CPAG'S BUDGET REVIEW 2013

An Analysis of the New Zealand Government's 2013 Budget

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Child Poverty Action Group (Inc.)
PO Box 56 11, Wellesley St, Auckland 1141, New Zealand

May 2013

This report is available for free download from http://www.cpag.org.nz/

ISBN 978-0-473-24803-1 (Electronic)

Cover image Mark Mitchell New Zealand Herald

THE 2013 BUDGET AT A GLANCE

The 2013 Budget is the present National Government's fifth budget and comes at a time when New Zealand is emerging from the worst economic recession since the 1930's. This recession has tended to frame not only this and preceding budgets but the whole fiscal stance of the Government. The Minister of Finance Bill English has consistently identified his desire to return the Government's finances back to surplus by 2015 and this budget more or less fulfils this ambition for him.

The economic assumptions behind the budget appear suitably cautious given the fragile nature of New Zealand's economic recovery and recent events in Australia with a ballooning Federal Government deficit and the reduction of the official cash rate to a 50 year low. Treasury is forecasting a subdued labour market, with unemployment rates remaining above 5% for the next four years. Inflation is forecast to hover around 2% while economic growth over the next four years will range from 2% to 3%.

The Government's progress to achieving an operating surplus is due mainly to expected increases in tax revenue with the restraints on spending being less important. Tax revenues are expected to grow by around 25% in nominal terms over the next four years while spending grows by 10%. The mix of taxes remains much the same as it did immediately following the 2011 income tax cuts and GST increases with direct taxes contributing 64% of the total tax take.

Pre-Budget announcements by Government Ministers have been somewhat misleading as has been the way the Minister of Housing has framed his Budget speech. For example announcements of new spending are highlighted while cuts, re-definitions and expected savings are more difficult to identify in the Budget documents. The use of summary figures for the various budget votes and appropriations tells a different story to that offered by Ministerial press statements however

Overall spending on education is expected to increase by just 0.3% in nominal terms and once inflation is taken into account there may be a real decline in the value of education budgets. Both as a share of core Crown expenditure and of GDP, education budgets are declining. By 2017 public spending on education is forecast to fall below 5% of GDP. Within the education budget Government has continued its commitment to early childhood education and specifically to addressing inequities in access and to funding the 20 free hours programme. Spending on primary and secondary school education is forecast to fall marginally. Primary school rolls can be expected to grow over the next two to three years while secondary school rolls may fall. This suggests that spending cuts in the primary sector may also result in a falls in the per student spend.

The public health budget is expected to grow by nearly 5% between 2012/13 and 2014/15 to $14.65 billion but then to fall gradually for the following three years. A contributing reason for this decline is the drying up of capital spending beyond 2013/14. Budgets district health boards appear just to be keeping pace with inflation and population growth. Spending on nationally funded health services have fared better with 7% growth expected over the next year. Disability support services and public health have gained most from this increase.

Income support programmes such as benefits, subsidies, Working for Families and New Zealand Superannuation will cost taxpayers an expected $21.6 billion in 2013/14 or nearly 30% of core Crown expenditure. New Zealand Superannuation accounts for over half this spending and the costs of Superannuation are expected to grow by $600 million each year for the whole forecast period and beyond. Nearly half (45%) of all new spending will be to meet growth in Superannuation costs.

One the other hand spending on working age benefits is forecast to remain relatively stable in nominal terms at around $4.6 billion. Spending on Working for Families will fall slightly in nominal terms as Government fails to index abatement and entitlement thresholds. The overall impression gained from how Government is treating both income support programmes is one of a quiet squeeze.

Despite the growing housing shortage in Auckland and the lost housing in Christchurch Government's approach to housing remains resolutely indifferent. New spending of $102 million over the next four years will mainly go on rent subsidies to Housing New Zealand or to a few community based social landlords. Housing for Maori living in rural areas gets a revamped programme with additional budgets and more generous income thresholds and while this may find some interest it is unlikely to address serious housing need.

The 2013 Budget has singularly failed to even consider questions of child poverty. The Minister of Finance remains convinced that the only way to lift vulnerable families out of poverty is through paid employment yet he fails to take account of Treasury's predictions that the labour market will be subdued over the next three or four years. As the economy moves past recession and as Government finances improve there may be scope to consider what new spending priorities might be feasible. Regrettably this Budget does not consider such challenges.

