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Budget 2018 Commentary

"The Responsible Budget"

Haratua 2018

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Highlights

Responsibility – Budget 2018 oozed fiscal responsibility. Budget 2018 oozed budget responsibility. In a nutshell, *responsibility rules*. *Responsibility* won the day. But, for many, a shift to a truly Wellbeing Budget probably cannot come quick enough.

Budget Speech

Foundations for the Future

Mr Speaker, I move that the Appropriation (2018/19 Estimates) Bill be now read a second time.

The tagline for the Budget documents was "Foundations for the Future", but the need to register short-term surpluses and meet debt-repayment targets remained paramount.

The Budget announcements loosened the purse strings in numerous areas. However, this Coalition Government will find their ambitions for transformation and a 'productive, sustainable, inclusive economy' being well and truly pincered unless they modify their self-imposed Budget Responsibility Rules (BRR).

Amongst the detail, the clear and well-signalled focus were boosts for health and education. And these boosts were considerable. In both operating and capital spending areas, the government is clearly aiming to see noticeable improvements in services. With an extra $3.2bn in the health operating spend and an extra $1.6bn in the education operating spend, these boosts are indeed significant. However, it is unclear just how much of these increases will be required for pay increases not to mention population pressures. Thus, the amount left over for actual service improvements may not be as great as the numbers imply.

Similarly, the capital spending allocations are a significant boost from previous years. But this spending will likely be not much more than a catch up on previous years of under-investment.

And there was also a boost for housing – with an additional 6,000 homes over the next 4 years in public housing to go alongside previously announced KiwiBuild programme.

Of course, much of the thunder for this year's Budget was stolen by last year's December mini-Budget (the Half-Year Economic and Fiscal Update). In addition to KiwiBuild, that announcement also included the $5.5bn Families Package, first-year tertiary education fees-free programme, and the restoration of contributions to the New Zealand Superannuation Fund.

Of particular interest to BERL and its immediate interests were

- direction to the Productivity Commission to study the funding model for Local Government to "… examine the adequacy and efficiency of the existing local government funding and financing frameworks."

  We note there have been numerous studies into the rating system and the funding of Local Government. The funding base in provincial New Zealand that is reliant on a static, if not declining, population that is ageing and increasingly asset-rich but cash-poor is a clear and undeniable indicator that the current model is unsustainable. Links to the Tax Working Group findings and recommendations may also be relevant here. Without doubt, a more positive partnership and relationship between central and local government is required if the wellbeing of New Zealand's local communities are to improve.

  The inquiry will make recommendations on whether additional revenue-raising tools are needed for local authorities and what changes, if any, are needed in Central Government's approach to funding and financing Local Government.

  The scope of this inquiry could cover a number of potential areas, including tourism costs, transport funding for roads, infrastructure support for new growth, and examining rates affordability for households.

These are all areas of interest to the communities we live in, and are big ticket items that impact on the debt ceilings of local government and their ability to provide infrastructure to create liveable communities; these areas impact on ratepayers and rates affordability; and these areas impact on the outcomes of local government elections, where councils can be voted in or out based on rate rises.

- additional funding to Statistics New Zealand to broaden the scale and purpose of the Household Expenditure Survey (HES) "… to provide a more accurate picture of child wellbeing and low income, so we can make sure our policies are making a difference".

  It has been stated that this additional funding will increase the sample size of the HES from 3,500 to 20,000. This expansion is to be welcomed, and indeed necessary if it is to meet its new purpose. We note that the HES was never designed to measure child wellbeing; its original and primary role was to sample household's spending in order to define the average 'basket of goods and services', which is used in the measurement of the Consumer Price Index (CPI).

