BusinessNZ
The voice of business

Lumley House
3-11 Hunter Street
PO Box 1925
Wellington 6140
New Zealand

Tel: 04 496-6555
Fax: 04 496-6550
www.businessnz.org.nz

Budget 2014 – Key Issues and Outcomes

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Background

The Budget 2014 (entitled *Managing a Growing Economy*) continues the focus on the main elements of the Government's Business Growth Agenda (BGA):

1. Responsibly manage the Government's finances
2. Build a more productive and competitive economy
3. Deliver better public services
4. Rebuild Christchurch

The Budget reflects both New Zealand's current domestic and international economic realities, avoiding an election year spend up. As budget forecasts indicated, the domestic economy is improving but the global environment is still relatively subdued.

While there has been some loosening of the purse strings (not unexpected with a general election coming up), generally speaking the Budget adopts a careful and measured approach. Expenditure is focused on areas most in need and in particular those able to enter the paid workforce are encouraged to do so.

Government finances have improved reasonably rapidly and the Minister of Finance announced that a small surplus ($372 million) will be achieved for the 2014/15 year. In the context of the Christchurch disaster, achieving a surplus is reasonably impressive. Future surpluses are forecast which will give the Government some room to reduce debt, look at future tax cuts and/or provide room for further targeted expenditure.

Despite an improving financial situation, some issues are still in the *too hard* basket but will need to be addressed in the foreseeable future. How to deal with an ageing population is of particular concern as is the cost associated of NZ Superannuation and an expanding health Budget.

Given the nature of the political process, large scale reforms are probably a thing of the past. The Government is trying hard to take the public with it through targeted initiatives although with a gradualist approach the danger is that the world will move on before substantial reforms can be implemented. Consequently, the Government is always in danger of being in catch-up mode.

Budget 2013 – The Economic Outlook

Key Economic Indicators:

- **Economic activity** is expected to be modest over the forecast period out to 2018. After peaking at 4% for 2014/15 it is expected slip to around 3% by 2016 and decline further to just over 2% in 2017 and 2018.

- **Inflationary pressures** are rising but forecast inflation is expected to remain close to the mid-point of the Reserve Bank's Target band of 1–3% over the forecast period although likely to peak at around 2.5% in 2016. But interest rates are forecast to increase over the next couple of years, largely in line with market expectations.

- **Employment growth** should grow relatively strongly (3% for 2014/15) before moderating in the out years to around 1.5%.

- **Unemployment** is expected to continue to trend downwards (currently 6%) to reach 4.4% by 2018.

- **Nominal wage pressures** are forecast to grow slightly over the forecast period in line with continued improvements in labour market conditions. Wage growth (as measured by the Quarterly Employment Survey – average hourly ordinary time earnings) is likely to increase from just over 2% currently, reaching 3.5% per annum by 2018.

- The **exchange rate** (as measured by the Trade-weighted Index – TWI) is expected to trend slightly downwards from its current high over the forecast period. The TWI currently sits at around 80, forecast to slip to around 77 by 2017 and 73 by 2018.

- **Interest rates (90-day bank bills)** are forecast to continue rising (currently 3%) to reach 5.3% by 2018.

BusinessNZ Thoughts/Reactions

While most Budget forecasts appear reasonable and are generally very positive, forecasting over such a long period means that risks abound in the out-years and what is forecast needs to be taken with a grain of salt.

Future exchange rates are a minefield to predict with any degree of certainty given some countries' changing approach to monetary policy settings.

However, while the key indicators underpinning economic health, such as overall economic growth and employment creation are forecast to head in the right direction, some concerns remain. Economic growth forecasts are relatively subdued in the out-years, which seems unduly pessimistic, while unemployment is forecast to go down to 4.4% which seems a little optimistic. In economist speak, 4.4% is generally considered to be full employment.

<u>Budget 2012 – Fiscal Position</u>

Key Points

- The Government's **Operating Balance before gains and losses (OBEGAL)** is expected to register a very small surplus of $400 million in 2014/15 (0.2% of GDP). After several years of running significant deficits (largely related to earthquake costs), a small surplus is quite an achievement.

- **Core Crown expenses** are forecast to decrease from 31% of GDP (current) to just under 30% by 2018.

- **Core Crown tax revenue** is forecast to increase relatively slowly from 27.5% to reach 28.5% by 2018. An increased tax take largely reflects a growing economy.

- **Net core Crown debt** is forecast to peak at 26.4% of GDP in 2015 before declining slowly to reach 23.8% by 2018.

Budget 2013 – Breakdown of Main Budget Areas for Business

The following areas, not necessarily in any particular order of importance, are likely to be of particular interest to the business community. Where relevant, we have included our own thoughts/reactions.

1. Rebuilding Christchurch

On current estimates, the Government's contribution to the rebuild is expected to be $15.4 billion, of which $7.3 billion will be incurred by the Earthquake Commission, net of reinsurance proceeds.

Budget 2014 includes:

- $50 million over two years to support the work of the Canterbury Earthquake Recovery Authority

- $14 million extra for the Canterbury Social Support Fund, including counselling, temporary accommodation and support services.

- $75 million from the Future Investment Fund for Canterbury housing development.

- $3.5 million in 2014/15 to offer up to 1,000 beneficiaries in other regions a one-off payment of $3,000 each if they have a full-time job offer in Canterbury.

2. Retirement Savings

Super Funds Contributions

Government will be resuming Super Fund contributions in 2020/21 provided net debt is no higher than 20% of GDP - two years later than projected in the most recent Half Year Update but what was anticipated when contributions were initially suspended in Budget 2009.

