OWN OUR FUTURE

Labour

SUPPLEMENT TO LABOUR'S FISCAL STRATEGY

REVENUE AND EXPENDITURE PLANS IN MORE DETAIL

Managing Crown expenditure is important. Prioritising expenditure to assist New Zealand to make structural changes to our economy is essential for New Zealand's long-term future. In order to set out an effective and credible fiscal course in this situation, this needs to be planned across multiple Budgets as the tax mix changes and private savings increase. Labour is setting out a programme of public investments that strategically commits some funds from the operating allowance for future expenditure, while leaving enough uncommitted to address 'business-as-usual' pressures and deal with urgent issues. Alongside this, our revenue strategy secures the sustainability of the New Zealand tax base, in particular through the introduction of the Capital Gains Tax.

This section outlines first the fairer tax package outlined in July, and then discusses the use of operating allowance to finance a programme of tax credits to support national savings as well as our programme of public investment.

The Fairer Tax Package

The Fairer Tax Package has a number of components. Revenue increases are used to put money back into the pockets of New Zealand families. This 'tax switch' is strongly revenue positive over the medium and long term. It is projected to generate annual net revenues of $776 million by 2019/20 and $1.8 billion by 2024/25. This enables us to reduce debt. The elements of the package are shown in **Table 1**, and are described below

Table 1 Elements of Fairer Tax Package

	2012/ 13	2013/ 14	2014/ 15	2015/ 16	2016/ 17	2017/ 18	2018/ 19	2019/ 20	2020/ 21	2021/ 22	2022/ 23	2023/ 24	2024/ 25	2025/ 26
Capital Gains Tax	0.018	0.078	0.249	0.464	0.639	0.837	1.152	1.419	1.699	1.986	2.275	2.560	2.839	3.111
New Progressive Top Tax Rate	0.225	0.321	0.334	0.356	0.369	0.392	0.414	0.420	0.443	0.455	0.480	0.493	0.519	0.546
Loss Ring-Fencing	0.055	0.260	0.265	0.265	0.265	0.265	0.265	0.265	0.265	0.265	0.265	0.265	0.265	0.265
Other Anti-Avoidance Measures	0.020	0.150	0.200	0.250	0.300	0.300	0.300	0.300	0.300	0.300	0.300	0.300	0.300	0.300
Emissions Trading Scheme Revenue	0.109	0.218	0.190	0.184	0.213	0.224	0.230	0.230	0.230	0.230	0.230	0.230	0.230	0.230
Tax-Free Zone	(0.210)	(0.970)	(1.387)	(1.400)	(1.412)	(1.424)	(1.436)	(1.449)	(1.461)	(1.475)	(1.489)	(1.502)	(1.515)	(1.528)
GST Off Fresh Fruit & Veges	(0.075)	(0.317)	(0.333)	(0.347)	(0.365)	(0.382)	(0.399)	(0.416)	(0.433)	(0.450)	(0.468)	(0.487)	(0.507)	(0.527)
R & D Tax Credit	(0.030)	(0.160)	(0.170)	(0.170)	(0.200)	(0.240)	(0.247)	(0.254)	(0.261)	(0.269)	(0.277)	(0.285)	(0.294)	(0.303)
Net revenue impact	**0.111**	**(0.419)**	**(0.651)**	**(0.397)**	**(0.191)**	**(0.029)**	**0.279**	**0.517**	**0.782**	**1.044**	**1.316**	**1.573**	**1.838**	**2.095**

Capital Gains Tax

The Capital Gains Tax will come into effect from April 2013, and will begin to have an impact from 2013/14.

Independent forecasting from BERL, based on conservative assumptions, indicates that CGT revenues will reach $464 million by 2015/16, and by 2018/19 they will exceed $1 billion per annum. The CGT will be starting to reach maturity around the end of the projection period, and revenues will be beginning to plateau in 2025/26 at $3.1 billion.

New Progressive Top Tax Rate

The second most significant revenue-raising measure is the re-establishment of a progressive top tax rate. It will affect the top 2% of earners, being those on an income over $150,000.

This measure raises less income than a CGT over time but is an important source of revenue particularly in the early years when CGT income is building. It raises $881 million over our first term.

Loss Ring-Fencing

As announced in January, Labour will remove the ability of landlords to avoid paying tax by offsetting rental property losses against their personal income. This measure targets negatively geared rental properties and means that losses may only be offset against future rental profits. Revenue forecasts are based on calculations used by Treasury when the option was under consideration for inclusion in Budget 2010

Other Anti-Avoidance Measures

Labour will establish a taskforce in its first year to find, and advise on, any administrative or legislative changes needed to close loopholes that are being used to allow some people to avoid paying their fair share.

