tax compliance are incomplete. In particular it will be argued that non-compliance involves more than tax evasion – the attempt to reduce tax liability by illegal means. Non-compliance also includes some forms of tax avoidance – reducing taxation by legal means. As discussed below, if a taxpayer takes trouble to rearrange his or her affairs only to avoid tax, this does not amount to compliance with the tax system, whether or not such activities are within the letter of the law. We then revisit the purpose of taxation – it is a means, not an end, and compliance is part of that means – and questions the point of incorporating fear and punishment into a system designed to promote the public good. Explanations of compliance are analysed and then applied to tax policy compliance in New Zealand. Finally, we conclude that there are alternative methods of promoting compliance and that it is important to strike the right balance in encouraging voluntary compliance as well as deterring willful non-compliance. Full references can be obtained from the original paper of the same title, which is available from the authors.

³ Simon James was a visiting professor at The University of Waikato from the School of Business and Economics, University of Exeter, UK.

Clinton Alley is a senior lecturer in Accounting at The University of Waikato.

Factors affecting Tax Compliance

There is no doubt that compliance is a major problem confronting all revenue authorities. For instance, in the USA, the Internal Revenue Service has gone to considerable trouble to estimate the amounts of tax revenue, which are not collected under the American system of self-assessment. One measure is the 'net tax gap.' This is the difference between 'true' individual income tax liability and that finally collected on a voluntary basis or by enforcement action. This gap has been estimated to be between \$US 78.3 to 80.4 billion or 14.2 to 15 per cent of US personal income tax liability in 1992. The majority of this loss consisted of the under-reporting of income, with smaller proportions attributable to the non-filing of returns and overstating tax deductions.

Self-assessment has implications for compliance and a movement towards a greater element of self-assessment has been taking place in countries such as New Zealand, the UK and Australia. Under self-assessment it is the responsibility of the taxpayer rather than the revenue authority to calculate the relevant tax liability and to ensure that the requirements regarding payment, for instance, are met. In New Zealand the Government issued a discussion document in August 1998 on legislating for self-assessment. One of the main proposals now enacted is that the legal provision requiring the Commissioner to make assessments has been replaced by a provision requiring taxpayers to assess their own income tax liability. There are clear implications for tax compliance in such a major change in tax administration. However, the first task is to define the concept of tax compliance.

The Concept of Tax Compliance

The definition of tax compliance is usually cast in terms of the degree to which taxpayers comply with the tax law. This is not an easy concept to measure but one suggestion is that the degree of non-compliance may be measured in terms of the 'tax gap'. This represents the difference between the actual revenue collected and the amount that would be collected if there were 100 per cent compliance. For instance the New Zealand Inland Revenue Department refers to 'minimising the tax gap between *theoretical revenue* and *actual revenue*' but without specifying what 'theoretical revenue' means.

However, the basic concept of the 'tax gap' of non-compliance seems to be inadequate. The 'tax gap' definition and measure are far too simplistic for practical policy purposes since successful tax administration requires taxpayers to co-operate in the operation of a tax system rather than to be forced to carry out every aspect of their tax obligations. Tax law cannot cope with every eventuality and therefore has to be supplemented with supporting provisions. Administrative procedures and decisions as well as appeal arrangements all have a part to play but the tax system cannot work properly without a reasonable degree of willing compliance on the part of taxpayers themselves.

There is the question whether 'compliance' refers to voluntary or compulsory behaviour. If taxpayers 'comply' only because of dire threats or harassment or both, this would not appear to be proper compliance even if 100 per cent of the tax were raised in line with the 'tax gap' concept of non-compliance. Instead, it might be argued that successful tax administration requires taxpayers to comply willingly, without the need for enquiries, obtrusive investigations, reminders or the threat or application of legal or administrative sanctions. A more appropriate definition could therefore include the degree of compliance with tax law and administration, which can be achieved *without* the actual application of enforcement activity.