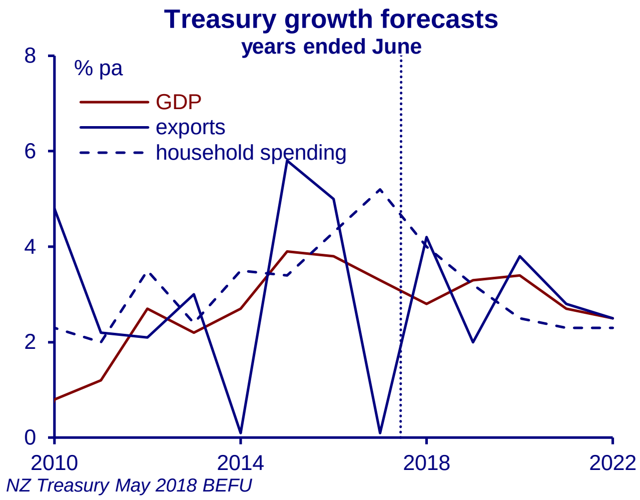
  Given the broader purpose of the new HES, we will be interested to see whether the funding also extends to increasing the regularity of the survey from its current 3-year cycle, to 2-yearly (or even annually).

- look into setting up an Independent Fiscal Institution (IFI) "… a body independent of Ministers of the Crown which will be responsible for determining if these rules are being met. The body will also have oversight of government economic and fiscal forecasts, shall provide an independent assessment of government forecasts to the public, and will cost policies of opposition parties".

  Similar to institutions overseas – e.g. the US Congressional Budget Office, the UK Office for Budget Responsibility, and the Australian Parliamentary Budget Office – the significance of an IFI is in its proposed political independence and neutrality. The importance here is the range and relevance of the terms of reference that it would operate under. Assessment and commentary on the relative fiscal costs of competing policy options would be standard for such an organisation. But, the more important (and more challenging) assessment of relative benefits (fiscal and other) may well be seen as a step too far.

  We understand there is still to be significant discussions and consultations before the precise scope of such an IFI is settled.

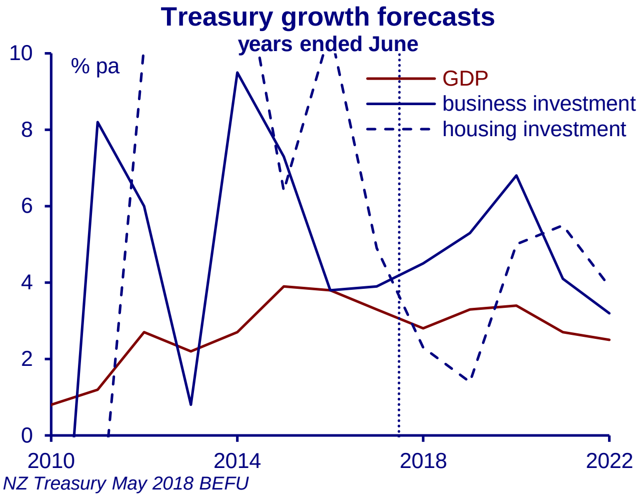
The economic and fiscal foundation



The economy is expected by Treasury to continue to grow over the forecast horizon. Further, the nature of this growth continues to be skewed towards business investment (which includes government) as the primary driver. GDP is expected to grow in the 2.5% to 3.4% per annum range over the yeast to 2022. In comparison, Treasury forecasts growth in business investment to peak at 6.8% in the June 2020 year, and well over 3.5% per annum in other years.

Household spending is also expected to assist in this growth scenario, albeit at a slowing rate. Additionally, the export sector is forecast to register positive expansion over this period. However, both of these components are essentially holding their own in that they are growing at rates similar to that of the overall economy.

In contrast, business investment is clearly set to grow faster than overall GDP. This is driven by large (and some would say ambitious) government capital spending plans. Also supporting the growth scenario is housing investment as both public and private sector residential construction growth continues apace.



