Tax Working Group
Te Awheawhe Tāke

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[1]

General comments

We note the very short deadlines for submissions – six weeks from the Submissions Background Paper to the cut-off date. We observe that such short deadlines are not necessarily conducive to well-informed public submissions.

In addition, while we note that a separate consideration of the tax-welfare interface is discussed, the scope and timing of this review is undefined at time of writing. The risk here is that there is a failure of coordination between the two processes and important issues fall between the gaps. To mitigate these risks, this submission addresses some important issues in relation to taxes and benefits where we consider there is a significant risk that the issues will not be fully covered in the unannounced second process.

Finally, it would be remiss of us not to note the various restrictions in the terms of reference of the working group in terms of what is off the agenda. We observe that these restrictions make little or no sense in terms of the criteria provided for the assessment of the efficacy of a tax system in the Tax Working Group's own submission paper. Consequently we must regard these exclusions as most regrettable for the purposes of rationally developing a coherent tax system.

What are the main risks, challenges, and opportunities for the tax system over the medium- to long-term?

The main tax challenges we identify include the following:

A. An insufficiently broad definition of income for income tax purposes
B. Lack of high quality data on comprehensive income in our sample and administrative surveys to assess true equity and efficiency issues
C. Inconsistent definitions of income across the distribution in terms of the tax-benefit system
D. Inconsistent treatment of units for the purposes of tax-benefit assessment across the household income distribution
E. An insufficiently broad definition of value added for GST
F. Low effective income taxation rates on tax payers self-reporting business income and expenditure
G. Lack of attention to taxation where supply is inelastic
H. Fiscal policy for stabilisation purposes is likely to become more influential in the future and we need to explicitly consider this in terms of the tax system – both in terms of automatic stabilisers and pre-planned discretionary instruments

How should the tax system change in response to the risks, challenges, and opportunities you have identified?

A. Broadening the income definition for income tax purposes

We believe the income tax definition should be broadened. A comprehensive measure of income is as follows. Income in a given period of time is the maximum amount that can be consumed in that period while keeping real wealth unchanged (the Hicks-Simon-Haig definition of income).

This broad definition of income thus includes capital gains (and losses), one-off and regular gifts, bequests, child support payments, lottery wins, as well as in-kind payments. It is noteworthy that this definition of income does not, largely speaking, correspond to the current definition of income for the purposes of levying income tax.

To create a comprehensive income tax would involve adding the following forms of income to current definitions of income to move as close as possible to the Haig-Simons-Hick definition:

1. Imputed income net of depreciation from owner-occupied housing
2. Imputed income net of depreciation from consumer durables
3. Accrued capital gains
4. *Inter-vivos* gifts in money and in-kind
5. Inheritances
6. Lottery winnings
7. Child support
8. The value of home production

This comprehensive income can then be taxed at a person's marginal income tax rate. There are obvious difficulties in expanding income definitions in these direction.

The terms of reference place (1) outside consideration by the Working Group. We recommend taxation of imputed income from owner occupied housing on both efficiency and equity grounds.

Both (2) and (8) are difficult to both measure and to value for income tax purposes, but they are likely to comprise a substantial proportion of comprehensive income.

A *specific* inheritance tax is ruled beyond the scope of the Working Group by the terms of reference. Additionally, if one designs an income tax to apply to comprehensive income, there is no good basis for a specific separate inheritance/gift regime. It is our view that incorporating inheritances (5) - and perforce *inter-vivos* gifts (4) - as part of a broader definition of income and subjecting all broader income to the normal income tax schedule falls within the terms of reference. Our recommendation therefore amounts to an income tax applied to income including inheritances, not an inheritance tax. On both efficiency and equity grounds, we recommend including inheritances and gifts into the income definition for income tax assessment and hence make them subject to the normal income tax rates and thresholds.

B. Improving data on comprehensive income

There is an urgent need to support Statistics New Zealand to develop a regular high quality large sample household income survey which collects information on an income concept more accurately aligning with Hicks-Simon-Haig definitions of income (see A above) for consideration of a wide range of income distribution/equity/efficiency issues and suitable for high quality tax-benefit policy modelling.