There is also a difficulty with the idea that there is some fixed tax revenue that would be collected if all taxpayers simply observed 100 per cent obedience to the law. The level of potential tax revenue is determined by the level of economic activity. It is possible that an intrusive tax regime might reduce the willingness of taxpayers to earn more money or engage in commercial activity. This could arise not only because of the associated tax liability but because that extra liability might involve inconvenient administrative requirements or the risk of a heavy handed official response. If taxes were considered to be intrusive or unfair, taxpayers might wish to reduce their tax liability by working less. Any cost is

outweighed by the satisfaction of revenge. It is also possible that taxes might be used as an excuse to avoid unwanted overtime or other obligations. The 'tax gap' definition of non-compliance might then have been partly eliminated because there is less to collect, but clearly there is a loss to society overall. Tax compliance may be seen in terms of tax avoidance and tax evasion. The two activities are usually distinguished in terms of legality, with avoidance referring to legal measures to reduce tax liability and evasion to illegal measures. While some commentators see non-compliance only as evasion, this does not seem to capture the full nature of the problem. Clearly tax evasion is a form of non-compliance. If taxpayers go to inordinate lengths to reduce their liability this could hardly be considered 'compliance'. Such activities might include engaging in artificial transactions to avoid tax, searching out every possible legitimate deduction, using delaying tactics and appeals wherever this might reduce the flow of tax payments and so on. 'Tax exiles' even seem to prefer to emigrate rather than fulfil their obligations as citizens. Even if such activities are within the letter of the law, they are clearly not within the spirit of the law. Compliance might therefore be better defined in terms of complying with the spirit as well as the letter of the law.

A further complication is that some taxes might actually have been imposed in the hope that they would be avoided. For instance, it has been argued that higher taxes on alcoholic drinks and tobacco would reduce the consumption of those products and this would lead to improvements in the health of the population. Any such changes in behaviour would constitute tax avoidance but it would be in the spirit as well as the letter of the law. There have also been developments in other forms of 'corrective taxation' referred to as environmental taxes, 'green taxes' and so on. The 'tax gap' method of viewing compliance is clearly inapplicable in such cases. Furthermore, although the alcohol and tobacco examples are very clear, the tax system is used by governments as an instrument of policy in all sorts of ways – encouraging some activities and discouraging others. Compliance in this context could appear to indicate compliance with government policy in the wider sense, rather than just compliance with tax law.

It would therefore seem that compliance is a much wider issue than simply the gap between actual revenue and some concept of 100 per cent of revenue collectable. A final definition of compliance might therefore be: the willingness of individuals and other taxable entities to act in accordance within the spirit as well as the letter of tax law and administration without the application of enforcement activity. There is no measure of such a definition that is both simple and accurate. However, this definition does indicate the main features, which should be considered in judging the compliance of taxpayers with the tax system.

The Purpose of Taxation and Tax Compliance

A further dimension to this topic is the purpose of tax compliance in the first place. Taxation does not exist in some sort of economic, social and political vacuum. Taxation is a means, not an end. It is therefore an advantage if compliance can be achieved willingly and on a genuinely voluntary basis so far as that is possible. It detracts from the whole purpose of raising taxation for the public benefit if compliance can only be achieved under the threat of severe penalties and enforcement action – the 'tears and terrors of the citizens' of Roman times mentioned before. If the amount of suffering involved in raising the revenue is greater than the benefits from the associated public spending then something is clearly wrong.

Yet it appears that some revenue authorities, at least on some occasions, have followed the policy that the only thing that matters is full tax compliance, regardless of other considerations. In 1970 a survey in Germany found that tax compliance was satisfactory in the narrow 'tax gap' sense but this involved other disadvantages as a result of a high degree of 'confrontation' which led to general tax resistance. It has also been alleged that the Internal Revenue Service (IRS) in the USA has used a heavy hand regarding compliance.

Explanations of Tax Compliance Behaviour

There have been many attempts to explain tax compliance. One traditional view might be described as the *carrot and stick approach* and this might be contrasted with the alternative *responsible citizen approach*.