We will set a target for that to increase tax revenues by $300 million per annum within five years. This is equivalent to one-third of a percent of overall tax revenue, and slightly more than National's expectations from its own more modest initiative to reduce avoidance through increased audit and compliance activity.

Additional Emissions Trading Scheme Revenue

The current government has recently begun banking the net revenue from the Emissions Trading Scheme (ETS) in the government accounts over the forecast period. We will continue this practice and also extend it into the projection period, in reflection of our commitment to the ETS.

The figures in table 1 are net of the figures in PREFU. More revenue is forecast than under the current government due to our commitment to restore the situation where agriculture comes into the ETS from 2013, rather than 2015, and return to an historical basis for calculating agriculture's fee allocation. Revenue is also calculated on the assumption of a carbon price of $25 per tonne for the whole period.

Tax-Free Zone

The main revenue reduction element of the Fairer Tax Package is the introduction of a Tax-Free Zone, initially on the first $3,000 of income from April 2013 and then rising to the first $5,000 of income from April 2014.

The cost of this begins to impact in 2012/13, rising to $970 million in 2013/14 and $1.387 billion in 2014/15. It continues to rise gradually from there, but not at the same rate as other person income tax measures, since, because people receive the same tax cut regardless of income, there is no income effect as people's earnings rise over time.

GST Off Fresh Fruit and Vegetables

Labour will take the whole GST off fresh fruit and vegetables from 1 April 2013. This has a partial impact in 2012/13, rising to $317 million in 2013/14 and increasing gradually from there.

R & D Tax Credit

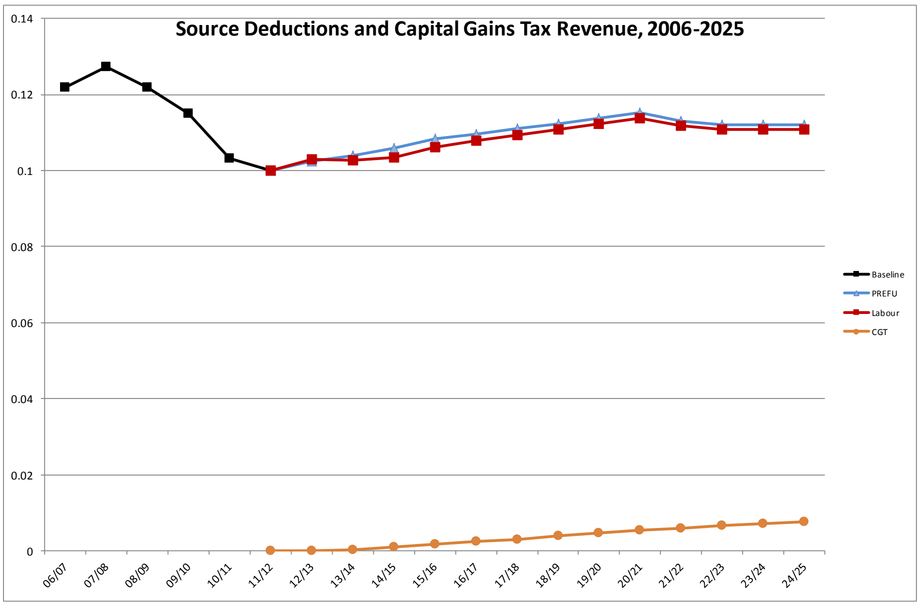
The R & D Tax Credit will be reintroduced from April 2013. In doing so, we will also cancel any further grants through the current government's three grant-based initiatives, although those grants that have already been awarded will continue to be paid.

This will cost around $30 million in 2012/13, rising to $200 million in 2016/17 (these costs are net of the savings from cancelling the grant-based initiatives).

Summary

The net effect of the Fairer Tax Package is to reduce reliance on Source Deductions (primarily personal income tax) and GST by widening the Crown's tax base to include income from capital. As **Figure 1** shows, source deductions are projected to decline relative to the PREFU, while CGT revenue gradually mounts.

Figure 1 Source Deductions and Capital Gains Revenue, 2026-2025



The Operating Allowance, Supporting National Savings and Public Investment

The Operating Allowance

The main source of funds for expenditure other than the Fairer Tax Package comes from the 'Operating Allowance' already in the PREFU baseline.