C. Addressing inconsistent definition of income across the distribution in terms of the tax-benefit system

The current system treats income for effective tax purposes differently across the distributional spectrum. Welfare benefits are no more or less than negative taxes, and taxes are no more than negative welfare benefits. The point was well acknowledged in earlier New Zealand tax reviews, as early as the 1967 Ross Tax Review, as well as in the 1982 McCaw Tax Report. But, while acknowledged, it has not be integrated into our considerations of the tax system. The terms of reference for the current review are, in our view, a retrograde step in this regard.

We further note that the Working Group's submissions background paper (*Future of Tax*, 2017) suggests a number of high-level principles and objectives that are difficult to achieve with a self-imposed blind spot that encompasses the transfer system. 'Coherence' is listed as a well-established criteria to which the tax system should adhere (pg. 5), despite the possibility of deep incoherence between the tax and transfers aspects of public policy. The distributional outcomes used by the Working Group specified as the "results of the tax system" are in fact the reductions in pre-tax income inequality that results from "the tax *and transfer* system" (pg. 6, emphasis added). The Group also invites submissions on "the most significant inconsistencies in the current tax system". Yet a tax system, in any sense other than pure abstraction, is a part of a particular social system. Its inconsistencies primarily stem from its interaction with the system in which it is applied, and as such, cannot be considered in isolation.

Keeping this essential tax-benefit equivalence at the forefront of one's analysis reveals some serious systemic problems. The manner in which the tax-benefit system currently operates treats extra income differently for poor people on a benefit compared to rich people not on a benefit, to the evident and considerable disadvantage of those on a benefit. Let us illustrate how this serious inequity arises.

If one earns $100,000 per annum, the income tax rate on any monetary gifts and child support payments is zero. However, by way of contrast, if one receives a first tier welfare benefit, regular gifts of money are abated (that is to say, effectively taxed) as income, often at substantial rates. Equally, if one receives the Accommodation Supplement, this supplement is effectively taxed or abated (in this case) against both regular and irregular gifts of liquid wealth.

Now consider child support. If one earns $100,000 and additionally receives child support, the tax rate on child support is zero percent. However, if one is on a first tier benefit and receives child support, one is taxed, at an effective rate of 100 percent, up until the first tier benefit payment is fully clawed back by the government.

As we have argued above, these matters cannot be neatly treated as issues of the tax system or the transfer system alone. They are issues of incoherence, inconsistency and inequity for the tax-negative tax (or benefit) system as a whole.

We recommend that income for net tax purposes be defined identically across the income distribution and also recommend that gifts and child support be treated the same for both rich and poor people in the tax-benefit system.

D. Inconsistent treatment of unit of tax-benefit assessment unit across the household income distribution

The benefit (or negative tax system) assesses *need* on the basis of *family* income. The income tax system assesses *ability to pay* on the basis of *individual* income. *Need* and *ability to pay* are two sides of the same coin. Need exists in the lower part of the income distribution. As one moves up the distribution the ability to pay grows. Thus need and ability to pay are both about fairness or vertical equity of the system.

We assess many (most?) fairness or equity issues in terms of families - as indeed does the Tax Working Group when considering distributional issues - not on the basis of individual circumstance. Yet we have a tax system – which has as an important goal equity – which bases income tax on individuals rather than families. This inconsistency in the treatment of taxable unit across the income distribution appears to be a major problem in terms of equity and coherence of the system.

We perceive both significant advantages and significant disadvantages in solving this issue via (1) individualising welfare benefits (negative taxes) or (2) taxing families rather than individuals. On this basis we recommend that serious research consideration be made by the secretariat of the Tax Working Group to the appropriate unit for assessment of ability to pay taxes, and to the pros and cons of a family based tax system, rather than taking it for granted that individuals are the appropriate unit for equitably levying taxes but not for negative taxes (welfare benefits).

E. Broadening value added taxation to include (1) the financial sector and (2) low value online imports

The exclusion of the financial sector from GST is a major flaw in the system. The omission of the financial sector distorts resource allocation by subsidising activities to consumers of financial services (likely better off consumers, who tend to consume more financial services) and is unfair to other sectors who have to bear a greater tax burden. There are considerable technical problems in applying a GST to the financial sector. As recommended by the IMF and the European Union, we favour a Financial Activities Tax (FAT) to complement GST in other sectors.

