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Eighth annual Budget breakfast

De Steve Poletti[1]

Budget 2008 LEFT BEHIND

The budget delivered yesterday by Michael Cullen is his 9th and most likely last budget is set against a gloomy economic growth outlook and major imbalances in the New Zealand Economy. One cannot help but look back over the last 9 years and wonder what might have been.

Reserve Bank Governor Alan Bollard at the end of April noted that: "Economic activity has weakened more markedly than expected in the Bank's March *Monetary Policy Statement*. There have been sharp falls in consumer and business sentiment, exacerbated by tighter credit conditions, a further decline in the housing market and weaker prospects for world growth. Financial market turbulence around the world continues to add to an uncertain economic environment. Further, the very dry summer is also weakening short-term growth prospects".

Interest rates remain at extremely high levels with the OCR at 8.25%. The current account deficit remains at an unsustainable level. The current account deficit for the year ended December 2007 was $14billion (8 percent of GDP).

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To finance this each year we have to sell assets to foreigners or borrow from overseas an extra $14billion. Statistics New Zealand dryly note that a significant feature of the recent borrowing required to finance the current account deficit "was an increase in overseas debt which is due to be repaid in less than 12 months".

Michael Cullen has made much of the **government's** improved net debt situation BUT what of the nation**--**As at 31 December 2007, New Zealand's foreign liabilities exceeded its overseas assets by $152.4 billion. On a per capita basis we are one of the most indebted countries in the world. The tragedy is that the vast bulk of this debt has not been used to make the country more productive and the economy stronger and more able to service the overseas debt. Instead much of it, especially over the last few years has fuelled a housing asset bubble in the first instance which then flows on to increased consumption as housing equity is drawn down.

In my view the government's analysis of the causes of the increase in overseas debt – Namely lack of private savings-is wrong. Instead the cause is increased inward capital flows which are a direct result of monetary policy and very high interest rates in New Zealand compared to other countries. Banks have used this ready supply of capital to lend to homeowners fuelling the housing bubble. This in turn has fueled consumption.

In other words much of the recent growth in New Zealand is due to increased borrowing from overseas to fund consumption.

The inflow of capital has also means a very high exchange rate which hurts the export and import substitution industries. Meanwhile with wages low and interest rates high businesses, until very recently, have woefully under invested in capital goods. The result is low wage and low productivity economy

In my view current monetary policy is complete madness and has cost and will cost the country dearly. New Zealand is now in an extremely vulnerable position to any change of sentiment amongst international lenders. As a well known economist famously put it: "If something can't go on forever, it won't." We cannot continue borrowing from overseas at this level as eventually the interest payments will outstrip the ability of the economy to pay. There is a real possibility that over the next few years there will come a time when speculators move en mass to ditch the Kiwi dollar resulting in a dramatic fall in the NZ dollar and a severe recession.

The vulnerability of the New Zealand economy is compounded by uncertainty in the international environment with world oil prices hitting $US134 a barrel, instability in the world's financial markets and weaker prospects for world growth.

But we hear very little about this in the budget. Nor do we hear anything of how to make sure the safety net is going to serve us in the tough times.   People are going to find when they lose their low paid jobs, instead of family support increasing as it used to, to provide a cushion—it will fall savagely by at least $60 a week with the loss of the in work payment…

The party line that New Zealand has a "Savings Problem" has also contributed to the misguided changes to the Kiwi Saver scheme announced in last years budget. Recent Research by John Gibson at the Waikato School of Management suggests that only a small fraction of every dollar (between 9 and 19 cents for each dollar) in the Kiwi Saver accounts represents new savings. "The rest is either reshuffling among existing saving and debt by KiwiSaver members, or else taxpayer and employer transfers which decrease national saving elsewhere," When the deadweight loss of tax incentives is taken into account, along with the administration, compliance and implementation costs, then KiwiSaver is likely to lower rather than lift national saving."

It is also clear that the KiwiSaver scheme (St John & Littlewood, 2006) will dramatically increase inequality. John Gibson, Chris Hector and Trinh Lee from the Waikato School of Management estimate that it will increase the Gini index of income inequality by 1.8%.

