

1931.

NEW ZEALAND.

SUPPLEMENTARY FINANCIAL STATEMENT, 1931.

(In Committee of Ways and Means, 6th October, 1931.)

BY THE HON. W. DOWNIE STEWART, MINISTER OF FINANCE.

MR. CHAIRMAN,—

The necessity for a supplementary Financial Statement arises from the fact that conditions have been, and are, changing so rapidly that it is impossible to peg down as reliable any estimates of revenue. Hence, if the drift in our public finance is to be checked, remedial measures must be applied whenever it is clear that further delay means further danger. No one can say what will be the economic position six months hence, particularly in view of recent happenings in Great Britain. Many people think that conditions in the Old World have now reached a stage when far-reaching measures of an international character will be taken that will lead to a substantial recovery in prices. If so, our difficulties will be automatically eased. But in the meantime I must budget on the facts as I find them.

It will be remembered by honourable members that my predecessor, in the Budget presented to the House on the 30th July, was faced with the problem of meeting an estimated prospective deficit of no less than £6,850,000. This sum, it was hoped, would be provided for by stringent economies, reductions in salaries and wages, the use of reserves, and other items, amounting to £5,056,000, leaving £1,800,000 to be provided for by additional taxation.

This additional taxation was to be gained to the extent of £730,000 by income-tax, and the balance was to be met by Customs and excise duties and stamp duties.

Although it is only about two months since the Budget was presented, it has since become fairly obvious that the shortages in revenue will be even greater than were allowed for by my predecessor, and it is now clear that the Budget will require to be further strengthened by a substantial amount.

The Customs revenue for the first six months of the financial year is already about £750,000 behind the estimate on a proportionate basis. There is very little prospect of this deficiency being made good by heavier importations during the coming months—in fact, the shortage is more likely to increase. The increased duties imposed by the Budget and calculated to yield about £900,000 are not likely to meet the position. In addition to this drop in Customs revenue, it is probable that falling land-values will affect death duties to a greater extent than was anticipated. Further, it is now estimated that the revenue from lands—interest on mortgages, rents, &c.—will show a falling-off greater than was allowed for in the Budget.

Finally, I may say the Budget estimates include £930,000 on account of interest on Railway capital, but the interim figures so far available show that this item can only be realized by the most rigid economies, and by attempts to fortify Railway revenue.

It is therefore practically impossible to form any proper estimate of what the Budget revenue will be when the financial year is finished. It is clear, however, that substantial assistance will require to be found from somewhere if there is to be any hope of checking the present drift and balancing the national accounts. The only methods available for the purpose are further economies, further taxation, and further recourse to any reserve funds which are available.

But over and above the Budget problem there is imperative need for rendering some assistance to the farmers if they are to stay on the land and if production is not to decline rapidly, and, indeed, if we are to avoid a national disaster in a general breakdown of the farming industry.

While prices of primary products remain at their present level it is, of course, impossible to restore the farming industry to a condition of prosperity. But in so far as it is possible to assist the farmer, it is in the interests of the whole community that funds be found from some source for this purpose.

The three great problems with which the country is faced are, therefore, the precarious position of the farmer, the position of the public finances, and the great and chronic problem of unemployment. These problems are inextricably interwoven, and they constitute a menace to the whole stability of our social organization.

FIXED INTEREST CHARGES.

Before dealing with the Government's proposals for assisting the farmers, balancing the Budget, and the problem of unemployment, I would like to refer briefly to the question of fixed interest charges. In some quarters it has been urged that relief for the Budget could be obtained by a writing-down of interest on all public securities held in New Zealand. It is suggested that this could be arrived at either by a voluntary conversion of our internal debt on the lines adopted in Australia or by a statutory reduction of interest rates.

The position of New Zealand, however, in this respect is not analogous to that of Australia. There are no large loans falling due in the near future which would lend themselves to conversion, and the average rate of interest at present paid on Government securities in New Zealand—approximately $4\frac{1}{2}$ per cent.—is too low to make it reasonable to expect that any lower rate will be obtained by conversion operations.

