NZIER INSIGHT

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New travel charge borderline at best

The Government wants to make travellers pay for the costs of border control but the border charge is a poor user charge and an inefficient tax: it will dampen services exports and hence economic growth more than other revenue raising options. If we need additional border control it would be far better to fund the system out of general taxation and welcome more visitors to New Zealand.

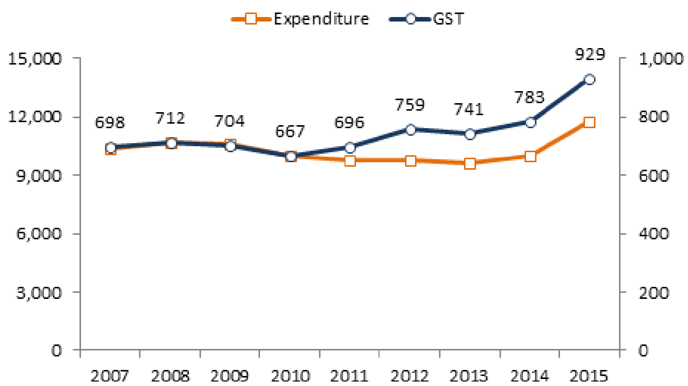
What's the problem?

The number of visitors to New Zealand continues to soar, partly due to a growing middle class in China right now, and New Zealand specific factors that make us a unique destination that's hard for competitors to replicate.

These visitors are also staying a little longer and spending a little more – boosting total spending (see the latest numbers from the Tourism Satellite Account in Figure 1). That's a welcome good news story. Bringing in export dollars helps grow the economy, lifting incomes and providing a chunky boost to GST revenue just when our dairy sector is taking a hit.[1]

Figure 1 International visitors pay almost a billion in GST

Forecasts of visitor expenditure and predicted GST take



Source: Tourism Satellite Account (2015)

But more people increase the costs of border control. From January 1 2016, the Ministry for Primary Industries and the New Zealand Customs Service will implement a border charge of $18.76 for arriving and departing air travellers – to fund the costs of New Zealand's customs and biosecurity operations for passenger travel that is forecast to raise $108 million in 2015/16.[2]

There are three problems with a border charge:

1. It is inefficient – increasing the cost of visiting New Zealand means fewer international tourists, fewer export dollars and less GST revenue compared to funding border control from general taxation.
2. It is a poorly designed user charge – it distorts some economic behaviour we want to encourage – for tourists to visit New Zealand.
3. It exacerbates existing distortions in the tax system from GST on international travellers – a point recognised by our trading partners who discount the taxes tourists pay.

Since Cabinet had already decided to implement a border charge, MPI and Customs constrained their consultation Regulatory Impact Statement (RIS) to how the charge is implemented – nationally, by location or by mode. We instead assess a border charge against other funding options including charging horticulture (who would be a major beneficiary of tightened border security). While a border charge might have low compliance and administrative costs – key criteria for user charges – the distortions a border charge create make funding border control from general taxation best (Table 1).

Table 1 Our criteria suggest funding border control from general taxation

	Tax horticulture	Border charge	General Taxation
Administration costs?	High	Medium	Low
Compliance costs?	Very High	Low	Low
Economic distortions?	High	High	Low

Source: NZIER

[1] In addition to the GST that tourists pay, domestic tourism firms and workers also pay tax including company profits and labour incomes. So the sector is paying a lot in tax already.

[2] A border charge could be used to fund services that provide faster border processing that would improve passenger experience at the border. But the Customs and MPI consultation RIS makes it clear their assessment of the primary benefits of the levy are mitigating risks associated with biosecurity including Queensland Fruit Fly Didymo and Foot and Mouth disease. Costs and benefits associated of changing visitors' services are not quantified.

A border tax is inefficient: not good tax policy

Setting a charge on tourists to recover border control costs runs against public finance guidelines that lay out principles for how the Government should raise tax revenue.

