NEW ZEALAND COUNCIL OF TRADE UNIONS
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Commentary

The Budget – what's likely

Summary

The government's 19 May Budget is a fateful one. It could push New Zealand back into deeper recession and unemployment, or it could give us a chance to pull out of three years of stagnation. It could set some directions to begin solving the big problems New Zealand faces, or it could be a vote-buying election setter, as directionless as the last two years, leaving the economy to continue on its low wage, commodity-based, speculation-driven path.

In previous commentaries I have explained why government debt should not be the focus of the Budget. Yet the government says that it will be, and will use that as a reason to cut government expenditure.

The biggest immediate danger to New Zealand as a whole is the ongoing recession which can now be seen as a failure of government economic management. The economy is stagnating with high unemployment. Cutting government expenditure risks worsening that situation further. By early next year, the reconstruction in Christchurch is expected to begin, raising GDP, employment and tax revenue. So there is a critical period that the government has a responsibility to bridge. But that depends on a generous and well-considered response to the Christchurch disaster.

The government has a credibility problem. It has labelled this a "need to have" rather than "nice to have" Budget, but has already loaned $43 million to MediaWorks, deferred until after the election an increase in fuel taxes worth $72 million per year and made other decisions such as $2 million for the "plastic waka" without credible "need to have" justification. It has already cut spending in many areas which can hardly be called "nice to have" including early childhood education, adult education, industry training, and support for victims of sexual abuse and family violence.

We outline changes to watch for in health, education, social welfare, housing, state assets, savings, superannuation, and the public services. The funding of the Christchurch recovery and reconstruction should be a major item.

The government's 19 May Budget is a fateful one. It could push New Zealand back into deeper recession and unemployment, or it could give us a chance to pull out of three years of stagnation. It could set some directions to begin solving the big problems New Zealand faces, or it could be a vote-buying election setter, as directionless as the last two years, leaving the economy to continue on its low wage, commodity-based, speculation-driven path.

We will be providing a brief backgrounder before the Budget and the usual Budget-day summary, but this commentary will focus on what we are likely to see in it.

What problems need to be addressed?

There are three problems confronting New Zealand which the government must address: the Christchurch earthquake, the continuing recession, and a stronger economy for the future. In previous commentaries I have explained why government debt should not be the focus of the Budget. Yet the government says that it will be, and will use that as a reason to cut government expenditure.

The biggest immediate danger to New Zealand as a whole is the ongoing recession which can now be seen as a failure of government economic management. The economy is stagnating with high unemployment. It was at 6.8 percent or 158,000 in December and is expected to remain above 6 percent for at least another year. GDP growth is expected to be 2 percent or less for the year. Cutting government expenditure risks worsening that situation further. By early next year, the reconstruction in Christchurch is expected to begin, raising GDP, employment and tax revenue. So there is a critical period that the government has a responsibility to bridge.

But that depends on a generous and well-considered response to the Christchurch disaster. The Budget must address Christchurch's needs convincingly – but not finally. There is much more to be done than what will be known in time for the Budget. The government has ruled out a special levy and any new spending funded by debt, so it must either cut other services and spending to pay for Christchurch or be miserly in its approach. Either way leads to danger.

The government has a credibility problem. It has labelled this a "need to have" rather than "nice to have" Budget, and will dress it up as cutting out "lower priority spending", but those are frequently simply political decisions. We have already seen it effectively lend $43 million to MediaWorks to pay for its broadcasting frequency licences (not a grant, but an increase in government debt), defer until after the election an increase in fuel taxes worth $72 million per year (again putting more pressure on debt) and make other decisions such as $2 million for the plastic waka events centre for the Rugby World Cup without credible "need to have" justification. Almost unnoticed were tax changes made by Cabinet following last year's Budget which reduced revenue by a further $51 million in this financial year, $18 million next year, and $35-40 million a year in subsequent years. All these mount up to significant sums.

The government defended the deferment of the fuel tax increase on the basis of Christchurch and difficult times – yet is willing to cut deeply into expenditure which is needed in hard times. It has told all government departments to dig deep to offer expenditure cuts and not to expect increases this year. Many of the resulting service cuts will be difficult to spot on the day and may not become apparent for some time. It has already cut spending in many areas which can hardly be called "nice to have" including early childhood education, adult education, industry training, and support for victims of sexual abuse and family violence.

