



2012
BUDGET

Budget Speech

Hon Bill English, Minister of Finance

24 May 2012

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New Zealand Government

Budget Speech

Mr Speaker,

I move that the Appropriation (2012/13 Estimates) Bill be now read a second time.

It's a privilege to deliver the National-led Government's fourth Budget.

This Budget is about investing in our future.

It shows the Government is responsibly managing its finances. We are on track to post an operating surplus in 2014/15, when we will start bringing debt down to prudent levels.

That is a considerable achievement given the difficulties New Zealand has faced over the past three years:

- A sharp recession that started in early 2008.
- The Global Financial Crisis, which is still being felt around the world.
- The destructive earthquakes in Canterbury.

Good fiscal management is important because it helps us pursue the other three priorities of this Government.

The first of these is building a more productive and competitive economy. The New Zealand economy lost competitiveness and built up large imbalances during the 2000s.

Those imbalances have to be reversed if we are to achieve sustainable growth.

The Budget is another step in creating an innovative and productive economy that sells more to the world - where people have the jobs, opportunities and higher incomes to get ahead here in New Zealand.

Secondly, the Government is committed to delivering better public services.

The Budget shows we are continuing to reform public services to deliver better results, protect the vulnerable in our society, and at the same time bring down many of the long-term social costs that drive public-sector spending.

And thirdly, the Budget continues the Government's strong commitment to rebuilding Christchurch and the surrounding areas.

Collectively, these priorities are about building a brighter future for New Zealanders from all backgrounds and walks of life.

Working constructively with the ACT, United Future and Māori Parties, we will continue to make balanced and fair decisions to support all New Zealanders through challenging times and put the economy on a more competitive footing for the longer term.

Mr Speaker,

The New Zealand economy has grown modestly but steadily, despite significant headwinds.

The efforts of all New Zealanders, supported by the Government's policies, are delivering results in difficult circumstances.

Since the recession, the economy has expanded in nine out of the past 10 quarters. Looking ahead, growth is forecast to rise to more than 3 per cent in 2014/2015.

Though moderate by historical standards, New Zealand's growth outlook is stronger over the next few years than that forecast for the Euro area, the United Kingdom, Japan, the United States, and Canada. It's similar to forecast growth in Australia.

Households and businesses have started to save and pay down debt. New Zealand's household savings rate is positive for the first time in a decade, and is forecast to increase to almost 4 per cent by 2016.

That is a positive and encouraging sign.

Increased savings will temper economic growth a little in the short term, but over time will leave New Zealand considerably less vulnerable to economic shocks.

Job creation is picking up. Over the past two years, 60,000 more people have been employed, and the Treasury expects a net 154,000 new jobs over the next four years. Unemployment is forecast to drop below 5 per cent by 2015.

Growth in the near term will be driven by a number of factors.

The rebuilding of Christchurch will be a key driver of domestic activity and is expected to contribute about one percentage point to annual growth in each calendar year from 2012 to 2016.

Our two largest trading partners – Australia and China – are forecast to maintain reasonable growth rates, therefore keeping up demand for our exports. We are also well placed to benefit from trade with other fast-growing economies in the Asia Pacific region.

And our terms of trade are expected to remain relatively high on the back of demand for our major export commodities.

These opportunities will be supported by Government policies to encourage businesses to invest, grow, and employ.

However, the global environment remains volatile.

In particular, the Euro area and the United Kingdom have yet to resolve the huge problems caused by a long-term reliance on debt and government spending to drive economic growth.

This global weakness and volatility means New Zealand must focus on the issues it can directly control, including getting back to surplus, reducing government and private sector debt, and improving competitiveness.

New jobs are created and incomes grow only when businesses have the confidence to invest, take risks to employ more people, and pay better wages from higher revenues.

Growth in the 2000s was built on unsustainable foundations – excessive spending, including from the Government, and high levels of household debt.

We are moving towards growth that is driven by savings, exports, and productive investment in the parts of the economy that trade with the rest of the world.

It is within this context that I present Budget 2012.

