

NZ economic growth

Where to from here

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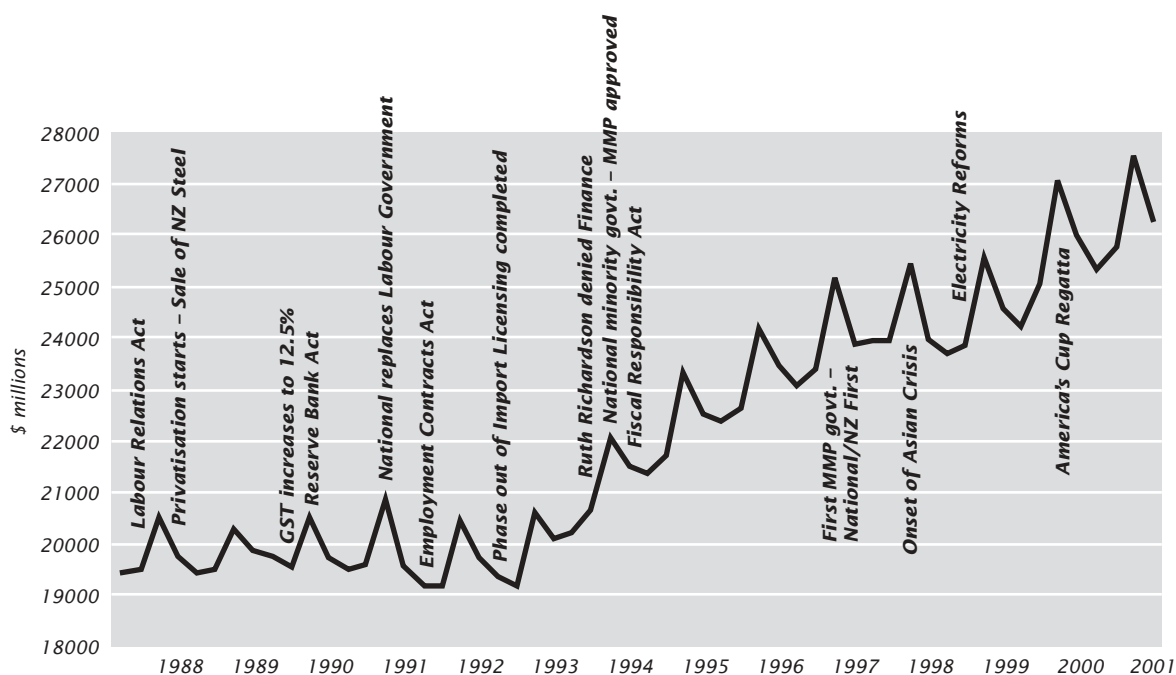
NZ Economic Growth – Where to from here?

Warren Hughes

NZ's economic performance is again showing signs of stalling. A significant change for the better in both government and business performance will be required to rekindle the economic growth spurt that followed the Rogernomics reforms. The focus of the current government on higher taxes for individuals and companies, the peoples' bank and parental leave (higher business costs) seems out-of-tune with the more growth orientated direction of Britain's Labour government for example (see below). Business mismanagement as in Air NZ's recent troubles and Fonterra's powdergate hiccup and director discontent has surely undermined consumer and business confidence in the country's future. In this election year, the country desperately needs innovative leadership to restore its faith in a prosperous future.

First we need to review NZ's recent economic performance. In Figure 1 below, real quarterly GDP for NZ is shown for the quarter ended June 1987 to March 2001. Note that "real" here means inflation has been removed from the GDP totals so any upward trend in the graph is not an illusion due to inflating prices. In the graph, the highest point in a set of adjacent points is always the December quarter, reflecting the higher economic activity in NZ in the festive quarter.

Figure 1: Quarterly Real GDP for New Zealand – June 1987 to March 2001



A quick examination of trends in the graph suggests three relevant periods for analysis. First, 1987-1992 showing abysmal economic performance, then a remarkable growth spurt in 1993-1996 and, as foreshadowed in our title, a period 1997-2001 with a suggestion that economic growth may be levelling off. Average annual growth rates for these intervals relative to growth rates for other countries are shown in Table 1.

Table 1: Annual Average Growth Rates in Real GDP

Region	Average Percentage Growth Per Year for Real GDP		
	1988 – 1992	1993 – 1996	1997 – 2000
World	3.0	3.4	3.8
Advanced Economies	2.6	2.6	3.4
New Zealand	-0.8	4.7	2.4
Australia	2.2	4.2	4.5

Note that Advanced Economies includes the US, Japan, other G7 countries, NZ, Australia and other countries similar to ourselves. These countries take most of our exports, so high growth for Advanced Economies should mean high potential growth for NZ. Note that the group performance of the Advanced Economies has been severely handicapped by the poor performance of Japan (the world's second largest economy) since 1990.

As expected, our bad relative performance is confirmed for 1988-1992 from the figures in Table 1. Then in 1993-1996, the effect of the reforms starting in 1984 and culminating with the Fiscal Responsibility Act in 1994 becomes apparent. However, the 1997-2000 column (only the March 2001 quarter is available) confirms our relatively poor performance of late. After out-performing Australia over 1993-1996, we have slipped to almost half the Aussie growth rate in the most recent interval. This at a time when World growth was at its highest.

In my view, the growth spurt of 1993-1996 was due to the change in business and consumer confidence engendered by the Rogernomics reforms that started in 1984. Privatisation, the introduction of GST, the lowering of high marginal income tax rates as well as the legislation starting with the Reserve Bank Act in 1989 awakened Kiwis to the prospect that a new era might be at hand. Given the many false promises of earlier governments, it is not surprising that a lag of several years elapsed before the population at large was persuaded that this time it was for real. Although controversial, the Employment Contracts Act of 1991 may have been the watershed legislation that finally convinced Kiwis that a new era had indeed commenced. The figures in Table 1 are incontrovertible evidence that we outperformed our usual benchmark countries quite significantly over 1993-1996.

The end of the political Rogernomics era can be dated as the last quarter of 1993 when Bolger decided against re-appointing Ruth Richardson to Finance should National be successful in the election of that year. One can still recall how some opposition members at the time trumpeted the forthcoming reversal of Rogernomics that would follow the election defeat of the National government.

Although re-elected, any short-term political gain for National came, as we can now judge, at some considerable cost to NZ's economy. Of course, the reforms had induced a head of steam that was only reined in by first an MMP government in 1996 (a major change for NZ that may have induced a wait-and-see attitude by investors) but then by the onset of the Asian crisis in late 1997. This resulted in major cutbacks in forestry exports and Asian tourism. The America's Cup regatta stimulated primarily Auckland, but also NZ as a whole, compensating somewhat for the Asian slowdown. With world growth now visibly slowing and world prices for our major commodity exports currently falling, the outlook for NZ growth for 2002 must be subdued. Treasury's latest prediction is for 1.3% growth for the year ended March 2003, almost half the 2.4% average over the period 1997 – 2000.

The current government likes to associate itself with Britain's "New Labour" government. Writing in *The Wall Street Journal* of 19 June 2001, Britain's Chancellor of the Exchequer Gordon Brown outlined some policy initiatives the Labour government plans for the UK:

- to put in place a pro-competition regime to match the best in the world
- to cut the capital gains tax from 40% to 10%
- to extend tax-advantaged share options to entrepreneurs
- to use other incentives to encourage business location in the UK, having cut corporate taxes to 30%
- to establish a venture capital fund
- to introduce tax incentives to encourage business location in run-down areas

Gordon Brown also stated: "The enterprise culture needs to start in our schools and colleges. We want every young person to hear about business and enterprise in school." Back on home turf, raising taxes for the "rich" and establishing a state-run "peoples' bank" clearly shows a different policy tack by NZ's present government.

A major contributing factor to NZ's generally poor economic performance over the second half of the last century has been the low returns from our agricultural and primary sectors. It remains to be seen if Fonterra can raise the rate of return on NZ's huge investment in dairying. Early indications are not promising. Fonterra's most experienced director resigned saying "he fears the dairy giant is headed for mediocrity". Richmond has just reported a good past year, but for every Richmond unfortunately there is an AFFCO. Carter Holt Harvey is on record as stating that many of their NZ operations do not earn their cost of capital, and Fletcher Forests shares languish close to their recent issue price. The NZ economy will continue to fall further behind the Australian economy unless these major industries perform much better than in their recent past.

