Hon Bill English

Minister of Finance

Pre-Budget Speech to the Wellington Employers' Chamber of Commerce

Members Gallery, Westpac Stadium, Wellington

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Embargoed until 12.50pm

Good afternoon everyone. It's a pleasure to be with you again this year.

Thank you to the Wellington Employers' Chamber of Commerce for once again organising this pre-Budget lunch.

I also want to acknowledge the Chamber's work in promoting the Wellington business community and in advocating policy to enable businesses in the capital to invest, employ and grow.

The Budget on 21st May will set out in detail the Treasury's revised economic and fiscal forecasts as well as the Government's decisions around new spending.

As the Prime Minister has said, you wouldn't open your Christmas presents before Christmas so I'm going to leave the details of the Budget until Budget day.

However, I want to take this opportunity to explain our approach to managing the Government's finances, because they put in context the decisions that will be announced in three weeks.

New Zealand's economic performance is a means of helping New Zealanders to have better lives, including those who need quite a bit of support.

Part of good economic performance is steady and sensible management of the Government's books.

When the Government's finances are in order, the community and those who provide public services to the community know that the support and resources of the Government are sustainable and secure.

When the Government contains its spending, it reduces pressure on interest rates and the exchange rate, to the benefit of households and businesses.

Drawing on the lessons of previous economic cycles, when we inherited a recession from Labour in 2008 we decided to support the most vulnerable, maintain benefits and focus on better public services, rather than cut spending.

Without slashing and burning, we have managed to rein in the runaway government expenditure that was a feature of the Labour Government in the early 2000s, when spending increased by 50 per cent in five years.

And we've done that while significantly improving public services.

The total annual cost of new initiatives in the Government's last six Budgets is less than $2.9 billion. By comparison, this extra cost in the last six Budgets of the previous Government totalled $20 billion.

Core Crown expenditure in the current year is expected to be around $73 billion - nearly $4 billion lower than was forecast in 2011, when we first set our surplus target.

This puts us on track to reduce core Crown expenses below 30 per cent of GDP in the next couple of years.

As recently as 2011, expenses were nearly 35 per cent of GDP.

The Government has also taken steps to limit the build-up of debt, for example by suspending contributions to the New Zealand Superannuation Fund.

And we’ve recycled capital by using the $4.7 billion proceeds of the Government’s share offer programme to reinvest in new public assets such as schools and hospitals.

Net debt is peaking now at around 26 per cent of GDP and will drop in the next few years.

So we’re heading in the right direction. Treasury’s Budget forecasts will show this improvement continuing over the next few years, as long as we stick to the path of responsible spending.

But we have not been driven solely by getting spending under control.

Since 2008, the Government has focused on delivering better public services for all New Zealanders, and in particular improving results for the most vulnerable in society.

Three years ago, the Prime Minister set 10 challenging targets for the public service. These included improving health and education outcomes, reducing crime, lowering welfare dependence, and increasing online connectivity.

The framework has contributed to some significant improvements. For instance,

- there has been a 38 per cent reduction in youth crime since 2011;
- the number of teenage solo parents on a benefit has dropped by 40 per cent since 2011; and
- immunisation rates for Maori are now almost as high as the rest of the population.

We’ve developed new tools to help tackle persistent social problems we used to regard as too hard to solve.

We have a better understanding of the large complex organisations that deliver government services.

We have more data and better analysis.

And this adds up to a far better understanding of our customers, the people of New Zealand who use our services and need our support.

That knowledge and information is starting to inform and drive spending decisions in the public sector.

The toolkit is by no means perfect yet, but it is a significant improvement on what used to happen and it will keep improving over the next few years.

For example, we have identified some factors in the life of a child that predict how dependent they are likely to be on government services as a teenager and adult.

Take a child under five who is known to Children, Youth and Family Services, has at least one person in their household on a benefit and either of their parents has had contact with Corrections.

Statistics can pretty accurately forecast that by the age of 35, that child is around five times more likely to have been on a benefit long term and seven times more likely to have been in prison by age 21.

On the face of it, this sounds obvious, and it is.

But it hasn’t previously influenced government spending in the way that would also seem obvious, which is to pay for the interventions that have the best chance of changing the path that child is following.

So we’re focusing on using the data, and our front-line knowledge about the people we serve, to intervene earlier to help people lead more-fulfilling lives.

We call this social investment. We’re willing to pay a bit more upfront to secure long-term results for the most vulnerable New Zealanders.

We’re investing in better lives for individuals who need our help so they can move from dependence to independence and contribute to a better society.

And we’re finding that when we do this, we can generate significant long-term savings for the Government.

A good example is welfare. Governments used to focus on getting newly unemployed people back into work, as unemployment is one of the biggest welfare costs.

But by looking at lifetime costs of individuals who receive a benefit, we’ve found that one of the most expensive groups is people who have recently returned to work from being on a benefit.

That’s because they are likely to slip back onto benefits. In any given month, 70 per cent of the people who sign up for a benefit have been on benefit before.

So this tells us the job isn’t done just because someone has moved into work – we need to do more to help them stay independent.

And it’s worth our while to help them do that because not helping them will cost us more, and likely mean a harder life for them and their families.

This approach is working.

Last year, we reduced the expected cost of supporting current beneficiaries over their lifetime by $7.5 billion. A key part of this was getting more sole parents into work.

Contrary to what some people might think, we don’t face a choice between addressing causes of social dysfunction or saving money.

Rather, if we are successful in addressing social dysfunction, we’ll save money – and a lot of human suffering – in the longer term.

That is why I’m confident that this Government can continue to responsibly manage spending, while still improving public services, for a number of years to come.

So we’re making strides.

But there’s a lot of work to do to embed this social investment approach, because it’s about measuring results for the long term, rather than simply measuring spending for this year, which is quicker and easier to do.