The *carrot and stick approach* is based on a narrow view of economic rationality under which it is assumed that individuals will wish to maximise their personal income and wealth. They will not comply with the tax system unless the benefits of doing so exceed the costs of not doing so in the form of fines and penalties. This narrow economic view assumes, implicitly or otherwise, that individuals are immoral and operate in some sort of social vacuum. Tax evasion is then explained simply in terms of factors such as the level of tax rates. However, an approach that treats human beings as little more than isolated experimental rats in a cage may not provide a full explanation of tax compliance behaviour. It might be added, of course, that the implementation of such a philosophy usually involves the use of sticks rather than carrots.

In contrast, the *responsible citizen approach* draws on other academic disciplines in suggesting that there might be additional factors that are important in motivating taxpayers regarding compliance. Sociological studies, for example, have identified a number of possible explanatory factors, such as social support, social influence, attitudes, and certain background characteristics such as age, gender, race, and culture. Psychological attitudes towards the state and revenue authorities are also important, as are perceptions of equity. Individuals' roles in society and accepted norms, of behaviour are also important. The essential thrust of these contributions from sociology and psychology are that individuals are not simply independent, selfish, utility maximisers (though this may be partly true). They also inter-act with other human beings according to differing attitudes, beliefs, norms, and roles. The result is that tax compliance may be viewed, as a 'behavioural problem' and that 'the success of an income tax depends on co-operation.'

The truth, of course, is likely to be found in some combination of these approaches. Some people might be amoral and totally materially driven in which case some carrots and sticks might be usefully applied. However, the majority of people seem to exhibit at least some evidence that they respond to social and other values and a successful tax compliance policy will take account of these. The danger is that the unnecessary application of sticks might provoke taxpayer resistance and undermine compliance behaviour on the part of otherwise responsible citizens. This would seem to be the basic question for tax compliance policy for New Zealand in an era of self-assessment.

Tax Compliance Policy in New Zealand

Self-assessment tends to be associated with a system of penalties for those who fail to assess their own liability and to pay tax as required. In the UK a new system of penalties was introduced along with the recent introduction of self-assessment from the tax year 1996/97. In New Zealand new compliance and penalty rules became law in 1996 partly to take account of the 'modernisation of tax administration' and 'an increasing responsibility placed on taxpayers to assess their own liability.' As indicated above, there is the risk that an excessively harsh regime could be counter-productive in securing the compliance of some taxpayers. There has been an important debate about allegations of the IRD's apparently extremely tough and inconsistent use of the new penalty provisions. Penalties are heavier than they were and a wider variety of types of conduct by taxpayers will cause a penalty to be imposed. There have also been moves to improve the position for at least some taxpayers. For instance, one way of clarifying the law is to operate a system of tax rulings. In New Zealand a system of binding rulings was introduced in April 1995 and this has covered an increasing range of circumstances. Furthermore there are new tax disputes resolution procedures which came into effect in October 1996.

Traditionally most of the attention paid to tax compliance by revenue authorities and others has been devoted to why some taxpayers do not comply rather than why others do so. It might easily be argued

the other way round. The norm is usually to comply rather than not to comply and for a tax system to be effective it must have the willing co-operation of a majority of taxpayers. It follows that there may be greater gains in assisting compliant taxpayers meet their fiscal obligations than in spending more resources in pursuing the minority of non-compliers. Many taxpayers might be willing to comply in full but are unable to do so because they are not aware of, or do not understand, the extent of their obligations. Even if they did, they may not be able to comply for other reasons. Additional resources devoted to assisting such taxpayers, for example, by improving the flow and quality of information or educating them into becoming more responsible citizens, might yield greater revenue than if it were spent on additional enforcement activities.

One other way forward is to simplify the tax law. A complicated tax system generates complicated tax laws. However, no matter how simply laws are written, other important factors have to be taken into account in order to achieve any lasting improvement in compliance.