Mr Speaker,

I want to talk first about responsible financial management, before I go on to talk about the other three, equally-important, priorities of this Government.

Over the past three years, the Government has faced very considerable fiscal challenges.

In 2008, net government debt was \$10 billion. Today it stands at \$50 billion, and is forecast to reach more than \$70 billion before we return to surplus and start paying-down debt.

That build-up in government debt has been the appropriate response to the triple shocks of a domestic recession, the Global Financial Crisis, and the Canterbury earthquakes.

The alternative would have been to dramatically slash spending or dramatically increase taxes, both of which would have brought considerable pain to households and damaged the economy at a time when the recovery was still fragile.

The Government chose to run larger deficits and absorb much of the impact of these shocks on its own balance sheet to protect vulnerable New Zealanders and enable the economy to get back on track.

But, as we made clear at the time, this could not continue indefinitely.

So the Government maintained spending, but slowed its growth significantly.

As an illustration, over its last four Budgets, from 2004 to 2008, the previous Government's final-year spending on new discretionary operating and revenue initiatives totalled around \$15 billion.

For this Government, the corresponding figure over four Budgets is about \$750 million.

This Government's discipline means New Zealand is on track to return to fiscal surplus in 2014/15, and then to start reducing debt.

The forecast fiscal surplus in 2014/15 is \$197 million. This surplus is forecast to grow to \$2.1 billion in 2015/16 and \$4.4 billion in 2016/17.

Mr Speaker,

These surpluses will allow the Government to rebuild New Zealand's resilience to further shocks, help lift national savings, keep interest rates lower for longer, take pressure off the exchange rate, and reduce future finance costs.

A significant surplus will also give us choices when it comes to public services which we don't have while we're running deficits.

This Budget takes a number of balanced decisions to ensure the Government reaches surplus in 2014/15.

These decisions include running a zero Budget again this year, where \$4.4 billion of new operating spending over the four-year forecast period is matched by a combination of savings and revenue initiatives.

The Government is making significant new investment in priority areas, while at the same time keeping a tight rein on growth in spending and public debt.

In terms of savings initiatives, we are continuing to reprioritise existing spending to ensure New Zealanders receive better public services, especially in health, education, welfare, law and order, and science and innovation.

This will allow core Crown expenses to fall progressively from 33.5 per cent of GDP in 2011/12, to 30.2 per cent of GDP in 2015/16.

We are also focusing on improving the effectiveness of spending across the board. Effective public services that get results are good for individuals and their families, and will also generate sustainable long-term savings.

In terms of revenue initiatives, the Budget continues the Government's focus on broadening the tax base, closing tax loopholes, and improving the fairness of the tax system.

This builds on the measures introduced in Budgets 2010 and 2011.

The Inland Revenue Department will receive an extra \$78.4 million to further improve its tax auditing and compliance functions. These extra compliance activities are estimated to have a net positive impact on the operating balance of \$345.4 million over the four years to 2015/16.

We are also broadening the tax base by:

- Tightening the rules for deducting costs of assets that are used both by their owners and rented out for income, such as holiday homes, boats, and aircraft.
- Putting changes to livestock valuation rules into Budget legislation to prevent farmers who change valuation schemes receiving an unintended tax break.

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- Removing three tax credits that no longer fit the purpose for which they were created.

Together, these changes will save about \$410 million over the next four years, and I thank the Honourable Peter Dunne for his work in this area.

Mr Speaker,

When the Budget is in sufficient surplus, the Government is committed to resuming contributions to the New Zealand Superannuation Fund. On current forecasts, this is expected to happen in 2017/18.

Furthermore, decisions will also need to be made on the rate of debt repayment, to meet the Government's longer-term objective of reducing debt to 20 per cent of GDP by 2020.

Resuming New Zealand Superannuation Fund contributions and repaying debt will require an on-going commitment to responsibly manage surpluses.

Budget 2012 proposes changes to the fiscal responsibility provisions of the Public Finance Act to reinforce fiscal disciplines.