The KiwiSaver scheme will cost the taxpayer about $1.2 billion in 2011. A huge amount of money to redistribute mostly to the wealthy. Furthermore as noted it will have almost no impact on fixing the non problem of NZ Savings. What a waste. It makes me sad and angry to think what impact that kind of money could make on the lives of the poorest in our society. Not to the mention the difference it could have made to the health and education budgets.

Interestingly Cullen referred to the "extraordinary success of the KiwiSaver scheme" in his 2008 Budget speech. With the tax-funded incentives (free money) so extremely generous why would you be surprised and congratulate yourself if a large number of people sign up.

Let me also remind the audience of another backdrop to yesterday's budget. As highlighted by CPAG in our recent publication "Left Behind".

- New Zealand has one of the worst rates of child poverty in the developed world.
- New Zealand has one of the worst rates of preventable child illnesses and deaths from injuries of any country in the developed world.

- We had the fastest growing gap between the rich and poor in the OECD during the last decade of the 20th century.
- Furthermore children of the poorest New Zealanders suffer from substandard housing, lack of educational resources and are exposed to increased social hazards such as liquor outlets and gambling.

Given this one would have expected some acknowledgement in the budget the severe hardship suffered by the children of the poorest New Zealanders. Instead as expected the centre piece of the 2008 Budget was a package of personal tax cuts.

The government is introducing a $10.6 billion programme of tax cuts from 1 October 2008, with further changes scheduled to take effect from 1 April 2010 and 1 April 2011:

Table 1

	NEW RATES		
Current rates	**From 1 October 2008**	**From 1 April 2010**	**From 1 April 2011**
15% to $9,500	12.5% to $14,000	12.5% to $17,500	12.5% to $20,000
21% to $38,000	21% to $40,000	21% to $40,000	21% to $42,500
33% to $60,000	33% to $70,000	33% to $75,000	33% to $80,000
39% over $60,000	39% over $70,000	39% over $75,000	39% over $80,000

In addition, the Working for Families Family Tax Credit and the income threshold will increase from 1 October 2008 to take account of inflation, The after tax income of individuals due to the tax cuts increases as below.

Table 3

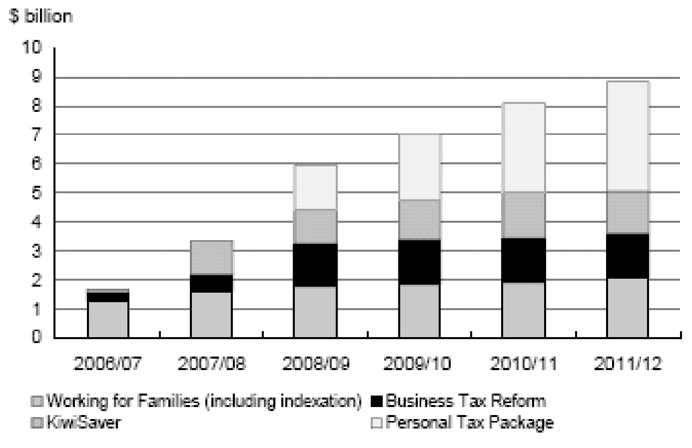
Current annual taxable income ($)	Weekly after-tax income increase above current ($) from 1 Oct 2008	from 1 April 2010	from 1 April 2011	Annual increase ($) 1 April 2011
20,000	12	18	22	1,130
30,000	12	18	22	1,130
40,000	16	22	26	1,370
50,000	16	22	32	1,670
60,000	16	22	32	1,670
70,000	28	34	44	2,270
80,000 and above	28	39	55	2,870

The after-tax incomes calculated in this table exclude the ACC levy.

Note that despite the government's claims, the rich benefit considerably more than low and middle income families. The overall impact is to increase the progressivity of the income tax scale by a small amount however the relative progressivity within the OECD remains the same. Turkey remains as the only OECD country with a more regressive personal tax regime then New Zealand.