What's likely to be in it?

So what is likely to be in the Budget? Bill English has said that there will be "new spending" of "almost $1 billion", mainly in health and education – but that these will "largely" be paid for by cuts elsewhere. That is not the end of it: there is likely to be at least a further $2 billion in other cuts to pay for "higher priority" spending. There will also be increases in spending due to the "automatic" increases in large items like benefits and New Zealand Superannuation. Last year those were forecast to cost an additional $1.6 billion in the coming year. That included increased numbers in education and training which this year will be reclassified as "new spending" to bring it under tighter control.

In last year's Budget, we showed that the increase in health spending fell about $150 million short of what was needed to maintain the current level of services. We will be doing a similar analysis this year.

In education, we are likely to see childhood education funded on a more targeted basis – leading to higher charges or reduced access for others. We may see higher fees in tertiary institutions and more internal pressures there to cut costs, particularly in the polytechnic sector. But these won't be mentioned in the Budget even if it causes them through underfunding. The government has already made clear it will be chipping away at student loan entitlements (such as tighter enforcement of repayment and ending eligibility to people over 55). The industry training sector has lost significant sums to universities this year: we will be watching to see how that is followed up.

The effect of Christchurch's earthquakes will be both visible and invisible in the Budget. Almost certainly there will be provisions for the beginning of rebuilding, but there is also plenty of need for ongoing support to workers and businesses, and the government's approach to finding the workers and skills for the reconstruction should become more apparent. Don't be misled by a provision – probably around $5 billion – for the reconstruction being brought to book in the accounts for this year. That's the way the accountants deal with it – charge it up when it happened. In fact the costs (the cash spending) will be spread over several years. And there will be hidden costs. The police were told to wear the costs of the Pike River disaster out of their normal budget. That will also be happening with emergency and other government services in the much more extensive Christchurch catastrophe.

In housing, the government will respond to the largely private sector Housing Shareholders Advisory Group report. Watch for reductions in State housing through changes in Housing New Zealand's role and financial incentives to the private sector to increase the stock of affordable homes.

While further announcements on the partial privatisation of state owned enterprises are more likely to be closer to the election, the Budget could bring strong messages on the management of government assets – most likely trying to wring greater profits out of them, which could compromise the wider purposes of holding them.

Savings Working Group recommendations will get attention, perhaps by cutting some of the tax incentives around Kiwisaver, but also encouraging more people into it through auto-enrolment and reduced fees. Though it is not a good time to fund further tax reductions, the government may well make announcements on recommendations such as cuts in tax on interest and PIE investments. Both this Working Group and the Retirement Commission have called for announcements on the future level of New Zealand Superannuation, but this seems unlikely in election year.

Some of the Welfare Working Group's recommendations are also likely to be part of the Budget. The group wants to reduce the numbers of people on benefits, reduce some entitlements, and impel single parents of very young children out to work. That may be accompanied by some increases in funding of early childhood education services but these will be targeted. Also expect cuts to Working for Families for higher income households (though most of them would be big families). The question will be how far down the income range the knife cuts.

The government may also announce further restructuring in the public service with major mergers of agencies expected.

Given its apparent approach to the Budget, the government will fail to address crucial issues. Have expenditure cuts and reorganising the public service become a substitute for an economic strategy?

Bill Rosenberg

Special Feature: The Business of Minimum Wages

For the first time in 2010, Statistics New Zealand's annual Business Operations Survey included a set of questions about the impact of the minimum wage on firms' wage setting practices. Released earlier this month, the findings paint a stark picture of low wage work in New Zealand.

On a positive note, the survey found 60 percent of businesses were not affected by the 2010 increase in the minimum wage from $12.50 to $12.75. Assuming they operate legally, this means most firms aren't paying minimum wages.

However the survey did find that 30 percent had to increase wages offered to their staff. On top of this, 13 percent of firms said they increased wages already above the minimum wage – presumably as a result of the reduced margin.

An even more interesting picture appears when the findings are broken down by sector and employer size. Forty-six percent of large employers (100+ staff) reported they needed to increase wages, as compared to 28 percent of firms with less than 20 staff.

Things get even starker on an industry basis. Sixty-three percent of firms in accommodation and food services and 54 percent in retail trade had to up wages to comply. In contrast only 7 percent of financial services companies and 9 percent of mining operations had to do the same.