We are proposing additional principles for Part 2 of the Public Finance Act, which ministers will have to take into account when setting fiscal policy. These changes will bring more transparency to government spending decisions and how they affect the wider economy and future generations.

The Government is also consulting other political parties about the possible introduction of a spending limit, as set out in the National-ACT confidence and supply agreement.

I acknowledge the initiative on this issue of the Honourable John Banks.

Mr Speaker,

The new operating allowances for future Budgets remain as they were, at \$800 million for Budget 2013, \$1.19 billion for Budget 2014, and thereafter rising at 2 per cent each Budget.

This allows the Government to maintain some flexibility to deal with future spending and revenue pressures, while still achieving a surplus in 2014/15.

Mr Speaker,

As I said earlier, good fiscal management is important because it helps us pursue the other three priorities of this Government.

So I want to turn to the first of these – building a more productive and competitive economy.

The Budget continues to support the wide range of actions the Government is taking to raise productivity and therefore create more jobs and raise incomes.

I want to mention just a few of them.

Budget 2012 contains \$385 million of new investment over four years in research, science, and innovation.

We need to support businesses and farms to innovate and stay ahead of the competition. And we need to ensure New Zealanders have the right skills to compete in an increasingly global labour market.

Over the next four years, Budget 2012 investments include:

- \$166 million to redevelop an Advanced Technology Institute, which will help New Zealand's high-tech firms grow, increase exports, and ramp up productivity.
- \$60 million to support a series of National Science Challenges, which will seek innovative solutions to specific questions of national significance.
- \$100 million additional funding for the Performance-Based Research Fund to support world-class research in New Zealand's universities.
- \$59 million to boost funding for science and engineering courses. Funding rates for engineering degrees will be increased by 8.8 per cent and for science degrees by 2 per cent.
- In its first three years, the Primary Growth Partnership has stimulated more than \$430 million in research and development investment from government and industry. A further \$270 million of investment by the Government and industry is awaiting approval of business plans or negotiating contracts.

Mr Speaker,

Budget 2012 continues the Government's programme of investment in productive infrastructure and other major capital projects.

In particular, the Budget establishes the Future Investment Fund. This fund will receive all proceeds from the Government's sale of up to 49 per cent of shares in four SOEs and Air New Zealand.

These proceeds are expected to be between \$5 billion and \$7 billion.

The Future Investment Fund will reinvest these proceeds in other public assets, such as modern schools and hospitals, over the next few Budgets. The Government will do this without having to borrow to pay for those new assets.

We have earmarked \$1 billion of the fund for modernising and transforming schools as part of the Government's 21st Century Schools programme.

This demonstrates that the partial sale of shares in the five companies does not result in any net loss of publicly owned assets, but simply changes the mix of those assets.

The Government would rather build new schools and better hospitals without having to borrow more from overseas lenders, and still retain a majority shareholding in these companies.

The share offers will provide New Zealanders with an opportunity to invest their savings in large New Zealand companies and will help to improve the transparency and accountability of the companies.

As part of the Budget, the Future Investment Fund is allocating its first \$559 million. This includes:

- The first \$34 million of funding for 21st Century Schools.
- \$250 million towards KiwiRail's Turnaround Plan.
- \$88 million for health sector initiatives, in particular hospital redevelopments.
- \$76 million for the capital costs of the new Advanced Technology Institute.

We expect to make a significantly larger contribution from the fund in Budget 2013, once the share offers are under way.

In addition, the Government is investing around \$12 billion in improving state highways over the next 10 years.

We are also investing more than \$500 million a year in improving and maintaining local roads, and completing the \$2.1 billion upgrade of the metro rail systems in Auckland and Wellington.

Through Transpower, the Government is investing \$4.6 billion in upgrading the national electricity grid over the next 10 years.

New Zealand's size and geographic isolation from the rest of the world mean communications technology matters.

That is why this Government is investing up to \$1.35 billion in the roll-out of Ultra-Fast Broadband and an extra \$300 million in the Rural Broadband Initiative, currently under way.