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ECONOMIC & BUDGET SETTINGS

Any budget is a forecast of the future and forecasts by their nature involve uncertainty and risk. To manage such uncertainty a budget has to be based on projections of key influences and on assumptions about the general environment in which the budget is set. This means of course that any budget is only as reliable and believable as the projections and assumptions which underpin it. For this reason it is worthwhile to open CPAG's review of the 2013 New Zealand Government Budget with a summary of the Treasury's underlying assumptions and projections and to reflect on how reliable these assumptions and projections have been in the recent past.

KEY ECONOMIC ASSUMPTIONS

Three economic indicators which are critical to the reliability of the Budget and its underlying assumptions are those of economic growth, unemployment and inflation. Treasury's assumptions for these are provided in table 1 below.

Table 1: Key economic assumptions of the 2013 Budget

Year ending March	**2013**	**2014**	**2015**	**2016**	**2017**
Economic growth	2.5%	2.4%	3.0%	2.6%	2.2%
CPI inflation	0.9%	1.9%	2.0%	2.0%	2.2%
Unemployment rate	6.9%	6.0%	5.9%	5.5%	5.2%

In the past Treasury has had mixed success in its economic forecasts tending perhaps to be slightly too pessimistic during downturns and slightly too optimistic during upturns. This is illustrated a little in Table 2 which compares forecasts from the Budget and Fiscal Update 2009 with the actual results.

Table 2: Review of Treasury's 2009 economic assumptions

Year ending March		**2010**	**2011**	**2012**	**2013**
Economic growth	- forecast	-1.7%	1.8%	2.9%	4.0%
	- actual	-0.7%	1.2%	1.9%	2.5%
CPI inflation	- forecast	2.4%	1.7%	1.2%	1.6%
	- actual	2.0%	4.5%	1.6%	0.9%
Unemployment rate	- forecast	7.5%	7.5%	6.3%	5.1%
	- actual	6.0%	6.6%	6.7%	6.9%

While is it easy to be wise in hindsight and while past biases in forecasts may have little to do with the accuracy of future forecasts, it is nonetheless wise to be a little cautious about forecasts which offer up relatively strong growth rates. A failure to achieve such high growth can produce a double wammy where tax revenues are lower than expected and welfare costs are higher than expected - as occurred in 2007-08 with the global financial crisis.

Treasury have modelled less optimistic economic scenarios than that offered in Table 1 and this modelling suggests that tax revenue may be $5.4 billion less over the four years of the forecast period, that Crown debt will exceed 30% of GDP and the date when Government finances return to breakeven is delayed two years until 2017.

REVENUE AND SPENDING FORECASTS

A summary of the Government's revenue gathering and spending plans is provided in Table 3. As signalled previously by the Minister of Finance the Government books are expected to return to surplus during the 2014/15 all going well with the underlying assumptions around growth and the control of spending. The debt associated with these deficits is expected to peak at 28.7% of GDP at the end of the 2014/15 year.

As should be expected from a fiscally conservative government, the agenda of reducing the state's share of the economy is also being run here. Core Crown expenditure as a share of GDP is expected to fall from 35% of GDP in 2011 to 30% in 201. However in 2008 under the former Labour Government and inmore buoyant economic times Crown expenses represented only 31% of GDP.

Table 3: Summary of revenue and spending from 2013 Budget *($ billions)*

Year ending June	2013	2014	2015	2016	2017
Core Crown revenue	63.8	68.4	72.3	75.8	79.5
Core Crown expenses	(71.6)	(72.4)	(73.5)	(75.2)	(77.2)
Operating balance (OBEGAL)	(6.3)	(2.0)	0.1	0.8	2.6
Closing net debt	57.9	64.8	68.2	69.7	70.3
Expenses as % of GDP (Exp)	33.5%	31.8%	30.9%	30.3%	30.0%

The expected return to surplus is based mainly on an expected 25% increase in tax revenues from 2013 to 2017 - from nearly $57 billion to $71 billion. The breakdown in these tax revenues is provided in Table 4. The expected growth in tax revenue is across all sources and as shown in Table 4 the share of total taxes from direct and indirect sources remains almost constant at a 64/36 split. Prior to the 2011 increase in GST this split was closer to 70/30. Over the forecast period corporate tax revenue is expected to contribute around 15% of the total tax take whereas prior to the 2007 recession this share was close to 18%.

