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BusinessNZ

Memo

To: BusinessNZ Members

From: John Pask/Steve Summers

Date: 16 May 2013

Subject: **Budget Summary 2013**

Action Required: For information

Budget 2013 (Building Momentum) – Key Issues and Outcomes

Background

The Budget 2013 (entitled 'Building Momentum') continued to focus on progressing the Government's Business Growth Agenda (BGA).

The Government reconfirmed its four priorities for this term:

- Responsibly managing its finances;
- Building a more productive and competitive economy;
- Delivering better public services; and
- Supporting the Christchurch rebuild.

As has been the custom for some time now, most initiatives were pre-announced in the weeks and days leading up to the Budget event itself, such as increased focus on tourism and new expenditure allocations targeted to improving economic and social outcomes for at-risk youth, Maori and Pacific peoples.

The Budget reflected both New Zealand's current domestic and international economic realities. While the domestic economy is improving, as evidenced by a number of recent official statistics and forward looking business surveys, the global environment is still relatively subdued. While NZ's largest trading partner, China, is still growing relatively strongly, our closest neighbour and second largest trading partner, Australia, has experienced some pretty mediocre economic results of late, which is of concern given NZ's dependence on Australia as a key export destination.

While there has been some loosening of the purse strings (not unexpected given next year is election year), the Budget in general represents a careful and measured approach to ensuring targeted expenditure is focused on areas which can improve NZ's competitiveness over the medium term, such as a continued focus on innovation or where particular social and economic problems persist, as with its child poverty initiatives.

The successful public float of 49% of Mighty River Power will add a welcome boost to NZ capital markets and interest from the general public should help ensure New Zealanders become more aware of the opportunities from (and potential risks of) investing. The announcement that Meridian will be the next cab off the rank in the second half of this year should ensure continued momentum.

Notwithstanding a financially good result, the Government's accounts have been under pressure for some time in response to, amongst other things, the on-going costs associated with the Canterbury earthquakes. Therefore the feeling is that NZ is still putting off dealing with a number of issues which will constrain its long-term prospects.

Improving the quality of regulation remains an issue. While actions through the BGA and targets to reduce compliance costs and increase online options are laudable, the overall direction of regulation is being addressed in a rather piecemeal fashion. Instead, the Government needs to grasp the nettle and embed quality regulatory outcomes through the adoption of a sound Regulatory Responsibility Act, as advocated by the 'Regulatory Taskforce' some years ago.

Second, the ageing population will impose greater fiscal costs in respect both to health and superannuation expenditure in years to come. Signalling changes in this space to ensure affordability over the medium time continues to be largely ignored.

Third, dealing with the key drivers of housing affordability (such as unnecessary restrictions on land use) needs to be front of mind. While some useful 'agreement' has been reached recently between the Government and the Auckland Council in respect to more rapidly freeing up available land for housing development, longer term, the issue of restrictive city boundaries needs to be seriously addressed.

Given the nature of the political process approach, large scale reforms are probably a thing of the past. This Government is being extremely careful to try and take the public with it through the reform process but the danger with a gradualist approach 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 Points

- **Economic activity** is expected to be modest over the forecast period out to 2017 averaging 2.5 - 3% growth per annum.

- **Inflationary pressures** are expected to remain close to the mid-point of the Reserve Bank's Target band of 1 – 3% over the forecast period.

- **Employment growth** is expected to show moderate growth, averaging around 1.5% per annum out to 2017.

- **Unemployment** is expected to trend downwards to reach 5.2% by 2017.

- **Nominal wage pressures** are forecast to be moderate over the forecast period to 2017. Wage growth (as measured by the Quarterly Employment Survey – average hourly ordinary time earnings) is expected to increase from around 2% currently to reach 3.3% per annum by 2017.

- The **exchange rate** (as measured by the Trade-weighted Index – TWI) is expected to increase slightly over the next year before dropping away in the out-years.

- **Interest rates (90-day bank bills)** are forecast to increase slowly to reach 4.8% by 2017.

BusinessNZ Thoughts/Reactions
While most forecasts outlined in the Budget look reasonable, and are positive compared with many countries we generally compare ourselves to, the danger with forecasting over such a long period is that risks abound in the out-years so any forecasts need to be taken with a grain of salt.