In the next place, any compulsory reduction of interest payable to bondholders would in reality mean default by the State, and would seriously damage our credit. Whatever the position of private borrowers may be, the State is still able to pay its debts. In my opinion, it could not, and should not, plead inability to pay when the bondholder demands his interest. European experience seems to show that destruction of confidence in the security of savings is the most serious calamity that can befall any nation, and the Government's chief aim must be a proper maintenance of public confidence.

Moreover, the State is not only a borrower, but a lender of many millions through the State Advances and other Departments. If, therefore, a concession were extracted from the bondholders, the State would be expected to pass this concession on to its borrowers. But many of these borrowers have been financed out of loans raised overseas, and under no circumstances could the State claim relief in respect of overseas interest payments. If, therefore, the concessions extracted from the New Zealand bondholders were passed on to all borrowers, the State would lose more than it would gain, by some hundreds of thousands of pounds. The result would be to further burden the Budget instead of bringing it relief.

It is well known, of course, that mortgage charges are perhaps the chief source of embarrassment to farmers and others under present economic conditions, but an arbitrary reduction would drive capital away from this class of investment. This would not be in the interests of borrowers themselves. Further, such a reduction would work out very inequitably in those cases where mortgagees are in a worse position than mortgagors. In the case of many farmers the relief afforded would be entirely inadequate. Moreover, if a fixed reduction were made the mortgagee would tend to regard that as the limit of his duty, whereas much greater concessions are being made by voluntary negotiations. Again, many mortgages are for a long term, and it is quite possible that prices will show some recovery within a year or two.

Finally, as the State holds about one-third of the mortgages in the Dominion, a reduction in mortgage charges alone would very seriously prejudice the budgetary position. So far as the State tenants and State mortgagors are concerned, the Government is doing its best to meet their necessities in a generous way. Each case is dealt with on its merits.

It may still be argued, however, that, although the State is in no position to claim a reduction of its interest payments to its bondholders, nevertheless these bondholders enjoy a secure income and should be called upon to share in the sacrifices which the whole community is being forced to bear. I agree with this view. But the most effective way to see that the holders of Government bonds bear their share of the general burden is through taxation, and the same considerations that apply to the bondholders apply to all receivers of investment income. If taxation is fairly and justly applied by the State, there is no breach of contract between the Government and its creditors.

THE FARMERS' PROBLEM.

While it is not considered advisable to make an arbitrary reduction in interest charges, it is considered that the position can best be met by some extension of emergency powers.

The Government is of opinion that the provisions of the Mortgagors Relief Act should be enlarged. Justice could be more fully done by this means than by a fixed reduction in interest, which would work out inequitably, sometimes granting insufficient relief and sometimes too much. It is therefore proposed to enlarge the powers of the Court so that it may not merely postpone payment of interest for twelve months, but may make such remission, reduction, or postponement of interest on existing mortgages as seems just and equitable. Moreover, where the mortgagee is the vendor for unpaid purchase-money, the Court may make reduction or postponement of principal or interest to a mortgagor. The Court will also be empowered to authorize a fair distribution between the mortgagor, mortgagee, and the holder of the chattel securities of the proceeds of the farm, to enable the best to be done for all parties and to ensure that production will be carried on. It also appears expedient, in view of the rapidly changing circumstances, that the legislation should enable the powers of the Court to be extended by Order in Council as circumstances may render necessary.

REDUCTION IN RATES.

Apart from interest, the principal items in the farmers' fixed charges are rates and taxes. Rates, in particular, are a heavy burden under present conditions. These rates have been heavily increased by the cost of road improvements and maintenance through the use of the roads by motor traffic.

Quite recently the Main Highways Board increased the subsidy to local bodies for maintenance of highways from a basis of £2 for £1 to £3 for £1, as from 1st April last, thereby assuming a greater proportion of the burden of highways.

An examination of the finances of the Highways Revenue Fund shows that after providing for all the normal requirements for maintenance, interest, sinking fund, and the subsidies on rates to local authorities, the probable revenue receipts for the year from the existing taxes and license fees, &c., together with the balance carried forward on the 1st April last, will provide a balance at the end of the year of not less than £250,000. This balance, or the greater part of it, the Highways Board would normally have transferred to Highways Construction, but under present circumstances it is considered that it would be better to somewhat curtail construction work for this year and apply the £250,000 by way of a special subsidy to rural local authorities in relief of the existing burden of rates. The basis on which the amount will be distributed has not yet been finalized, but will be announced later when the necessary empowering legislation is brought down.