One of those key principles is that taxation should be efficient and minimise the impact on competition and economic growth. According to the OECD (2014):

> *"A long-standing principle in public finance holds that public expenditure should be targeted where it provides most benefit, while taxes should be targeted where they cause least harm; the way money is raised should not determine how it is spent."*

GST is levied on consumption by New Zealanders. Goods exports pay no GST but under a location-based consumption tax system – the system operated in almost all countries – services exports pay GST.

Since tax on consumption goods is higher – and more comprehensive – in New Zealand than in competing destinations, international tourists already opt to holiday elsewhere, crimping demand for New Zealand made tourism services.[3]

Such a consumption tax is already inefficient when it comes to tourism and a border tax only exacerbates existing incentives that encourage tourists to travel elsewhere. If we need to provide more border control, it would be better to fund activity from general taxes, such as consumption and income taxes.

That approach would be more efficient and is supported by a long history of public finance literature and practical advice on how to fund public goods and services.[4]

A border charge is poorly designed as a user charge

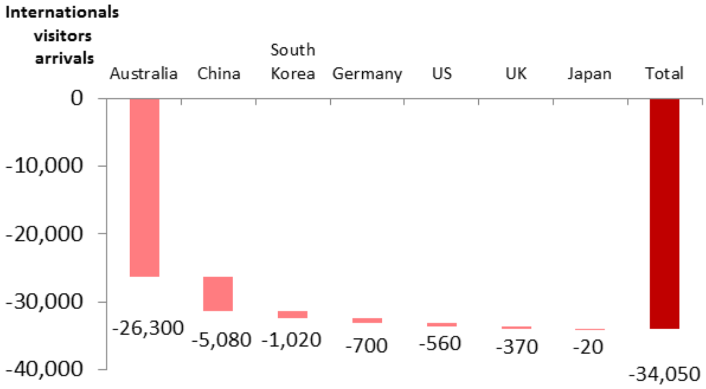
Sapere (2015) estimate that on a market-by-market basis, a $22 increase in the ticket price reduces the demand to travel to New Zealand by 0.9 percent, shown in Figure 2. That means 34,050 fewer tourists each year, a permanent decrease as a result of the charge being implemented.

That makes for $55 million fewer tourism dollars each year – while the Government takes $61.6 million in revenue from international tourists that pay the border tax.[5] So on net, it's not a great revenue earner and while exchange rates and other factors will influence the outlook, this is clearly at odds with the Ministry for Primary Industries and New Zealand Customs consultation RIS that says:

"People will not be put off travelling to New Zealand, as the Levy is less than 1% of an international fare".

Figure 2 Expect fewer Australian and Chinese visitors after the border tax

Impact of the border tax on visitor arrivals



Source: Sapere (2015)

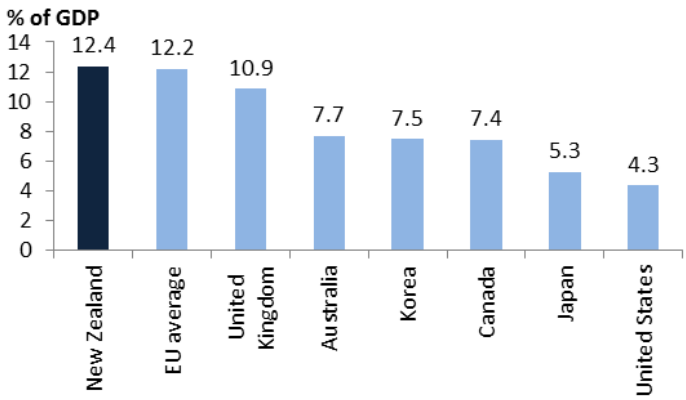
A border tax exacerbates existing distortions

Generally GST is a good way to raise tax revenue since its broad base on consumption raises few distortions. Exports of goods from New Zealand don't pay GST. That's because our goods exports would be less competitive in international markets where other international suppliers would have a price advantage. For example, if we apply a 15 percent tax to whole milk powder, we could lose significant market share.