Table 4: Breakdown of forecasted tax revenues from the 2013 Budget *($ billions)*

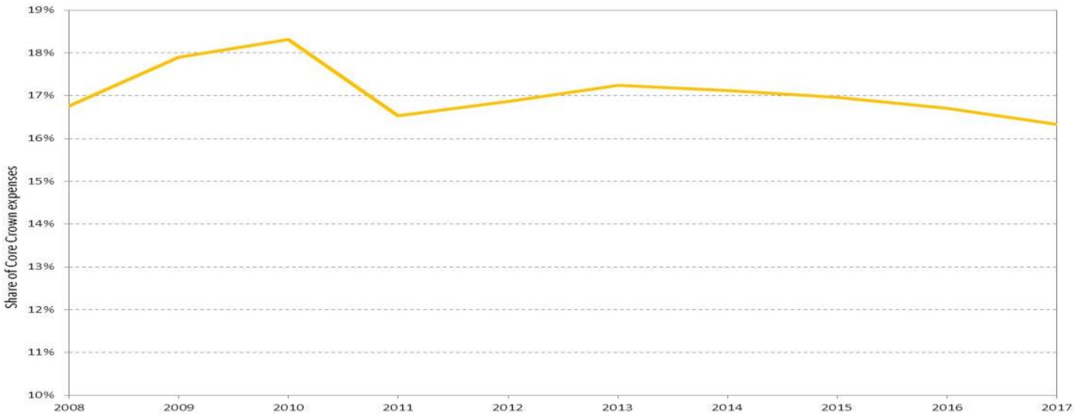
Year ending June	2013	2014	2015	2016	2017
Source deductions from individuals	22,240	23,584	24,761	25,980	27,395
Other source deductions	3,484	3,803	4,215	4,354	4,513
Corporate taxes	8,535	9,175	9,851	10,294	10,492
Other direct taxes	1,995	2,277	2,491	2,972	3,341
Total direct taxes	36,254	38,839	41,318	43,600	45,742
GST (net)	15,070	16,157	17,222	18,106	18,775
Other indirect taxes	5,414	5,699	5,995	6,312	6,519
Total indirect taxes	20,484	21,856	23,217	24,418	10,492
Total tax revenue	56,738	60,695	64,535	68,018	71,036
Direct tax as % of total tax	63.9%	64.0%	64.0%	64.1%	64.4%

EDUCATION

The 2013 Budget appropriation to education rose just 0.3% in nominal terms to $12.4 billion or just over 16% of core Crown expenditure.   Figure 1 provides an indication of Vote Education's share of core Crown expenditure since 2008 and as forecast in the 2013 Budget through to 2017.

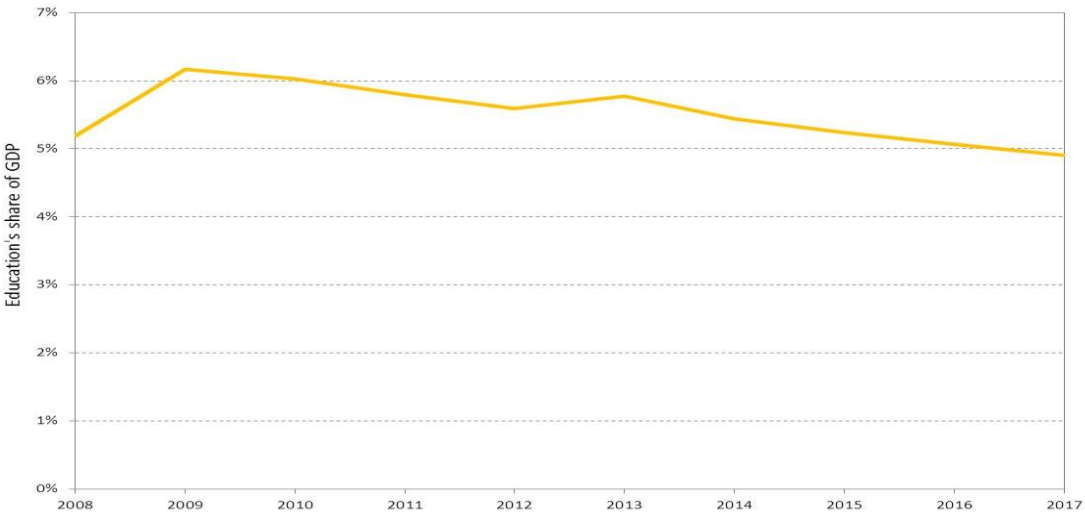
Expenditure on education over the four years between 2013/14 and 2016/17 is expected to grow by just 2.1% in nominal terms to $12.6 billion. If Treasury's inflation forecasts prove correct this minimal growth in expenditure will represent a real reduction in value of around 6%.

