



Submission

on

Proposed GST Increase

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Background

An increase in GST from 12.5% to 15% sounds easy to implement, simple for consumers to understand and it is supportive of a move to shift a greater proportion of tax paid from an income base to a consumption base.

However, from the point of view of the retail sector it might not be as simple as it seems. There are a number of issues that need to be considered by Government if they decide to follow this course of action.

This paper does not set out to debate the issues between taxation on income vs taxation on consumption but rather it is simply an outline of the issues likely to be faced by the retail sector if the proposed increase in GST goes ahead.

The Key Issues

- 1 The Effect on Consumer Buying Behaviour
- 2 Exemptions
- 3 The Pricing Model
- 4 Pre-pricing of Stock – Lead Time
- 5 Timing of Implementation
- 6 The Tourism Impact
- 7 NZ vs The World – International Competitiveness Effect

Examination of the Issues

1 The Effect on Consumer Buying Behaviour

What could be the impact of a permanent increase in GST?

The last NZ experience was 1989 when the rate increased from 10% to 12.5%. The retail sales statistics from that time suggested that unlike the original introduction of GST, this increase did not have a significant distortionary effect on sales.

	Share of Year's Retail Sales (Cumulative)		
	1988	1989	1990
	%	%	%
Jan	7.5	7.5	7.9
Feb	15.1	14.8	15.4
Mar	23.8	23.4	23.9
Apr	31.5	31.1	31.8
May	39.7	39.6	40.2
Jun	47.6	48.2	48.0
Jul	55.6	56.0	55.9
Aug	63.8	64.2	64.1
Sep	72.2	72.3	71.8
Oct	80.4	80.6	80.6
Nov	89.2	89.4	89.1
Dec	100.0	100.0	100.0

Had the GST increase caused any distortion in consumer behaviour we would have seen significant difference in the cumulative share over the months June – July compared with 1988 and 1990.

We have also reviewed the recent UK experience where VAT was reduced from 17.5% to 15% for 12 months as a stimulus in the period of recession.

The retail sales performance over this period was as follows:

**% Growth – All Retail
(vs prior year)**

2006 (December Year End)	+4.8
2007	+4.3
2008	+1.6
2009*	+3.4

(The VAT reduction ran from 1/12/08 through until 31/12/09).*

On a monthly basis the comparison of 08 and 09 were as follows:

	% Change on Prior Year	
	2008	2009
Jan	4.9	3.2
Feb	3.9	0.1
Mar	1.1	0.6
Apr	1.0	6.3
May	4.6	0.8
Jun	2.1	3.2
Jul	1.7	3.6
Aug	1.4	2.2
Sep	1.0	4.9
Oct	-0.1	5.9
Nov	-0.4	4.1
Dec	-1.4	6.0
Full Year	1.6	3.4

The performance from Jan 2009 certainly indicated an improved performance on the prior year. However, how much of this was due to the VAT stimulus and how much was due to some economic improvement is difficult to tell.

When the level of VAT was increased back to 17.5% in the month of January 2010, the performance once again deteriorated.

Having been running at growth levels of between 4% and 6% for the final few months of the year, the January growth stalled at only 1.2%

How much of this was the VAT increase, how much was snow etc... we have received mixed views from commentators.

So, overall, the increase in GST is likely to have some impact on buyer behaviour. How much is difficult to quantify but in our view and on the basis of past experience it is unlikely to be huge.

2 Exemptions

The New Zealand GST system is administratively simple and covers the provision of goods and service (excluding financial services). In a number of other countries governments have tried to ease the burden on some sectors of the population by introducing exemptions.

We do not believe exemptions work. Government should not have a role to play in the shopping decisions of the consumer. Deciding whether to buy a cooked chicken or a frozen chicken should not be influenced by whether one has GST imposed and one doesn't.

3 The Pricing Model

Comments on the proposed change from 12.5% GST to 15% seem to have assumed that retail prices will simply move up by the appropriate amount. That is, an item currently selling for \$10 plus 12.5% (\$11.25) will simply shift to \$10 plus 15% (\$11.50) – an increase 2.2%.

We believe this would be unlikely.

Obviously pricing decisions have to be taken by each individual operator and we, as the New Zealand Retailers Association, cannot get involved in this debate. Equally, no other party can impose pricing policy on an individual retailer. However, we believe it is important to raise the possibilities here so that Government have an appreciation of what could happen.

Consider the following:

- 1 At consumer level New Zealand has adopted a GST inclusive pricing model. That is, the price on the shelf or on the price tag already has the GST built in. This differs from some countries where sales tax is added at the point of sale.

