Fiscal policy

The context for fiscal policy

After nine years of Michael Cullen's stewardship of the economy, the Treasury is forecasting operating deficits in each of the next 10 years and a marked increase in the government's debt-to-GDP ratio. The New Zealand economy is in recession and there is considerable uncertainty in global financial markets.

National will improve the Crown's financial position, and the longer-term productivity of the economy, through careful revenue and spending initiatives.

National will not slash spending at a time when people are looking to the government for a sense of security.

National's economic management package will deliver stimulus to the economy, especially in 2009/10 when it is most needed. For the New Zealand economy to pick itself up and grow out of this recession, people will need cash in their hands to do things like hire tradesmen, buy farm equipment, and shop at local stores. Our tax cuts will enable this to happen.

Ultimately, however, fiscal policy takes a medium-term view. In developing our economic management package we have concentrated on the fundamentals of the economy and particularly on laying the foundations for a future increase in productivity.

This year's rapid downturn has highlighted how quickly the economy came up against capacity constraints. Unless we address those constraints they will simply re-emerge as the economy gathers speed again.

New operating spending

New operating allowances will be the same for National over the next three years as they would be under Labour.

National will maintain the $1.75 billion operating allowances for spending and revenue initiatives in future Budgets, as signalled in the PREFU.

Budgets in the next three years will be tight, but manageable.

National's priorities are:

- Health – to meet indicative funding allocations for the next three years.
- Law and order – to meet the costs of National's policy commitments.
- Education – to meet the costs of National's policy commitments, annual cost adjustments, and the pre-commitment of funding against Budget 2009 for the Teachers' and Principals' Collective Agreements.

- Meeting the costs of our other policy commitments.
- Meeting the costs of the previous government's defence pre-commitments.
- Allowing enough funding for what the Treasury has identified as upcoming "significant pressures" that cannot be deferred or absorbed.

Tax cuts

National's rebalancing of the tax system is self-funding and requires no cuts to public services or additional borrowing.

This is shown in Table 1. Totalled over the next term of government, the cost of National's personal tax cuts is balanced by the revenue savings from:

- Changes to KiwiSaver.
- Discontinuing the R&D tax credit.
- Replacing Labour's proposed tax cuts.

Table 1 – Costs and savings in National's rebalancing of the tax system

	2008/09 ($m)	**2009/10 ($m)**	**2010/11 ($m)**	**2011/12 ($m)**	**Total ($m)**
Cost of National's tax cuts	290	1,290	1,834	2,300	**5,714**
Savings from tax changes	-217	-1,101	-1,969	-2,710	**-5,997**
Net cost of tax cuts	73	188	-134	-410	**-283**

Table 1 makes it absolutely clear that to fund the tax package National announced today there is no requirement for additional borrowing and there is no requirement to cut public services.

There is, in fact, a small saving to be made, of $283 million, which will be used to reduce the operating deficit.

Changes to KiwiSaver

National is committed to keeping KiwiSaver but will make three changes to the scheme. These are described in the accompanying policy paper.

The changes we are making to KiwiSaver will save around $3 billion over the years 2008/09 to 2011/12.

R&D tax credit

As part of National's Research, Science & Technology policy, we announced that the R&D tax credit would be reduced from a 15% credit to a 10% credit. This was because much of the money that will be paid out will effect no change in the level of R&D whatsoever.

The reason for not abolishing the R&D tax credit altogether was that most OECD countries have such tax credits, and they are accepted as part of the international business landscape.

However, given the persistent operating deficits revealed in the PREFU, these tax credits have become a "nice-to-have" item that is simply not affordable any more.

National will, therefore, discontinue the R&D tax credits altogether. The additional saving from discontinuing the tax credits, rather than just reducing them to 10%, totals $619 million over the years 2008/09 to 2011/12.

Expenditure control

In office, National will rigorously review government spending. Our focus will be on improving frontline services, making government agencies more efficient, and eliminating low-priority spending.

To start with, we will cancel proposed new spending on the Ministry of Foreign Affairs & Trade.