Table 3 of the executive summary of the budget makes interesting reading

Figure 3 **–** The Government's recent tax initiatives



Source: The Treasury

The cumulative impact of taxation relief in this budget and previous budgets is projected to increase to almost $9 billion a year by 2011. This includes KiwiSaver subsidies at 1.1billion a year, business tax cuts of $1.5billion a year, Working for families at $2billion a year as well as personal tax cuts worth almost $4billion. This is a huge amount of money. And almost all of it increases the gap between those on benefits and those in work with an overall dangerous widening of the income and wealth distribution

The budget also includes increased spending on infrastructure including railways and broadband ($500m over 5 years) which is a significant and positive contribution to New Zealand economics growth (albeit long overdue). Sadly missing was any major new investment in public transport in Auckland.

There are other positive initiatives in the budget which CPAG welcomes including an extra $79million for child and oral health and an extra $24million to increase the money that family caregivers such as grandparents receive for looking after children so that it is the same as foster parents receive.

Health spending increased as well by a modest amount - an extra $750 million a year of which $500million covers increased costs due to inflation.

As discussed earlier on the economic environment is very uncertain with a marked slowdown in growth predicted and much downside risk. As Cullen notes in his speech “rising international oil and food prices are seeing all New Zealanders pay more at the pump and supermarket checkout” Over the last few days we have seen layoffs from a meat processing and manufacturing of over a 1000 in Dunedin.

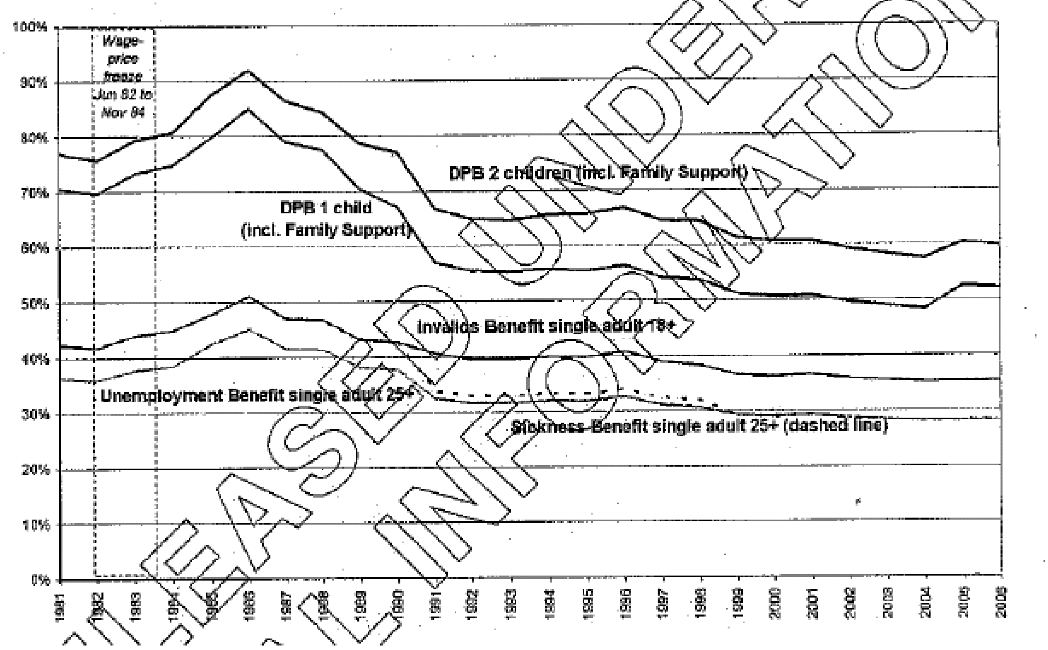
Times like this you would have thought that the government would be ensuring that there is decent safety net so that if people do lose work or are unable to work their living standards are protected. Instead workers in Dunedin are finding as well as losing their job and income they are punished further as they lose over a $60 a week reduction in their Working for Families entitlements.