The survey also asked what factors in general were used to determine entry-level wages for new staff. The most common factor across all employers was the wages of similar employees within the businesses (51 percent), followed by the wages of similar employees outside the business (19 percent). But the third most common factor – 16 percent – was still the minimum wage.

Again, broken down by industry, a concerning patterns emerges. In accommodation and food service the minimum wage was the most commonly cited factor in setting entry level wages (43 percent), compared to only a third who cited the wages of similar employees within the businesses. In retail the minimum wage was not the most commonly cited factor, but over a quarter (27 percent), referred to the minimum wage.

The survey also asked about the effect of the GST increase on price and wage setting. The increase was reported to be a factor in wage and salary negotiations for 5 percent of the businesses, and 30 percent reported that though it had not been yet, it was expected to be a factor in future wage negotiations. Bear in mind that the businesses were likely to have answered this question before the GST rise actually occurred on 1 October 2010.

Sent out in August 2010, the Business Operations Survey targets private sector enterprises with six or more employees. The survey excludes the public sector and businesses in creative and performing arts activities and personal and other services. This year's results were based on responses from a randomly selected 5,369 of an estimated 35,307 such businesses.

Andrew Chick

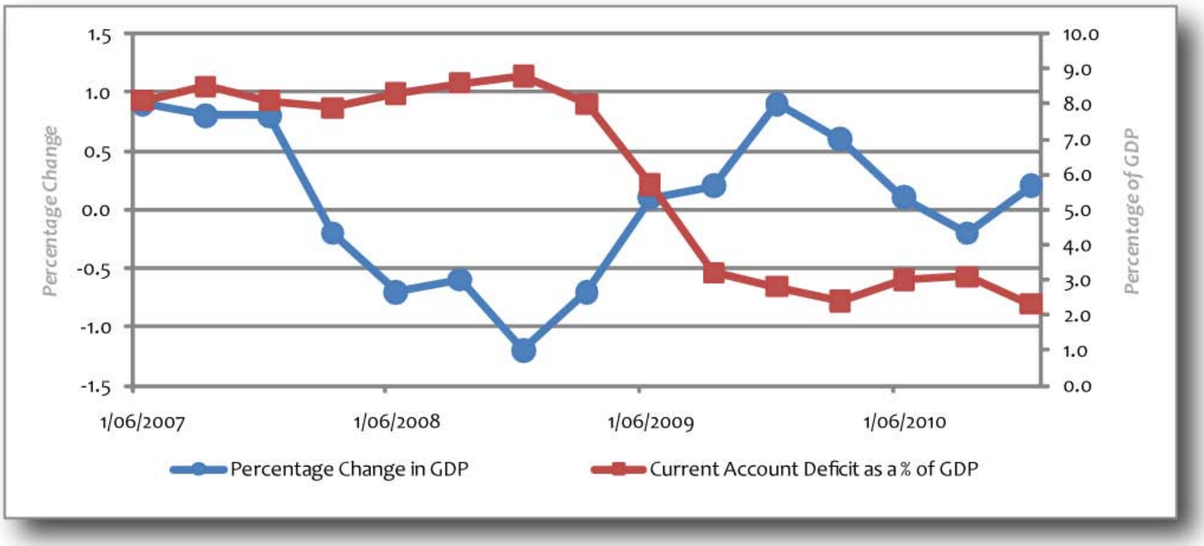
Forecast

This NZIER consensus forecast was published on 21 March 2011.

Annual Percentage Change (March Year)	**2010-11**	**2011-12**	**2012-13**
GDP	0.8	2.0	3.9
CPI	4.6	2.6	2.6
Private Sector Wages	1.7	2.9	3.2
Employment	0.8	1.8	2.6
Unemployment	6.7	6.4	5.5

A ★ indicates information that has been updated since the last bulletin.