- 2 A significant proportion of pricing in New Zealand is focused on a number of key price points – e.g. \$1.95, \$9.95, \$49.95 etc. These prices include GST of 12.5%.
- 3 When GST shifts to 15% what will happen to these price points? They won't shift to \$1.99, \$10.17, \$20.39 and \$51.06. A more likely outcome is that some prices will stay where they are and others will be increased more so that on average the retailer receives an additional 2.2% to cover the higher GST payment. (Note: the increase in GST is 20% but the estimated price impact is 2.2%).
- 4 The upshot of this is that consumers could have considerable difficulty understanding what impact the increase in GST has had on their consumption expenditure.

In fact the wise retailer might shift his prices up well in advance of any change and simply make no further changes (or claims) when the 15% rate comes in.

- 5 This treatment will differ by product category and store type.

4 Pre-Pricing of Stock

As will be appreciated once we shift outside of the supermarket sector a huge proportion of goods on offer are imported (e.g. clothing, footwear, gift products etc).

The major chains have these products price marked at the factory. That is, the shirt that you buy in *Farmers* or the shoes you buy at *The Warehouse*, the consumer price tag will have been placed on the item in China.

Therefore, it is critically important for the industry that sufficient lead time is given so that pricing changes can be made. The New Zealand buyer must negotiate their buy price with the supplier, decide on the consumer price including GST and have the price tags prepared.

Retailers would need 5 – 6 months lead time to allow for this. That is, a May announcement in the budget should/could be implemented in October.

5 Timing of Implementation

If the announcement of a change is made in the May budget we would support an October implementation at the earliest. (The ideal would be 1 April 2011 but we realise that this would be unlikely given that 2011 is an election year).

Consider a 1 October implementation...

- Winter sales are largely out of the way by then.
- New seasons products can be priced to take account of the new GST level.
- The down month after implementation will be two months clear of the critical retail month of December.
- Price changes at the factory could be implemented (see '4' above).

6 The Tourism Impact

Since the announcement of the possibility of a GST increase there has been considerable comment from the tourism sector highlighting the impact that such an increase could have. Travel, accommodation, meals, fuel and so on will all be more expensive and compare less favourably with other destinations.

However, one thing the Government could do to help is to consider a GST refund scheme. This has been talked about often and formal applications have been made to a variety of government agencies and Ministers. Such schemes already operate in a number of countries (e.g. Australia, UK, and Singapore to name just a few).

It is interesting to note that retail sales are the biggest component of the tourist spend and offering such a programme could be one way of restoring some degree of competitiveness.

The Tourism Satellite Account provided by Statistics NZ highlights the following:

	%
Air passenger transport	19
Other passenger transport	10
Retail sales - fuel & other auto products	10
Food & beverage serving services	11

Accommodation services	9
Other tourism products	12
GST paid on purchases	7
RETAIL SALES OTHER	<u>21</u>
	100%

Retail sales are significant.

Obviously extensive modelling of the numbers would be necessary to identify the total value of purchases made by foreign tourists and taken out of the country. We need to be competitive if we are going to maximise the sales opportunity. If there is a will to consider this proposal we will prepare a separate and more detailed submission.

7 NZ vs The World – The International Competition Effect

Retail sales are no longer restricted to the bricks and mortar establishments within New Zealand. We now compete on the world stage with every internet site offering goods for sale.

Private imports under \$400 in value come into the country free of GST.

Thankfully the Government has recently rejected a proposal to increase the allowance to \$1,000 and this was widely applauded by the retail sector.

But... a move to 15% GST doesn't help. The New Zealand based retailer, employing New Zealand staff, paying New Zealand tax, renting premises off New Zealand landlords is further disadvantaged compared with the off-shore internet operator.

We are not wanting to turn the clock back and deny the existence of web sales but we would appreciate a level playing field.

There may be a way of efficiently collecting GST on all private imports (except gifts). If Government is prepared to consider collecting all GST liability then we will develop a proposal on how this might be achieved.

It is appropriate to signal the issue as part of this paper as the move from 12.5% to 15% will only make things worse and this point needs to be noted. It is also important to realise that if efficient collection is possible this could prove to be a valuable additional source of government revenue.

Summary

This paper has highlighted some of the issues that need to be considered in the context of an increase in GST from 12.5% to 15% and the NZRA will be undertaking discussions with various parties in regards to these issues

Appendix I - About the New Zealand Retailers Association

The New Zealand Retailers Association is the largest Association representing the retail industry in New Zealand.

Our 6,000 members include the major supermarket and general merchandise chains, specialised chains, traditional department stores and thousands of owner operators spread throughout the country.

Our membership also includes a number of specialised trade groups representing manufacturers, distributors and retailers in the plumbing materials, metal fastener, pet, equestrian, jewellery, bicycle and sporting goods sectors.

Retail sales currently total some \$65b per annum and the industry employs approximately 325,000 people (20% of the workforce) in over 49,000 outlets spread throughout the country.