Notwithstanding the above, most of the key indicators underpinning economic health, such as overall economic growth and employment creation are forecast to head in the right direction, which is positive.

Some forecasts seem a little pessimistic, e.g. economic growth is forecast to 'peak' at 3% per annum in 2015 before dropping slightly in the out-years to reach 2.2% by 2017 - slightly less positive than forecasts by some private sector agencies. On the other hand, future exchange rate forecasts are a minefield to predict with any degree of certainty given the changing nature and approaches of some countries in respect to monetary policy settings.

Budget 2012 - Fiscal Position

Key Points

- The Government's **Operating Balance before gains and losses (OBEGAL)** as a percentage of GDP is expected to decline significantly from a current deficit of 2.9% of GDP to register a very small surplus of GDP ($75 million) in 2017.

- **Core Crown expenses** are forecast to decrease from 33.5% of GDP (current) to around 30% by 2017.

- **Core Crown tax revenue** is forecast to increase relatively slowly from 29.8% currently to 30.9% by 2017.

Budget 2013 - Breakdown of Main Budget Areas for Business
The following areas are likely to be of particular interest to the business community:

1. International Growth Package

Overall Result: generally positive

One new Government initiative involves a $100 million-a-year internationally-focused growth package, including:

- $200 million over four years for funding of science, innovation and research. This encompasses:
  $75.2 million for business R&D grants
  $31.3 million for repayable grants for start-up businesses
  $73.5 million for the National Science Challenges
  $20 million for the Marsden Fund
- $158 million over four years to attract more visitors to NZ, particularly high-end spenders.
- An additional $40 million over four years to market and promote NZ's international education sector.

BusinessNZ Thoughts/Reactions
Given NZ's place in the global economy, funds directed to enhancing opportunities in the science, innovation and research space are welcome. Also, given NZ's relative closeness to Asia, a stronger focus on increasing the number of high-end tourists to this country will provide an additional boost to the service sector.

2. Retirement Savings

Overall Result: Mixed

<u>Super Funds Contributions</u>
The Government has announced it will be resuming Super Fund contributions in 2020/21 provided net debt is no higher than 20% of GDP. This is two years later than projected in the most recent Half Year Update but is what was anticipated when contributions were initially suspended in Budget 2009.

BusinessNZ Thoughts/Reactions
In terms of the Superannuation Fund, it could be argued that resuming contributions makes little sense, given that the Government still has significant levels of debt.

3. Government Share Offer Programme

Overall Result: Positive

Widely tipped as the next cab off the rank for part sale, it has been confirmed that Meridian Energy will be the next company to be prepared for a partial share offer in the second offer for 2013.

The share float of Mighty River Power has contributed another $1.5 billion to the Future Investment Fund. Spending announcements regarding the fund include:

- $426 million will be invested in redeveloping Christchurch and Burwood Hospitals.
- Contingencies totaling over $700 million have been set aside for key projects that include new, modern schools, Christchurch's justice and emergency services' precinct, and Canterbury tertiary education institutes.

- $50 million for school network upgrades, $94 million for the fourth year of KiwiRail's turnaround plan and $80 million for irrigation infrastructure.

Overall, across multiple Budgets, the Government intends to spend a total of $1 billion from the Future Investment Fund on 21st century schools and classrooms, and $1 billion on priority health investments.

4. Education and Training

Overall Result: Positive

There are a few new initiatives in the education and training space announced in the 2013 Budget. In the current year and over the next four years, around $900 million will be spent on education initiatives across early childhood, primary and secondary education (a good proportion comes from savings and reprioritisation). Over the next four years, new operating funding will include:

- $173 million for early childhood education.
- $215 million for schools.
- $92.4 million for Greater Christchurch Education Recovery and Renewal and 21st Century Schools.
- $73.1 million of operating expenditure to support the ongoing maintenance and costs of the school property network.