Government too must be prepared to radically reform its institutions. Taxation would be a good place to start. Income and company tax (including the Fringe Benefit Tax estimated to net \$350m annually) should be abolished in favour of an expenditure tax such as GST. We could raise the GST rate from 12.5% to 33%. Income and company tax at a low level could be retained for a transitional period but should ultimately be abolished for all individuals and firms that pay GST. An income tax at an appropriate level would be retained for those companies and other organisations that attempt to avoid paying GST. Withholding taxes (perhaps at a higher level) should be retained only for non-residents. This means that New Zealanders classed as non-residents for tax purposes would be subject to both withholding tax and the higher GST rate on their NZ expenditure. They would therefore pay tax at a higher rate than would other New Zealanders. In any case, there should be no exemptions for any NZ citizen or organisation from some form of taxation. The gains for NZ from this proposal would be:

- huge savings by making redundant the income and company tax empire of accountants, lawyers, family trusts, overseas trusts, imputation credits, provisional tax, resident withholding tax and IRD oversight etc.
- savings encouraged by an expenditure tax
- capital gains captured by an expenditure tax making a separate capital gains tax unnecessary
- expenditure in health etc. on behalf of foreign tourists would now be funded at least in part by the higher expenditure taxes paid by tourists while in NZ
- net tax yield greater under expenditure taxes versus income taxes, hence a 33% GST rate equivalent to a 25% rate on tax-inclusive cost (and lower government expenditure) may eventually suffice to cover lower government outlays
- continued revenue from other indirect taxes such as excise and customs duties to remain in place.

As with all taxes, evasion would not be eliminated by replacing income tax with a raised GST. However, enforcement focusing solely on GST compliance by the IRD would keep evasion minimal. Beneficiaries would need to be compensated with higher allowances etc. to leave them no worse off under such an expanded indirect tax regime. Computers and business organisation generally now make expenditure tax a better alternative than the income and capital gains taxes of earlier generations. Previously, computational costs to administer and collect an expenditure tax were too high compared to an income (and company) tax.

The other area that government should address is harmonisation of regulation, law and financial markets with Australia as much as possible (see following article). This does **not** necessarily mean a common currency or a merger of NZ and Australian stock exchanges to begin with, although either or both could be the ultimate outcome of the process. The objective is to make it as easy as possible for all Australasian business to be conducted from Auckland as opposed to Sydney. World class Canadian companies such as Nortel Networks do not find it necessary to shift to the US, although this is by far their biggest market. Recent NZ companies shifting to Australia include Lion Nathan and Fernz (now Nufarm) with Tower Group scheduled to shift to Sydney in the near future. Other NZ companies with significant Australian operations include Carter Holt Harvey (about to dual list in Australia), The Warehouse, Hallenstein-Glassons and Michael Hill Jeweller. Companies such as these should be encouraged to maintain their head offices in NZ (make dual stock exchange listings easier), and our two hour lead over Australia should be exploited more in world financial markets.

As evidenced by recent events in the airline industry, Australian unions and other players will oppose any initiatives that could lead to gains for NZ workers and companies, so our government has to be proactive in any harmonisation process. The maximum possible harmonisation with Australia is the logical conclusion to draw from the success of the CER arrangement signed in 1983.

A Comparison of the New Zealand and Australian Definition of “Residence” for Individuals

Clinton Alley¹, Duncan Bentley² and Simon James³

Introduction

Residence is a critical concept in the tax legislation of most countries. In its more general meaning it identifies those persons belonging to the country. It is defined more strictly for tax purposes. In most jurisdictions, persons defined as tax residents are taxed on their worldwide income. Non-residents are usually taxed on their domestic income arising within the taxing state. Therefore the definition of residence in domestic legislation is an essential determinant of liability to taxation. It is not the sole determinant. Definitions of residence aim to delineate the taxing rights of a country. Bilateral double tax treaties allocate taxing rights between countries in an attempt to prevent double taxation or double non-taxation.

Although the definition of “residence” for individuals differs between Australia and New Zealand there are fundamental similarities. This article puts forward a “number of days” test as the most appropriate to protect the revenue and attract foreign investment. This may be reinforced by using the “centre of vital interests” definition as a tie-breaker. Using this discussion, the article examines the advantages and disadvantages of each of the New Zealand and Australian definitions and puts forward proposals for the revision of the Australian definition, while suggesting that a common definition could be used for both countries in the context of the Tax Law Improvement Project.

Residence in context

Why is residence for an individual of such great importance in Australia and New Zealand? Australia taxes residents on their worldwide income irrespective of the source of that income and taxes non-residents only on that income which has its source in Australia. A similar basic rule is used in New Zealand. Residents of New Zealand are liable for New Zealand income tax on income derived from any part of the world. This applies whether or not this income is remitted back to New Zealand. Non-residents are liable for New Zealand income tax only on income derived from New Zealand.

In defining whether a taxpayer is resident, the Australian *Income Tax Assessment Act 1936* (Cth) (“ITAA36”) does so using a complex definition of residence. A non-resident is defined as “a person who is not a resident of Australia”. The definition therefore includes those taxpayers who do not fall within the resident classification and relies on the latter complex definition for its meaning. The New Zealand legislation defines both a resident and a non-resident, using a simpler definition in the *Income Tax Act 1994* (“ITA94”).

In their definitions, both New Zealand and Australia rely in part on an arbitrary number of days of presence in (and for New Zealand, absence from) the relevant country to determine residence status. Crucial to the definitions, but far less arbitrary and, as a result, more difficult to define, is the concept of “permanent place of abode”. The complexity of the Australian definition is further increased by the use of the common law definition of residence and the concept of domicile.

The Organisation for Economic Co-operation and Development’s (“OECD”) *Model Convention on Income and on Capital* (“OECD Model”) acknowledges the different types of definition. The OECD Model allocates taxing rights to individuals on the basis of their primary place of residence in Art 4, para 2. There is an ordering of criteria. A permanent home is the first indicator of residence and it is the permanence factor that is emphasised. If there is a permanent home in two states, then the test uses closer personal and economic relations or the centre of vital interests. Where there is no permanent place of abode or if the centre of vital interests is unclear, the place of habitual abode is used. If this test is unclear then nationality is used as the tie-breaker. Failing that the states must settle the issue by mutual agreement. Article 4, which is widely adopted in bilateral double tax treaties,

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operates as a tie-breaker clause to prevent double taxation where both countries define the individual as tax resident.

An Art 4 tie-breaker clause is needed in double tax treaties. However, an individual is less likely to be in a position to become a dual resident under detailed definitions that look to the facts of each case. Dual residence is more likely where countries use an arbitrary number of days test to determine residence. Some countries, such as Malaysia, simply use the arbitrary number of days test. Others, such as New Zealand and Australia, operate an arbitrary number of days test in conjunction with other more detailed tests. If a country adopts an arbitrary number of days test, it should ensure that either it has comprehensive bilateral tax treaties with its major trading partners, or, like Malaysia, it treats tax residents generously. Otherwise, the double taxation for executives and other expatriate personnel could influence the decision to invest in that state, other factors being equal. Both Australia and New Zealand have substantial tax treaty networks, which makes the arbitrary number of days rule justifiable in an economic environment where both countries have undergone significant economic liberalisation to attract foreign investment.

This article continues by discussing the residency laws of first New Zealand and then Australia. As a basis for this discussion the specific sections of the respective Acts are stated in the table that follows. The article concludes with a statement of the changes that are necessary for both countries. Then, drawing on the New Zealand law as a starting point recommends that, with the suggested changes, this could become the basis for a common set of rules for residency which will be applicable to both countries.

<p>Section OE 1 Income Tax Act 1994 (summarised)</p> <p>(1) A person, other than a company, is resident in New Zealand... if that person has a permanent place of abode in New Zealand, whether or not that person also has a permanent place of abode outside New Zealand.</p> <p>(2) Where that person... is personally present in New Zealand for a period or periods exceeding in the aggregate 183 days in any period of 12 months, that person shall be deemed to be resident in New Zealand from the first day within that period of 12 months on which that person was personally present in New Zealand.</p> <p>(3) Where that person... is resident in New Zealand and is personally absent from New Zealand for a period or periods exceeding in aggregate 325 days in any period of 12 months, that person shall be deemed not to be resident in New Zealand from the first day within that period of 12 months on which that person was personally absent from New Zealand...</p> <p>(4) Where that person... is personally present in New Zealand for part of a day, that person shall be deemed to be personally present in New Zealand for the whole of that day...</p> <p>(5) Notwithstanding any other provision of this section, a person, other than a company, who is personally absent from New Zealand in the service in any capacity of the Government of New Zealand, shall be deemed to be resident in New Zealand during that absence.</p>	<p>Section 6(1) Income Tax Assessment Act 1936</p> <p>“resident of Australia” means –</p> <p>(a) a person, other than a company, who resides in Australia and includes a person –</p> <p>(i) whose domicile is in Australia, unless the Commissioner is satisfied that his permanent place of abode is outside Australia;</p> <p>(ii) who has actually been in Australia, continuously or intermittently, during more than one-half of the year of income, unless the Commissioner is satisfied that his usual place of abode is outside Australia and that he does not intend to take up residence in Australia; or</p> <p>(iii) who is (summarised): a member of certain Commonwealth superannuation schemes or the spouse, or a child under 16, of such a member.</p>
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“Residence” in New Zealand

The test for determining whether a taxpayer is a resident in New Zealand is stated in s OE1 of the *Income Tax Act 1994* (“ITA94”). It is a twofold definition that, unlike the Australian definition, defines when a taxpayer is both resident and non-resident. Until amended in 1988, a natural person was adjudged a resident in New Zealand if that person had a permanent place of abode in New Zealand, or was present in New Zealand for a continuous period of 365 days, with certain permitted absences.