Each year, the government in preparing its accounts puts aside a sum of money for additional operating expenditure in each subsequent Budget. The current government has cut back the 'Operating Allowance' it has set aside for Budget 2012 and Budget 2013 to $800 million per year, which adds to $1.6 billion a year by 2013.

The operating provision set aside by the current government for Budget 2014 is more in line with previous years, at $1.192 billion additional each year. This brings the total new expenditure available for 2014/15 and beyond to $2.792 billion. Provisions for subsequent Budgets build upon these amounts.

Labour considers that the amounts available for Budgets 2012 and 2013 are below what is prudent. Conservative estimates of 'business as usual' expenditure comes to $800 million on their own. This relates primarily to largely non-discretionary annual adjustments such as adjusting education funding rates for inflation and taking into account demographic pressures in the funding to District Health Boards.

On the other hand, given the tight fiscal situation and the priority of paying down debt, we consider that operating allowances beyond 2013 need to come down slightly.

The revised operating allowance, with comparison to the PREFU baseline, is shown in **Figure 2** and **Table 2**. More is spent in Budgets 2012 and Budgets 2013, with ongoing impact, but by

2016/17 cumulative new expenditure balances back to PREFU levels, and in future years it is somewhat below. (This reflects the fact the Savings costs less in outyears than it does initially.)

Figure 2 Operating Allowance, 2012/13 - 2018/19, previous and revised

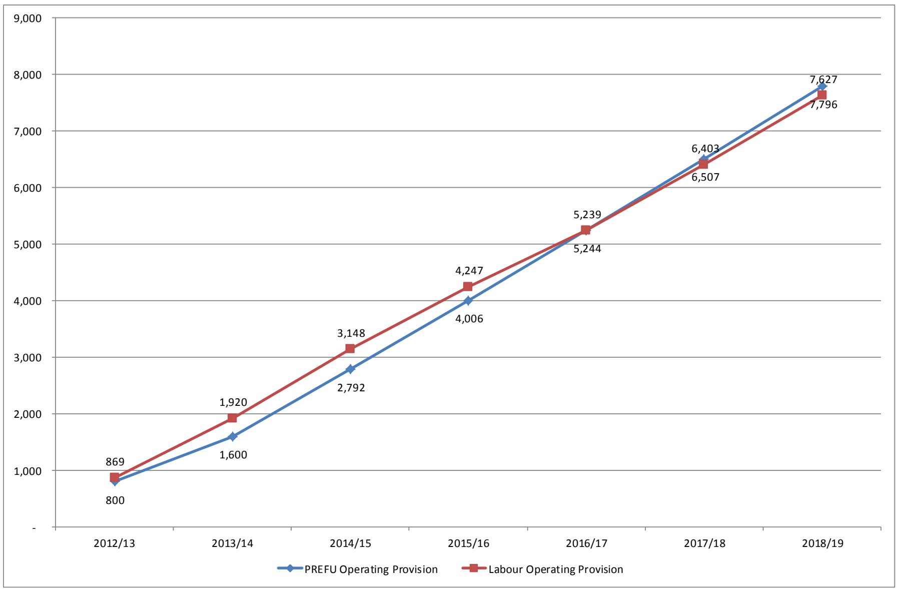


Table 2 Operating Allowance, 2012/13 - 2018/19, previous and revised

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	*TOTAL*
PREFU Operating Provision	800	1,600	2,792	4,006	5,244	6,507	7,796	*28,745*
Labour Operating Provision	869	1,920	3,148	4,247	5,239	6,403	7,627	*29,453*
Difference	*69*	*320*	*356*	*241*	*-5*	*-104*	*-169*	*708*

Figure 3 and **Table 3** show how the Operating Allowance will be used. Most of the funds are still being 'held back' for 'business-as-usual' commitments. In each Budget year, at least $800 million of new funding will still be available for this purpose.