A FAT is a tax on the sum of the profits and remuneration paid by financial institutions. While existing FATs (e.g. Norway, Denmark) only tax the wage portion of value added, we favour a complete value added tax, including profits. A FAT of this kind could make the tax treatment of the financial sector more like that other sectors and so help offset a tendency for the financial sector to be too large. Additionally, for consistency and simplicity, we favour a rate equal to the current GST rate (15 percent).

Furthermore, we favour adding taxation to as many low value imports, which currently typically do not attract GST, as possible, for reasons of both efficiency and equity.

F. Low effective income tax rates for self-reported income and expenditure

Opportunities for tax avoidance (legal) and evasion (illegal) in New Zealand are unequally distributed across different sources of income, raising serious horizontal and vertical equity concerns. Wage and salary earners in the PAYE system have very few opportunities for avoidance and evasion. IRD has independent information on the major income source for those in the PAYE system, information which is provided to them by a third party – their employer. In addition, tax is deducted at source.

The biggest avoiders and cheaters are the ones for whom it is easiest to evade (unfair) or avoid (unfair, and illegal) particularly farmers and those running small businesses like building or plumbing firms, as well as other independent contractors. In these businesses, the people generating the income and choosing their expenditures are the same ones who decide the information to share with IRD. There is no disinterested third party — an employer or investment manager — to pass those details to the tax agency.

High quality regular independent research into the tax gap between actual and reported income needs to be instituted, making the size of this inequity more transparent to wage and salary taxpayers (the line between the two is likely to be blurry in many circumstances).

In addition, for reasons of equity and efficiency (for over-burdening of wage and salary earners), we recommend that a greater IRD resource should be devoted to enforcement in this area.

G. Taxing where supply is inelastic

In this context, there is a strong case to be made for introducing a significant in-bound tourist poll tax. In-bound tourism offers a potentially broad and rapidly expanding tax base. In 2017 New Zealand received about 3.7 million tourist visitors from overseas. Tourism is forecast to continue to grow at about over 5% pa in volume.

The available evidence suggests that the price elasticity of demand for in-bound tourism to New Zealand is inelastic. As one piece of research concludes, "international visitors are unlikely to greatly change their travel behaviour within NZ due to higher prices, even for transport price increases (e.g. the international airfare)."[1] A meta-analysis of international

[1] Schiff, A., & Becken, S. (2011). Demand elasticity estimates for New Zealand tourism. *Tourism Management*, *32*(3), 564-575.

elasticities supports this conclusion, suggesting that price elasticity of demand in-bound tourism to Oceania is also less than unity.[2] Thus an inbound tourist poll tax is likely to be efficient. This inelasticity makes in-bound tourism an ideal base for tax purposes.

As well as being efficient, from a New Zealand perspective the tax is fair. In terms of incidence it falls, in the first instance and to a large extent ultimately (for demand is inelastic) on foreigners, not New Zealanders. A tourist tax is thus almost uniquely fair in New Zealand's potential tax-choice suite. In addition, it primarily falls on well-off foreigners, since it is these people who have sufficient largesse to travel internationally long-distances by aeroplane to New Zealand. So even in a global sense it is fair. It also makes sense on the benefit principle.

If the price elasticity of demand is assumed to be about 0.9 (on the high side, based on the econometric work referred to above), New Zealand could progressively levy a poll tax on in-bound tourism, starting at $250 in the first year (about five percent of the price of an average visit to New Zealand, adding tourist spending locally to airfares paid to get here) and raising it by that increment in four year period to $1000. Phasing in the tax in such a way would ensure a more stable adjustment, without absolutely reducing tourist numbers and threatening tourism business stability.

Given that annual swings in real exchange rates, which change the price to in-bound tourists in a similar manner to a real exchange rate change, have considerably exceeded five per cent on several occasions, the tourist industry is more than capable of adjusting to such a tax introduction.