Defining When An Individual Is A New Zealand Resident

Who is and who is not a New Zealand resident for tax purposes is outlined in s OE 1, incorporating the following definitions (in summarized form):

An individual is resident in New Zealand if that person:

- (1) has a permanent place of abode in New Zealand or
- (2) has been present in New Zealand for more than 183 days of any 12 month period.

An individual ceases to be a resident in New Zealand if:

- (1) that person is absent from New Zealand for more than 325 days of any 12 month period and
- (2) during that period of absence has at no time a permanent place of abode in New Zealand and
- (3) is not absent in the service of the Government of New Zealand.

A person present for any part of a day is deemed to be in New Zealand for the whole of that day.

Under this legislative provision, the “permanent place of abode” concept overcomes the arbitrariness of a test based solely on the number of days spent in the country. A person is a New Zealand resident if they have a permanent place of abode in New Zealand or if they have been personally present in New Zealand for more than 183 days in any 12 month period. It is an either/or situation so that only one of those situations need apply for that person to be adjudged a resident. The reduction in the number of days from 365 to 183 days in any 12 month period reflects the reality of modern travel and the transitory status of many taxpayers. Conversely, to be a non-resident a person must have been out of the country for more than 325 days in any 12 month period and must not have a permanent place of abode in New Zealand. Both criteria must apply. This introduces the permanent place of abode concept into the definition of a non-resident.

The broadening of the definition appears to be driven by a desire to protect the revenue base. It is easier to become a resident and subject to the tax laws than it is to become a non-resident and fall outside the New Zealand tax laws applicable to residents. There does not appear to be any reason for the reduction in the number of days it takes to become a non-resident from 365 to more than 325. However, the fact that it only takes 183 days to become a resident, as compared to the 325 days to become a non-resident, underlines the importance of the additional permanent place of abode test and the need for the tie-breaker provision in double tax treaties.

Permanent Place of Abode

The increased significance of a permanent place of abode in the definition of residence means that it is important to consider what is meant by this concept. The only case under the old definition that throws any light on this is the case of *Geothermal Energy New Zealand Ltd v CIR*. The judgement in this case concluded that “home” was a place around which the taxpayer’s domestic life revolved. That is, in the case of a married man (or woman) where his wife (or her husband) and children resided at that particular time, and in the case of a single person the place which is the centre of their interests and affairs.

It follows that an individual’s home is not determined by the ownership of any interest in the residence or property, a view previously held by the Commissioner of Inland Revenue (“CIR”). Although it is not defined in the ITA94, the Inland Revenue Department (“IRD”) has issued the following list as a guide for determining an individual’s permanent place of abode:

- the presence of the person in New Zealand, whether continuous or interrupted;
- accommodation, whether owned or not;
- social ties, family membership of clubs etc;
- economic ties, bank accounts, credit cards, investment, superannuation funds etc;
- employment or business in New Zealand, whether permanent or transient and casual;
- personal property, whether furniture, clothing, car etc has been maintained in New Zealand;
- welfare benefits received in New Zealand;
- intentions, whether the intention is to live in New Zealand or return overseas after a period of time.

It is important to note that under domestic law, a taxpayer can maintain similar ties, a residence, a physical home, or a permanent place of abode in other countries but still be a New Zealand resident for tax purposes. If the taxpayer has an enduring relationship in New Zealand that is a permanent place of abode, the taxpayer will always be a resident of New Zealand. This test overrides the provision relating to the number of days the taxpayer is in New Zealand.

Summary

New Zealand operates the traditional permanent place of abode test together with the arbitrary number of days test. The interpretation of permanent place of abode has changed significantly. As shown above, the significance of an interest in, or ownership of, any residence or property is no longer paramount, but rather one of several factors to be taken into account. This accords with the centre of vital interests test, which is being applied as the permanent place of abode test. It would be preferable for the test to be renamed the centre of vital interests test to accord with international understanding and the OECD Model.

“Residence” in Australia

In Australia individuals are resident for tax purposes if they are:

- Australian residents under common law (the common law or ordinary meaning test); or
- domiciled in Australia, unless the Commissioner is satisfied that their permanent place of abode is outside Australia (the domicile test); or
- in Australia, continuously or intermittently for more than one half of the year of income, unless the Commissioner is satisfied that their usual place of abode is outside Australia and they do not intend to take up residence in Australia (the 183 day test); or
- a member of certain Commonwealth superannuation schemes (or the spouse or child under 16 of such a member).

The Australian definition is more complex and less clear than the New Zealand definition. This reflects a different drafting style and a tendency towards complexity for which the Australian statute has become infamous. The last statutory test is fact specific and limited in operation and is not considered in this article.

Common Law Residence Test

This test is not used in New Zealand. There is substantial relevant case law both in Australia and the United Kingdom which attempts to determine the ordinary meaning of residence at common law and it is this ordinary meaning that forms the starting point in determining whether or not a taxpayer is resident. The underlying theme is that a taxpayer resides in the place where he or she has a “home”. This is a question of fact, and if a taxpayer is found to have a “home” in Australia, there is no need to proceed further.

The word “reside” was defined by Viscount Cave LC in *Levene v IRC*:

...and is defined in the *Oxford English Dictionary* as meaning “to dwell permanently or for a considerable time, to have one’s settled or usual abode, to live in or at a particular place.” ... In most cases there is no difficulty in determining where a man has his settled or usual abode, and if that is ascertained he is not the less resident there because from time to time he leaves it for the purpose of business or pleasure.

His Honour also cited *Cesna Sulphur Co Ltd v Nicholson*:

There is not much difficulty in defining the residence of an individual; it is where he sleeps and lives.

There may not have been much difficulty in applying such a definition in 1876. However, it is often less clear today. Where the application of the ordinary meaning of residence is uncertain, the specific statutory definitions that extend the common law definition become more important. In practice it is often simpler to start with the specific statutory definitions, since if they apply to make a taxpayer resident there may be no need to proceed with the more detailed factual analysis necessary using the common law definition. This is consistent with the proposal for an arbitrary number of days test, combined with a centre of vital interests test. The common law meaning of residence most closely relates to the centre of vital interests test.

Domicile Test

There are essentially three types of domicile in Australian tax law: domicile of origin, which is the domicile of the father at the date of birth (with special rules for an illegitimate child); domicile of choice, which is established by the *Domicile Act 1982* (Cth) and the intention to select a new permanent place of abode; and domicile by operation of law, which applies when, for example, a child’s domicile changes as a result of its parents changing their domicile.

Although Australian domicile may be established, the individual will still not be treated as a resident if that individual’s permanent place of abode is outside Australia. The test of domicile, in effect, becomes superfluous to the “permanent place of abode” test. Irrespective of domicile, the individual will be a resident in Australia if the “permanent place of abode” is established in Australia and a non-resident if it is established outside Australia.

Permanent Place of Abode

The leading Australian authority on the words “permanent place of abode” is *Applegate*. It is also frequently quoted in New Zealand residency case law. In *Applegate*, it was held that “permanent” does not mean “everlasting” and that if a taxpayer has an intention to make a home outside Australia for the time being, then that will be an important element in characterising the home as permanent place of abode. This allows for taxpayers to become non-residents even though they may have the intention to return to Australia at some point in the future. The principle has been applied in subsequent cases.

In *Applegate*, Fisher J stated:

To my mind the proper construction to place upon the phrase “permanent place of abode” is that it is the taxpayer’s fixed and habitual place of abode. It is his home, but not his permanent home. It connotes a more enduring relationship with the particular place of abode than that of a person who is ordinarily resident there or who has there his usual place of abode. Material factors for consideration will be the continuity or otherwise of the taxpayer’s presence, the duration of his presence and the durability of his association with the particular place.