BusinessNZ Thoughts/Reactions

It could be argued that resuming contributions to the Super Fund makes little sense, given that the Government still has significant levels of debt.

3. Capital Projects & the Future Investment Fund

A Budget focus is on targeted capital expenditure aimed at improving economic growth prospects, including a $375 million loan to the New Zealand Transport Agency. The loan is to kick-start $815 million of Auckland Transport projects to further reduce congestion I Auckland.

In addition, the Government will allocate a further $1 billion of new capital from the Future Investment Fund (FIF), including:

- $200 million for health sector projects
- $198 million for KiwiRail
- $172 million for school property expansion
- $40 million to invest in irrigation infrastructure.

This leaves $1.7 billion to be allocated from the Fund in the 2015 and 2016 Budgets.

4. Education, Skills & Training

The Budget signals new education funding of $858 million over 2013/2014 and the next four years (taking total early childhood and school spending to $10.1 billion in 2014/15). The new spending includes:

- $359 million to invest in educational success by strengthening leadership and quality teaching across schools
- A further $85 million for schools' operational grants
- $172.5 million capital and $111.5 million of operating funding to support school property development
- $2.5 million to extend the Computers in Home programme for a year
- $4.7 million for teacher aide support for students with high health needs
- $2.4 million for the Reading Together Programme

Tertiary Education Sector

Tertiary education receives $199 million additional investment, including:

- $28.6 million for ICT training initiatives (including $11.8 million of contingencies)
- Up to $20 million in 2013/14 and 2014/15 for a further 6,000 extra places created as part of the apprenticeship reboot, taking the number of places to 20,000.
- $83 million additional funding for science, agriculture and health science.
- $53 million to establish three extra Centres of Research Excellence (CoRES) from 2016.

5. Science and Innovation

New science and innovation initiatives include:

- $57 million extra over four years for contestable science funding
- $58 million in increased tax deductions for R&D by start-up firms

- $69 million for New Zealand Trade and Enterprise (NZTE) to expand New Zealand's presence in China, South America and the Middle East.

BusinessNZ Thoughts/Reactions

Further R7D spending is welcome, especially the targeted increase in business R&D to 1 percent of GDP.

6. Other Issues

a. <u>Tax</u>

To boost business innovation, loss-making start-up companies will be able to cash out all or part of their tax losses from R&D expenditure. All businesses will be allowed tax deductibility for R&D 'black hole' expenditure, currently neither deductible nor able to be depreciated. These two measures will return an estimated $58 million in tax to business.

In addition, the Government announced some relatively minor changes to New Zealand's tax system, including:

- $132.3 million over the next five years for IRD to bolster tax compliance (estimated to generate a gross increase of tax revenue of $297.5 million).

- Cheque duty of five cents a cheque to be abolished from 1 July 2014.

Last, pre-Budget hints that future tax rate cuts are an option, given an operating surplus from the 2015 Budget of $1.5 billion a year, growing at 2 percent a year thereafter, were confirmed. Treasury has advised that these will not materially affect interest rates.

BusinessNZ Thoughts/Reactions

While the tax changes outlined are generally sound, and the signal of future tax rate relief is welcome, it would have been good to see more meat on the bones – a greater indication of likely tax rate changes in 2-3 years' time. Would, for example, a tax reduction affecting middle New Zealanders also be extended to further reduce the company tax rate to boost New Zealand's competitiveness.

b. <u>Paid Parental Leave</u>

As widely expected, the Government will put an additional $172 million into extending paid parental leave, providing:

- An additional four weeks' leave, starting with a two-week extension from 1 April 2015 with a further two weeks from 1 April 2016.

- Extended eligibility to caregivers other than parents and to extended parental leave payments to people in less-regular jobs or who have recently changed jobs.

- $42 million to increase the parental tax credit from $150 a week to $220 a week and increasing the payment period from eight to ten weeks from 1 April 2015.

c. ACC

As the Government now agrees that in the near future there will be scope for significant reductions in ACC levies, particularly in respect to the Motor Vehicle Account, allowance has been made for levy reductions across all accounts (subject to consultation) of around $480 million in 2015/16. This is in addition to the nearly $1 billion fall in annual levies since 2011/12.

BusinessNZ Thoughts/Reactions

While motorists, businesses and households will welcome ACC levy reductions, it will be important to analyse the key drivers for reductions. It will be important to know whether the reductions are sustainable (i.e. based on reduced cost and number of claims) or are largely made possible by good investment returns. Whatever the answer, the Budget announcement reinforces the fact that premiums should be set independently of government to ensure they reflect actual insurance principles, not political considerations.

d. *Welfare*

Budget initiatives to build on progress made in the area of welfare include:

- New funding of $100 million (on top of the $188.6 million in Budget 2013) to support people off welfare and into work, including:
  - 8,000 more employment and work-readiness places targeted to beneficiaries at risk of long-term welfare dependency
  - Trialing new approaches for beneficiaries with complex needs
- Additional $8.6 million for Youth One-Stop Shops providing support to young people
- $5.6 million over the next four years to help newly-arrived refugees during their first 12 months in New Zealand

BusinessNZ Thoughts/Reactions

Given the economic and social loss associated with high levels of benefit dependency, it makes sense to ensure resources are focused on doing whatever is needed, up-front, to get beneficiaries ‘work ready’.

e. Housing

A handful of mechanisms to ease concerns around social and affordable housing are outlined, including:

- Temporarily removing tariffs and duties on building materials, reducing construction costs by $3,500 for a standard home.

A $30 million boost to the Social Housing Fund from 2015/16 to help the community housing sector to provide homes for high-need families.