So there are a few thoughts on spending, and I’ll turn now to government revenue.

We support a broad-base, low-rate tax system.

We've undertaken major tax reforms with this in mind, and we have brought down all marginal tax rates to incentivise investment and work.

The top personal tax rate is now 33 per cent, down from 39 per cent, the company tax rate is now 28 per cent, and we have reduced annual ACC levies by $1.5 billion over the last few years.

And we've reduced those tax rates in a fiscally neutral way by increasing GST, implementing stricter rules around investment property and reducing some of the very expensive and ineffective tax credits introduced by the previous Labour Government.

We remain committed to further reductions in income tax rates or thresholds, when fiscal and economic conditions permit.

You'll know that last year, we were among the fastest growing developed economies in the world.

We remain on track for solid economic growth over the next few years – building on growth of almost 3 per cent per year we've seen on average over the past four years.

This is allowing tens of thousands of new jobs to be created each year, and unemployment is expected to fall below 5 per cent over the next two years.

The growing economy is allowing wages to rise faster than the cost of living.

It's giving businesses the confidence to invest. Export businesses in particular are proving to be remarkably resilient in the face of headwinds such as the strong exchange rate, volatile commodity prices and patchy global growth.

Households are saving a bit more and paying down debt, which gives them a greater sense of security.

And New Zealanders are staying home or returning in significant numbers because opportunities are better here than elsewhere.

Unusually in the context of consistent GDP growth, we are currently experiencing very low inflation – or more accurately over the last six months, deflation. Usually, in an economy growing at 3 per cent, inflation is rising, not falling.

Annual inflation is currently just 0.1 per cent – well below the 2 per cent mid-point of the Reserve Bank’s target band.

This environment of solid real economic growth and low inflation is mostly good for New Zealand households.

It means we can expect unemployment to keep falling and sustain real wage growth.

Lower than expected inflation suggests there is a bit more capacity in the economy to keep growing strongly for longer than we might have expected previously, so most forecasters see solid growth continuing most of the way to 2020.

And it means that interest rates will likely stay lower for longer – helping both households with a mortgage as well as businesses wanting to invest for growth.

But at the same time, very low inflation and lower commodity prices means growth in the nominal economy – which is the dollar value of what we produce each year – is more muted than expected.

And just yesterday Fonterra again revised down its current forecast for the current season to $4.50 per kg of milk solids.

The Treasury now expects nominal GDP over the next four years through to 2019 to be around 1.5 per cent lower than forecast in Budget 2014 – mainly because of lower inflation.

That is about $15 billion less and, to put that in context that is more than half of the impact of the global financial crisis.

So these conditions are presenting some real challenges for the Government's books because it's the nominal economy that drives PAYE, company tax and GST receipts.

In addition, although we're seeing more bank deposits which would ordinarily lead to us collect more tax, these are being more than offset by lower interest rates. Consequently, the Government is collecting less tax.

In total, Treasury now expects the Government will collect $4.5 billion less tax revenue over the next four years than it expected at the last Budget.

The lower-than-expected revenue, as well as some quite significant non-cash items in the Government accounts, means getting back to OBEGAL surplus is more challenging

In the Half-Year Update in December, the Treasury forecast an OBEGAL deficit of around $570 million for the 2014/15 year, which is just 0.2 per cent of GDP.

And it forecast a similar OBEGAL surplus for 2015/16.

The Treasury is still finalising its forecasts for this year’s Budget.

But it’s fair to say that both of those forecasts have deteriorated a little since the Half-Year Update.

So we expect the Budget to forecast a slightly bigger deficit for 2014/15 and to forecast a slightly smaller surplus for 2015/16.

While progress on surpluses is slower than expected, we are on track to surplus and repaying debt.

The surplus target is important. It has imposed a discipline on us and on government agencies to work hard on achieving value for money and providing new spending only where we can get better results.

The factors that have reduced government revenue and therefore our surplus track are the same factors underpinning sustainable growth for households and businesses - low inflation and low interest rates.

A small deficit, should it eventuate this year, isn't a risk to the economy. In fact, the downturn in revenue is due to positive economic conditions – strong growth but low inflation and low interest rates.

And because we’re confident about the ongoing improvement in the Government’s finances, it won't constrain our decision making in the Budget.

We will not be pursuing cuts in services or income support in a knee-jerk response to lower tax revenue.

Such measures would undermine the confidence of New Zealanders in the quality and effectiveness of public services.

It would also undermine the excellent work done by so many public servants in recent years to improve public services.

So despite the downturn in revenue, we will stick with the $1 billion annual operating allowances for Budgets 2015 and 2016.

We have a track record that I think the public understands.

We’ve maintained welfare support, we’ve maintained and improved health and education, and we’re thinking ahead to the requirements of a growing economy and a better community through to 2020.

We won’t change that approach just to turn a small forecast deficit into a small forecast surplus. Other things matter more.

So to finish:

The National-led Government was elected in a domestic recession and the global financial crisis, with considerable public anxiety about what at the time was a pretty precarious situation.

Under John Key’s positive leadership, the Government has been stable and cohesive.

That’s allowed us to get on and do what needed to be done – as well as having the confidence to see what can be done differently and better.

I think that strength has, in turn, helped build New Zealanders’ confidence - both in their homes and at work.

In turn, that’s helping us maintain a strong level of economic growth.

So New Zealand is in good shape, though we’re not complacent.

There are very real risks in the world and we’re aware of them.

We’re much better placed to manage them now than when we took office.

In the meantime, we’ll continue to look to the future with confidence and optimism.

We are making good progress, but there is a lot more to be done.

Providing we stick to our plan, I’m confident that we will build the brighter future New Zealanders deserve.

Thank you.