Figure 1: Total education appropriation as share of Core Crown expenses 2008-2017



As a share of GDP, spending public education is forecast to decline from around 6% in 2011 to less than 5% in 2017. This trend is shown on Figure 2

Figure 2: Total Vote Education appropriation as share of GDP 2008-2017



Early childhood education is set to get a further $65 million boost in spending from $1.42 billion in 2012/13 to $1.48 billion in 2013/14 - a nominal increase of just under 5%. The main component of this increase is a $46 million or 5% increase in funding for the 20 free hours programme. As well the targeted funding pool, which is designed to improve equity of access to ECE, will increase by $2.5 million between 2012/12 and 2013/14 to $58.5 million. Government's on-going commitment to early childhood education is further illustrated by the fact that real per capital spending on ECE is likely to rise by $100 per child between 2012/13 and 2013/14 to around $7,250.

Spending on primary education is forecast to fall by $30 million between 2012/12 and 2013/14 to $2.76 billion. Population forecasts suggest that the primary school age population may grow by around 0.6% each year for the next two or three years so this in turn suggests that this modest reduction in the total primary education spend represents a real reduction in the per student spend. This reduction Is estimated to be around $200 per student per year or from $5,800 per student annually to $5,600. In 2008 the per student spend on primary education was slightly more than $5,200 at 2013 dollar values so the 2013/14 outcome is still quite favourable.

The 2013 Budget reports that spending on secondary education is set to decline by $57 million to just under $2.0 billion for 2013/14. This small spending cut is against a background of a likely 1.0% to 1.5% decline in the national secondary school roll so on a per student basis the spend is relatively constant at around $7,000 per student at 2013 values.

Spending on special needs education is forecast to decline slightly from $340 million in 2012/13 to $335 million in 2013/14 although this decline should be seen in the context of recent and significant increases in this appropriation. In 2007/08 spending on special needs education was $280 million

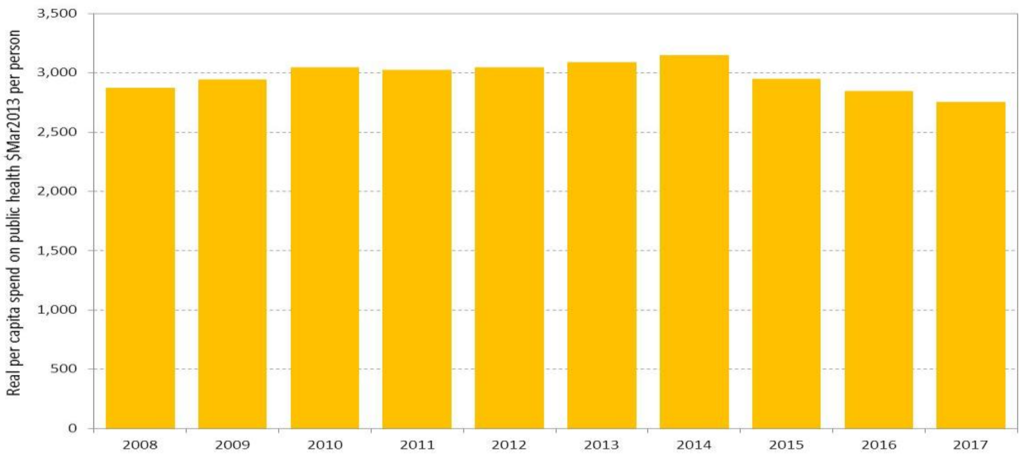
The budget for scholarships for students private schools remains unchanged at $4.1 million annually while the budget for remission of NCEA fees also remains unchanged at $1.3 million The Mapihi Pounamu programme which aims to assist students at year 9 and above to remain at school saw a small budget cut from $3.7 million to $3.3million between 2012/13 and 2013/14.