Mr Speaker,

As part of the Government's programme to deepen capital markets, the Budget last year made several changes to KiwiSaver.

We announced an increase in the minimum contribution from individuals and employers from 2 per cent to 3 per cent, to take effect from 1 April 2013.

About 15,000 New Zealanders a month are joining the scheme, and since March last year, total KiwiSaver funds have grown from \$9 billion to more than \$12 billion.

Budget 2012 further strengthens KiwiSaver.

New disclosure rules, to take effect from April 2013, will allow people in KiwiSaver to evaluate and compare the performance of different funds. Fund managers will be required to report their performance and returns, fees and costs, assets and portfolio holdings, and liquidity and liabilities.

In addition, the Government is today issuing the terms of reference for a review of KiwiSaver default-provider arrangements to ensure they are working in the best interests of investors.

The Government is also deferring its auto-enrolment exercise for KiwiSaver. Proceeding with auto-enrolment in 2014/15 as originally intended is now not possible without putting the updated forecast surplus at risk. Therefore, public consultation on auto-enrolment has been deferred until after 2012.

In building a more competitive economy, the Government will develop initiatives across its business growth agenda.

This will help businesses with the research, capital, ideas, skills, natural resources, and infrastructure that they need to grow, employ, and trade successfully with the rest of the world.

This is how the Government will support job growth.

Mr Speaker,

Another of the Government's priorities is delivering better public services within tight financial constraints.

A better-performing public sector is central to the Government's plans over the next three years. The Government wants to see better results and improved services, as well as reduced costs and more efficiency.

To assist those changes, the State Sector Act, the Public Finance Act, and the Crown Entities Act will be amended, as recommended by the Better Public Services Advisory Group.

Earlier this year, the Prime Minister announced 10 challenging results for the public sector to achieve over the next three to five years.

We can help create better communities by achieving these results, which include: reducing long-term welfare dependency; supporting vulnerable children; boosting skills and employment; reducing crime; and improving interaction with government.

We've already announced one of the targets – 85 per cent of 18-year-olds having NCEA level 2 or equivalent in five years, up from 68 per cent currently.

Today we are announcing two more as part of Budget 2012.

The first is reducing prisoner reoffending by 25 per cent in five years. Reaching this target would mean 18,500 fewer victims of crime every year.

The second is increasing the rate of participation in early childhood education to 98 per cent, up from 94.7 per cent currently. This will ensure that as many children as possible have a strong platform for learning when they start school.

We are still finalising our other Better Public Services targets and they will be announced by 30 June.

Progress towards achieving the results will be reported publicly, so New Zealanders can judge for themselves how well we are doing.

As we've said, achieving these results will be demanding – in fact, for some of them, it will be quite difficult. We make no apology for that.

Mr Speaker,

Despite tight financial constraints, this Government has made investing in better frontline health services a priority over the past three Budgets. This continues in Budget 2012.

Over the next four years, the Government is committing almost \$1.5 billion extra to Vote Health, partly funded by \$129 million of savings identified in 2011/12. This will:

- Deliver 4,000 more elective operations a year.
- Provide better service for cardiac and cancer patients.
- Provide \$12 million to reduce rheumatic fever.
- Invest \$133 million in disability support services.

In addition, the Government will provide \$60 million in capital for new buildings and hospitals.

As we've already announced, pharmaceutical co-payments will be increased from \$3 to \$5, up to a maximum of 20 prescription items per family per year, after which items are free.

Prescriptions for children under six will remain free.

This is a modest increase that allows us to spend more on frontline health services than we would otherwise have been able to.

As part of its wider health policy, the Government will also continue to increase tobacco excise by 10 per cent over and above inflation each year for the next four years.

The first increase will occur on 1 January 2013, followed by annual increases on 1 January in each of the following three years.

Previous increases in the excise have reduced tobacco consumption, as smokers have given up or cut back and fewer young people begin smoking.

I acknowledge the work and support of the Māori Party and its ministers, the Honourable Tariana Turia and the Honourable Pita Sharples, in this area.