The Government announced earlier this year that it would significantly increase its spending on the Ministry, creating hundreds of new jobs both in New Zealand and overseas, and opening a number of new embassies and foreign posts. Around $350 million of operating funding has so far been appropriated for these purposes over the next four years.

When this spending was first proposed, the Treasury pointed out that there was no good case for it, and that the Ministry did not have any capability issues sufficient to warrant such an increase in funding. The Government's subsequent confirmation of this spending was clearly in the nature of a political trophy for the former Minister.

National will not commit to this increased funding, apart from expenditure which has already been incurred. This will save around $265 million over the years 2009/10 to 2012/13, which will be used to reduce the operating deficit. These savings will not be used to fund our programme of tax cuts.

Stimulus in the package

The composition of National's economic management package will provide some much-needed stimulus to New Zealand's flagging economy. It will increase the forecast fiscal impulse, particularly in 2009/10 where Labour has not proposed any tax cuts.

Fiscal stimulus comes because:

- Much of the KiwiSaver tax credits that were going into long-term savings accounts will now be redistributed as tax cuts. These tax cuts put money into people's pockets which can then be spent in the economy.
- Similarly, KiwiSaver members will have the opportunity to put a smaller proportion of their salary into their KiwiSaver accounts, and therefore have more in their pockets to spend.
- National plans increased infrastructure spending, over and above what is allowed for in current forecasts.

New capital spending

National has previously announced its commitment to increasing infrastructure spending over the next six years, including an increased investment in roads and on broadband. This is on top of the $900 million allowance for new capital spending that is currently allowed for in the Crown's accounts.

Our previous commitment entailed a debt-to-GDP ratio two percentage points higher than Labour on average over the next 10 years.

Increased infrastructure spending will be an important part of sparking growth in the economy over the next few years. It will also be a key factor in improving the productivity of the New Zealand economy as we begin to move out of this recession and into a period of growth.

However, in light of the recent sharp decline in the New Zealand economy and the marked increased in debt signalled in the PREFU, we are phasing in our increased infrastructure spending to avoid putting additional strain on the Crown's fiscal position.

Table 2 shows the indicative pattern of National's increased infrastructure investment over the next six years.

Table 2 – National's programme of infrastructure investment

	Increased infrastructure investment ($m)
2009/10	300
2010/11	500
2011/12	650
2012/13	750
2013/14	750
2014/15	750

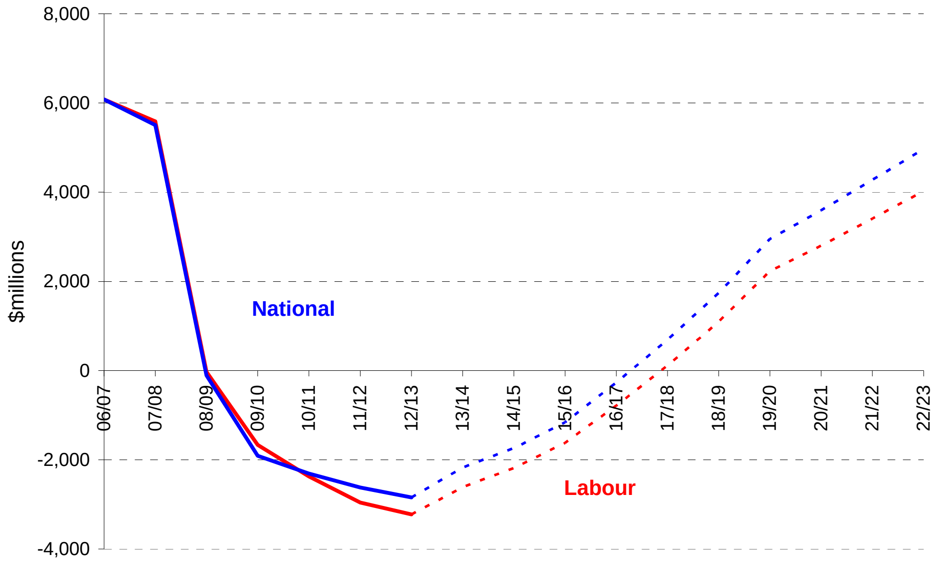
Effect on the fiscal aggregates

Figure 1 shows the effect of National's fiscal policies on the Crown's operating balance. It demonstrates National's commitment to peg back the persistent operating deficits that Labour has generated.

