

# Investing in the Next Generation

The last Budget before the new millennium provides New Zealand with an opportunity to reflect on the gains delivered by 15 years of economic and public sector reform, and on the challenges and opportunities that lie ahead of us.

To do so is to realise again that we still have to keep working to ensure that improvements in productivity continue to make a measurable improvement in lives and living standards of New Zealand families.

In the decade to 2002, on data to date and the current forecasts, the economy is growing three times faster than in the previous decade.

Together with prudent management this has enabled the Government to reduce income tax substantially, to cut tariffs and to reduce net Crown debt by 50%, while increasing spending on priority social initiatives.

The Government's policy platform founded on openness, price stability, lower debt, lower tax and quality spending has proved its worth.

Recently, the drought and economic turmoil in Asia threatened our living standards.

A sound economic strategy and a careful approach to economic management have helped ensure that the recession was shorter and less painful than anyone predicted. Growth is now forecast to average more than 3% annually in the next three years.

The quick economic rebound has helped the Government to announce its sixth consecutive surplus. Surpluses are projected to improve to around \$1.5 billion in 2001/02.

The Asian crisis underlined the fact that lower debt puts New Zealand in a substantially better position to adapt to adverse international events. The Government therefore re-affirms its long-term commitment to lowering net Crown debt to below 15% of GDP.

As debt heads below 15%, which on current projections is achieved by 2004/05, new options open up for New Zealanders to achieve higher living standards through further tax cuts.

The Government is confident that, with good fiscal management, a continuation of the current domestic and international economic prospects, and a steady reduction in debt, we will be able to commit to further income tax reductions within the next term of Parliament.

The building of a sound economy is important, but only as a means of widening the choices available to New Zealanders.

This Budget makes substantial new investment in school buildings and information technology to ensure that all children have a world-class education.

Efforts to improve our health status include major investment in new hospitals and more funding for elective surgery and mental health services.

We intend to invest more towards strengthening families at risk and helping their children to overcome educational disadvantage.

This Budget allocates more money and sharpens the focus of spending to improve Maori health, education and employment.

As part of the Government's commitment to improve competition and innovation, more resources will go to research and development.

The Government is immediately lowering the burden of taxation.

A new tax credit for low and middle income working families with new babies will ease the financial strain on those in real need at an important time for the family.

The broadcasting fee, an unfair way of collecting revenue, will be abolished from 1 July 2000.

Stamp duties will be removed from Budget Night, recognising that the burden of this tax is uneven and falls

mostly on farmers and small businesses.

In delivering my last Budget, I am proud of the part I have been able to play in a policy programme that has put this country on track to a bright future.

This Budget will ensure that the benefits of productivity are increasingly delivered to New Zealand families so that all New Zealanders face the new millennium equipped to meet its challenges and take advantage of its opportunities.

We enter the 21st century with a strong growing economy, a prudent and improving fiscal position, a policy framework that has brought us successfully through the Asian crisis, our lowest interest rates for 30 years, and a social programme of which any nation could feel justly proud.

Rt Hon Bill Birch  
Treasurer

# 1999 Budget Overview

## Introduction

The central focus of spending and taxation initiatives in the 1999 Budget is the family. The package has been developed by Ministers working in teams across portfolios, sharing ideas and working with the public towards the following goals:

- education of competitive world quality for all young people
- a fair chance at a better future for the disadvantaged and their children
- reward for enterprise and innovation in business and the public sector
- a solid foundation of openness, price stability, low debt and lower taxes.

The Budget contributes to a sound economic and fiscal strategy that is delivering lasting improvements to New Zealanders' living standards. A prudent fiscal strategy in the short- and medium-term will allow us to maintain a strong fiscal position in the face of future possible shocks and the pressures of population ageing. It will also increase the scope for future tax cuts.

Further tax rate reductions over time are the best way to help New Zealand grow and to improve New Zealanders' living standards. Although we are still picking ourselves up after the impact of the drought and the Asian crisis, we are already in a position to make tax reductions worth over \$200 million a year to taxpayers.