Mr Speaker,

Raising student achievement and improving the tracking of student performance is important for New Zealand and therefore a priority for this Government.

As we have confirmed, the Government is committed to the ambitious goal of 85 per cent of 18-year-olds with NCEA Level 2 or equivalent qualifications.

Reaching this goal means resources must be managed to get better results for all students.

Evidence shows the single most important thing we can do to raise achievement is to improve teaching quality. So Budget 2012 makes a significant investment in this area.

Over the next four years, the Government will commit \$512 million towards new frontline education initiatives. This takes the Government's total investment in early childhood education and schooling to \$9.6 billion in 2012/13.

This Government wants to create a flexible, skilled, and professional workforce through these initiatives to support principals and teachers.

We are committing an extra \$60 million to lift the quality of teaching in our schools. This is in addition to the \$304 million we are spending on professional learning and development for teachers in primary and secondary education over the next four years.

Budget 2012 also sets aside further funding to support priority learners. This includes:

- \$83 million in school operating grants.
- \$51 million to continue the roll-out of ultra-fast broadband in schools.
- \$48 million to increase participation by vulnerable groups in early childhood education.
- \$19 million to support Māori-medium early childhood education providers.

The Government will provide extra parenting programmes and relationship education in secondary schools at a cost of \$4 million over four years.

We will also support a variety of youth mental health initiatives with an extra \$17 million over four years.

To increase investment in raising student achievement, and to manage the costs of increased primary-school-age children over the next four years, we are making small changes to current school funding ratios.

Mr Speaker,

I have already mentioned some of the new initiatives in tertiary education.

In addition, Budget 2012 invests in providing more pathways into work and further training for young people leaving school.

It provides an additional free 3,000 tertiary-based Youth Guarantee places at the cost of \$37.7 million over four years.

The Government will also continue to better target student assistance to where it is most needed and ensure better value for taxpayers.

From 1 January this year, we implemented tighter income rules to ensure the student allowance is fair.

Budget 2012 confirms a number of further student loan changes from 1 April 2013, including:

- Increasing student loan repayments from 10 cents in every dollar earned over the income threshold to 12 cents.
- Widening the definition of income for student loan repayment purposes.

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- For student allowances, continuing the freeze on parental income thresholds until 31 March 2016.
 - Targeting allowances to first degrees only, and removing exemptions for long programmes such as postgraduate training, taking effect from 1 January 2013.

These changes are consistent with the Government's intention to see better value for New Zealanders, ensure the longevity of the student loan scheme, and improve alignment with Working for Families and other social policy initiatives.

Mr Speaker,

It is concerning for our future that around one in eight New Zealanders aged 18 to 64 is on a benefit, and around half of them have spent at least five of the past 10 years on a benefit.

This Government has embarked on ambitious reforms focused on supporting New Zealanders out of welfare and into work.

The Budget invests \$287.5 million over four years in the first phase of this programme.

This funding provides more education and training for young people. It will also focus on work availability and preparation for sole parents, widows, women alone, partners within the benefit system, and parents who have subsequent children while on a benefit.

The second phase of welfare reform will be implemented in July 2013. This will involve changes to benefit categories.

Both phases of the reforms are a shift towards a new investment approach to welfare.

The investment approach provides greater transparency over the long-term cost of welfare, and focuses government agencies on reducing this cost through employment support and training.

Mr Speaker,

Budget 2012 continues the Government's policy of staying strong on crime.

The justice sector, including the Ministry of Justice, and the departments of Police and Corrections, is developing new ways of working together and making better use of existing resources. This includes more flexible funding arrangements and shared use of staff and assets.

This will allow the sector to focus on results – reducing total crime, violent crime and youth crime, and reducing reoffending. For example, the Policing Excellence programme helped reduce total crime by 5.6 per cent between 2010 and 2011.

As I've confirmed today, the Department of Corrections aims to reduce reoffending by 25 per cent by 2017.

To help achieve this, it will invest \$145 million of reprioritised money from prison closures and cost reductions out to 2019/20 in rehabilitation programmes.