HEALTH

The 2013 Budget appropriation to health grew a credible 4.8% from $13.98 billion in 2012/13 to $14.65 billion in 2013/14. Health spending is however forecast to decline by around 4.3% over the following three years to just over $14 billion by 2016/17. The main reason for this decline appears to a drying of capital spending. During 2013/14 $520 million has been budgeted for capital spending. This includes a reported $426 million in the re-development of Christchurch and Burwood Hospitals in what the Minister of Finance in his Budget Speech described as 'the biggest building project in the history of New Zealand's public health system'. However beyond this splash, capital spending is forecast to fall quickly to $75 million during 2014/15 and further to $30 million in each of the following two years.

Taking account of expected inflation and population growth, the forecast increase in spending on health looks more modest however. Figure 3 illustrates the real per capita spend on public health since 2008 and includes forecasts offered in the 2013 Budget. In per capita terms spending peaks during 2013/14 at around $3,150 per person but under the scenario offered in the Budget this spend quickly falls away to around $2750 by 2016/17. This is the lowest per capita spend since 2007

Figure 3: **Real per capita spend on public health** **-** Mar2013 $'s per person

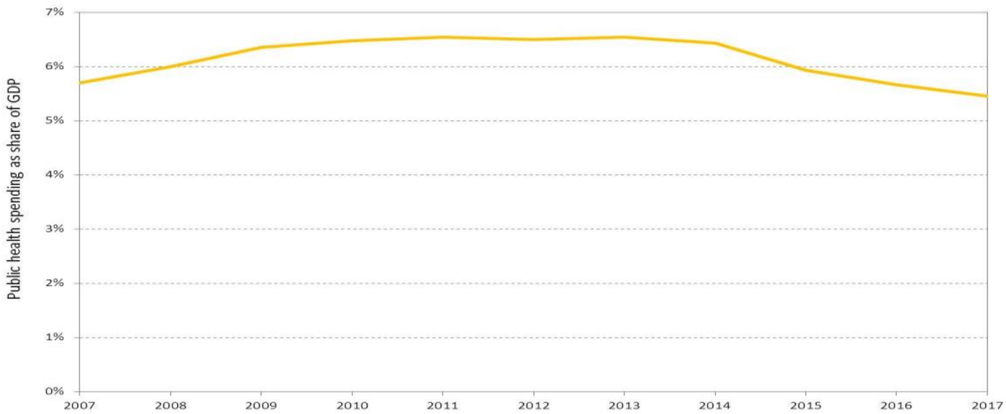


As a proportion of GDP public health spending also peaks in around 2013/14 and falls away over the following three years covered by the 2013 Budget forecasts. This decline is illustrated in Figure 4.

While the budget speech and supporting information to the Vote Health appropriations place considerable emphasis on new spending, it is difficult finding this new spending in the total figures offered in detailed budget papers. These papers indicate that appropriations to district health board are budgeted to rise from $10.89 billion in 2012/13 to $11.10 billion and increase of 2%. However once expected inflation of 1.9% and annual population growth of just less than 1% are taken into the account the increase is hardly tangible.

Nationally funded services such as maternity, health and disability and mental health services make up most of the remainder of the Vote Health budget. The total budget for such services grew a credible 7% between 2012/2013 and 2013/14 to $2.52 billion. The biggest budget increases can be found in disability support services and public health while elective surgical services grew nearly 4% on the back of similar rises over the previous two years. While national child health services saw a small 2% drop between 2012/13 and 2013/14 to $80 million this spend is still 30% more than the $62 million in 2010/11.

Figure 4: Total Vote Health appropriation as share of GDP 2008-2017



INCOME SUPPORT

Government is planning to spend over $21 billion or nearly 30% of its total budget on a variety of income support programmes. The largest of these is New Zealand Superannuation which during 2012/13 exceeded $10 billion for the first time. The cost of Superannuation is expected to grow by around $600 million per year for the entire forecast period while 45% of the expected increase in core Crown expenditure over the next four years will be due to increasing Superannuation costs.