Assuming assume 4 million visitors prior to imposition of the tax, and the average tourist visit including airfares costing about $5000, the levying of a steady state $1000 per head tourist tax could raise about $2.5 billion, a significant sum compared to the current tax take in the order of $75 billion.

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[2] Peng, B., Song, H., Crouch, G. I., & Witt, S. F. (2015). A meta-analysis of international tourism demand elasticities. *Journal of Travel Research*, *54*(5), 611-633.

Further gains to tax efficiency could be made via segmenting the market by country of origin, as the research indicates that demand elasticities may be significantly lower for tourists from Australia, the United Kingdom and Germany.

Looking forward, this tax base would then grow in excess of 5 percent per annum, which is significantly more rapid than GDP, which going forward is another attractive characteristic.

In terms of the other criteria for assessing a good tax, given the tax will be levied on people before they get on a plane (less often a boat) to come to the islands of New Zealand, the tax is very difficult to evade and avoid. Additionally it has low compliance and administration costs.

Because of the low price elasticity of demand, we do not view the proposed tourist tax primarily as a corrective tax, as some discussions have focussed on. However, to the extent that the tax results in a lower interim visitor path, pressure on infrastructure and on congestion is relieved.

For similar reasons of both efficiency and equity, we also favour a land tax on the value of unimproved land.

H. Taxes and fiscal policy for stabilisation purposes

The experience of the global financial crisis [GFC] and its enduring consequences over the past decade have refocused the attention of many policy-makers on the adequacy of the policy tool kit in response to major economic shocks to aggregate demand. The Submissions Background Paper (2017) contains no consideration of the stabilisation role of the tax system, both in terms of automatic stabilisers or in terms of discretionary tax policy. The Paper however notes that New Zealand will face "other shocks and surprises that we have not considered and cannot foresee".[3] The logical response to this is to consider what measures

[3] https://taxworkinggroup.govt.nz/sites/default/files/2018-03/twg-subm-bgrd-paper-mar18.pdf

will enhance the resilience of our system and institutions, and what sort of tax policy contingencies might help us prepare for a shock.

The prevailing pre-crisis wisdom suggested that monetary policy had primary responsibility for macroeconomic stabilisation (largely through targeting price stability), and that central banks had the tools necessary to achieve that. Fiscal policy, though important in earlier times, was considered to be an undesirable option due to long lags in its implementation,[4] concerns as to the accumulation of public debt, and scepticism that discretionary fiscal policy would be well-designed, given political considerations.[5] Aside from these concerns, the responsibility placed with central banks to achieve their agreed targets was presumed to mean that monetary policy would in normal circumstances offset the effects of fiscal policy.

The GFC provided clear evidence that fiscal policy would be necessary to respond to some shocks. Furman has set out a 'new view' of fiscal policy, being that fiscal policy is:

- Beneficial as a complement to monetary policy, particular in light of the long-term decline in real interest rates and the corresponding limitations placed on monetary policy due the issue of the zero lower bound. The prospect of there being inadequate space for nominal interest rates to fall in order to stimulate the economy in the face of a substantial shock is a real concern for policy makers internationally, and means that governments are more likely to have to rely on fiscal policy than many would have previously believed;

[4] This is primarily a concern around 'inside' lags – see discussion below.

[5] Elmendorf, D. and Furman, J., *If, When, How: A Primer on Fiscal Stimulus*. Strategy paper. Brookings Institution, 2008

- Very effective in circumstances where monetary policy is constrained, and more likely to crowd in additional private sector spending than crowd it out through higher interest rates;
- Less limited by fiscal space than many have assumed, due to the benefits of increased growth on government balance sheets. This can mean that fiscal stimulus causes output to grow faster than debt, lowering debt-to-GDP ratios;
- Sustained fiscal policy "can play a critical role not only in demand but also in expanding productivity and aggregate supply going forward".[6]

The fact that the world is currently facing a conditions of persistently low inflation and correspondingly low nominal interest rates also significantly reduces the capacity of monetary policy to respond to negative aggregate demand shocks.[7]

The prospect of future crises beyond the ability of monetary policy to deal with is a major future challenge. It also has important implications for the role that the tax system must play in New Zealand. To what extent can the tax system contribute to macro-economic stabilisation in an environment where this is likely to be an ongoing concern? What additional tools, systems or contingencies within the tax system could improve the effectiveness of fiscal policy in situations where monetary policy is indeed constrained?