In the tertiary space, new spending of over $130 million includes:

- $36 million for the expansion of Maori and Pasifika trades training.
- $27 million to boost funding for science and engineering courses.
- $29 million to equalize funding rates between Private Training Establishments and Tertiary Education Institutions.
- $32 million to support an increase in the proportion of young people with higher-level qualifications.
- Confirmed increased support for NZ apprenticeships and industry trainees.

R&D student grants are retained to provide support for undergraduate and post-graduate students to work within R&D active businesses (internships).

With student loans, the only change involves targeting overseas-based student loan borrowers with new initiatives to increase repayments and reduce defaulting. Access to student allowances will be removed for those aged 65+ and access will be reduced to 120 weeks for those over 40 years of age. This makes the piecemeal work the Government is doing to provide better access to high quality information on the employment outcomes and rates of return to study choices take on greater importance.

BusinessNZ Thoughts/Reactions

Overall, the focus on education and training expenditure has been to support the better public services targets. On the other hand, the minor changes to interest free student loans could be considered timid, but long overdue.

5. Other "Issues"

Overall Result: Mixed

a. Tax

The Government announced some relatively minor changes to New Zealand's tax system. These include:

- The release of a public consultation document in June on a proposal to allow tax losses arising from R&D expenditure to be refunded up to a certain limit. This will be targeted at R&D intensive start-up firms.
- Changes to the thin capitalisation rules to ensure multinational companies investing in New Zealand pay their fair share of tax. This change is expected to generate $20 million over three years from 2014/15.
- IRD receiving an additional $7 million a year so that it can better pursue tax compliance in the area of property investments. This is expected to return about $45 million a year in additional tax revenue.

BusinessNZ Thoughts/Reactions

These changes signal the Government's ongoing programme of 'tax tinkering' that has been commonplace in recent years following the tax switch announcements in the 2010 Budget. For long-term competitiveness, the Government should look at still further ways in which tax rates could be reduced to improve NZ's position.

b. ACC

The Government is now satisfied that there is scope for significant reductions in ACC levies in the near future. Therefore, allowances have been made for levy reductions of around $300 million in 2014/15, while reductions will increase to around $1 billion in 2015/16.

BusinessNZ Thoughts/Reactions

While both business and households will welcome reductions in ACC levies, the fact remains these reductions are simply possible as a result of the Government keeping levies artificially high over the past couple of years. This reinforces the fact that premiums should be set independently of Government to ensure that premiums reflect actual insurance principles rather than political considerations.

c. Monetary Policy

The Minister of Finance and the Reserve Bank Governor have signed a memorandum of understanding on measures aimed at further protecting the economy and financial system.

The memorandum will require banks to:

- Hold additional capital on their balance sheets as a buffer during an economy-wide credit boom.
- Hold additional capital against loans in specific sectors if risks emerge in those sectors
- Adjust their funding ratios to use more stable sources of funding to avoid short-term funding shortages.
- Apply quantitative restrictions on the share of high loan-to-value ratio loans in the housing sector.

There will be reasonable 'controls' and 'threshold' tests on when these tools will be used.

BusinessNZ Thoughts/Reactions
Giving the Reserve Bank's such tools to be used in appropriate circumstances is acceptable. However, it is important the reasons for potential financial risks e.g. 'housing costs' are addressed by dealing with the underlying factors (such as land supply) rather than using loan-to-value ratios which could have adverse impacts.

d. *Welfare*

A number of gradualist welfare reforms are included with the objective of lifting vulnerable families out of poverty. These include funding for more intensive case management for people who are able to work and will see Work and Income staff actively working with over 40% of beneficiaries.

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 benefacaries 'work ready'.

e. Housing

There are a number of initiatives in the housing area focusing on areas such as improving land supply, speeding up consent processes and greater flexibility in the provision and management of social housing.

The Government has announced that legislation to speed up the provision of new housing in areas where the pressure is greatest will be introduced tonight.

Special housing areas will be designated under accords between the Government and councils.

Other areas of housing policy include:

- Funding of $100 million over three years for improving home insulation etc.
- Provision of social housing by other providers rather than Housing NZ.

BusinessNZ Thoughts/Reactions
Movement to address a number of issues regarding the provision of housing and affordability costs are very welcome, while a greater role for providers outside Housing NZ will ensure greater flexibility to meet the needs of at risk families.