With good fiscal management, a continuation of the current economic prospects, and a steady reduction in debt, the Government is confident that we will be able to commit to further income tax reductions within the next term of Parliament.

In the pages that follow, the 1999 Budget Package has been set out under the following broad headings:

- 1999 tax reductions package
- education
- health
- strengthening families
- improving outcomes for Maori
- justice and security
- enterprise and innovation.

## 1999 Tax Reductions Package

The Government is committed to further tax reductions over time. High taxes reduce the take-home pay of working families, limit choice and do not promote prosperity.

### **Family Plus**

This Budget enhances the tax credit package already provided for low and middle income working families, and renames that package *Family Plus*. *Family Plus* has the following three components:

- A new *Parental Tax Credit* for working families will be available for the first time from 1 October this year. Budget Night legislation will provide for low and middle income parents not on income support to receive on the birth of a child a tax credit of up to \$150 a week for eight weeks.
- A *Child Tax Credit*, formerly the Independent Family Tax Credit, pays low and middle income working families up to \$15 a week per child.
- A *Family Tax Credit*, formerly the Guaranteed Minimum Family Income, ensures a minimum income for parents working at least 30 hours a week.

The new Parental Tax Credit will ease financial stress on low and middle income working families after the birth of a child.

At a cost of \$29 million a year, the new tax credit will make up to \$1,200 available to 26,000 working families on low and middle incomes. Just under half of all births in any year will qualify.

### *Reduction in Taxes*

(\$ million)	1999/00	2000/01	2001/02	Total
Total Tax Reductions	146	215	215	576
Comprises:				
Parental Tax Credit	22	29	29	80
Public Broadcasting Fee (GST inclusive)	54	109	109	272
Conveyance and Lease Duties	70	77	77	224

The amount of help a family will get depends on their income and the number of children. For example, a family with three children will get some assistance up to an income of \$53,800.

### **Abolition of Public Broadcasting Fee**

The Public Broadcasting Fee costs 1.1 million families up to \$110 a year each. Collection costs are high, and only around half the remaining revenue is spent on activities relating to television. It is therefore difficult to justify charging only television owners this fee. Budget Night legislation will abolish the fee from 1 July 2000, and services funded from the fee will in future be funded from general taxation. People will pay only the pro-rata amount for the period to that date.

### **Abolition of conveyance and lease duties**

Conveyance and lease duties are to be abolished by legislation effective from midnight 20 May 1999. They currently collect around \$77 million net per year. These duties are highly inefficient, with costly distortions to economic behaviour and significant compliance costs. Large commercial businesses are increasingly able to avoid these duties, leaving small businesses and farmers to carry the can.

### **Death duty**

Estate duty has not been payable since 1992, but Budget Night legislation will take it off the statute books entirely.

## Raising Education Standards for the New Millennium

Through *Tomorrow's Schools*, we have been making the education system more responsive to student need and more accountable to the community. This Budget will help improve the quality of education for all our children, including those at risk.

Major initiatives in the 1999 Budget include:

- *Operational Funding:* School operational funding has been boosted by a further 1.6% from 1 January 2000.
- *Massive School Building Programme:* We will have 37,000 more secondary pupils by 2006. Some 200 new primary and 80 new secondary classrooms will be set in place during 1999/2000. Work begins on five new secondary schools. The total building programme of \$537 million over two

years includes a new capital contribution of \$100 million.

- *Computer Technology:* A new \$25 million pool will encourage every school to have an Information and Communications Technology (ICT) plan and an Internet connection in place by 2000. \$10 million per year is also provided for long-term ICT maintenance and support.
- *Overcoming Educational Disadvantage:* We have set a national goal that all children can read, write and do maths by nine years of age. Measures to help children at risk in the education system include providing more social workers in schools, and additional funding for school-based alternatives for problem teens.