Figure 3 How the Operating Allowance Will Be Used, 2012/12-2018/19

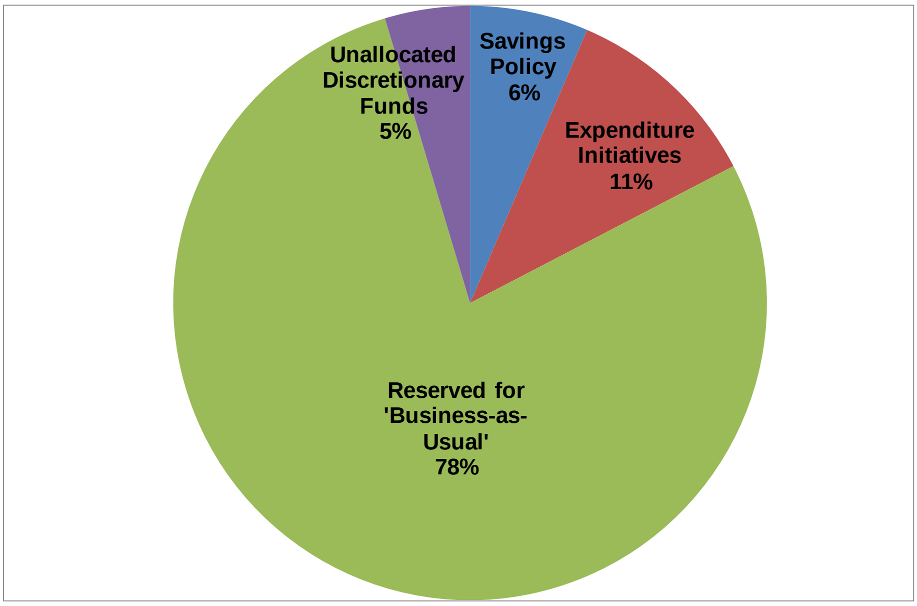


Table 3 How the Operating Allowance Will Be Used, 2012/12-2018/19

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	TOTAL
Savings Policy	-	94	374	372	369	366	326	**1,901**
Expenditure Initiatives	69	227	358	526	569	654	815	**3,217**
Reserved for 'Business-as-Usual'	800	1,600	2,416	3,248	4,097	4,963	5,846	**22,971**
Unallocated Discretionary Funds	-	-	-	100	204	420	640	**1,364**
TOTAL	**869**	**1,920**	**3,148**	**4,247**	**5,239**	**6,403**	**7,627**	**29,453**

Some of the funding for the Budgets beyond the 2011/14 parliamentary term has also been left unallocated. It is not necessary to allocate this spending as yet, and it is important to preserve some flexibility for the government in future to respond to new challenges and priorities as they arise.

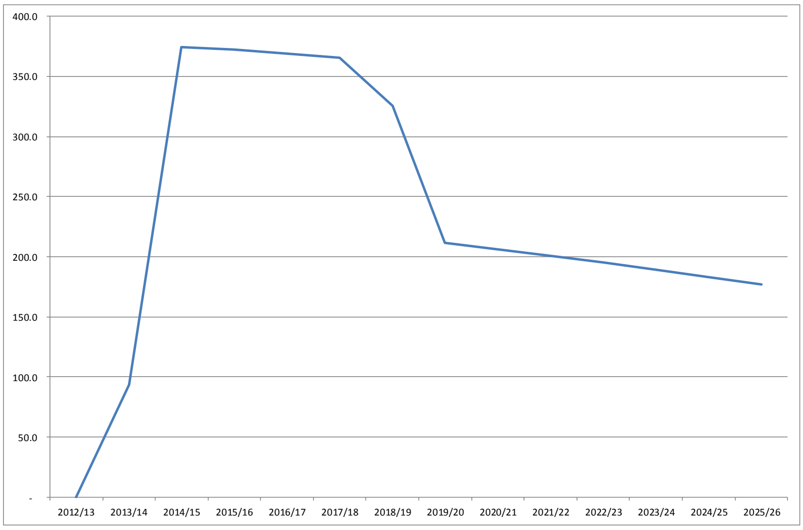
The remainder of the operating allowance is divided between paying for the Saving Policy and a range of carefully-prioritised and staged expenditure initiatives.

Supporting National Savings

Labour has announced a plan to make KiwiSaver universal from 2014. This has a fiscal impact from the 2013/14 year, as shown in **Table 3** above. As indicated at the time of the announcement, this will be paid for from within the Operating Allowance (the funding from 2014/15 onwards fitted within the unadjusted PREFU allowance for Budget 2014).

Moreover, it is worth noting that this is a policy that costs less in outyears than it does initially. This is partly because of tax revenues from KiwiSaver investment income (other than capital gains), but primarily because of the temporary impact of the five-year-phased Kickstart for those enrolled in April 2014. Once the impact of this is complete in 2019/20 the cost of the policy reduces substantially, as illustrated in **Figure 4**.