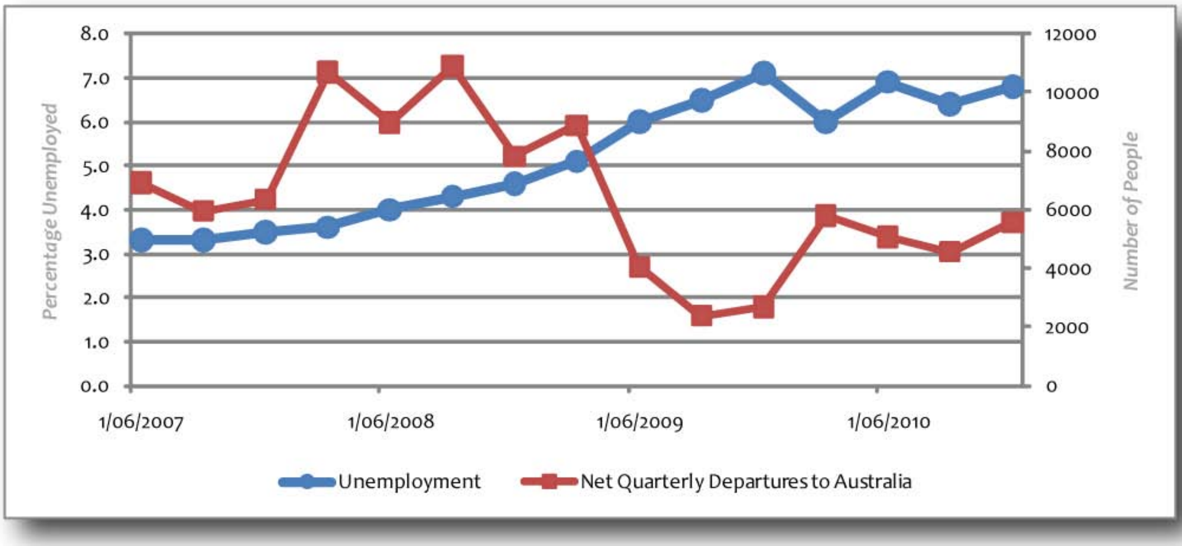
Economy



- Gross Domestic Product was up 0.2 percent in the December 2010 quarter, leaving GDP growth for the year to December 2010 at 1.5 percent.
- New Zealand recorded a Current Account deficit of $2.8bn for the December 2010 quarter and a deficit for the year to December of $4.4bn (2.3 percent of GDP). This compares with a current account deficit of $5.2 billion (2.8 percent of GDP) for the year ended December 2009.
- The country's Net International Liabilities were $159bn at the end of December 2010 – 81.7 percent of GDP and $1.3bn less than at the end of September.
- ★ For March 2011 Overseas Merchandise Trade recorded a $ 464m surplus – 10.0 percent of the value of exports for the month. For the year to March 2011, New Zealand recorded a surplus of $631m (1.4 percent of exports). The value of dairy products, logs, wood, meat and precious metal exports all rose significantly between March 2010 and March 2011, while aircraft and petroleum products were again the biggest increases in imports.
- ★ The Performance of Manufacturing Index for March 2011 fell to 50.1[1], down from 52.6 in February. The employment sub-index was only one of two to show further expansion – up to 53.2.

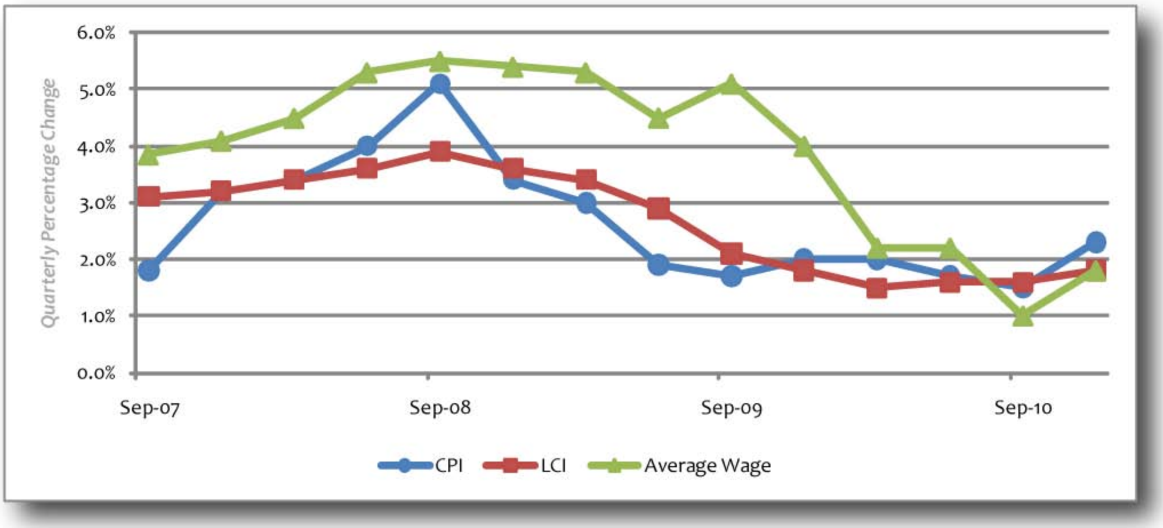
- ★ The Performance of Services Index for March 2011 was 50.8[1], flat from February. At 50.4, the employment sub-index showed expansion for the first time since September 2010.
- ● The Retail Trade Survey found retail sales were down 0.1 percent between the September and December 2010 quarters but up 1.5 percent on the December quarter in 2009.
- ★ On 28 April 2011 the Reserve Bank left the Official Cash Rate unchanged at 2.50 percent. The next review will be on 9 June 2011.
- ★ The REINZ Housing Price Index recorded a 0.5 percent increase in house prices for the month of March 2011, with the median house price rising $15,000 to $365,000. However house prices are still down 1.8 percent for the year to March.