Figure 1 shows that the operating balance would be healthier under National than under Labour in every year apart from 2009/10.

In 2009/10, the operating balance under National is very slightly lower as result of the timing of the costs and savings of tax package (as shown in Table 1).

Figure 1 – Operating balance



Note: The measure shown here is the Operating Balance Excluding Gains and Losses (OBEGAL) excluding NZS Fund retained revenue.

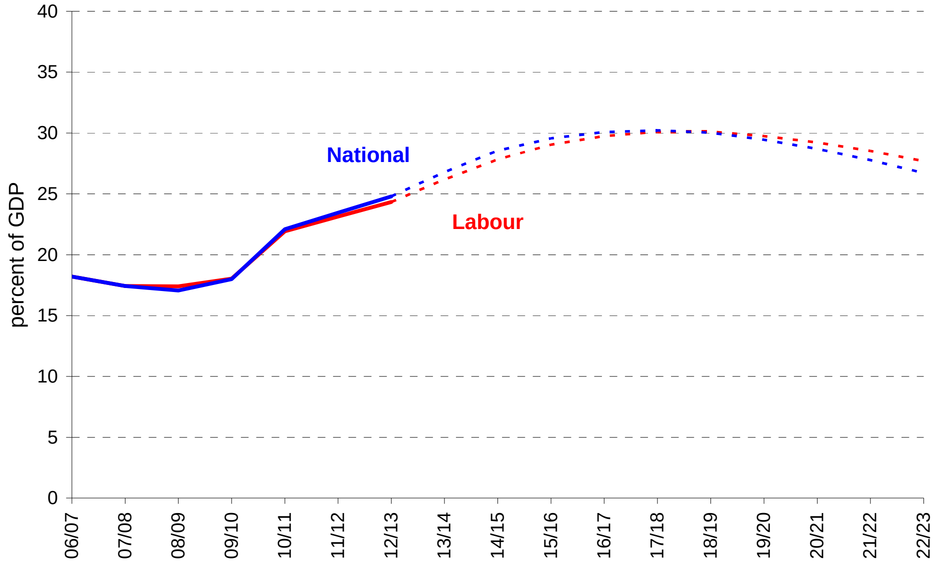
Source: Treasury's Fiscal Strategy Model.

Figure 2 shows the effect of National's fiscal policy on core Crown gross debt.

There is very little difference in gross-debt-to-GDP between National and Labour, both in the short term and in the longer term.

On average over the next fifteen years, gross-debt-to-GDP averages 26.9% under National compared to 26.8% under Labour.