Modernising court services will ensure that people can access services faster and more conveniently.

Mr Speaker,

Working with non-government providers, the Government is committed to improving housing affordability and providing assistance to households in need.

Budget 2012 provides funding of \$104 million for this over three years. This will be used to trial greater innovation, diversity, and scale in the social housing sector.

The Government's housing policies will work alongside welfare reform to assist people towards independence.

We are working with the housing sector to use our \$15 billion investment in state houses and almost \$2 billion of annual subsidies more effectively to house people in need.

The Government will also work with councils to improve housing affordability for all New Zealanders.

Mr Speaker, the Government's final priority is rebuilding Christchurch.

The Government remains absolutely committed to supporting the rebuilding of Christchurch, our second largest city.

The total cost of the damage is estimated at more than \$20 billion, so it is without doubt the largest – and most complex – economic project in New Zealand's history.

I want to pay tribute to the work of my colleague the Honourable Gerry Brownlee and the many public servants, community organisations, and families who have worked so hard to help each other through this disaster.

Considerable progress is being made.

Work on about three quarters of the 1,000 buildings required to be partially or fully demolished in the Christchurch CBD has been completed. Some 13,000 repair jobs are under way across greater Christchurch.

A significant number of infrastructure repair projects, worth about \$820 million, have been completed, are under way or in the design stage.

And nearly 5,000 of the 7,000 property owners in the residential red zone have formally accepted the Government's offer to purchase their properties.

About half of these owners have already settled, allowing them to move on and restart their lives.

Mr Speaker,

The Government is providing considerable resources for the Canterbury rebuild.

We set aside \$5.5 billion in Budget 2011 for the Canterbury Earthquake Recovery Fund.

We established the Canterbury Earthquake Recovery Authority.

And we passed special legislation so the Government can step in where required to remove structural barriers to reconstruction.

Looking ahead, the Government is developing a blueprint for the central city to take forward the draft Central City Plan prepared by Christchurch City Council in consultation with the people of the region.

That blueprint will focus on anchor projects and precincts, and provide sufficient direction to encourage the investment needed for rebuilding.

The Government has assisted with land supply for housing by using special earthquake-recovery powers to amend land-use rules to allow rezoning of residential subdivisions.

There is now a significant amount of residential land available in greater Christchurch - potentially 26,000 sections over the next five years.

About 6,600 greenfields sections are expected to be released to the market within the next two years.

The Government is determined that residents can rebuild and move into their new or repaired homes as soon as possible.

Finalising the remaining residential land zoning decisions and the settlement of outstanding insurance claims is therefore a priority.

Mr Speaker,

It is now almost four years since the collapse of Lehman Brothers, which set off the Global Financial Crisis and global recession.

Since then, we have witnessed significant disruption to economies around the world, and that is likely to continue for years to come.

The Euro area and the United Kingdom are going back into recession this year. The United States has low and uncertain growth.

By comparison, New Zealand is going through a moderate adjustment. We are avoiding the substantial cuts to public services and living standards that we are seeing in many other developed countries.

Our outlook is more positive than most. We are a food-producing economy on the doorstep of a rapidly growing middle class in the Asia-Pacific region.

Providing we stick to the Government's balanced and ongoing economic programme over the coming years, I am confident we will grasp these opportunities.

Mr Speaker,

Budget 2012 sets out the next steps in that programme.

It's about investing in our future.

It's about implementing the Government's plan to build opportunities for New Zealanders from all walks of life.

It's about returning to surplus in 2014/15, when we can start reducing debt brought on by the recession and the earthquakes.

We are building a more productive and competitive economy, where New Zealanders have the jobs, higher incomes, and opportunities to get ahead in their own country.

We are delivering better public services within tight financial constraints. And we are firmly focused on getting better results for New Zealanders and their families.

We are helping to rebuild Christchurch and standing beside the people of Canterbury.

New Zealanders have shown great resilience through challenging times. Budget 2012 supports their aspirations for a brighter future.

Mr Speaker,

I commend this Budget to the House.