Conclusions

Tax compliance is a complex subject more so than most appreciate. There are two main approaches to encouraging taxpayers to comply with the system. The *carrot and stick approach*, usually confined to sticks, may be necessary to enforce compliance by those taxpayers who would otherwise refuse to discharge their obligations as citizens. However, there are dangers in using such an approach more widely. It is suggested that taxation is a means to an end and an unnecessarily harsh enforcement regime detracts from the whole exercise of raising money for the public benefit. Furthermore, such harshness can reduce the willingness of otherwise responsible citizens to comply with what may then be perceived as an unjust system. There is a clear need to strike the right balance in encouraging voluntary compliance as well as deterring willful non-compliance.

Self-assessment increases the risk that a revenue service might resort too readily to a penalty driven compliance policy. With the introduction of self-assessment in New Zealand, this is a trap into which the New Zealand Inland Revenue Department may be falling. Traditionally they have attempted to follow the alternative *responsible citizen approach* of assisting responsible citizens in assessing themselves. This surely must be the best way forward for tax administration in New Zealand.

Outlook for New Zealand's Main Trading Partners

Warren Hughes

Global growth in 1999 has now been estimated at 3.3% as compared to the 2.2% forecast at the end of 1998. Currently, world growth for the year 2000 is projected at 4.25%. However, the experience from earlier global business cycle upturns is that they have often turned out to be stronger than anticipated.

Sustainable world growth, in the opinion of **The International Monetary Fund**, will depend on:

- Containing excess demand pressures in the US, including the avoidance of a significant relaxation in the fiscal stance (i.e. no tax cuts following the presidential election).
- Promoting robust and durable economic expansions in Japan and Europe.
- Making greater progress on structural reforms over the medium term in Europe and especially Japan.

United States

The U.S. economy has been the undoubted success story of recent years. In 1999, real GDP (after inflation) rose 4.2%. Domestic demand rose 5.1% resulting in a widening current account deficit approaching \$400 billion or 4% of GDP. Despite this ever-widening deficit, the U.S. dollar continues to strengthen against almost all currencies, most notably the Euro and the pound. Latest projected growth for the year 2000 is 5% with 4% plus projected for 2001. Thereafter a steady 3% rate is forecast.

Australia

The introduction of GST on July 1 has distorted recent data on the Australian economy. Retail sales dropped 8.7% in July versus June, more than the 5% fall predicted by market consensus. Building approvals slumped 14% versus expectations of a 2.5% rise. Clearly Australian consumers and builders bought ahead of GST. Around 4% growth is projected for Australia over the next two years, the same forecast for NZ.

China

China grew by 7% in 1999 and this same growth rate is projected for year 2000. The recoveries in competing regional currencies have meant a relative depreciation in China's exchange rate. This has reduced previous pressure for a nominal devaluation and has aided export growth. Net capital inflows into China have resumed and this is another confidence boosting factor for the Asia/Pacific region.

Japan

Real growth was just 0.3% in 1999 with a projected rate of 0.9% for year 2000. For the quarter ended June 2000, the Japanese economy grew at a 4.2% annual rate. If this rate is sustained, it is indeed good news for the World economy. However, business investment in this quarter actually fell and this is not a good omen for a sustained recovery. The key to a lasting recovery for Japan (important for world growth) is structural reform in the financial, corporate and labour sectors. Without this, Japan's dismal growth record of the 1990s (see page 3) is likely to continue well into the new century, despite the good news for the latest quarter.

Europe

Real GDP growth in 1999 was a relatively moderate 2.3%. This is projected to accelerate to 3.2% in year 2000. Supportive macroeconomic policies and a highly competitive Euro rate could produce an even stronger upswing. The European Central Bank recently raised its key interest rate by a quarter point to 4.5%. This was prompted by the view that in the face of favourable growth prospects, it was imperative to contain perceived medium-term inflationary pressures. The prospects for Europe's equity markets are also currently viewed as favourable. However, in terms of market capitalisation, Europe is still far behind the U.S. Currently, Euroland's total equity market capitalisation stands around 80% of nominal year 2000 GDP. The U.S. percentage is about double this.