The tax system has long had a well-recognised role as an automatic stabiliser. Tax liabilities and eligibility for tax credits will tend to be counter-cyclical at the individual or household level. This is because as peoples' income falls (through unemployment, underemployment or

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[6] Furman, J., "The new view of Fiscal Policy and its application", 2016, retrieved from https://voxeu.org/article/new-view-fiscal-policy-and-its-application

[7] Romer, C. and Romer, D., "Phillips Lecture – Why Some Times Are Different: Macroeconomic Policy and the Aftermath of Financial Crises", *Economica*, 85, 2018, 1 - 40.

hours being cut), their tax liability decreases and their entitlement to income-tested transfers increases. In aggregate, this can help offset fluctuations in the broader economy without the need for any discretionary intervention by policy makers.[8] Despite this, the objective of contributing to macro-economic stability has not always been treated as an explicit priority in policy discussions around tax, and has not been explicitly considered so far by the current Tax Working Group. We consider this lack of design consideration another serious lacuna.

To the extent that the tax system *can* contribute to stabilisation, this function deserves to be weighed up against other objectives. The consequences of economic turmoil and unemployment for human wellbeing are such that more good could be done through a proper consideration of a stabilisation objective than through any marginal improvement in pursuit of other goals. To paraphrase Keynes, when our problems change, we must change our minds about what public policy is trying to address. And as the economists' saying goes, "it takes a lot of Harberger triangles [inefficiencies generated by behavioural change due to tax in this case] to fill an Okun's gap [loss of output experienced in a recession]".

The topic of macroeconomic stabilisation as an objective of the tax system has received only sporadic attention in New Zealand over the years, as fiscal policy has been targeted on government debt ratios and the rest of tax policy has been micro-economically focussed.

The use of a variable GST as a counter-cyclical stabilisation tool has been proposed or discussed at different stages by Federated Farmers, Buiter[9] and the Reserve Bank of New

[8] http://www.taxpolicycenter.org/briefing-book/what-are-automatic-stabilizers-and-how-do-they-work

[9] Buiter, W, "Stabilisation policy in New Zealand: Counting your blessings, one by one", 2006 Retrieved from https://willembuiter.com/nz.pdf

Zealand.[10] For many, the appeal of this tool was found not only in its potential as a counter-cyclical measure, but in the promise that it would alleviate the pain felt by interest rate-sensitive sectors of the economy by reducing the unequal sectoral burden of monetary policy (the impact of interest rates on the exchange rate being the main area of concern). The weaknesses in this proposal are that providing such an option to the central bank might results in its two primary tools – the Official Cash Rate and the proposed variable GST - working against each other. Increasing GST to dampen aggregate demand and inflationary pressure would also increase the consumer price index and make the Central Bank's task in controlling inflation *more* difficult.[11] Although there are international examples of cuts to GST/VATs to stimulate the economy, such as in the UK,[12] the wisdom of adding further deflationary pressure to the economy at a time when central banks are consistently undershooting inflation targets is not particularly clear.

For some of the reasons stated above, Ball suggested that an independent 'Macroeconomic Policy Committee' be given the power to temporarily vary income taxes in response to macroeconomic fluctuations.[13] Parliament would retain control over the average level of income taxes, and their level of progressivity.

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[10] https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Monetary%20policy/About%20monetary%20policy/3075586.pdf?la=en

[11] Additional concerns include menu costs, and adding to the variability of prices. Claus, I. and Sloan, B., "Variable GST/VAT: A tool for monetary policy?", 2008, retrieved from https://www.otago.ac.nz/economics/news/seminars/otago079331111.pdf

[12] https://www.theguardian.com/business/2009/aug/26/vat-cut-ineffective

[13] Ball, L., "A proposal for the next macroeconomic reform", 1996, retrieved from https://www.rbnz.govt.nz/research-and-publications/research-programme/visiting-researchers/fellowship/a-proposal-for-the-next-macroeconomic-reform

Brash proposed that the Reserve Bank governor be given the power to adjust the excise tax on fuel in order to complement the effect of traditional monetary policy. [14] This was envisioned to be a way to spread the burden of tighter monetary policy across the economy more broadly, while avoiding further upward pressure on the exchange rate.