These measures will give some relief from the burden of rates. As a means of providing more permanent and far-reaching relief, the Government proposes to proceed with the inquiry by Royal Commission into the possibilities of national economy through the amalgamation of local authorities and a general overhaul and reorganization of the whole system of local government.

GRADUATED LAND-TAX.

This tax is operating with extreme harshness at present both on rural and urban lands. It is not based on any principle of ability to pay, and it has been condemned for many years.

I may quote, from among many and repeated condemnations, the report of the 1924 Royal Commission on Land and Income Tax which stated:—

“The graduated land-tax was originally designed to break up large estates. There is no evidence to show that it is required any longer for this purpose, and there was much evidence showing that it is now preventing the development of large areas of land requiring a considerable amount of capital expenditure to break in. The graduated land-tax applied to business premises is a serious handicap to trade and industrial enterprise, and serves no good purpose.”

I propose, therefore, to assist farmers, and also the recovery of trade and industry generally, by abolishing the graduated land-tax, while retaining the flat rate of 1d. in the pound of unimproved value.

The abolition of the graduated land-tax will, of course, involve the elimination of the 5-per-cent. allowance on unimproved value at present allowed in the assessment

of income-tax. This allowance was made to avoid the double taxation involved in taxing the land and also the income derived from it. With the flat land-tax standing at 1d. a shortage will require to be made up, which will in part be done by the abolition of the 5-per-cent. allowance and partly by the further tax proposals which I will refer to presently when dealing with the budgetary position. I may say, however, that to a considerable extent the burden will fall collectively on the same shoulders as formerly paid the graduated land-tax, although the individual incidence will be different.

So far as rural lands are concerned, the taxpayers in the higher scale, above £7,500 unimproved value, already pay income-tax; but it is proposed to make provision by legislation, which will operate from next year, to bring farmers with an unimproved value of £3,000 or over under the operation of the income-tax, subject to the usual exemptions. This will mean that all income will then be treated alike.

FERTILIZERS.

The measures that I have already referred to will assist the farmers to remain on the land by lightening their fixed obligations. In addition, however, the Dominion as a whole is vitally concerned to see that the volume of production is maintained, and even increased.

Before the Special Parliamentary Economic Committee many witnesses urged that, if farm production is to be maintained, it is imperative to provide further assistance to farmers. The following extract from evidence is emphatic on the point :—

“ A falling-off in the volume of our farm production will be a serious matter for the whole country, and will affect not only public revenue, but the earning-power and standard of living of every one. A serious falling-off such as seems to us to be in evidence will be nothing short of a calamity, which will upset and disorganize our whole economic relationships. What is needed is an increase in the volume of farm production to balance the reduction in values that now obtains, and that seems likely to continue. The whole economic future of this country depends upon increased farm production. This is the question of supreme importance at the moment.”

Maintenance of production can be greatly stimulated by fertilizers. It is found that there has been an alarming falling-off in the use of these manures, brought about, no doubt, by the efforts of the farmers to cut down expenses.

Under these circumstances it is essential that the prices of fertilizers must be reduced, and if production is to be maintained it will be necessary for the whole community to assist. For this purpose the Government has arranged to share a substantial portion of the cost of the raw phosphate rock, which will ensure to the farmer a material reduction in the purchase-price of fertilizers. The cost to the Government for this year is estimated at approximately £100,000.

ARBITRATION COURT.

The bearing of the operations of the Arbitration Court on the farmers' costs, unemployment, and the industrial situation in general has received the careful consideration of the Government.

It is considered that many conditions and restrictions now in operation in many of the Arbitration Court awards seriously militate against the employment of our people. The economic conditions now existing demand more flexibility. For the purpose of making it possible for employers and employees to arrive at agreements that will enable costs to be reduced, and at the same time allow for maximum employment and the fullest development of our industries, it is proposed to amend the Act mainly on the lines suggested by the 1928 Industrial Conference, the chief feature of which is known as compulsory conciliation and voluntary arbitration.