Permanent place of abode is not defined by the legislation in either Australia or New Zealand so case law is very important. As the New Zealand IRD have produced a set of guidelines for taxpayers, so has the Australian Taxation Office (“ATO”) issued similar guidelines in *Income Tax Ruling IT 2650* on residency. The ruling (at paragraph 23) offers a useful checklist of criteria for establishing “permanent place of abode”:

- the intended and actual length of an overseas stay;
- whether there is any intention to return to Australia or to travel on to another country;
- whether the taxpayer has established a home outside Australia;
- whether the taxpayer has abandoned a home in Australia to go overseas;
- the duration and continuity of the taxpayer’s presence in the overseas country; and
- the durability of association with a place in Australia, as evidenced by bank accounts, notifications to relevant authorities, and family, social and business ties.

The criteria mentioned in the New Zealand and Australian guidelines are very similar, although none of these factors is decisive. However, it is important to note that the Australian definition focuses on a permanent place of abode outside Australia in contrast with the New Zealand requirement of a permanent place of abode inside New Zealand. From an evidentiary perspective this makes the New Zealand definition easier to administer and control.

Income Tax Ruling IT 2650 recognises that the existence of a permanent place of abode is a question of fact in each case and that the duration of an individual’s stay or intended stay out of Australia is not, of itself, conclusive and must be considered along with all other relevant factors. This is in contrast to the specific time element legislated in the New Zealand rules. However, given the practical advantages of setting down a broad time limit, the Commissioner exercises his discretion in *Income Tax Ruling IT 2650* and states that as a general rule he will accept that a taxpayer becomes a non-resident after two years spent abroad.

As a result, in order to help them qualify under the ruling for non-resident status, taxpayers seconded overseas have tended to negotiate contracts for periods longer than two years, or open-ended or renewable contracts with a two year minimum period. This is somewhat arbitrary, as is the New Zealand legislation on this issue, but the certainty it gives to taxpayers compensates for this. The downside is that the ATO requires compelling reasons to treat someone as non-resident who has been overseas for less than two years. Although it should be noted that in *Applegate* the individual was treated as a non-resident and was actually absent from Australia for less than two years.

A significant practical consequence of the difference between the New Zealand and Australian definitions of residence arises from the New Zealand focus on an individual having a permanent place of abode in New Zealand, as compared with the Australian focus on an individual having a permanent place of abode overseas. Under the New Zealand definition, provided any time requirements are satisfied, residence would only appear to apply to individuals while they are actually in New Zealand. Therefore they would become resident on arrival and cease to be resident on departure.

In Australia, on the other hand, residence continues until a permanent place of abode is established overseas. Non-residence ceases when an individual relinquishes a permanent place of abode overseas. This can lead to complications. For example, expatriates working overseas can be detrimentally affected in that payments made to them in respect of services performed as non-residents or income earned from any source while overseas could in fact be derived by them as residents once they have given up their permanent place of abode overseas,

even though they have not physically returned to Australia. It is fairly common for expatriates to take leave overseas after a secondment and prior to returning to Australia. If the domicile test applies they will no longer have a permanent place of abode outside Australia and consequently, any income derived while on leave will be taxed in Australia on the basis that they are resident. This again leads to uncertainty and the need for taxpayers to have high-level professional help to navigate a safe passage through the complexities of ITAA36. Following through the earlier argument that the permanent place of abode test should change to a centre of vital interest test, it is interesting to note the approach to interpretation of permanent place of abode taken by the ATO. The rulings seem to have broadened the concept of permanent place of abode to encompass the factors taken into account for the common law residence test and the centre of vital interests test. Practically, the focus on a taxpayer living in a permanent location is no longer sufficient as an objective test of residence. Other factors that are taken into account should be recognised in the law.

The 183 Day Test

The half year or 183 day rule is calculated by days and hours in both Australia and New Zealand. In *Wilkie v IRC*, a taxpayer present in the UK (which also has a 183 day residency rule) for 182 days and 20 hours in an income year of 366 days, was held not resident for a period equal to six months.

In Australia, if this test applies a person is treated as resident for the entire income year. This is not the case in New Zealand where the residency applies as from the first day of arrival in New Zealand counted in the 183 days.

The fact that the Australian legislation refers to more than one half of “a year of income” means that a person could be in Australia for just under half of two years of income; that is, for a total of just under a full year, and not become a resident under this test. The New Zealand legislation appears to get around this problem by referring, in both tests, to a number of days in “any twelve month period”.

In New Zealand, the 183 day test stands on its own. If a taxpayer satisfies this test, he or she is a resident. In Australia, taxpayers may be resident unless the Commissioner is satisfied that their usual place of abode is outside Australia and that they do not intend to take up residence in Australia. This test helps to determine when a person takes up residence in Australia but does not help in determining when a person has ceased to be a resident. The term “usual” is used for this test rather than “permanent” place of abode but how these terms differ seems unclear.

Conclusion

Australia’s tax legislation began its current metamorphosis under the auspices of a Tax Law Improvement Project. Its stated aim was “to rewrite the law with a better structure, and make it easier to understand”. The definition of residence has not yet been rewritten and is one area where simplification of the definition should include substantive change. This is necessary to overcome the shortcomings of the existing legislation and to give statutory effect to the approach taken in practice by the Commissioner.

If the rules for residence can be postulated in a brief, clear and concise manner yet still cover all the necessary circumstances, as it appears the New Zealand legislation comes close to achieving, this must be a desirable feature. However, the New Zealand and Australian permanent place of abode tests should be recognized as having moved their definition away from the central position of a permanent family home. In this regard, the OECD Model’s centre of vital interests test should be used to give the same practical effect.

The New Zealand legislation overcomes several problems identified in the Australian legislation:

- Many of the Australian cases attempt to use legislation and case law to define a non-resident; there being no definition of a non-resident in the Australian tax legislation. New Zealand residence cases have been saved this difficult and often fruitless activity by the inclusion in the legislation of a definition of a non-resident, albeit more restrictive than that of a resident. A taxpayer is a resident if present for more than 183 days and a non-resident if absent for more than 325 days in any 12 month period. Australia should have arbitrary day tests to establish both residence and non-residence. This will provide certainty, particularly for expatriates moving in and out of Australia.
- The New Zealand legislation overcomes the arbitrariness of a test based solely on the number of days present or absent from the country by using the permanent place of abode test in addition to number of days. However, it manages to avoid the complexity of the Australian definition of residence. A similar approach in Australia would give effect to the way the Commissioner has in practice attempted to exercise his discretion, but using the OECD centre of vital interests test rather than the permanent place of abode test would provide more uniformity.

- Focusing on the existence of a centre of vital interests in Australia rather than outside Australia, following the New Zealand approach with the widely defined permanent place of abode test, eliminates many unnecessary evidentiary and control problems for both the ATO and the taxpayer. It also helps to make the law more certain and less likely to be unwittingly contravened.
- As “permanent place of abode” has become a crucial concept in both Australia and New Zealand its broadening definition should be reflected by it being renamed as the “centre of vital interests”. This ties in with international nomenclature and better describes what the test is really for. The legislation should also provide broad guidelines as to the content of the test. This should be worded in a similar manner to the checklists of criteria already stated by the IRD in New Zealand (page 7) and in the Australian *Income Tax Ruling* IT 2650 (page 9).
- It is better to avoid the multiple tests for residence in Australia in the interests of certainty, simplicity and clarity. The arbitrary number of days test combined with a centre of vital interests test would help to provide certainty and protect the revenue base.

There is always room for improvement in tax legislation. The New Zealand statutory definitions are not perfect, but different countries can learn from each other and improvement to the legislation should be a continuing process. The time is right for a revision of the Australian legislative residency laws that reflects the reality of the changing global environment in which it operates, and in doing this there should be agreement with the New Zealand counterparts, who should also make some additions and minor changes, so that in this small area of the taxation law there is some harmonization.

Waikato Innovation Park: An Opportunity for the Region

Frank Scrimgeour

In 1990 the Waikato Technology Foundation proposed to establish the Waikato Innovation Park (WIP) on land close to The University of Waikato and the Ruakura Research Centre. Park construction looks likely to commence during 2002 given that on 6 December 2001 *Industry New Zealand* announced a \$2 million grant as a contribution to its establishment. This is to be supplemented by other seed funding from Hamilton City Council and local trusts. This is a significant opportunity for the region given the Park's potential to enhance regional development. Several studies have been conducted on the feasibility of the WIP. An "Innovation Park Feasibility Study" was completed by Chris Kirk and John Jackman in 1996. In February 2000, *Arrow International* was commissioned to undertake the first stage of a feasibility study for the proposed WIP. Arrow proceeded with the second stage of feasibility study in May 2000. Despite the broad scope of previous studies, a number of significant aspects remained unclear and early in 2001 the Economics Department at The University of Waikato completed an economic evaluation of the WIP proposal. This study focuses mainly on the economic and financial aspects of the WIP proposal and its impact on the Waikato regional economy.