Figure 2 – Gross debt to GDP

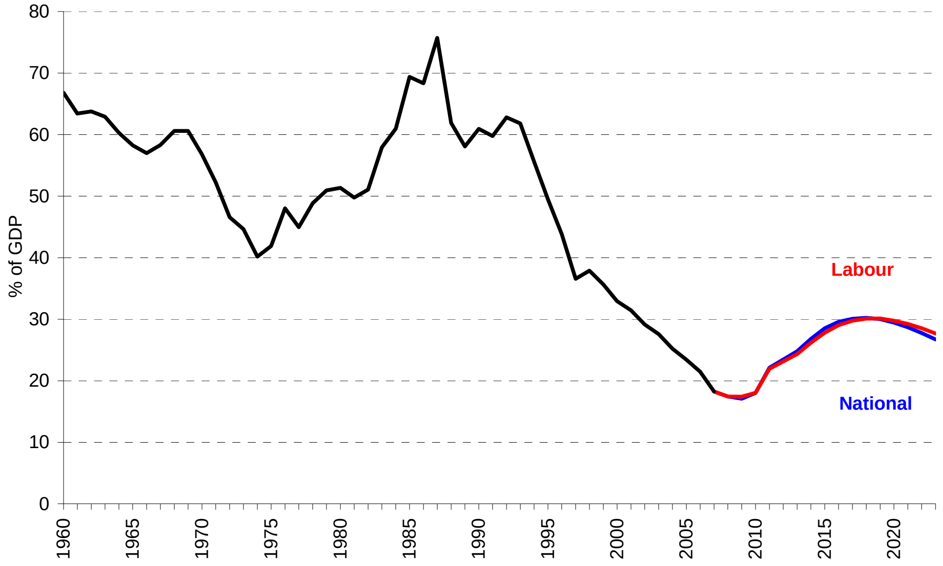


Note: the measure shown here is Gross Sovereign-Issued Debt (GSID), excluding settlement cash, as a percentage of GDP.

Source: Treasury's Fiscal Strategy Model.

Though National does not intend to increase the gross debt track contained in the PREFU, it should be borne in mind that the current level of government debt in New Zealand is low from a historical perspective (Figure 3).

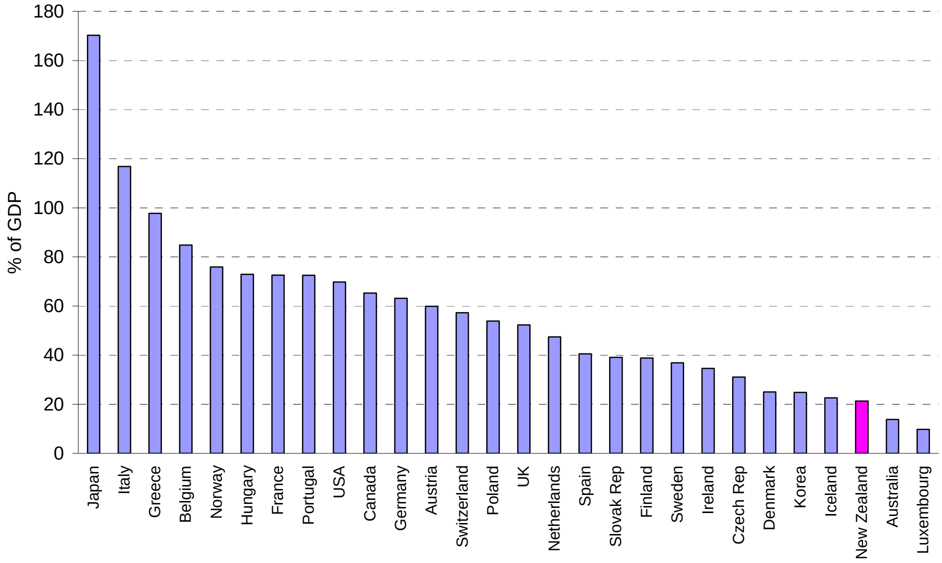
Figure 3 – New Zealand's gross debt since 1960



Source: Historical information from the Parliamentary Library.

Government debt in New Zealand is also very low from an international perspective. (Figure 4).