Figure 4 Fiscal Impact of Universal KiwiSaver



Other Public Investment

Table 4 Expenditure Initiatives

Policy	2012/ 13	2013/ 14	2014/ 15	2015/ 16	TOTAL
Youth Employment Package	31	44	36	23	**134**
Overseas Development Assistance	22	28	30	30	**110**
Aged Care - first shifts towards pay parity	10	20	30	30	**90**
Extra police officers	6	12	18	24	**60**
Smaller Initiatives Announced to Date	22	33	38	42	**135**
Subtotal - Announcements to Date	*91*	*137*	*152*	*149*	***529***
Policies yet to be announced	59	170	286	457	**971**
Other minor initiatives	20	20	20	20	**80**
Savings: Reprioritising National's Spending	-100	-100	-100	-100	**-400**
Subtotal Expenditure Initiatives	**69**	**227**	**358**	**526**	**1,180**

The main expenditure initiatives financed within the Operating Allowance are listed in **Table 4** and described briefly below. A full set of announced initiatives over a longer period can be found in the table 'Labour's revenue and expenditure plans'.

Youth Skills & Employment Package

Labour's Youth Skills & Employment Package was announced on 1 September 2011. It contains a range of initiatives with the objective of to ensuring that every at-risk 15-19 year old will be either learning or earning by the end of our first term. The policy's expenditure is front-loaded and some of it scales back from 2015/16 as the policy is projected to have achieved its initial purpose, although initiatives will continue in place to meet the needs of new cohorts of 15-19 year olds.

Overseas Development Assistance

Labour is committed to lifting levels of Overseas Development Assistance (ODA) over time, yet ODA was currently projected to decline as a proportion of Gross National Income on current PREFU forecasts. This funding over our first term will prevent that from occurring.

Aged Care - shifts towards pay parity

In our Aged Care policy Labour indicated its intention to have a time-lined plan to, as Budgets allow, implement pay parity between staff working in residential and home-based care with their equivalents in the public health system. This funding of an additional $10 million each Budget for the next three Budgets represents the first step towards this plan.

Extra Police Officers

We intend to bring all Police Districts back up to the strength funded in 2008, and will ensure that any allocation changes benefit all Districts. This will require additional funding for approximately 145 constables at a cost of $24 million a year, phased in over four years.

Other Minor Initiatives

Across Labour's policy documents there are a range of small initiatives that may require some additional resourcing for government agencies. In a number of cases this will be able to be met from within baselines, but in other cases relatively small amounts of additional funding may be required.

Savings: Reprioritising National's Spending

Labour is committed to getting best value from public expenditure. In particular we will carefully review all spending initiatives undertaken by the current government and cancelling those that do not have effective results or do not accord with Labour's strategic priorities.

POLICIES AFFECTING THE CROWN'S CAPITAL ACCOUNTS

Retaining our assets

Labour will not sell assets, as proposed by National. This will allow the Crown to still receive the dividends from these assets, which can then be used to fund expenditure.

The PREFU deals with the current government's asset sale plans in an unsatisfactory manner. The revenue from asset sales is booked to fund new capital expenditure. This appears in the PREFU as a line called "Balance sheet funding of capital spending" (pages 21, 30, 82 and 91). However, the PREFU does not account for foregone dividends resulting from asset sales.

Labour will maintain the same capital expenditure allowance as the PREFU. But Labour has decided to fund the capital expenditure that National would fund from asset sales from borrowing instead. Because the Crown's cost of borrowing is lower than the returns realised by the SOEs, this is the prudent and responsible economic choice.

Labour's decision not to sell assets has required unbooking the 'Balance sheet funding of capital spending" line, which totals $3.910 billion by 2025/26, and accounting for the financing cost of taking on debt instead. This calculation appears in the net debt tables in the fiscal strategy.

Retaining the assets also means retaining the dividends. The PREFU has been corrected in this document to account for the dividends that would be lost if asset were sold, and Labour's calculations show them being retained

Future Investment Fund

National's Future Investment Fund is no more than a renaming of the existing allowance for new capital spending. Labour will keep the allowance but not fund it from asset sales.

Reprioritisation of capital allowance

Labour is committing to the same new capital spending allowance as the PREFU but not necessarily to building the same projects with that as National. For example, Labour will not be building National's 'Holiday Highway'. Instead, it will fund half the cost of the Auckland CBD rail link and upgrade the existing Puhoi to Wellsford highway.

New Zealand Superannuation Fund

Labour will restore contributions to the New Zealand Superannuation Fund from 2012/13.

Contributions will be increased every year, starting with $750 million in 2012, and then ramping up by $750 million a year until we reach the legislated contribution rate in 2015/16.

This will mean more gross debt, which will be more than offset by the larger asset value of the NZS as a result of the contributions and their returns. The tax on those additional returns will also contribute to the Crown's operating revenue under Labour.