Science Parks

The rationale underlying a Science Park is the observed tendency of firms of a similar type or in the same industry to cluster together. Recent international experience with Science Parks is positive, provided they are well conceived and well managed. At the macro level, the benefits include regional economic development and diversification, better investment opportunities and both job creation and job security with many competing employers. At the micro level, Science Parks can attract more specialised human capital and improve industry communication and information sharing at a lower cost level. It also enables a higher growth rate for individual firms within the cluster due to better technology diffusion and the increased likelihood of synergistic co-operation.

The success of Science Parks can be defined in terms of long-term outcomes of regional development and job creation. Those who concentrate on a shorter time frame will measure it in terms of technology diffusion and creating synergies. The most commonly cited key factors for the success of a science park include local commitment, a local university, and skilled labour supply.

NZ Context and the Waikato Economy

The NZ government has put significant stress on improving the knowledge contribution to the national economic and social environment. *Industry New Zealand* has been allocated money to promote incubator developments, however the amount is minimal. The *Ministry of Economic Development* has a Regional Development Programme, which aims at facilitating sustainable regional development and helping regions respond to local opportunities. The Waikato Innovation Park was the selected applicant for the Waikato Region.

The WIP is significant because the New Zealand innovation system consistently performs below the average for G7 and other small, high-income OECD countries. It is generally recognised that the nation's science base is small and skewed towards certain areas like biology, clinical medicine and agriculture. Although New Zealand has a high output of scientific papers relative to the size of its economy, our ability to transfer science into wealth has been lacking.

The Waikato Region represented just under 10% of the New Zealand economy in 2000, whether measured by population, gross regional product or retail sales. Analysis of key indicators suggests that the Waikato region is falling behind neighbouring regions such as the Western Bay of Plenty and Auckland. However, the existing capacity in the building, manufacturing and engineering sectors together with the high-level educational institutions endow the region with many of the necessary skills to leverage investments in business areas seen as having growth potential. Table 1 characterises the Waikato region in terms of six key variables. The advantages and disadvantages indicate where some of the challenges lie in encouraging investment in the region. The potential impact of the WIP reveals the extent to which it may exploit opportunities and address regional disadvantages.

Table 1: Waikato Region Strengths and Weaknesses

Factor	Advantages	Disadvantages	Impact of WIP
Natural resources	Land, agricultural, and forest resources, hydro and geothermal resources	Limited growth prospects for these sectors	Limited impact but potential for significant new developments leveraged off old technology
Human capital and labour resources	Significant number of University and polytechnic graduates	A limited number of high value added jobs	Increased opportunities support a broader skill base and easier retention of critical skills
Locational factors	Half of NZ's population within two hours drive	Difficult to commute to Wellington and South Island Many specialists in Auckland – not Hamilton	Minimal effect due to limited impact on manufacturing and trade in short term
Cost and infrastructure factors	Cheap land and buildings Good utilities	Not yet the critical mass of related activity to maximise growth rate	Immediate enhancement at the WIP with gradual enhancement city wide
Quality of life factors	Excellent schools Minimal congestion problems	Minimal city life	More high value added jobs will lead to more social amenities
Recent economic performance	Opportunities for improvement exist	Slow growth in GDP and employment	WIP focuses on sectors with higher growth potential

Using an 87-sector economic model of the region, the dynamics of the Waikato economy are analysed by key indicators such as value added, net household income, full-time equivalent employment (FTE). Table 2 shows the fastest growing sectors in the Waikato region.

Table 2: Fastest Growing Sectors in the Waikato Regional Economy

	Year 2000 FTEs	Current FTE Growth Rate in % p.a.
HIGH GROWTH SECTORS		
Horticulture	1553	9.71
Ham & Poultry Processing	790	17.86
Metals & Metal Products	1990	9.06
Storage & Warehousing	520	17.27
Advertising & Business Services	3540	7.06
MEDIUM GROWTH SECTORS		
Transport Manufacturing	940	5.80
Restaurants & Accommodation	6830	4.99
Road Freight	2610	5.42
Real Estate Services	2240	5.32

We have identified the highest linkage values for the Waikato economy and corresponding NZ values using the same model and established Input/Output methodology. Table 3 summarises the results. The dollar value *backward* linkage measures the total dollar impact in the economy resulting from a dollar increase/decrease in the output of the sector in question. The higher this value, the more valuable is the sector as a driver of the economy in question. The dollar value *forward* linkage estimates the value of the sector in question as an input producer for other sectors in the economy. The higher this value, the more valuable this sector is as a producer

of inputs for the regional or national economy in question. Table 3 shows Research to be the *least valuable* sector for both the Waikato and NZ economies as an input producer. However, it is *the* most valuable sector in the Waikato economy as an output driver, even exceeding Building which is usually one of the highest driving sectors of any economy.

Table 3: Backward and Forward Linkages in the Waikato Economy

BACKWARD LINKAGES			FORWARD LINKAGES		
<i>Sector</i>	<i>Waikato</i>	<i>NZ</i>	<i>Sector</i>	<i>Waikato</i>	<i>NZ</i>
Research	2.72	4.70	Electricity	3.49	4.08
Building	2.41	3.10	Water	3.35	1.21
Ham & Poultry Process	2.36	3.75	Finance	3.24	4.36
Dairy Manufacturing	2.35	3.45	Insurance	3.23	4.10
Meat Processing	2.22	3.53	Communications	3.08	3.59
			Research	1.01	1.06

Interventions to the local economy have a greater chance of success in industries like agriculture, forestry, horticulture and associated engineering and support services. Education, tourism and health related activities are also likely to provide good results for interventions.

The Waikato region lacks a major local market as enjoyed by the Auckland region. Furthermore, logistics to the major Auckland market are difficult. The recent delay in the four-lane highway to Auckland is a significant obstacle. The lack of stylish entertainments encourages younger people to relocate to Auckland or overseas. These are constraints on regional development.

Pre-conditions for a Science Park in Hamilton

The assessment of the local environment was conducted against 4 criteria: 1) the commitment by key stakeholders, 2) skilled technologists who want to be involved, 3) technologies which are capable of generating the new products and services on which to base new business ventures or expand existing ones, and 4) companies which are interested in locating on the Park and in taking part in networking. The local consensus on the importance of WIP has been reached and the commitment now is higher than it has been before. Second, skilled local labour force and mobility of NZ workforce are a plus for WIP albeit the low salaries cast potential difficulties on recruiting and retaining certain staff. Thirdly, recent trends towards the commercialisation of research activity combined with the science-industry projects of The University of Waikato favours the establishment of WIP, and fourthly, there is a good probability of achieving a high occupancy rate within two years.

Assessing Impact of WIP on the Waikato Region

In seeking to come up with a robust methodology by which data could be obtained and analysed in a limited time frame, the analysis combines the advantages of two methods: Benefit Cost Analysis and Regional Input/Output Analysis. A benefit cost analysis has been completed which draws on the regional Input/Output analysis to come up with estimates of indirect benefits. These indirect benefits when combined with the direct benefits and costs allow the calculation of total benefits and costs for the region (or regional GDP or GRP). In this way the study provides evidence about both value added in the region and the efficiency with which this is obtained. However, caution needs to be taken when one uses the information in this study as 1) impacts have been quantified based on conservative assumptions, 2) the economic activities associated with the WIP is likely to grow at a faster rate than the more general economic activities, and 3) the interaction effects between growth at WIP and associated growth outside the Park are not captured in this study.

Using the 87-sector Input/Output model of the Waikato economy the ongoing economic impact of the WIP on the region's economic activity was estimated. Initially at Stage 1, only 8000 square metres of building are planned. At completion, 90,000 square metres will be constructed of which 67% will be Office/Research buildings reflecting the research focus proposed for the Park. The Value Added per FTE for activities in the WIP has been estimated to be in the range of \$50,000 to \$75,000 per year. Also value-creating activity in Research will spin off into other sectors of the regional economy creating additional value added in those sectors.

Table 4: Economic Impact of WIP on the Waikato Economy

	\$ Millions	
	Value Added @ \$50k per FTE	Value Added @ \$75k per FTE
Direct Value Added from WIP with 3357 FTEs	167.9	251.8
With flow-ons to other 86 sectors in region	384.5	576.6
Total addition to GRP in Waikato region per year	552.4	828.4
Value Added increment as percent of		
current Waikato GRP of \$10,320 million	5.4%	8.0%

GRP = Gross regional product the regional equivalent of GDP.