Many countries recognise the disparate treatment of goods and services and make allowances for tourists who can claim back GST on purchases of goods and services. Figure 3 shows that these discounts mean that New Zealand can be expected to be taking a larger slice of tourism expenditure than elsewhere in the OECD.[6]

Figure 3 New Zealand collects more in GST than comparator countries

Revenue collected from consumption taxes as a percent of GDP



Source: OECD

[3] Gago et al. (2006) show the impacts can be substantial and Ihalanayake (2007) suggests "…tourism tax increases can cause a considerable reduction in international tourism consumption in the short- and long-run".

[4] See for example, American Institute of Certified Public Accountants (2010), Gill (2013), Treasury (2002).

[5] That is 2,857,400 international visitors (from 2014) at $18.76+GST.

[6] We are implicitly assuming that the consumption to GDP ratios apply equally to the tourism sector.

For example, tourists that leave Australia can claim back GST on purchases over $300 by simply presenting their goods and receipts at the airport. Making it that easy in New Zealand would boost our tourism sector and economy but exacerbate concerns about falling revenue.[7]

To offset distortions that work against the tourism sector, many countries offer discounted rates at the time of purchase on hotels and restaurants.[8] Some countries go further. Israel refunds VAT on all goods purchased by tourists to encourage demand and boost tourism jobs.

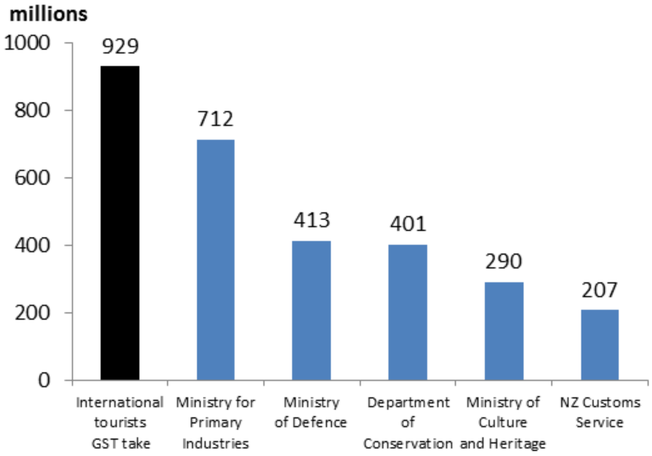
A border charge misses the big picture – international tourists pay their own way

Tourists already pay more tax than they receive in benefits, on every purchase from a latte in Queenstown to a hotel room in Auckland and that looks set to swell the Government's coffers by up to $1 billion in 2016. That tax goes into the general Government revenue pool and funds teachers, nurses, Police and social welfare benefits.

While tourists also use our infrastructure, new infrastructure tends to be focussed on relieving daily commuting congestion in our largest cities – not the time of day tourists typically travel. Right now tourists pay enough in tax to fund not just border control but the Ministry for Primary Industries' entire budget (see Figure 4).

Figure 4 International tourists pay enough to fund MPI not just border control

International GST take vs selected department budgets



NB. We use Budget 2015 to assist comparison to the latest Tourism Satellite Account 2014/15 GST estimate. See http://www.treasury.govt.nz/budget/2015/summarytables/estimates/09.htm

Source: Budget 2015, Tourism Satellite Account 2015

If additional border control is required, on tax efficiency grounds it would be far better to fund the system out of general taxation and welcome more visitors to New Zealand. Tourists already pay more than enough tax when they visit New Zealand. Whacking the tourism sector, just when it's getting going, looks like a poor policy choice.

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7 A CGE model could be used to quantify the size of the benefits and which industries would stand to gain the most from such a move.

8 See OECD (2014) for a comprehensive list of practices in the OECD.