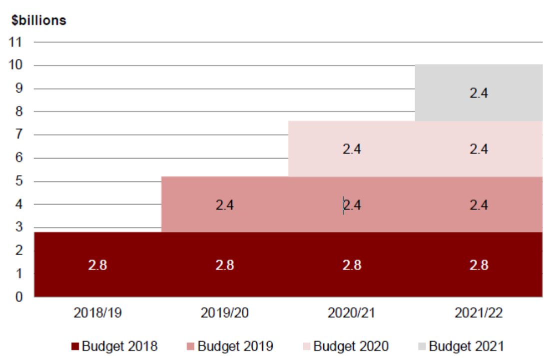
As always the growth scenario hinges on some critical assumptions. Arguably, the most important being around the global geo-political situation. The impact of renewed protectionism would not be welcome, nor would renewed volatility in oil prices. Domestically, the impact of the mycoplasma bovis has the potential to dent primary production as well as general business confidence. Of course, the ongoing migration inflow (in assisting both the supply and demand sides of the short-term growth scenario) remains another much-debated unknown. Additionally, the capacity (in both business and labour) of the construction sector to cope with an infrastructure investment upswing could well act as a critical constraint on the growth scenario.

Despite these (and other) unknowns the Treasury sees unemployment decline towards 4% over the forecast horizon, while the external current account deficit remains seemingly stable near the 3% of annual GDP mark. Of course accumulated external debt remains high by international standards, with the Treasury forecasting it to peak at 57% of annual GDP.

Within the above economic scenario, the government's books remain solid. Comfortable surpluses are expected to be booked, with Crown debt at negligible levels. An expected surplus of $3.1bn for the 2017/18 June fiscal year is forecast to grow to $3.7bn in the coming 2018/19 year, and accelerating to a forecast $7.3bn in the 2021/22 year. Net Crown debt is currently at $60.9bn if you exclude the assets of the NZ Superannuation Fund (NZSF). Including the more than $39bn of assets here, which would provide a more correct measure, puts net Crown debt at $21.4bn, or 7.3% of annual GDP. It is important to note that such a figure is low by historical New Zealand standards and low by OECD standards. Moreover, net Crown debt (including the NZSF) is forecast to fall to $8bn in 2022 – or a mere 2.3% of GDP.

Some detail

Figure 1 – Budget 2018 (average per year) and future Budget operating allowances



The strength of the government's books is reinforced by the operating allowance allocations. This represents the pool of funds available for new policy spending in future years. Note, though, historically this pūtea tends to be gobbled up by health spending requirements as an ageing population increases demand for health services.

The December 2017 Half-year Economic and Fiscal Update (HYEFU) confirmed an operating allowance of $2.6bn for 2018/19; and then a further $1.875bn per year for the following three years. As illustrated though, Budget 2018 has increased these allowances to $2.8bn for the 2018/19 year, and to $2.4bn per year for each of the following 3 years. On the capital side, the December HYEFU set allowances at $3.4bn for 2018/19 and 2019/20; followed by $3.1bn and $2.7bn for the next two years. Budget 2018 has also pushed these allowances up to be $3.8bn, $3.7bn, $3.4bn, and $3.0bn, respectively. The increases in these allowances add further to the 'headroom' available to the Government to tackle its priorities.

Further, the December's statement indicated major investments were to be made in housing, health, education, the Police and infrastructure. Between this and the Families Package, the HYEFU was therefore labelled by the media and various commentators as the "mini Budget".

The mini Budget

Just to recap, the Families Package involves delivering "more money" to families with children, and initiatives to help reduce child poverty. The ability to deliver "more money" is due to the reversal of the previous Government's package of tax cuts, and in official speak with numbers the quote is: "… around 384,000 families with children will be better off by an average of $66 more per week in the tax year ending 31 March 2019, rising to $75 per week in 2021 when Best Start is fully in place. The impact of the Families Package is expected to reduce the number of children in poverty by approximately 44% in 2019 rising to 48% in 2021. This equates to around 71,000 children in 2019 rising to 88,000 by 2021 – 39,000 more than under the previous Government's package."

In early May, a pre-budget announcement was made of spending $63.4m over four years on the Housing First programme. Napier, Hastings, Whangarei, Northland, Rotorua, Nelson and Blenheim will receive funding because they are considered high need areas, with large numbers of people in insecure housing and receiving Emergency Housing Special Needs Grants.