Table 5: Distribution of Direct Benefits Arising from WIP Operations

Distribution of Value Added from WIP	Percent	\$ Millions	
		VA @ 50k	VA @ 75k
Net Household Income after tax	55.7	93.5	140.3
Household tax, saving & super	23.9	40.1	60.2
Company surplus after tax, before depreciation	14.2	23.9	35.8
Company tax	3.2	5.4	8.0
Indirect tax	3.0	5.0	7.5
Total Value Added	100.0	167.9	251.8
Local Govt., Cleaning, Sewerage, Waste	1.0	1.7	2.5

As shown in the last line of Table 5 above, the model estimates that at full capacity, the WIP will contribute directly between \$1.7 and \$2.5 million annually to Local Government, Environment Waikato and waste management and similar services.

At a Value Added per FTE of \$50,000 for WIP staff, average gross salary works out at just under \$40,000 per WIP employee. At a \$75,000 Value Added per FTE, this increases to just under \$60,000. With current FTE employment in the Waikato region at 138,984, the total WIP employment impact works out at 4.8% to 6% depending on the value added realized. This percentage is based on the conservative employment multiplier of 2.0 or 2.5. The WIP will contribute significantly to household income in the region. Tax revenue and local government will also benefit significantly from WIP operations as detailed in Table 5.

In terms of regional development, WIP will facilitate the creation of an economic portfolio of projects for the region. Even if the subsidised activity fail to deliver the benefits to the extent estimated above, the WIP will still have value to the region with above-normal rents and other benefits flowing from the Park. Establishment of the WIP will, in effect, create a so-called "cluster" of similar organisations in this region.

The WIP will diversify the current population mix. It will add to Hamilton's vibrancy and input a more intellectually challenging atmosphere into the city. It would be expected that the WIP would have a greater chance of attracting international firms and staff to Hamilton than would commercial initiatives in the developing areas of tourism, horticulture and other traditional sectors in the region. WIP will also increase opportunities for industry/university collaboration and interaction.

Conclusions

The WIP is a significant initiative for the Waikato region. It has the potential to enhance employment and Gross Regional Product in the short run and be the foundation for a new business sector. Although the WIP is an economically worthwhile venture the achievement of this initiative is dependent upon cooperation between the University, Hamilton City Council, the Government and local trusts, businesses and research organisations in its establishment phase. It is hoped that that the WIP will be the first of many new initiatives to enhance the breadth and vigour of economic activity in the region.

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Internet Usage and Computer Training in the Waikato Region

Bridget Daldy and John Gibson

Introduction

The impact of technology and international competition has led to a growing emphasis on the need for an educated and well-trained workforce. The ability of workers to use computers may be especially crucial as firms attempt to compete in an increasingly digital economy. At the same time, businesses are changing the ways that they interact with their customers, placing greater reliance on the Internet and other forms of e-commerce.

Information is available at the national level on both the skill base of New Zealand workers, in terms of information technologies, and on the access that New Zealand consumers have to the Internet and their reliance on it for carrying out e-commerce transactions. However, at a regional level much less information is available, and this void may hamper the attempts of local businesses to participate more fully in the digital economy.

This article summarises the regional results of two national surveys of Internet use and workforce computer training. The aim of the article is to provide information that may be relevant to Waikato region businesses who are either contemplating greater use of the use of Internet or providing greater levels of workforce training in computing and information technologies.

Internet Usage

The data came from the AC Nielsen NetWatch survey, which provides detailed information on Internet usage. A total of 12,000 people aged 10 years and over are surveyed each year throughout New Zealand. The results reported here come from the July 2000 to June 2001 survey, where the sample for Hamilton had 470 respondents.

The NetWatch survey asks about whether people have ever used the Internet and whether they have used it in the last four weeks. For the purposes of this article, the people using the Internet in the last four weeks are considered as regular users. Unlike some other sources of data, the Internet usage reported by the NetWatch survey can be from the respondent's own home, from their workplace or school, and from other locations.

According to the survey results, just under one-half (47.7%) of New Zealanders aged 10 years and above can be considered as regular Internet users. The proportion of regular Internet users in Hamilton is similar to the national average, and corresponds to approximately 58,000 users.

Table 1: Internet usage in Hamilton compared with other areas

	<i>Hamilton</i>	<i>Other major urban areas^a</i>	<i>New Zealand</i>
People regularly using the Internet ^b	58,000	854,000	1,533,000
Population percent using the Internet	48.7%	53.3%	47.7%

^a Other major urban areas includes Auckland, Wellington, Christchurch and Dunedin.

^b Regular use is considered to be in the last four weeks.

But compared to other major urban areas, Hamilton residents are less likely to be regular Internet users, with a gap in the participation rate of almost five percentage points. Regular use of the Internet in the other urban areas varies from around 57% in Dunedin and Wellington, to approximately 52% in Auckland and Christchurch. It is interesting that Dunedin and Hamilton are of approximately similar size, yet have a significant difference in the rate of regular Internet usage. Therefore, it does not seem likely that the lower rate of Internet usage in Hamilton is due to it being a smaller urban area.

Further evidence on the relatively low rate of Internet usage in Hamilton comes from disaggregating the results for the non-regular users into those who have never used the Internet and those who used it in the last 12 months but not in the last four weeks. According to the survey results, 47.9% of the Hamilton population have never used the Internet. This is rather higher than the average for other major urban areas (40.4%) and is higher even than the average for all of New Zealand (45.4%).

Overall, the NetWatch survey results suggest that Hamilton residents lag somewhat behind other urban New

Zealanders in their use of the Internet. This may be a relevant factor for Waikato region businesses to account for when they are designing e-commerce strategies for their home market.

Employer-provided training

The data used here came from the Education and Training Survey, conducted by Statistics New Zealand as a supplement to the September 1996 Household Labour Force Survey. This was the first, and remains the only major survey of job-related training in New Zealand. The survey asked respondents aged 15-64 about their participation in training either provided by an employer or obtained externally. A total of 13,988 people who had worked for wages or salaries in the 12 months prior to the survey answered the questions on employer-provided training. A total of 22,257 people answered the questions on external training. For each in-house and external training course (up to a maximum of four) the survey asked respondents about the main subject of the course, where "Computing" was included as a choice along with eight other broad subject areas.

Concentrating first on the results for employer-provided training, it appears that workers in the Waikato region were significantly less likely to have received training in computing than were workers in the rest of New Zealand. In fact, the training rate in computing for Waikato workers (2.3%) was less than one-half that for workers in the Auckland region (4.8%), and less than one-third of that for workers in the Wellington region (7.2%).

Table 2: Training rates in computing amongst all wage and salary earners

<i>Area</i>	<i>% of wage and salary earners who received employer-provided training in computing in the previous year</i>
Waikato region	2.3%
New Zealand	4.1%

The low training rates in computing for Waikato region workers may be because there is either:

- a low rate of employer-provided training in the region, across all subjects, or
- concentration on subjects other than computing for those workers in the region who received employer-provided training.

To distinguish between these two causes, a further analysis was conducted but is restricted just to the 3194 workers who had received some form of employer-provided training in the 12 months prior to the survey. Nationally amongst these workers, 17.5% indicated that at least one of their training episodes had Computing as its main subject. However, amongst Waikato region workers who received training, only 9.3% of them indicated Computing as the main subject of one of their training courses. In other words, the Waikato region appears to have been marked by a low emphasis on computer training rather than by a low level of training in general.

Table 3: Computing as a share of training subjects

<i>Area</i>	<i>% of those receiving employer-provided training who indicated the main subject was computing</i>
Waikato region	9.3%
New Zealand	17.5%

Similar regional trends are apparent for the 'external' training, which might be accomplished with short courses at night and in the weekends, and is organised by the individuals rather than their employers. Across all of New Zealand, 2.6% of the working age population participated in external courses where the main subject was Computing but in the Waikato region the participation rate was only 1.7%. Amongst those who did an external training course on any subject, in the Waikato only 15.8% chose Computing as the subject, whereas the national average indicates that 21.3% chose Computing.

Conclusions

The results of the two large-scale surveys summarised here suggest that the Waikato region may lag behind other areas of New Zealand in both Internet use and computer training. While the situation for training may have changed since the 1996 survey was carried out, the information presented on Internet usage is very up-to-date. The fact that both surveys point in the same direction, seems to support the inference that the Waikato region lags behind competing regions. To the extent that Internet use and workforce computer skills are important determinants of business success in an increasingly digital economy, these trends may provide some grounds for concern about the competitiveness of the Waikato regional economy.