Table 5 below offers a summary of the various income support and benefit programmes available. This table shows clearly the impact of rising Superannuation costs on overall expenditure on benefits. In 2012 nearly 45% of all benefit expenditure was toward New Zealand Superannuation and by 2016/17 this share is expected to rise to nearly 54%.

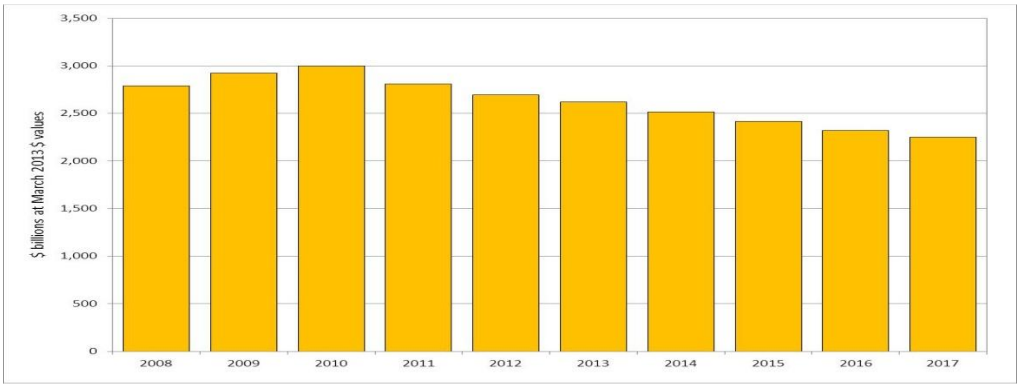
Table 5: **Summary of benefits and income support programmes -** *$billions*

Year ending June	2013	2014	2015	2016	2017
New Zealand Superannuation	10,235	10,894	11,495	12,102	12,712
Housing subsidies	1,815	1,853	1,894	1,947	2,006
Working age benefits	4,655	4,634	4,643	4,667	4,697
Working for Families credits	2,619	2,565	2,514	2,461	2,442
Other benefits	1,518	1,664	1,422	1,425	1,436
Total all benefit expenses	20,842	21,610	21,968	22,602	23,293

The 2013 Budget is the first to budget for the new working age benefits resulting from the Government's benefit reform programme. These new benefits are the Supported Living Payment, the Sole Parent Support and the Jobseeker Support . Treasury's estimates of the number of people receiving these new benefits are similar to those presently receiving the older style benefits. It seems likely then that real value of these new benefits will fall with inflation given that total spend is changing very little – as indicated in Table 5.

The Working for Families package will also see a subtle decline in the real value of payments most likely due to a failure by Government to index abatement and entitlement thresholds. This real decline is illustrated in Figure 5 which measures the real value of Working for Families budgets over the period 2008 to 2017.

Figure 5: **Real cost of Working for Families programme 2008-2017**



HOUSING

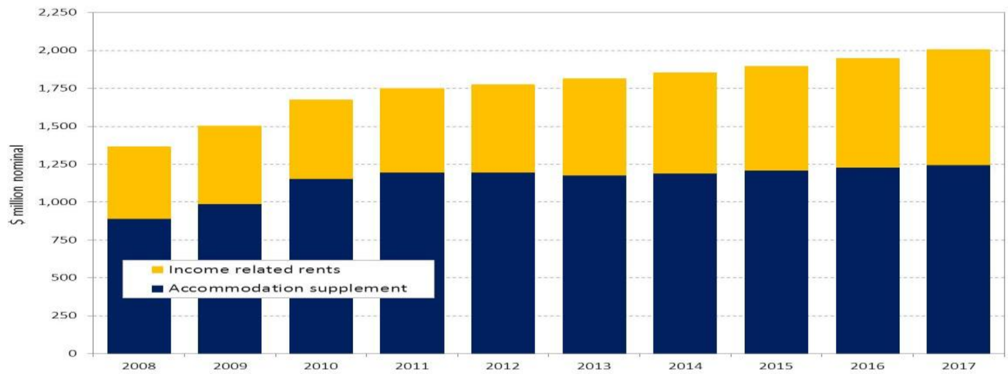
Housing has been a deepening problem over the past decade as succeeding Governments have ignored both the need to reconsider housing policy and to commit to making substantially greater financial investment into the supply of affordable housing. The outcome of this neglect has been a growing shortage of affordable housing particularly in Auckland where the shortfall over the past five years may now exceed 15,000 units. In addition there has been the loss of perhaps 8,000 dwellings in the Christchurch earthquakes and the absence of any deliberate effort or coherent plan by Government replace these. The Kainga Whenua programme was launched in 2010 to assist rural Maori communities to meet their housing needs. The programme had expectations of making 180 loans per year yet by 2012 just four loans had been made.