As mentioned already, such proposed changes to the tax system are often grounded in concerns about the costs of fighting inflation, particularly those felt by the tradeable sector through the impact that higher interest rates have on the exchange rate. In many of these instances, there is an implicit assumption that monetary policy already has, for the most part, adequate firepower to respond to large economic shocks. However, in a world where fiscal policy is likely to be a more frequently-utilised tool, the principles guiding a macroeconomic stabilisation role for the tax system will be different.

Krugman has summarised some guiding principles for fiscal stimulus, which include:

- effectiveness;
- short time lags;
- targeted at sectors strongly affected by the shock;
- include assistances for levels of government less able to borrow to maintain spending;

An important option for fiscal stimulus is direct assistance to individuals and households. Though our concern here is how the tax system can be designed to contribute to the goal of macroeconomic stability, it is important to note that 'assistance through the tax system' can

[14] Brash, D., "How can our Reserve Bank keep raising interest rates when the U.S. Federal Reserve keeps dropping theirs?", Speech in memory of Michael Joseph Savage, La Trobe University, 2008, retrieved from http://www.donbrash.com/after-parliament/how-can-our-reserve-bank-keep-raising-interest-rates-when-the-u-s-federal-reserve-keeps-dropping-theirs/

refer to a wide range of policy measures. Some stimulus measures incorporate permanent changes to income or company tax rates, or other aspects of tax policy. However, there are also discretionary lump-sum payments that are administered through the tax system, but are unrelated to any chance in tax policy. The 2008 and 2009 Australian stimulus package totalled 5% of GDP of which discretionary cash payments to households was 40%.[15]

In terms of pure effectiveness, direct spending by the government (for instance, on infrastructure) should provide the most "bang for the buck", as - unlike households - the government will not choose to save any portion of the allocated money. The arguments for providing government assistance through the tax system is that assistance can be targeted to alleviate economic suffering at the same time that the wider economy is supported. Nonetheless, the effectiveness of such stimulus on aggregate demand depends primarily on the marginal propensity to consume of the recipient. This provides support for targeting assistance at lower income individuals and households, who have less ability to smooth their consumption over time, and are therefore more likely to spend any additional money received.[16]

An additional advantage of providing fiscal stimulus through the tax system is relatively short lags in its effectiveness. There is always a delay between changes in the national economy and the impact of policy responses. It is common to distinguish between 'inside' and 'outside' lags. An inside lag is the time taken for policy makers to perceive, consider and respond to changes in economic conditions. This is distinct from the 'outside' lag, or how

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[15] Hyslop, D. The Distributional Effects of the Australian Cash Bonus Payments Response to the Global Financial Crisis", 2014. Retrieved from "http://www.nzae.org.nz/wp-content/uploads/2015/01/NZAE_Hyslop2014.pdf

[16]Elmendorf, D. and Furman, J, 2008.

long it takes for policy to have an effect. Though macroeconomic stabilisation is often a necessary function of government, too great a lag (of either sort) risks mistiming the support, and exacerbating the business cycle rather than offsetting it. Milton Friedman's memorable analogy was of a furnace reacting to a thermostat in the furthest room of a house – meaning that the furnace was likely to be warming or cooling at the precisely the wrong times.

Though modern central banking institutions allow for monetary policy decisions to be made promptly, it is well recognised that there is a considerable lag in the impact of a change to the official cash rate. This is commonly estimated at 12-18 months or longer (and likely differs between transmission channels).[17] Conversely, fiscal policy has the potential to have a much more timely impact on economic conditions and avoid exacerbating fluctuations through mistiming. Elmendorf and Reifschneider find significant short-run impacts associated with a one-off tax rebate, provided that it is directed towards households that are likely spend it.[18] Infrastructure projects and investment incentives (which are options that often dominate thinking on fiscal stimulus) tend to operate over a much longer timeframe. Though these measures may be worthwhile for other reasons (e.g. a positive effect on long-term productivity), and might form part of a broad fiscal package, they appear to be less worthwhile as an options for timely macroeconomic stabilisation.