Airlines on the Edge of the Abyss

Ewan Wilson ⁴

Poor management, self assurance and ultimately greed, coupled with the horrendous and the mostly unforeseeable events of September 11 has brought a cold front right across the aviation industry. In aviation it is always a litany of events, which bring about change. September 11 2001 was just one more ingredient in what has been a rather deadly cocktail for the industry. The recent trend in aviation was the creation of mega alliances, such as the Star Alliance and One World in an attempt to gain market shares. To counter this move some airlines created their own groups such as Swissair who created the Qualiflyer Group by purchasing non-aligned European carriers like Sabena and TAP. Carriers like Canada 3000 also bought into the concept of buying market share with the purchase of Canwest. Similarly, Singapore Airlines purchase of 49% Virgin Atlantic. Unlike the latter, the former has proven to be fatal. The facts are the airline industry as a whole had been suffering from rising fuel costs and a general downturn in the global economy. Furthermore, governments continued the trend of distancing themselves from their former owned and now privatized carriers. Air service agreements were beginning to loosen up and open sky policies were being cautiously but favourably viewed.

Air NZ – What Happened?

In Australia, Air New Zealand (Air NZ) has been receiving headlines it would prefer not to have. However, most of it is truly deserved.

Air NZ has been outwitted, outplayed, and may well be out of the game. For any casual observer the last six months has seen the New Zealand aviation scene come under neck breaking pressure. The Qantas New Zealand collapse left many people shaking their heads as to how an airline can lose so much money in such a short time. Then through the gray clouds comes Air NZ looking horribly shaken and worse for wear.

It is fair to say that Air NZ had done a very good job of becoming one of the most profitable and well-run airlines in the early 1990's. Its problem was that if it was to make even more money for its shareholders it would need to expand into a larger market, namely the Australian market. Now that is not easy in the airline business. Airlines need approval from governments to fly to and from different countries. These are bilateral agreements. However, it is basically impossible for one country's airline to be able to fly domestically within another country unless the airline buys into another airline, or the two countries have an open skies agreement. Such policies are often constrained to minimize the effect on the host country's own air services agreements.

New Zealand and Australia have always had close ties. In the early 1990 there were discussions about a single aviation market, which would have permitted "cabattage". A shipping term, which would have meant Air NZ, could fly within Australia.

Reliable sources report that Air NZ was putting the final touches on plans to launch their own operation in Australia. This was the birthplace for Freedom Air. It was incorporated in 1990 for the sole purpose of penetrating the Australian market. Ironically, Freedom Air flew its first flight some five years later, this time to counter a newly launched Kiwi Air. Interestingly enough the father of Freedom Air went on to sell the concept to a Greek shipping magnet who bought the idea and is now flying under the banner of Easy Jet.

The single aviation market agreement was pretty much in the bag when at the eleventh hour the Australian Government reneged on the agreement. Apparently someone within the Australian Government had forgotten that the Government owned airline, Qantas, was about to undergo a public float. Clearly, a Qantas executive sat down and calmly explained to the Government that the single sky agreement would reduce the amount of money that would be raised in the Qantas float. So the bubble burst and Air NZ was left with only one other option, buy in to the Australian market. The question was which vehicle.

Air NZ entered into discussions with News Corporation Ltd (News) to buy its half of Ansett Australia. Negotiations got bogged down. Then in November 1995 Air NZ announced its intended purchase of TNT's holding in Ansett Australia. In September 1996 the deal was done. Air NZ announced the purchase of TNT's 50% holding in Ansett Holdings for a total outlay of A\$475 Million. Ansett Holdings was the holding company for Ansett Australia the Australian domestic airline, and also held 49% of Ansett International.

News was keen to sell their position in Ansett and was clearly upset with the turn of events. News retained the powerful management rights - mistake number one by Air NZ. Furthermore, News was not interested in

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contributing more funds to the airline, which was desperate for re-capitalisation to upgrade its aging fleet. The long and the short of it was that the cost savings envisioned never eventuated and Ansett continued to trade by a wing and a prayer.

In late 1996 the Australian Government then agreed to the original single sky agreement. It's all in the timing. So the Australian Government and Qantas got what they wanted and Air NZ got half of Ansett and a share of the Australian market. All they had to do now was turn Ansett Australia into a profitable airline. With News controlling management, this would be hard work for Air NZ. The next year was tough but by February 1998 Air NZ announced an interim profit of NZ\$82 million, an increase of NZ\$5.2 million or 6.9% over the previous year. Air NZ continued to battle to turn Ansett around. It must be said though that all this time Air NZ operations were running very well. It was the Ansett problem, which kept damaging the profit line. Clearly what happened next was the beginning of Air NZ's real trouble. In February 2000 Air NZ announced the conditional purchase of the remaining 50% of Ansett Holdings Limited from News for A\$580 m, with a further deferred consideration equivalent to 10.5% of the issued capital to be settled between two and four years. Now who in their right mind would want to buy the remaining 50% of a loss making venture for A\$105 more than you paid for the first half?

Singapore Airlines was also keen to also get into the Australian market, for the same reasons as Air NZ and started negotiations with News. The News analysts had ascertained that Air NZ did not have the ability to purchase the second half of Ansett so started to negotiate a deal with Singapore Airlines. Air NZ had the first right of refusal to buy the balance of Ansett, and so News was in the enviable position of being able to play one off against the other. Air NZ won the day, or so it appeared at the time. It is fascinating to learn that although Air NZ had owned 50% of Ansett for four years, when it came to the purchase of the remaining balance, they failed to do adequate due diligence. Their explanation was "the lack of time".

Singapore Airlines continued to be very interested in the Australasian market and saw an opportunity to buy into Air NZ. They did, and the first decision was to get rid of the Chief Executive, Jim McCrae. This left both Air NZ and Ansett without leadership. Sir Selwyn Cushing became the executive chairman of the Air NZ/Ansett group and clearly struggled. This position alone would have been extremely demanding, requiring intimate understanding of airline systems and a well thought out global strategy. To be able to implement cost saving strategies with the merging of two airlines requires in-depth knowledge of the industry. Sir Selwyn at the time was a director on no less than six other boards.

Things just kept getting worse. It soon became obvious that Air NZ paid too much for Ansett. Some estimate the overpayment at more than A\$100 million. They under-estimated the negative effect Virgin Blue (and the now departed Impulse) would have on its newly purchased asset Ansett. Furthermore they failed to hedge appropriately against fuel and currency fluctuation. Finally, to make things even worse, all of the Ansett 767 fleet was grounded because of safety concerns.

Air NZ was now in a death spiral, loosing \$1.3 million a day. The obvious solution was for its existing shareholder, Singapore Airlines to increase its equity stake. To achieve this it would require the New Zealand government's approval.

Clearly, a large capital injection was required. But even with the Singapore arrangement this did not address some of the fundamental issues facing Ansett. The airline was over staffed and having to pay onerous salaries and live with draconian work awards imposed on it by the battle hardened unions.

The Role of the New Zealand Government

Should Singapore Airlines have been allowed to lift its stake in Air NZ to 49%? The government's delay in using its discretion to facilitate such a transaction clearly endangered Air NZ's survival and was as reckless as the decision-making that has resulted in Air NZ finding itself in its current predicament.

Air NZ made contact with the government in June 2001 detailing its problems and requesting the government alter the legislation to enable Singapore Airlines to increase its equity stake. This was not the first time that Air NZ had called upon the government to alter legislation to get what it wanted. It was able to convince the government in 1996 to turn a blind eye when it purchased the first half of Ansett to overcome alleged dominance in the market place. The government's reaction to Air NZ's latest request was one of reluctance. It expressed concerns regarding its effect on existing air service agreements.

The reality is that the existing legislation permits a foreign entity to own up to 49% of the national carrier. The restriction that limits one foreign airline from owning 25% and two foreign airlines owning up to 35% is poorly thought out. The excuse that raising the percentage of shares that a foreign airline can hold in a New Zealand designated airline affecting existing air service agreements is inherently misleading. The reality is that a majority of existing air service agreements simply requires a New Zealand designated carrier to show that the place of incorporation and principle place of business is New Zealand. There are only four air service

agreements that require substantial ownership and effective control. These are between New Zealand and Fiji, Japan, France, and the United Kingdom.

In the case of Fiji, its own national carrier, Air Pacific has Qantas as a 46% shareholder. It would clearly be unlikely that the Fijian government would not agree to an amendment. Japan's air service agreement is unlikely to cause many obstacles as JAL code shares on all Air NZ's flights to and from Japan and New Zealand. It would be unlikely to bite the hand that feeds them. Our air service agreement with France mostly deals with flights to the French territories such as New Caledonia and Tahiti. Both countries rely on tourism from New Zealand and as such would be unlikely to put obstacles in the way of what many would view as an essential air service. Finally Britain is in a phase of breaking down the regulatory barriers to facilitate the creation of open skies within Europe. Therefore, it would probably provide few obstacles in permitting a newly cashed up Air NZ to continue its service to the UK.

Air NZ then took steps to try and sweeten the deal. The national carrier then committed itself to retain the brand, remain New Zealand based, employ mostly New Zealand staff, keep existing routes and preserve their current overseas markets.

