Budget 2009 – Key Issues and Outcomes

Background

Those who thought the Budget 2009 would be full of "big bangs" will be disappointed. As the title of the Budget suggested (*The Road to Recovery*), it reflected both the domestic and economic situation New Zealand is currently in, with a careful approach from Government towards ensuring that both businesses and households get through the worst of the current recession as unscathed as possible. It was certainty not a slash and burn budget but nevertheless reflected the significant deterioration in the Government's accounts over the last six months.

The 2009 Budget has focussed on three objectives:

- Helping New Zealanders through the recession and supporting jobs;
- Lifting productivity and raising New Zealand's international competitiveness, and
- Taking steps to keep Government debt under control.

The Budget was delivered against a back-drop of continued international pessimism and low business and consumer confidence. However there are tentative signs that the worst effects of the international recession are behind us, yet we need to be mindful that the scars of a rapid build up of debt, bailouts and nationalisation of companies and banks on the international stage will take a long time to unravel. Both domestic and international economic growth forecasts continue to be revised downwards in light of the global recession. New Zealand, despite continued negative growth, is still in a much better position than many of its competitors.

As is generally well known, the general recession and negative growth has impacted not only on the expenditure side of the equation in respect to increased social welfare expenditure but also significantly on the revenue side in respect to reduced taxation. This exacerbates the difficulty for the Government in managing its accounts over the medium term (3-5 years).

As expected, the Government has sought to address the significant projected increases in debt levels over the next 10 years with a range of measures. The most prominent signalled before the Budget, at least implicitly, was the decision to postpone the proposed second and third round of the personal income tax cuts, and suspend contributions going into the NZ Superannuation ("The Cullen") fund.

While the merits of postponing the tax cuts will be debated for some time, on the positive side of the ledger, the Minister of Finance has stated that they still intend making further cuts to personal tax rates as economic conditions permit. This is much more positive than simply cancelling the tax cuts as some opposition parties urged the Government to do. He also tacitly spoke of the need for New Zealand to improve its productivity record and underlined the need to remain internationally competitive in respect to broader tax rates. In this respect, the Government's underlying focus on improving productivity through a range of approaches including improving the quality of Government Regulation is soundly based.

While the announcement of the taxation working group to look at tax issues was outlined before the election, it is a positive step towards ensuring that a first principles approach to the future of taxation is looked at, without undue pressures from Government.

The decision to postpone payments going into the NZ Superannuation Fund was a sound decision given the Government's medium term financial risks (essentially projected build up of net debt). Future contributions are expected to recommence from 2020/21, unless there is an earlier surprise on the upside in terms of the Government's books.

Putting aside the merits or otherwise of trying to partially pre-fund Superannuation, delaying payments makes sound sense given that it is ludicrous to borrow money and pay interest on that money, as a means of storing up reserves. It could be likened to householders deciding to invest money in Government stock rather than pay off more of their mortgage.

Despite the above, one could argue that there may be a case for Government to continue investing in the "Cullen" Fund for two reasons. One is that it creates a degree of certainty that those retiring in 20 years time can be assured they will receive superannuation. The second, and one which can be debated, is that given world stock markets have taken a pounding over the last year, now is arguably a good time to be entering the market to pick up bargains. Over recent months the NZ Superannuation Fund has recouped a proportion of the losses suffered over the past year. However, of more fundamental importance, it is not the role of government to gamble taxpayers' money on risky investments as such decisions are best made by individuals and households based on their unique risk profiles.

Budget 2009 - The Economic Outlook

Key Points

- **Economic activity** is expected to remain largely negative on an annual basis over the forecast period out to 2010/11, before turning positive in 2011. Projections of growth out to 2012 and 2013 are expected to be more robust at 2.9% and 4.0% respectively.

- **Inflationary pressures** are expected to reduce further over the forecast period, to a low of 1.2% in 2012.

- **Employment growth** is expected to remain negative through to 2011/12, before showing expansion in the years following.

- **Unemployment** is expected to continue to rise out to 2010, when it will peak at 7.5%. The rate will hold at that level through to 2011, before retracting back to 5.1% by 2013.

- **Wages pressures** are forecast to continue to lessen over the forecast period, reaching a low of 1.2% by 2011. After that, modest pick-ups are expected.

- The **exchange rate** (as measured by the Trade-weighted Index – TWI) is expected to remain relatively stable through to 2013 (at roughly 52.0).