UNEMPLOYMENT.

In spite of the most strenuous efforts by the Government, the Unemployment Board, the local bodies, and numerous social organizations, and the provision by the taxpayers of a huge sum of money to assist the unemployed, no substantial or satisfactory solution of the problem has yet been achieved. Every one is agreed that no real progress will be made until the unemployed are engaged on reasonably productive work which will reflect itself in increased exports or increased local manufactures. The Government is engaged in an attempt to change over from the present policy to a new policy on the lines indicated above. If it proves successful, it should result in the gradual absorption of the unemployed in productive industry

and in lessening the need for taxation. But in the meantime a position has been reached in which all the funds available are strained to the utmost and are insufficient to cope with the immediate need of granting relief. There is no margin of funds to enable the Government to change over from the old policy to the new. If the new scheme is to be tried out, it appears as if the Minister in Charge of Unemployment will require temporarily some additional funds, which can only be got from additional taxation, as no further money can be obtained from the Consolidated Fund. One of the main objects in view is the use of the unemployed in preparing land for settlement. Further particulars will be placed before the House as soon as possible.

BUDGETARY POSITION.

I now propose to sum up the budgetary position so far as it can be seen at present.

As indicated in my opening remarks, it is practically impossible under present conditions to estimate with any degree of accuracy the yield from the various items of revenue. In my opinion, however, we will have to cope with a further shrinkage in revenue amounting to at least £1,250,000, which amount is arrived at on the present deficiencies in sight, but goes no further. The amount is made up as follows :—

	£
Customs	900,000
Stamp and death duties	150,000
Interest on Public Debt Redemption Fund	100,000
Other items	100,000
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	£1,250,000
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In addition to these revenue shrinkages, the expenditure will be still further increased by the absolute necessity for giving some further assistance to Hospital Boards. It is proposed to provide up to £75,000 for this purpose, which will be made available by way of additional subsidy.

The change-over from the graduated land-tax will involve a net additional burden of £320,000. There is also the amount required for fertilizers already mentioned of £100,000.

Certain exchange profits on remittances to Australia and savings consequent upon the voluntary reduction in deposit rates arranged by the Prime Minister last July will provide a saving of £150,000 towards these increases.

The total net additional amount involved in the revenue shortages and these additional items is thus £1,595,000, made up as follows :—

	£
Shortages referred to above	1,250,000
Less exchange profits and reductions in deposit rates	150,000
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	£ 1,100,000
Fertilizers	100,000
Land-tax, gross	475,000
Less elimination of 5-per-cent. allowance on unimproved value	155,000
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	320,000
Hospital subsidies	75,000
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Total	£1,595,000
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The reduction in land-tax is only a substitution of one form of taxation for another, and not an addition to the general burden of taxation.

ECONOMIES.

Having thus arrived at the total net increase that must be added to the Budget, the question to be answered is how is this to be made up. The first duty of the Government has been to undertake further economies in Government expenditure. The Economy Committee set up by the late Government has already made substantial reductions in expenditure, which, together with the reductions in salaries and wages, amounted to approximately £2,000,000. But, in my opinion, the public will not willingly submit to further taxation unless it is satisfied that the most drastic economies have been effected in departmental expenditure. Cabinet therefore resolved that an effort should be made to reduce expenditure to the extent of £1,000,000 per annum, and immediate steps

have been taken to curtail expenditure on this basis. For the remaining months of the year it is expected that the result should be a saving of about £400,000.

In view of the extent to which the Departments have previously been combed, these further economies must mainly be effected by curtailment of services. Some of the proposals will, no doubt, be strongly resisted, but it is useless to disguise the fact that unless the public is prepared to support these steps it will have to submit to higher taxation or allow a heavier drift to take place in our finances, and this would seriously affect our credit. The details of these economies will be furnished to the House in due course.

RESERVES.