### Key Education Initiatives

(\$ million) GST inclusive	1999/00	2000/01	2001/02	Total
Total 1999 Education Package	63	58	58	179
Includes:				
Operational Funding	6	12	12	30
Information and Communications Technology	30	10	10	50
School Building Programme (Capital Funding)	100	-	-	100

## Improving Health Care and Facilities

Health care and health-care facilities are being continuously upgraded, including:

- Major Investment in Hospitals:* In the 1998 Budget, the Government forecast a \$1 billion investment in hospitals over the following three years. 1999 Budget decisions include the go-ahead for a new \$250 million 710-bed hospital in Central Auckland.
- Increase in Funding for Care:* Increases in funding for the public health system from 1999/2000 onwards were announced last November. Next year, funding will rise to almost \$6.7 billion. These funding increases, targeted to priority areas, include an extra \$75 million over three years for mental health, and an extra \$25 million in 1999/2000 for elective surgery.

### Key Health Initiatives

<b>(\$ million) GST inclusive</b>	<b>1999/00</b>	<b>2000/01</b>	<b>2001/02</b>	<b>Total</b>
Total 1999 Health Funding Package	222	211	211	644
Includes:				
Mental Health	15	30	30	75
Elective Surgery	25	-	-	25

## Strengthening Families

A small but significant number of families face multiple disadvantages, including unemployment, poor skills, health and housing, and criminal histories. The goal of the Government's Strengthening Families Strategy is to prevent children growing up in such families falling into similar patterns.

### Helping those at risk

- *Family Start for up to 2700 More Families:* Family Start is a targeted home-based support service for families with new-born babies who face significant difficulties. Already working well, the programme will now expand into 13 more centres, serving up to 2700 more at-risk families a year. This intensive individualised long-term help will cost \$41 million in the next three years.

- *70 More Social Workers in Schools:* 70 more social workers will move into primary schools, covering an extra 35,000 students. They will identify at-risk children, and develop intervention plans in partnership with family, whanau, school and other agencies.
- *Child and Youth Mental Health:* Since 1996/97, we have provided extra mental health funding to implement the Mason report. Next year, this funding will top \$100 million for more and better services, including:
  - \$3 million for the 700 children with severe mental health needs in care or contact with Children, Young Persons and Whanau Services
  - funding to train 500 caregivers.

### Strengthening Families: Key Initiatives

(\$ million) GST inclusive	1999/00	2000/01	2001/02	Total
Total Social Team Package	25	34	33	92
Includes:				
Family Start	11	15	15	41
Social Workers in Schools	2	4	5	11
Child and Youth Mental Health	3	-	-	3

## Improving Outcomes for Maori People

Better Maori health, education and employment are a national priority. Specific initiatives in the 1999 Budget include:

- *Land and Business Development:* The Budget provides \$8 million over three years for a new programme complementing the Ministry of Commerce BIZ scheme, which will help Maori landowners and potential entrepreneurs get business advice.
- *New Maori Education and Language Initiatives:* The Budget provides for:
  - a campaign to raise Maori expectations about what their children could achieve at school
  - additional funding for Kura Kaupapa school property and Maori language education resources for primary schools
  - new funding for the Maori Language Commission and Te Puni Kokiri to promote the Maori language and produce a Maori-only dictionary.
- *New Maori Health Initiatives:* Improvements in health services for Maori in the 1999 Budget include regular home health visits for up to 30% of Maori children and their whanau, extra dental health services, and development of a proposal for a Maori primary mental health care programme.

### *Improving Outcomes for Maori: Key Initiatives*

<b>(\$ million) GST inclusive</b>	<b>1999/00</b>	<b>2000/01</b>	<b>2001/02</b>	<b>Total</b>
Total Disparities Taskforce Package*	17	22	18	57
Includes:				
Business Advice	2	3	3	8
Maori Education Media Campaign	3	5	5	13
Maori Language Strategy	3	3	2	8
Maori Language Education Resources	1	3	3	7

\* Note that of the three-year total of \$57 million, \$23 million relates to funding redirected from within existing departmental baselines, or included in the 1999 Education Package.