Figure 4 – Gross debt to GDP in the OECD



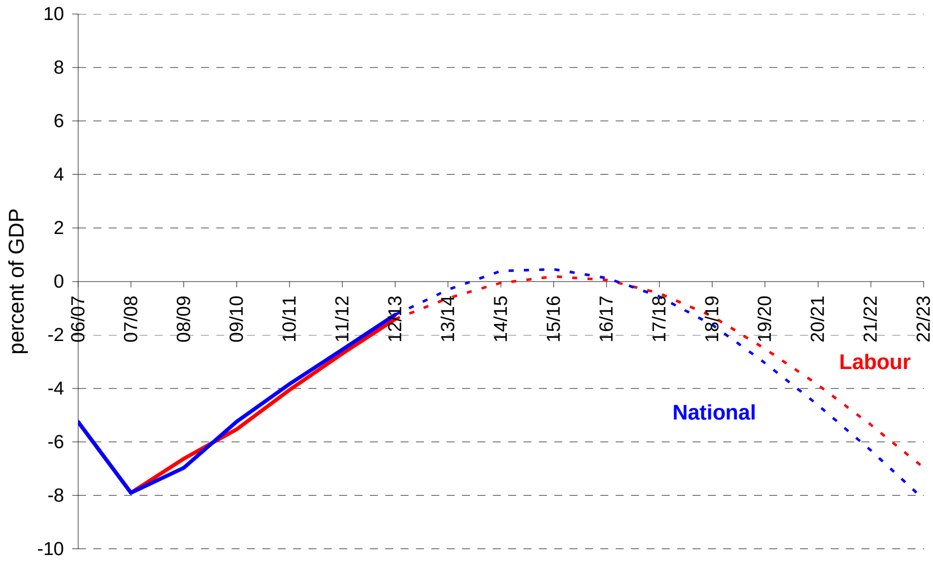
Note: the measure shown here is general government gross financial liabilities, estimated for 2009.
Source: OECD Economic Outlook 2008.

Figure 5 shows the effect of National's fiscal policy on core Crown net debt.

Core Crown net debt is core Crown gross debt minus core Crown financial assets. In New Zealand, net debt is negative, meaning the Crown has more financial assets than it has debt.

There is almost no difference at all between net debt under National and Labour over the next three years, and on average over the projected period.

Figure 5 – Net debt



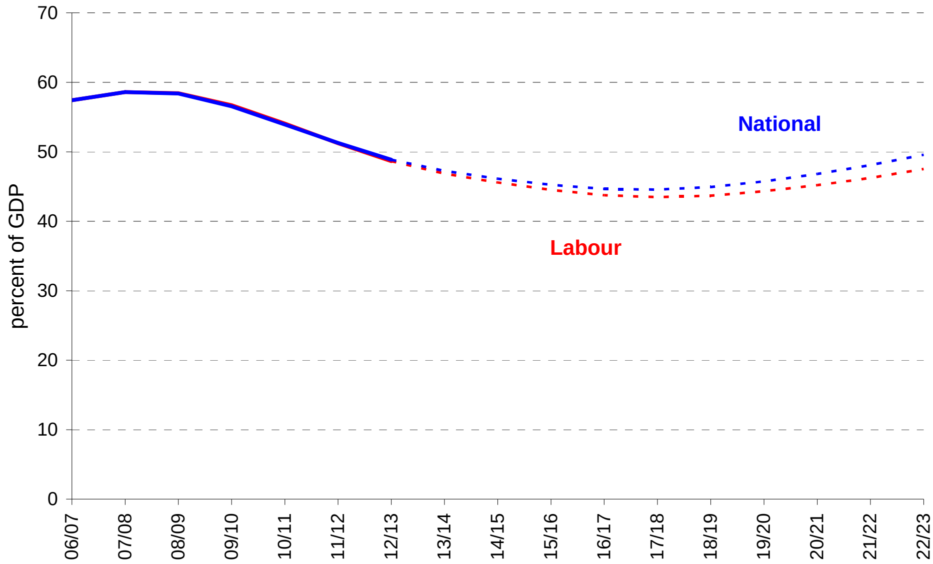
Note: the measure shown here is net Core Crown debt, including NZS Fund assets, as a percentage of GDP.
Source: Treasury's Fiscal Strategy Model.

Finally, Figure 6 shows the effect of National's fiscal policy on the Crown's net worth.

The Crown's net worth is its total assets minus its total liabilities.

Net worth is slightly higher under National in the longer term. This is because National's increased infrastructure programme, outlined in Table 2, increases the Crown's stock of assets at the same time as it increases debt. Other fiscal policies have the overall effect of paying off debt, and therefore increase the Crown's net worth.

Figure 6 – Total Crown net worth



Note: The measure shown here is Total Crown Net Worth, as a percentage of GDP.

Source: Treasury's Fiscal Strategy Model.