Towards the balance I hope to obtain £350,000 by drawing still further upon reserves. As no doubt honourable members are aware, a large part of the accumulated surpluses of the Consolidated Fund from the war and post-war years was invested in discharged-soldiers-settlement mortgages, repayable by instalments over a long period. These investments were constituted part of the Public Debt Redemption Fund, the interest on which goes to the Consolidated Fund as a set-off against the expenditure provided for under the Repayment of the Public Debt Act. The £350,000 which it is proposed to take represents the repayments of principal by the mortgagors that it is estimated will be available during this financial year. I may add that, in view of the uncertainty of the whole revenue yield, I propose to ask the House for legislation empowering me to obtain further assistance from the Discharged Soldiers Settlement Account. This may necessitate making special arrangements by hypothecation or otherwise for liquidating any amount that may be required over and above the £350,000 estimated to be available from the capital repayments. With this special provision in reserve, I am hopeful that budgetary stability can be maintained.

TAXATION.

These proposals leave about £470,000 to be provided for by additional taxation over and above the amount proposed in the main Budget. The first question is as to where this can be imposed with the least hardship.

As regards Customs taxation, the tariff rates are already so high that the law of diminishing returns is operating over many of the items. I propose, however, to move a resolution to-night with regard to two classes of imports which I think will provide about £240,000 towards the amount required.

For the rest I am driven to review the position and the possibilities of further direct taxation through the income-tax. Income-tax is always less palatable to the taxpayer than indirect taxation; but in the present emergency we have no option. The payers of income-tax will view with strong disfavour further burdens being imposed upon them. I take it, however, that these taxpayers would prefer to shoulder further burdens rather than see reductions made in the old-age pensions, soldiers' pensions, and pensions for the blind. They would equally resent any suggestion that the State should default in its interest payments. A reduction in pensions may at any time become an imperative necessity if the world's price-levels remain low, but for purposes of my present computations I have laid this on one side.

Dealing now with the income-tax, it is well known that the company-tax in New Zealand is the heaviest in the British Empire, if not in the world, while individual income-tax is the lowest in the British Empire. I do not therefore consider it expedient or just to add anything more to the company-tax than was imposed by the main Budget. More particularly is this the case in view of the fact that a large proportion of the companies engaged in business in New Zealand are engaged in financing or assisting the primary producer, and any further tax burdens imposed upon companies is liable to reflect itself in a restriction of advances to farmers or withdrawal of other forms of assistance. I therefore exclude the companies from consideration in reviewing the prospect of further revenue from direct taxation.

INDIVIDUAL INCOME-TAX PAYER.

Having already stated that the imposition of further taxation on companies is not justifiable, I now come to the position of the individual taxpayer. At present his contribution by way of income-tax is the lowest in the Empire, by reason of the low minimum rate at which our Act starts and the liberal exemptions he enjoys. I am not forgetting the fact that the main Budget increased his surtax from 10 per cent. to 30 per cent., but I have pointed out that the receiver of gilt-edged income is called upon in these troubled times to bear his share of the burden. He is more concerned than any one else to see that the State remains solvent. European

experience shows that in a general breakdown he suffers irretrievably more than any one else. In imposing any fresh burden, it is pointed out that he should bear a share commensurate with the risks he has at stake. With these aims in view, I propose in order to secure the measure of assistance which it is considered indispensable that the income-tax should yield:—

- (1) To impose a special emergency tax on unearned income of individuals equal to one-third of the income-tax payable on such unearned income, and to eliminate the 10-per-cent. deduction at present allowed on earned incomes up to £2,000.
- (2) To include in the assessments (but only for the purpose of fixing the rate and the general exemption) all tax-free income and income taxed at the source, and to remove the present discrimination on income derived from certain local-body and company debentures.
- (3) To impose a special flat-rate tax of 4d. in the £1 on incomes of individuals, after allowing a general exemption of £500.

It is estimated that the effect of these alterations with the abolition of the graduated land-tax will be to increase the net yield on these items of taxation by about £230,000.

The foregoing provisions for economies, support from reserves, and taxation (all additional to the main Budget) should, if realized, strengthen the Budget to the extent of about £1,250,000. But it should be clearly realized that the scene is changing daily, and estimates cannot be relied on in any degree. It is our duty to do our utmost to check the drift in our public finances. But the ground is shifting from under us every day, and the position may be required to be reviewed again before the end of the financial year.