New Zealand

NZ's real GDP has been forecast to grow at around 4% for years 2000 and 2001. Currently, good news from the export sectors supports these projections. However, a low NZ dollar will mean higher inflation and this will handicap real growth in the future. **Statistics NZ** has just reported July sales for all NZ are 4.6% ahead of July 1999 sales. Our projections for retail sales in the Waikato region (page 17) show a 7.4% gain for the September quarter and a 3.4% gain for the Tauranga District Council region (page 18). While the Waikato projection is significantly ahead of that for Tauranga, both are broadly in line with the latest July figures for NZ as a whole. Note that all these results are in nominal or current dollars, so although higher petrol prices contribute to higher sales gains, the volume of petrol sold has almost certainly fallen in recent months.

Summary

The above projections for NZ's main trading partners are certainly good news for NZ exporters and the NZ economy as a whole. The recent fall in the NZ dollar will also enhance returns to exporters, but will certainly pressure the Reserve Bank into attempting to rein in the inflation that will surely follow. Business and consumer confidence has also tumbled and higher prices for imported goods such as cars and for services such as travel may moderate demand thus reducing the need to raise interest rates to a level that may otherwise be necessary. Perhaps the government could also look to tax incentives for saving in order to boost investment and reduce consumer spending.

Waikato Regional Indicators and Outlook

Warren Hughes

Table 1 below shows that our projections for Waikato economic activity in the previous *Bulletin* were too pessimistic for Retail Sales and too optimistic for Building Consents. The current confidence in the agricultural sectors reaffirms our 6 – 7% gains for Retail Sales for the rest of year 2000 and into the first half of 2001. For Hamilton City Building Consents, we are projecting building activity at around a \$45 million quarterly rate. However, building activity in the wider Waikato region may pick up significantly as confidence returns to the rural sectors.

TABLE 1: PROJECTIONS FOR WAIKATO RETAIL SALES AND BUILDING CONSENTS

Quarter	WAIKATO REGION RETAIL SALES				HAMILTON CITY BUILDING CONSENTS			
	\$ m Actual	\$ m Projected	% Error	% Change over Previous Year	\$ m Actual	\$ m Projected	% Error	% Change over Previous Year
Sep 99	913.4	875.6	-4.1	5.7	44.8	44.9	0.0	24.1
Dec 99	1034.2	999.8	-3.3	4.0	41.7	52.5	25.9	3.5
Mar 00	964.7	940.8	-2.5	4.1	47.8	46.4	-2.9	29.2
Jun 00	936.4	887.9	-5.2	6.6	42.7	55.3	29.5	-6.4
Sep 00		980.9		7.4		47.3		5.6
Dec 00		1097.0		6.1		45.7		9.6
Mar 01		1032.5		7.0		43.9		-8.2
Jun 01		999.0		6.7		45.2		5.9
Sep 01		1007.2		2.7		48.8		3.2
Dec 01		1123.3		2.4		47.3		3.5
Mar 02		1058.8		2.5		45.3		3.2

Although our Retail Sales projections for the four quarters ending in June 2000 were reasonably close to the actuals, all projections were less than actuals. Quite possibly increased overseas tourism and the flow on from the America's Cup event in Auckland led to stronger than forecast sales in the region. However, our forecasts for Building Consents was too optimistic. Other data suggests that house prices in some suburbs of Hamilton have fallen as much as 8% over the last year. This cannot be good for confidence in the city's building sector. Demand for industrial and commercial property in Hamilton is also not brisk. The city will need a sustained upturn in dairying and other manufacturing sectors before property investment will again become attractive. As a result, projections for Hamilton Building Consents show only moderate growth in Table 1 out to the beginning of 2002.