Still the New Zealand government was reluctant and New Zealanders should never underestimate our Trans Tasman friends. Qantas has an uncanny ability to surface at the worst possible times, ably supported by their loyal lackey, the Australian government.

Just when Air NZ looked like they had persuaded the government to facilitate the Singapore Airlines deal, Qantas used the ever pliable Deputy Prime Minister for Australia to throw an alternative solution into the mix. Everybody but the New Zealand government could see this latest move by Qantas for the smoke screen that it was. By the time the New Zealand government realised it was simply a distraction, Air NZ's losses had hit the front page of every New Zealand newspaper. Now the government took it upon itself that before any approval of any sort was given they wanted to know Air NZ's true financial state. From Air NZ's point of view, this was simply frustrating, as all they had so far asked for was approval to increase Singapore Airline's stake in Air NZ. The subsequent delays devalued the airline's worth even more and by the end, even Singapore Airlines was looking for a way out.

Most people agree that the New Zealand government at this stage had no other option other than to bale out the struggling national carrier, due to its national importance to the country's economy. However this begs the question. Would it not have been more beneficial to have facilitated the Singapore Airlines deal from the outset? The government's argument that doing so would have simply resulted in Air NZ coming to them with cap in hand at a later date just does not hold water.

Airlines – Is There a Prosperous Future?

The short answer is yes, but only for a few airlines. The airline industry will continue to struggle over the next 2-3 years. We have seen names such as Swissair, Sabena, Canada 3000, Ansett Australia all fall by the wayside in the last few months. There will no doubt be a lot more to follow. Carriers that fly to the America's as their core business are the most vulnerable. Air NZ would be wise to re-route its London flights via the Asian markets and ironically, the one thing that Air NZ feared the most, becoming a small regional airline, may at the end of the day be its saving grace.

Waikato Regional Indicators and Outlook

Warren Hughes

Table 1 below shows that our projections for regional Retail Sales in the previous *Bulletin* were around 3% less than what actual sales turned out to be. Confirming this under-prediction, forecasts for Building Consents were also too pessimistic, although the prediction for the March 2001 quarter was spot on. In previous *Bulletins*, the forecasts for sales and building had been too optimistic. In attempting to correct this bias, the forecasts out to the September 2001 quarter have obviously overcompensated in the opposite direction. With dairy payouts continuing at a high level, the upturn in construction will hopefully continue into 2003. However, overriding all prognoses will be the actual path of world growth (projected to slow) and, in particular, the flow-on from any further incidents similar to those of 11th September 2001.

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
Mar 01	1065.3	1032.8	-3.1	10.5	27.4	27.4	0.0	-42.7
Jun 01	1030.2	998.0	-3.1	10.1	56.6	35.2	-37.8	32.9
Sep 01	1053.8	1022.7	-3.0	8.8	41.2	36.3	-11.9	27.2
Dec 01		1138.5		3.6		40.9		58.5
Mar 02		1055.2		2.2		30.1		9.9
Jun 02		1012.6		1.5		62.3		10.1
Sep 02		1014.0		-0.1		45.3		10.0
Dec 02		1126.1		-0.1		45.0		10.0
Mar 03		1050.0		-0.1		48.9		62.5
Jun 03		1010.8		0.0		63.1		1.3

Retail Sales are seen as growing at around a 2% rate for the rest of 2002 before leveling off in 2003. Even before September 11th, prices of dairy commodities began to fall from historically high levels, and this trend has continued over recent months. Dairying is very important for the Waikato and even though payouts to farmers continue at a high level, waning confidence about the future profitability of dairying could moderate current retail sales activity in the region.

Hamilton City Building Consents show a 10% growth rate for the 2002 year over 2001. The seasonality in this series seems to have changed somewhat with the March quarter particularly affected. This started with the low \$27.4 m value for the March 2001 quarter. Of course, a single large project such as the stadium (or its deferment) can play havoc with traditional seasonality patterns, so it may be better management practice to look at annual growth rates as an underlying indicator rather than place undue reliance on forecasts for particular quarters in Table 1.

Western Bay of Plenty Regional Indicators and Outlook

Warren Hughes

The regional indicators for the Bay of Plenty are Tauranga District Council Retail Sales in millions of dollars and Building Consents in millions of dollars for the combined District Councils of Tauranga and Western BOP.

The projections and errors for Retail Sales for the first three quarters of year 2001 are shown in Table 1. Our previous forecast of strong sales growth in 2001 proved very accurate with around a 2% forecast error. The June 2001 quarter forecast was spot on with an extraordinary 14.5% gain in sales over the June 2000 quarter.

The projections and errors for Building Consents for the first three quarters of year 2001 are also summarised in Table 1. For this period, forecasts in the previous *Bulletin* significantly underestimated actual consents. Although actual consents did fall as forecast, the actual decline was not as precipitate as projected in our previous *Bulletin*.

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
Mar 01	318.8	325.7	2.2	2.8	61.5	43.1	-29.9	-8.2
Jun 01	336.3	336.1	-0.1	14.5	73.7	61.0	-17.2	4.7
Sep 01	340.6	347.5	2.0	11.9	73.1	61.9	-15.3	-2.0
Dec 01		383.8		9.2		73.3		38.8
Mar 02		352.3		8.2		64.0		4.1
Jun 02		345.1		2.7		76.7		4.1
Sep 02		350.3		0.8		76.1		4.1
Dec 02		395.0		2.9		76.3		4.1
Mar 03		358.7		1.8		67.2		5.0
Jun 03		369.1		7.0		80.5		5.0

The projections for Tauranga District Council area sales show the recent healthy growth continuing until the March 2002 quarter. Thereafter, growth in retail sales moderates into 2003. However, if world economic activity picks up in the second half of 2002 as some have predicted, these forecasts will prove too pessimistic.

Building Consents are notoriously difficult to forecast as our recent experience has shown. Currently our forecasts show 4 – 5% growth over current levels to continue into 2003. As for Retail Sales, a pick up in world growth could see even higher gains in the building sectors for the Western BOP region into 2003.

Steady returns in primary sectors such as deer, kiwifruit and dairying suggest the retail and building indicators for the Western BOP will continue their upward trends. Increasing tourism will also underpin economic activity in the region.

Economic Statistics

REAL GROSS DOMESTIC PRODUCT

<i>(\$ Millions, 91/92 prices for quarter ended)</i>	<i>June '00</i>	<i>June '01</i>	<i>% Change</i>
Agriculture	1056	1093	3.5
Forestry, Fishing & Mining	724	731	1.0
Manufacturing	4057	4244	4.6
Total Gross Domestic Product	25342	26157	3.2

RETAIL SALES

<i>(\$ Millions for year to date)</i>	<i>Sep '00</i>	<i>Sep '01</i>	<i>% Change</i>
Auckland Region	14140.8	14846.2	5.0
Waikato Region	3902.6	4248.6	8.9
North Island	32439.4	34228.3	5.5
South Island	10474.8	11186.5	6.8
All New Zealand	42914.2	45414.8	5.8

BUILDING ACTIVITY

<i>(Work in place \$m to year ended)</i>	<i>June '00</i>	<i>June '01</i>	<i>% Change</i>
Dwellings: All New Zealand	4644.7	3831.8	-17.5
South Auckland Statistical Area (Waikato & BOP)	851.0	647.9	-23.9
Total : All New Zealand	7444.0	6703.3	-10.0
South Auckland Statistical Area (Waikato & BOP)	1171.8	1024.5	-12.6

LABOUR MARKET

	<i>Sep '00</i>	<i>Sep '01</i>	<i>% Change</i>
All New Zealand : Unemployment Rate %	5.7	5.1	-10.5
Waikato Region : Unemployment Rate %	6.0	5.6	-6.7
All New Zealand : Labour Force ('000)	1886.3	1914.7	1.5
Waikato Region : Labour Force ('000)	177.2	177.4	0.1
Working Age Population ('000)	263.9	266.2	0.9
Participation Rate %	67.1	66.6	-0.7

PRICES

	<i>Sep '00</i>	<i>Sep '01</i>	<i>% Change</i>
Consumer Prices (June '99 = 1000)	1034	1059	2.4
	<i>June '00</i>	<i>June '01</i>	
Producer Prices (June '99 = 1000)	1060	1146	8.1

INTEREST & EXCHANGE RATES & RESERVES

	<i>Sep '00</i>	<i>Sep '01</i>	<i>% Change</i>
Reserve Bank Base Rates (% p.a.)	10.57	9.70	-8.2
Total Official Reserves (\$ millions)	8712.70	8932.10	2.5
	<i>Oct '00</i>	<i>Oct '01</i>	<i>% Change</i>
Trade Weighted Exchange Rate (Jun '79 = 100)	47.00	49.00	4.3



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