

ECONOMIC NOTES

Treasury Bill Tenders and Open Market Operations

August commenced with moderate cash withdrawals from the financial system, accompanied by \$66 million of discounting of predominantly short dated government securities. This reflected normal flows of sales and customs tax revenue which occur around the beginning and end of each month. \$74 million of securities were discounted on 16 August in conjunction with the final settlement of outstanding entitlements from Stock Tender 21. A further \$271 million of discounting occurred during the last week of September, again reflecting normal end of month tax flows to government.

A total of \$355 million of Treasury bills were sold by tender during August, including \$182 million of March 1986 maturities. The sale of March bills reflected the continued desire by the Bank to shift liquidity into a period when tax payments would result in large net withdrawals from the financial system.

TREASURY BILL TENDERS AND OPEN MARKET OPERATIONS

Treasury Bill Tenders

<i>Tender</i>	<i>Amount Offered \$m.</i>	<i>Term</i>	<i>Amount Sold \$m.</i>	<i>Weighted Average Rate %</i>
28	25	56 days	37.5	23.293
	75	210 days	37.05	24.609
29	50	70 days	37.5	25.948
	50	98 days	37.5	26.149
	50	210 days	75.0	25.321
30	30	203 days	30.0	24.23
31	30	48 days	30.0	22.914
	70	196 days	70.0	24.186

Open Market Operations

	<i>Amount Offered \$m</i>	<i>Term</i>	<i>Amount Sold \$m</i>	<i>Amount Purchased \$m</i>
8 August Treasury Bills	20	214	20	—
22 August Treasury Bills	25	42 days	25	—

The Reserve Bank conducted open market operations on two occasions in August. On 8 August the Bank sold \$20 million of March 1986 Treasury bills in response to larger than anticipated cash injections during that week. On 22 August the Bank sold \$25 million of October Treasury bills, again in response to larger than anticipated cash injections.

The settlement of Government Stock Tender 21 was completed on 16 August. As has been the pattern in recent tenders, the major portion of settlements occurred over the final days of the settlement period; \$148 million out of total settlements of \$293 million occurred on the final day.

Primary liquidity began the month at \$1,174 million and fluctuated around this level before reaching a peak of \$1,379 million on 14 August. Primary liquidity declined to \$929 million at the end of August reflecting strong flows to Government over this period, in association with sales of March 1986 Treasury bills.

Taxation and Benefit Reform

A statement on taxation and benefit reform was presented to Parliament on 20 August 1985 by the Minister of Finance, the Hon. R.O. Douglas. The main points of the statement are summarised below.

Business Taxation

- Dividend income received by shareholders will be assessable in shareholders' hands, but a credit will be allowed for company tax previously paid (a 'full imputation system'). This measure will be introduced in 1988/89 subject to consultation with the business sector.
- As an interim short-term measure and starting immediately, dividends paid from capital sources will be taxable in shareholders' hands.
- The company tax rate and the fringe benefits tax rate will be raised from 45 per cent to 48 per cent from the income year commencing 1 April 1986.

- In order to stem an avenue for international tax avoidance, income derived after 20 August 1985 by New Zealand companies by way of dividends on redeemable preference shares, interest on convertible notes, or interest on equivalent securities will be subject to tax where the related payment is deductible to the offshore firm.
- A withholding tax on interest will be applied from 1 April 1987, after consultation with the financial sector.

Indirect Tax Reform

- A Goods and Services Tax (GST) will come into force on 1 October 1986. It will be applied at a single rate of 10 per cent to the widest possible range of goods and services supplied in New Zealand and to all imports of goods. No tax will apply to exports, and exporters will be entitled to a credit of GST paid on the inputs to exporting. It is estimated that the GST will raise about \$2,700 million in full-year 1986/87 terms; about \$1,300 million of the revenue will be used to reduce existing indirect taxes.
- GST will replace almost all indirect taxes, including Sales Tax. However, selective taxes will remain on alcoholic beverages and on tobacco products. A special tax will replace existing sales tax on motor vehicles, so that prices will not be affected by the introduction of GST, but this special tax will eventually be phased down. Various other taxes including Lottery Duty and International Departure Tax will be superseded by GST, and Stamp and Cheque Duties will be reviewed in the 1986 Budget. However, levies and special taxes (such as Road User Charges) designed to recover the cost of government-provided goods and services will be retained and GST will apply as well.

Personal Tax and Benefit Reform

- From 1 October 1986 a new income tax scale will be introduced with only three steps:
 - for the first \$9,500 per year of taxable income, the rate of tax will be 15 per cent;
 - from \$9,501 to \$30,000 the rate will be 30 per cent;
 - above \$30,000 the rate will be 48 per cent.
- The present Family Care scheme and the Family Tax Rebate will be combined and supplemented in a new Family Support scheme, to be paid to all low and middle income families from 1 October 1986. The Family Benefit will stay in its present form.

- For families not otherwise receiving benefit assistance, the level of assistance will be \$36 per week for the first child and \$16 per week for each subsequent child. Family Support payments will be reduced at a rate of 18 cents in the dollar on joint incomes in excess of \$14,000 per annum. From 1 October 1986, the Government will ensure a guaranteed minimum family income for all full-time earners with dependent children. For families with one child, the guaranteed family income will be \$250 net a week, including Family Benefit. For each additional child, the guaranteed weekly family income will increase by \$22 (including Family Benefit). Family Support will also be extended to income-tested beneficiaries and national superannuitants with dependent children, through a restructuring of benefits.
- With the introduction of the new tax scale and Family Support, existing child supplements and the current principal income earner rebate will be abolished. To ensure that full-time low-income earners without children are not disadvantaged by the abolition of the rebate, a transitional tax allowance will be introduced from 1 October 1986.
- From 1 October 1986, a new income exemption level of \$50 per week for beneficiaries without children (\$60 for beneficiaries with children) will be introduced. Between the \$50 or \$60 allowable level and \$80 of other weekly income, their benefit will be reduced at the rate of 30 cents in the dollar. Above \$80 per week it will abate at 70 cents in the dollar.
- Additional assistance in the form of a temporary non-taxable allowance will be provided from 1 April 1986 under a new scheme to encourage long-term beneficiaries to make the transition to work.

Conclusion

The Minister concluded by stating that the measures outlined would give New Zealand a fairer tax system. They would reduce the burden of personal income tax on wage and salary earners, encourage harder work and make extra effort worthwhile, and provide more disposable income for families.

The measures are estimated to cost \$1,057 million in 1986/87 and \$737 million in a full year. The Minister stated that these major reforms could be accommodated without in any way compromising the Government's overall fiscal strategy. The measures would largely determine the Government's revenue for the next financial year. However, the annual budget cycle review of expenditure would begin shortly, and expenditure would be controlled to ensure that the Government's fiscal strategy remained in place — in particular the Government remained committed to a declining trend in the deficit as a percentage of GDP.