Housing First currently operates in Auckland; with the aim of the programme to help end homelessness. According to the Minister, "Housing First is a proven way to house and support people who have been homeless a long time, or are homeless and face multiple and complex needs. The approach is simple: provide housing quickly then offer tailored support for as long as it's needed to help people stay housed and lead better lives."

This was followed by the Prime Minister's pre-budget announcement of an extra $21.5m over four years for early intervention in behaviour, learning, and speech and language support (focused on under 5 year olds). Education Support Workers are employed directly by the Ministry and work with individual children in early childhood services, giving support around medical, health and toileting needs, and using teaching strategies to support the child's learning.

This announcement was for extra operating funding, with an extra $272,000 capital to support the IT costs of additional staff. This funding is for children to access and gain extra learning support before they start school. In theory, nearly 8,000 more children will receive extra support over the next four years.

This budget

In total, the Budget allocated $13.1bn in extra spending over 5 years. However, between December's HYEFU mini Budget and the various pre-Budget announcements, many of the big ticket items were already ticked off by Budget Day. It was just a matter of further nuances being made.

Table 2.5 **–** Composition of the increase in gross spending[10]

Year ending 30 June $millions	2018 Forecast	2019 Forecast	2020 Forecast	2021 Forecast	2022 Forecast	5-year Total
Health	20	784	825	817	811	**3,257**
Economic and industrial services	135	558	356	418	475	**1,942**
Education (including tertiary)	6	238	340	437	577	**1,598**
Law and order	31	236	238	276	317	**1,098**
Core government services	5	201	235	290	361	**1,092**
Social security and welfare	-	127	155	156	158	**596**
Housing and community development	-	95	108	122	182	**507**
Defence	-	28	106	106	106	**346**
Environmental protection	1	37	65	61	69	**233**
Primary services	51	61	51	21	23	**207**
Heritage, culture and recreation	-	12	8	10	11	**41**
Transport and communications	-	18	4	3	3	**28**
Other	-	83	48	39	39	**209**
Contingencies	46	284	418	584	614	**1,946**
	295	**2,762**	**2,957**	**3,340**	**3,746**	**13,100**

Source: The Treasury

Education and health

These nuances included an additional 1,500 new teachers by 2021; and over 200 new classrooms through the School Growth Package, which will pay for new infrastructure for 7,400 students. A sizable proportion of the new spending focussed on early childhood education. This sector received $105m extra in operating spending and a whopping $984m over the next five years "to meet increasing demand". Also included in the budget is a focus on learning support services. All up this new spend amounted to around $281m over five years; $133m of this being for the Ongoing Resourcing Scheme (ORS) for learning support.

The largest nuance was a $3.2bn boost to health sector spending over the next five years. This included $210m for disability support services, $2.196b additional DHB support for wages, inflation and meeting extra demand; $126m for elective surgery; $112m for support or maternity workers. The new government also elected to increase spending on subsidising GP visits. This programme has been extended to all children under 14, and all community service card holders. The cost of this is an extra $365m over the next five years. On the capital side, an additional $750m set aside in the Budget DHB capital investment could well be just the first down-payment on bringing health sector infrastructure into the 21st century.

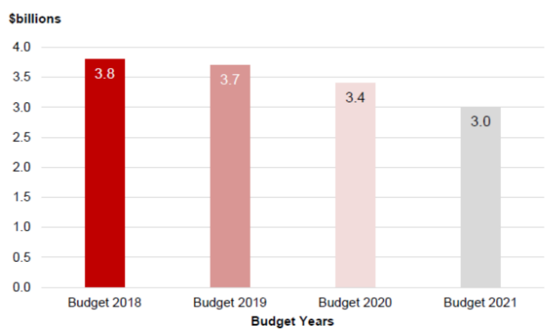
Other

Māori development had $21m reprioritized into enhancing education and employment for rangatahi as well as some $15m on the Papakāinga Housing Development. All in all Māori Development received around $15m new spend over the next five years.