There is no mention of child poverty in this budget. No goals to eliminate it. No proposals. No timetables. No increases in benefit levels. Those on benefits are offered only two small things. First, the inflation adjustment to their family tax is brought forward. This merely stops that payment being eroded further and is a gain of only a little over $2 a child per week for this financial year. It is hard to get excited about an inflation adjustment, but welcome that at last the government is going to index family assistance properly.
Second, if they earn up to $80 a week, they will pay less tax on that income which would be a gain of up to $6.80. But it is still not worth them earning above this because that $80 threshold has not been changed in this budget.

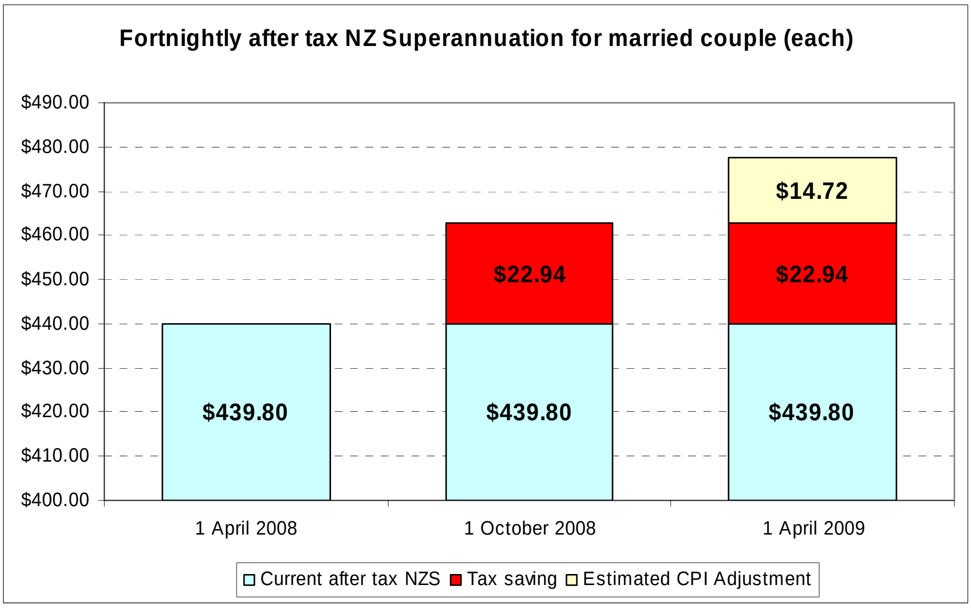
Using 2004 data the Ministry of Social Development identified 26 percent of NZ children were in severe or significant hardship. A 2007 report shows that the officials were very concerned that despite Working for Families there were ‘pockets of significant hardship’ and intense price pressures on the poorest families.

CPAG received a copy of the Ministry of Social Developments “Pockets of Significant Hardship” report. One of the graphs reproduced in the handout looks at the after tax income of people on a benefit compared to the after tax average wage. It finds that their relative income has fallen further and further behind. For example the standard DPB plus family tax credit for a parent and child has fallen from 85% of the average wage to only 52% in 2006.

Figure 2: Real net benefit rates as a percentage of real net average earnings, 1981 to 2006



Contrast this to the treatment of pensioners who will also be helped significantly in this budget because their benefit is tied to net average wages. A couple over 65 with limited extra income will get an extra $23 a week. Always ahead of welfare benefits they will now get $155 more a week in total than the couple on a sickness or unemployment benefit. They also gain extra discounts through the super gold card, (regardless of wealth or income) including free-off peak travel and a future rebate for electricity is promised.



Budget 2008

Cullen states in his speech "this budget is about continuing to build a FAIR society and strong economy". There is nothing fair in this budget for the 200,000 of the poorest children in our society who live in families which miss out on much of working for families because their caregivers are dependant on a benefit.

In fact this budget means that those children and families slip behind even further. After tax income on the average wage will increase. This means that relative poverty and measured poverty will INCREASE. That doesn't seem very fair to me. It is to the shame of this government that they refuse to acknowledge let alone try and eliminate child poverty resulting from benefits levels that are ridiculously low.