Western Bay of Plenty Regional Indicators and Outlook

Warren Hughes

This issue of the *Bulletin* starts a new section devoted to forecasting economic prospects for the Bay of Plenty in a similar fashion to that for the Waikato region. We have selected Retail Sales for the Tauranga District Council area and Building Consents for the combined District Council areas of Tauranga and the Western BOP. The cost of obtaining data from **Statistics NZ** means that we could not get detailed data for all BOP regions. Retail Sales, for example, costs about \$500 per District Council. However, the series below will provide some indication as to how the BOP generally can expect future economic activity to unfold.

Since this is the first of such projections, the percent error column in Table 1 below is empty. In future *Bulletins* we will report how good or bad these forecasts proved to be.

TABLE 1: PROJECTIONS FOR WESTERN BOP RETAIL SALES AND BUILDING CONSENTS

Quarter	TAURANGA D.C. RETAIL SALES				TAURANGA & WBOP BUILDING CONSENTS			
	\$ m Actual	\$ m Projected	% Error	% Change over Previous Year	\$ m Actual	\$ m Projected	% Error	% Change over Previous Year
Sep 99	289.1			8.4	85.1			60.6
Dec 99	334.1			4.6	75.3			13.7
Mar 00	310.3			16.4	67.0			-8.7
Jun 00	293.9			4.9	70.4			-23.0
Sep 00		298.8		3.4		72.3		-15.0
Dec 00		327.6		-1.9		64.0		-15.0
Mar 01		300.1		-3.3		62.8		-6.3
Jun 01		306.9		4.4		78.2		11.1
Sep 01		311.5		4.3		72.8		0.7
Dec 01		350.9		7.1		64.4		0.6
Mar 02		324.0		8.0		63.3		0.8

WBOP stands for Western BOP District Council.

Looking at Retail Sales, we see that for the quarter ended March 2000, sales were 16.4% ahead of the same quarter in the 1999 year. This is an exceptionally good outcome that may have resulted from a good summer at the beaches plus an America's Cup flow on. Whatever the reason, the following June quarter sales were just under 5% ahead of the same 1999 quarter, which is still good if less spectacular. The forecasts above indicate a further slowing in sales growth for the current September quarter and negative growth for the next six months. Growth in Retail Sales is then projected to recommence starting the June quarter of 2001.

Turning to Building Consents for the Western BOP regions, we see an exceptional gain in building activity of over 60% for the quarter ended September 1999. Growth at this rate simply cannot continue indefinitely. As a result, activity for the quarter ended June 2000 is 23% down on the same quarter last year. Projections in Table 1 show this negative growth continuing over the next year. Note that negative growth from very high levels in the previous year is not necessarily disastrous, since current levels of over \$60 million per quarter means much building is still going on, at around the 1998 level. However, it is still a significant drop from the \$80 million quarterly rate of 1999. As for Retail Sales, we expect growth in building activity to recommence after the first quarter of next year.

Agricultural Statistics for the Waikato Region

Warren Hughes

For the first time in the *Bulletin*, we have included a section on agricultural statistics. Over time, it is planned to incorporate coverage of the Bay of Plenty Regional Council area and to further expand the statistics reported. Table 1 below shows currently available data for the Waikato Regional Council area. We might legitimately complain that these statistics are not up-to-date. It is hoped that more current data will be available for our December issue. However, only **Statistics NZ** can determine this.

TABLE 1: AGRICULTURAL DATA FOR THE WAIKATO REGION

	1990	1995	1996	1999
Number of farms	12655	11954	11428	14478
Permanent full-time employees	3390	5698	4877	
All fertilisers applied (tonnes)	402,924	724,073	710,967	
Dairy Cattle	1,276,689	1,523,259	1,553,004	1,503,208
Beef Cattle	758,382	864,223	771,586	679,406
Total Cattle	2,035,071	2,387,482	2,324,590	2,182,614
Sheep	4,471,206	3,515,338	3,367,980	2,865,674
Pigs	64,346	72,673	79,485	67,130
Goats	180,865	38,557	32,407	
Deer	153,686	140,868	148,822	153,651
Horses	18,861	14,252	13,151	
Total all vegetables (hectares)	2248	7287		
Total all fruit (hectares)	2258	2610	2406	

Although the years shown are not uniform, it is clear that up to 1999 all animals farmed, apart from deer, have dropped significantly in recent years. According to the Ministry of Agriculture and Forestry, farm profitability should rise dramatically. Average cash farm surplus available for living expenses, loan repayments and farm upgrading should rise from \$83,000 in the year ended 2000 to \$100,000 in the 2001 year for sheep and beef farmers with an even bigger rise from \$90,000 to \$130,000 for dairy farmers.