Family violence prevention and programmes got an increased spend over five years of $76m. Child poverty efforts including those by Oranga Tamariki received and additional $117m. $105m is going to help clothe those children being cared for via an Orphan's Benefit or an Unsupported Child's Benefit.

Climate change is happening and the 2018 budget includes a one-off $100m injection to set up the Green Investment Fund and $25m over the next five years in operating expenditure. There is an $81m boost to funding to control and eradicate predators.

Figure 2 – Budget 2018 and future capital allowances



A strong focus on community policing and "combating" organised crime resulted in funding to train an additional 1,800 more Police officers. And $139m is being spent on youth justice to include 17 year olds in the youth justice system and manage remand pressures. There were "discussions" regarding mega prisons in question time with the Minister, but no confirmation that this government will undertake this build.

The Minister of Finance noted that Cabinet is still working on decisions regarding building another prison. Contingency is still in the Budget for such a build, but the target is to reduce the prison population by 30% over 15 years. This means a different approach is required in the justice sector to reduce the number of people going to prison, and Cabinet needs to weigh up options.

Budget 2018 therefore reflects a Cabinet and coalition government that is still working through policy decisions. A large amount of the additional spending is still noted as a contingency in this Budget ($1.95bn), including public sector pay rises. To assist with this decision-making, and the weighing up of options, three advisory groups have been established. These include the already announced Tax Working Group, and the previously signalled Welfare

Expert Advisory Group; and a new Future of Work Forum, which was announced as part of the Budget 2018 papers.

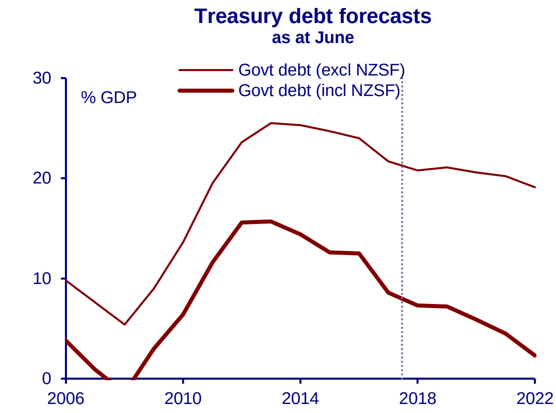
The Future of Work Forum is to include representatives from the Government, the New Zealand Council of Trade Unions and Business New Zealand. It is to be a collaboration set up "to address the challenges facing workers and businesses." This Forum will complement work the Productivity Commission has and is undertaking, and provide "insights into some of the key productivity challenges facing the New Zealand economy."

Last words

But, there remains a pall over these headline programmes – cast by the shadow from the BRR.

While the Budget 2018 documents were headlined as 'Foundations for the Future', binding constraints are imposed by the BRR short-term obligation to bring net core Crown debt down to 20% of GDP by 2022. And it is even more short-sighted in that the measure ignores the $39bn in assets already accumulated in the NZSF and the forecast true net Crown debt position in 2022 of a mere 2.3% of GDP.

More malign is the passive acceptance that a budget surplus is a metaphor for responsibility.



HYEFU 2016

In the 1990s, the nation swapped a fiscal deficit for an infrastructure deficit. And many would argue we continue to pay the price in low productivity numbers that now see a low-wage business model at the heart of our economic mechanism.

Since the 1990s, the nation has embedded the virtue of budget surpluses, achieved at the expense of numerous deficits across whānau, communities, and social networks and services.

Next year's promised Wellbeing Budget cannot come quick enough. And, with it, a re-write of the BRR to be consistent with a responsible definition of 'fiscal responsibility'. A definition that encompasses wellbeing, including intergenerational wellbeing, and allows the Government to responsibly take on debt to build a true legacy of top-class social, community and national infrastructure for future generations.

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