The proposals to meet the additional burden of £1,595,000 are therefore as follows:—

					£
Economies	..	..	..	..	400,000
Reserves	..	..	..	..	350,000
Customs taxation	..	..	..	..	240,000
Income-tax—				£	
To cover land-tax adjustment	..			320,000	
Additional	..	..	..	230,000	
					550,000
Reduction in amount provided in main Budget for supplementary estimates and contingencies	..				55,000
					<u>£1,595,000</u>

BUDGET ESTIMATES.

With the adjustments I have outlined, the revenue estimates for the year shown in the main Budget at £24,946,000, must now be recast as follows:—

					£
Customs	..	..	..	..	6,750,000
Beer duty	..	..	..	..	650,000
Film-hire tax	..	..	..	..	50,000
Motor-vehicles—Duties and licenses	..	..	..	..	1,760,000
Stamp and death duties	..	..	..	..	2,990,000
Land-tax	..	..	..	..	625,000
Income-tax	..	..	..	..	4,935,000
Interest receipts—				£	
Railway capital	..	..	..	930,000	
Post Office	..	..	..	535,000	
Public moneys	..	..	..	745,000	
Public Debt Redemption Fund	..			720,000	
					2,930,000
Miscellaneous—					
Post Office surplus	..	..	..	1,090,000	
From reserves	..	..	..	1,490,000	
Other	..	..	..	1,396,000	
					3,976,000
					<u>£24,666,000</u>

The estimated expenditure of £24,763,781, as shown in the main Budget, will be increased by £100,000 for fertilizers and £75,000 for subsidies to Hospital Boards, and, on the other hand, reduced by £400,000 on account of economies, so that the Budget position for the year is now estimated to be as follows :—

	£
Revenue	24,666,000
Expenditure	24,540,000
Leaving	126,000

to provide for supplementary estimates and contingencies.

LOAN EXPENDITURE.

Nearly half the net expenditure of the Consolidated Fund consists of debt charges, and any further loan expenditure is a direct factor in the budgetary position. The fall in the national income and in the taxable capacity of the people has automatically increased the relative burden of the existing debt charges. The sooner we can cease borrowing abroad the better, and this remark applies equally to the loan expenditure of local authorities as well as to Government expenditure.

For this financial year no additional capital is being provided for State Advances, but repayments from existing advances are available for fresh advances. For public works the additional loan capital to be provided has been limited to approximately £4,750,000, which means that a curtailment of over 40 per cent. has been made in the raising of fresh capital. If State Advances is included, the curtailment is over 50 per cent. compared with the amount borrowed last financial year.

CONCLUSION.

In conclusion, the main difficulty in framing a policy consists in knowing whether the present price-level is to be regarded as temporary or permanent. If prices are likely to rise, then temporary measures to bridge a short but difficult period will meet the case, but if the present price-level is to remain, then more drastic measures will certainly be necessary. Most of the economists who gave evidence before the Special Parliamentary Economic Committee considered it reasonable to suppose that there will be some recovery in prices, but that we are not likely again to reach the high prices of our more prosperous times.

Various schemes have been put forward for stabilizing the local price-level on the basis of export prices. But there are serious objections to all these schemes. Moreover, experience in other countries seems to show that an increase in the volume of money often fails to affect the price-level in the way desired. In America, the Reserve Banks made vigorous efforts to sustain prices, but the only effect was a violent financial speculation in securities, and the prices of goods remained the same or continued to fall. In France, when the note-issue was nearly doubled, prices fell about 20 per cent. But although the attempts so far made by Central Banks to stabilize prices are very disappointing, it is reasonable to hope that the difficulties will be more successfully overcome when definite international action is agreed on by the Central Banks.

In the meantime, so far as our public finances are concerned, it appears to me that the best way to cope with our problems while conditions are changing so rapidly would be by a financial dictatorship. As that is not politically possible, the next best course is to make provision to meet the position as we find it now, and review it again before the end of the financial year, so that if necessary and if practicable further steps may be taken to check any further drift and maintain stability in our public finances. We must never cease to remember that we are trustees for the future as well as for the present.