Employment



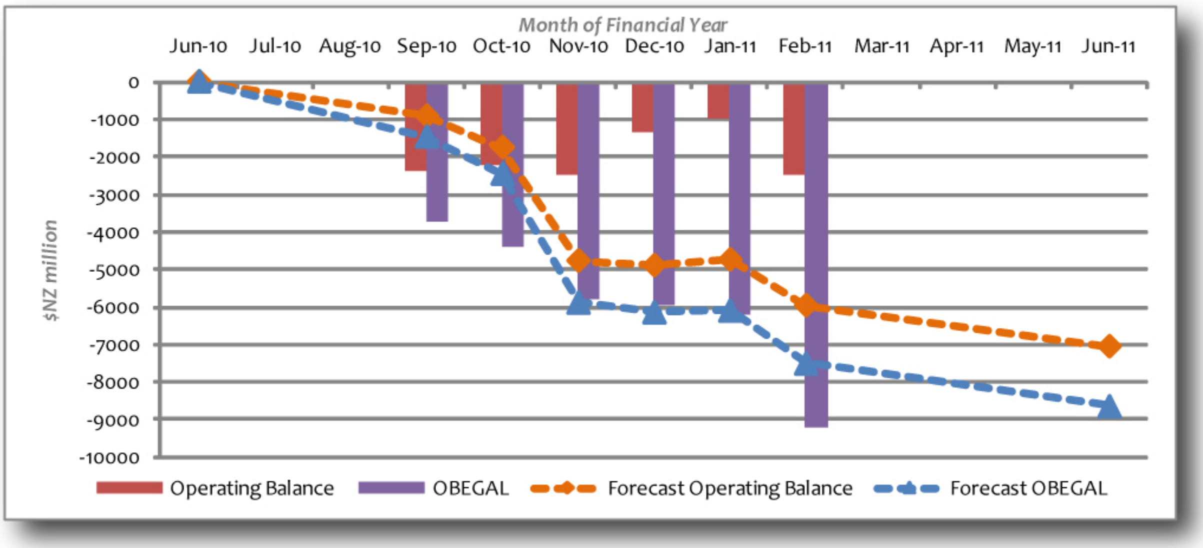
- ● According to the Household Labour Force Survey the unemployment rate in the December quarter was 6.8 percent, up 0.4 percent on the September quarter. The participation rate was 67.9 percent – down 0.4 percent on September. Māori unemployment was 15.5 percent, Pacific unemployment was 13.5 percent, Asian unemployment was 9.3 percent and European/Pakeha unemployment was 4.6 percent. Youth unemployment (15-19 year olds) was 25.5 percent.
- ★ At the end of March 2011 there were 59,343 people on the Unemployment Benefit, a decline of 4323, or 6.8 percent, from February 2011. (Quarterly figures on Unemployment Benefit numbers are available from the MSD website.)
- ★ In the three months to the end of March 2011 Job Vacancies Online increased 6.2 percent and advertised vacancies for skilled jobs increased 7.1 percent.
- ★ International Travel and Migration figures show 8,932 permanent and long-term arrivals to New Zealand in February 2011 and 6,760 departures. Net migration in the year to February 2011 was 8,249 arrivals. Net migration to Australia in the year to February was 23,518 departures.