Despite its pre-Budget rhetoric there is very little additional money in the 2013 Budget to address housing supply problems. The new initiatives announced in the budget are relatively very minor in budget terms amounting to $102 million over four years. These initiatives include:

- $26.6 million over four years to extend income related rent subsidies to some community based housing providers.
- $16.7 million over four years for so-called ‘Special Housing Areas’ which are intended to reduce regulatory barriers to building and subdivision consent for new house construction
- $12.0 million over four years for the Kainga Whenua Mark II scheme to provide whanau Maori with assistance to develop housing on Maori land
- $46.8 million during 2015/16 and 2016/17 as an additional income related rent subsidies to Housing New Zealand as they move out state house tenants who are assessed as being able to afford market rental accommodation.

The big housing related budgets are in the income –related rent subsidies to Housing New Zealand and the Accommodation Supplement. As shown in Figure 6 total expenditure on these two programmes is forecast to increase from $1.8 billion in 2012/13 to $2.0 billion in 2016/17 with most of this increase being for income related rents. The unchanging costs of the Accommodation Supplement since 2010 and throughout the forecast period point to a serious anomaly in this payment as means of financial reducing hardship caused by high housing costs. The numbers of household receiving this payment is expected to remain relatively constant over the next four years at around 300,000, so it is clear that the average value of the payment will also remain unchanged even as rents rise.

Figure 6: Housing subsidies 2008-2017



CONCLUSIONS

As in past years the distractions of pre-Budget announcements by Ministers have drawn attention away from the real story of the Budget. As in past years a great deal of media attention and analysts' commentary has been around what are in the wider scheme of things relatively minor gestures. The reality remains that the bulk of Government revenue is derived by PAYE and GST while the bulk of spending is on health, education and income support.

It appears that few if any changes in these settings are being anticipated over the next five years although it is becoming increasingly difficult to hide the increasing burden of New Zealand Superannuation on today's and tomorrow's taxpayers.

The economic parameters around which the Budget is constructed appear realistic although perhaps marginally optimistic. Growth expectations of between two and three percent over the next four years are not unrealistic although the recent recovery is probably still quite fragile and there is a risk for us in New Zealand with Australia's economic and fiscal fortunes which presently appear vulnerable. Treasury's assumptions around unemployment and joblessness also appear quite sober and these appear a little at odds with the Government's rhetoric that suggests we will soon work and grow our way out of poverty.

The 2013 Budget has continued to tell a story of fiscal conservatism – of giving emphasis to moving out of deficit while at the same time more or less maintaining the social contract around public health, public education and retirement incomes. This is not the language or intent of austerity such as that being offered in Europe although it has quite successfully limited debate around unmet needs and alternative priorities. To the credit of this Government this fiscal conservatism has been a consistent and unwavering theme over the past three years and if its growth expectations are accurate this stance may be politically successful – at least for another electoral term.

The social contract is however looking frayed around the safety net offered by working age welfare benefits with the Government's welfare reform programme. Despite the rhetoric from those supporting and opposing this reform programme, changes in levels of benefit take up remain roughly consistent with changes in employment fortunes over the past three years – perhaps with the exception of youth and young adults who appear more excluded. The Government has however successfully limited growth in spending on working age benefits although any savings here are small and perhaps one-offs so will not really pay for the burgeoning Superannuation bill which is growing by $600 million per year.

The more recent social contract with working families in the form of the Working for Families package is gradually being eroded away by neglect, inflation and a failure to index income thresholds.

The 2013 Budget does not address some serious underlying economic and demographic pressures such as those around an aging population alongside youth marginalisation and a growing current account deficit and rising foreign debt alongside a re-inflating housing bubble. Expecting budgets to do all of this is perhaps unfair although there are no signs of any political will to do so at present.