The Waikato region is NZ's prime dairying region. The region's principal dairy company, NZ Dairy Group, has just reported for the year ended May 2000 and some statistics from this report are shown in Table 2.

TABLE 2: SELECTED STATISTICS FROM NZ DAIRY GROUP RESULTS

Data for May Years	1999	2000	Percent Gain
Milksolids Own Supply (millions kg)	386.1	570.3	47.7
Dairy Production ('000 tonnes)	583.8	866.0	48.3
Number of Suppliers	6696	7502	12.0
Number of Employees	3739	4037	8.0
Group Revenue (\$ billions)	2.5	3.4	36.0
Payout in cents per kg of solids	363	375	3.3

While data in Table 2 show pleasing productivity gains per farm and per employee, group revenue has lagged behind the production gains and the payout per kg gain of 3.3% is significantly below the decline in the NZ dollar over the same period of around 11%.

Economic Statistics

REAL GROSS DOMESTIC PRODUCT

<i>(\$ Millions, 91/92 prices for quarter ended)</i>	<i>March '99</i>	<i>March '00</i>	<i>% Change</i>
Agriculture	1284	1405	9.4
Forestry, Fishing & Mining	615	590	-4.1
Manufacturing	3898	4134	6.1
Total Gross Domestic Product	22507	23748	5.5

RETAIL SALES

<i>(\$ Millions for year to date)</i>	<i>June '99</i>	<i>June '00</i>	<i>% Change</i>
Auckland Region	12831.0	13911.1	8.4
Waikato Region	3662.8	3848.7	5.1
North Island	30087.3	32070.6	6.6
South Island	9615.2	10304.3	7.2
All New Zealand	39702.5	42374.9	6.7

BUILDING ACTIVITY

<i>(Work in place \$m to year ended)</i>	<i>June '99</i>	<i>June '00</i>	<i>% Change</i>
Dwellings: All New Zealand	3638.2	4644.7	27.7
South Auckland Statistical Area	697.1	851.0	22.1
Total: All New Zealand	6243.5	7444.0	19.2
South Auckland Statistical Area	1019.4	1171.8	14.9

LABOUR MARKET

	<i>June '99</i>	<i>June '00</i>	<i>% Change</i>
All New Zealand: Unemployment Rate %	7.0	6.1	-12.9
Waikato Region: Unemployment Rate %	8.1	5.6	-30.9
All New Zealand: Labour Force ('000)	1866.9	1867.5	0.0
Waikato Region: Labour Force ('000)	166.6	177.9	6.8
Working Age Population ('000)	254.9	269.4	5.7
Participation Rate %	65.3	66.0	1.1

PRICES

	<i>June '99</i>	<i>June '00</i>	<i>% Change</i>
Consumer Prices (June '99 = 1000)	1000	1020	2.0
	<i>March '99</i>	<i>March '00</i>	
Producer Prices (June '99 = 1000)	994	1043	4.9

INTEREST & EXCHANGE RATES & RESERVES

	<i>June '99</i>	<i>June '00</i>	<i>% Change</i>
Reserve Bank Base Rates (% p.a.)	8.36	10.50	25.6
Trade Weighted Exchange Rate (Jun '79 = 100)	58.20	52.20	-10.3
	<i>May '99</i>	<i>May '00</i>	
Total Official Reserves (\$ millions)	7698.40	7830.30	1.7

Department of Economics

WAIKATO MANAGEMENT SCHOOL

Te Rauapa