The lags associated with fiscal policy are more of the inside variety – policy makers recognising the need for action, debating and deciding on the form of the assistance, and then implementing their preferred policy response. The concentration of decision-making power

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[17] Ball, 1996; http://economistsview.typepad.com/economistsview/2006/05/lags_in_monetar.html

[18] Elmendorf and Reifschneider, "Short-Run Effects of Fiscal Policy with Forward-Looking Financial Markets", *National Tax Journal*, 55:3, 2002, 377.

within the executive branch of government in New Zealand puts us in a better position to take decisive action should the need arise. However, the lags associated with policy formulation and implementation mean that the tax system needs to be designed with this function in mind, with a range of options available for quick implementation depending on the need and context. There is also the matter of what one might call the political economy of urgency, whereby the need for a quick response weakens normal accountability mechanisms and leads to worse decisions being made.[19]

We believe that clear thinking and prior preparation around the discretionary ability of the tax system to contribute to macroeconomic stability may also contribute to greater coordination between fiscal policy and monetary policy in the face of a large scale shock.

There are a number of reasons why the shape of the assistance might make a difference as to whether individuals or households choose to spend the money or save it.[20] Richard Thaler's 'mental accounts' framework suggests that money that recipients consider as falling into the 'current income account' is more likely to be spent (a marginal propensity to consume of close to one) than that ear-marked as 'asset account' or 'future income account'.

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[19] A version of this concern was raised by Republican economist Doug Holtz-Eakin in response to the Obama administration's stimulus bill, which in his view was made up of ready-to-go projects that had previously been debated and rejected. https://www.washingtonpost.com/business/2011/10/04/gIQALuwdVL_story.html?noredirect=on&utm_term=.27f3f4d5c05c

[20] Sahm, C., Shapiro, M. and Slemrod, J. "Check in the Mail or More in the Paycheck: Does the Effectiveness of Fiscal Stimulus Depend on How It Is Delivered?", in *Am Econ J Econ Policy*, August 4:3, 2012.

Furthermore, the visibility of a change in income may effect whether the recipient considers it to be permanent or not, and whether it is in fact spent.[21]

Recent literature has considered the effectiveness of different means of fiscal stimulus:

Sahm, Shapiro and Slemrod find that a one-off tax rebate paid to households through the US tax system in 2008 was around 3 times more likely to be mostly spent compared to a 2009 tax credit that was disbursed gradually through a change in withholding. This was contrary to what one would expect according to the mental accounts hypothesis (and against the expectations of the Obama administration officials who designed the stimulus).[22]

Leigh uses survey data to estimates a marginal propensity to consume of around 40 cents in the dollar for payments made to households as part of the Australian government's stimulus package. These payments, made at two stages in 2008 and 2009, were of various forms – some linked to eligibility for the Child Tax Benefit, and others a tax 'bonus' paid in relation to taxable income in the previous tax year (with higher payments going to lower income individuals). This MPC is a higher rate than similar studies in the US, despite the fact that US households seemed to be more credit-constrained. Leigh suggests that framing the payments as a 'bonus' rather than a 'rebate' might have increased the programme's impact. [23]

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[21] Ibid.

[22] Ibid.

[23] Leigh, A., "How much did the 2009 Australian Stimulus Boost Demand? Evidence from Household Reported Spending Effects", in *B. E. Journal of Macroeconomics*, 12:1, 2012.

Hyslop also examines the case of the Australian stimulus, and finds that the payments were effective at counteracting the effects of the GFC on individuals and households (more so the latter than the former).[24]

In anticipation of future negative aggregate demand shocks in a low inflation environment, we recommend the work be undertaken to determine how fiscal stimulus through the tax system could be undertaken with minimal lags, and in a way that complements other government measures aimed at macroeconomic stabilisation.

[24] Hyslop, 2014.