- **Interest rates (90-day bank bills)** are assumed to have bottomed out at around 2.5% by 2010/11, but projections are for interest rates to more than double by 2013.

Budget 2009 - The Government's Fiscal Position

- The Government's operating balance as a percentage of GDP is expected to go from the positive position achieved of 3.1% of GDP in the year to March 2008 to a negative of around 5.1% by 2011. The out years are expected to show some improvement, reaching -4.2% by 2013.

- After taking into account the Government's capital programme, core Crown residual cash will record significant deficits over the forecast period.

- Core Crown expenses (excluding NZSF) are forecast to peak at 36.9% by 2011, while declining after then.

- Core Crown revenue is forecast to remain relatively stable at around 32% through to 2013.

- Net core Crown debt is projected to increase from 8.7% currently to 30.9% by 2013. Net debt is expected to peak at over 40% by 2016, before gradually reducing in the out years. Without changes announced in the Budget, net debt would have ballooned out to around 70% by 2023.

Budget 2009 - Breakdown of Main Budget Areas for Business

The following areas are likely to be of particular interest to the business community, although it should be noted that many of the points below have already been signaled well in advance of the 2009 Budget:

1. Regulatory Reform

Overall Result: Positive

Announcements include:

- Regulatory Responsibility Taskforce
- Further review of key pieces of legislation (e.g. RMA (part 2), Building Act and the Overseas Investment Act).

Business NZ Thoughts and Reactions
These are all positive in terms of improving the day-to-day climate for business, and looking at the areas which cause excessive compliance costs for businesses.

2. Tax

Overall Result: Negative (on balance)

Announcements include:

- Delaying personal tax cuts scheduled for 2011 and 2012.

Business NZ Thoughts and Reactions
Although it is disappointing to see that the Government has decided to postpone the next two tax cut installments, it is pleasing to see that the Government has established a tax working group to examine New Zealand's key tax policy issues over the medium-long term. We would expect recommendations from the group to be enacted over the next few years, particularly as economic conditions improve.

3. Education and Industry Training

Overall Result: Mixed

While there were no specific policies announced that were targeted directly at business, there were some general announcements towards improving the capability of the future labour force, although this was offset somewhat by negative announcements. These include:

- The disestablishment of a number of initiatives announced in last year's Budget, including 'capability funding', increases to industry training funds and the development of some new training funds.
- Further $36 million to support improvements in numeracy and literacy standards.
- Begin implementation of a youth guarantee scheme targeting at risk youth towards getting them into the labour market.

Business NZ Thoughts and Reactions
The Government is obviously taking a very long term perspective to the pay-offs associated with improved funding for education policies aimed at youth. It is also trying to look at policies aimed towards closer integration between welfare and work to improve outcomes for the younger labour force.
However, this is offset by cuts to schemes that had been announced by the previous administration, but had not been costed.

4. Research/Innovation

Overall Result: Negative (on balance)

Announcements include:

- As previously announced, the R&D tax credit has been disestablished along with the $700 million Fast Forward Fund.
- An extra $40 million over four years to the Crown Research Institution Capability Fund.
- Funding of $190 million for a new primary growth partnership. This will be matched dollar for dollar by industry.
- A range of other initiatives, including increased funding for the Marsden fund, as well as increased health research.

Business NZ Thoughts and Reactions
While the new initiatives are obviously positive, the fact that there is no major replacement for the now defunct R&D tax credit scheme leaves a gaping hole in terms of the broader issue of R&D in New Zealand. While the new primary growth partnership mentioned above is encouraging, on the scale of things it is very much the 'mini-me' compared to the previous Fast Forward Fund.

5. Infrastructure

Overall Result: Positive

Announcements include:

- Kick starting the Government's $1.5 billion plan for ultra-fast broadband to the home - $290 million.
- Increased investment from the Land Transport Fund in the state highway network of about $1 billion over the next three years, lifting the total amount spent on state highways to about $1 billion a year.

Business NZ Thoughts and Reactions
Given the importance of infrastructure to New Zealand's economy, the announcements are seen as positive steps by the Government.

6. Other

Announcements include:

- KiwiSaver mortgage diversion facility to be closed to new applicants from 1 June.
- Line-by-line Government department reviews to free up $2 billion over the next four years.
- $323.3 million allocated over the next four years for a New Zealand Insulation Fund, aimed at all houses built before 2000.