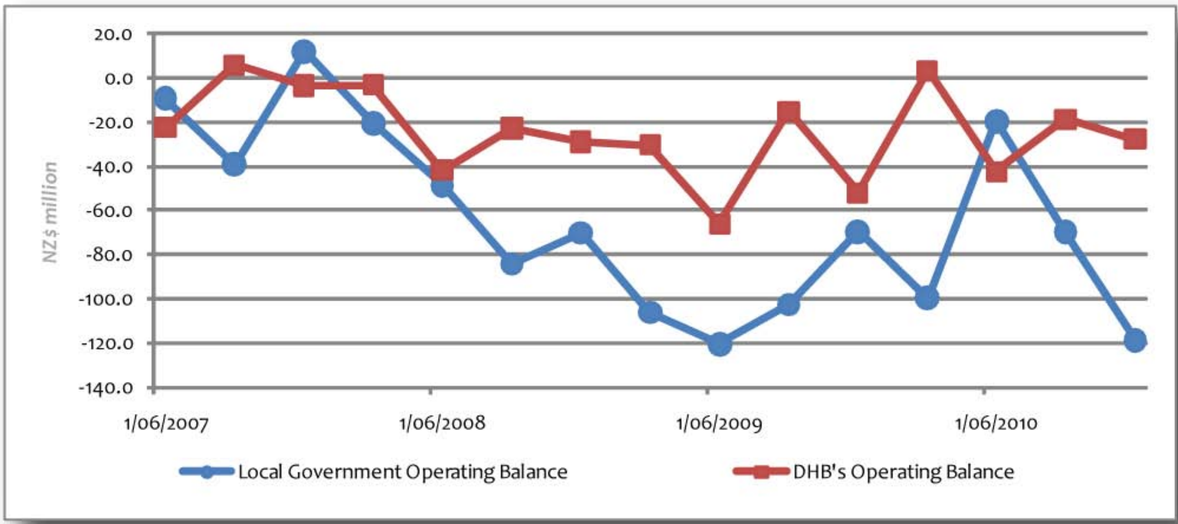
Wages



- The Labour Cost Index (Wage and Salary Rates) (LCI) rose 1.7 percent for the year to December 2010 and 0.5 percent for the December quarter. For those surveyed who received an increase in their salary or wage rate during the year, the median increase was 2.9 percent.
- The December 2010 Quarterly Employment Survey found the average hourly earnings for ordinary-time work was $25.83, up 0.5 percent on the September quarter. The average ordinary-time wage was $23.87 in the private sector (up 0.6 percent) and $32.71 in the public sector (up 0.3 percent). Per hour, female workers earned 87.7 percent of what male workers earned.
- ★ The Consumer Price Index for the March 2011 quarter rose 0.8 percent, and 4.5 percent for the year to March.
- ★ The Food Price Index rose 0.3 percent in the month of March, contributing to a 5.5 percent increase in food prices between March 2010 and March 2011.

Public Sector





- According to Treasury's Month End Financial Statement for the eight months to the end of February 2010, government revenue was down $624m (1.7 percent) on HYEFU figures and expenditure was up $255m (0.6 percent). The operating deficit before gains and losses (OBEGAL) was $9.2bn, $1.7bn higher than forecast mainly because of the booking of a $1.5bn cost to the Earthquake Commission for the February Christchurch earthquake. The operating deficit was $2.5bn, $3.5bn below forecast due to strong gains in value in the ACC, GSF and NZS investment funds more than offsetting EQC's earthquake cost. The Government's net debt is 19.3 percent of GDP, 0.3 percentage points better than budgeted in the HYEFU.
- District Health Boards recorded a $27.9m deficit for the December 2010 quarter, down from a deficit of $18.7m in the September Quarter. Employment costs were $1.2bn, up 1.0 percent for the quarter, compared to total expenses of $3.2bn up 0.1 percent.
- Local Government recorded a 5.7 percent increase in income and an 8.1 percent increase in costs for the December 2010 quarter, resulting in a deficit for the quarter of $118.8 m.

Notes

1 For the Performance of Manufacturing Index (PMI) and Performance of Services Index (PSI) a figure under 50 shows the sector is contracting; above 50 shows that it is growing. Previous month's figures are often revised and may differ from those published in a previous Bulletin.

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