## Justice and Security

Criminals should be caught and punished. But this Government also wants to keep young people out of jail where possible, and ensure they do not re-offend after release.

- *Stopping Cycles of Crime:* Young criminals should not be in adult prisons alongside hardened criminals. The Government is building a new youth unit in Hawkes Bay, and six additional new youth units in new and existing prisons

around the country. Units are designed to help prevent youth suicide in custody, and improve rehabilitation programmes.

- *Getting Tough on Crime Hot-Spots:* Hot-spot teams of about 10 police each are provided in eight regions where crime is higher than the national average.
- *Safety in Courts:* Uniformed security officers will be provided in ten courts at risk from security breaches.

### Key Justice and Security Initiatives

(\$ million) GST inclusive	1999/00	2000/01	2001/02	Total
Total Justice Team Package	11	14	16	41
Includes:				
Youth Units	2	4	7	13
Police Hot-Spots	6	6	6	18
Court Security	1	1	1	3

## Encouraging Enterprise and Innovation

International competitiveness is the key to New Zealand's success as a trading nation. The Government is promoting seminars in centres across the country to consult with business, unions and all relevant interests. Key initiatives in the 1999 Budget are:

### ***A wider shareholding democracy***

The Government has announced a potential sale of Vehicle Testing New Zealand. This year, we intend to scope our ownership interests in the MetService Ltd. In anticipation, legislation introduced today will permit the removal of VTNZ and MetService Ltd from the SOE Act if we decide to sell. New Zealanders have shown a widespread public desire to participate in the ownership of former State businesses. Our policy is to continue to offer ordinary New Zealanders, wherever practicable, maximum opportunity to acquire shares in such enterprises.

### ***Creating innovation opportunities***

#### *Innovation through research and development*

The Budget boosts science and technology funding by \$28 million in the next three years. Work will focus on research and development likely to seed new high-technology industries. The Budget also provides a new liaison unit to attract business migrants, more facilitation of foreign direct investment, and more funding for Asia 2000 and trade access development.

#### *Key Enterprise and Innovation Initiatives*

<b>(\$ million) GST inclusive</b>	<b>1999/00</b>	<b>2000/01</b>	<b>2001/02</b>	<b>Total</b>
Total Enterprise and Innovation Team Package	24	37	28	89
Includes:				
Research and Development	6	11	11	28
Environmental Initiatives	8	8	8	24

#### *Improving the quality of our regulations*

**ACC Reform:** Competition in accident compensation will reduce costs, improve prevention, and get injured people back to work faster. To facilitate more competitive options for future management of the ACC's motor vehicle account, Budget Night legislation will move the account to a system where the future costs of accidents in a year will be fully funded from that year's revenue. To make the transition to covering the future cost of past accidents, motor vehicle registration fees will need to be increased. For a car this will mean an annual increase of \$47.50 from 1 July 1999.

Other regulations being revised include the Resource Management Act, Commerce Act remedies and penalties, and occupational licensing. We also continue to simplify the taxation system to reduce compliance costs on taxpayers.

### ***Safeguarding our environmental heritage***

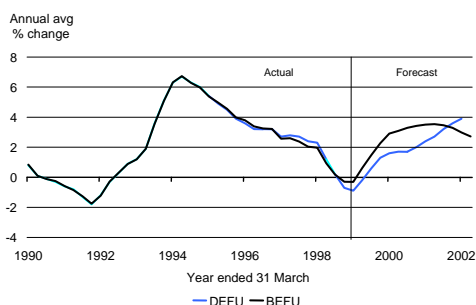
Around 1000 of our known animal, plant and fungi species are considered under threat. The Government is developing a strategy for the next 20 years to halt the decline in biodiversity. This Budget provides for a baseline stocktake of biodiversity, monitoring of biodiversity indicators, control of stoats, work extending a complete eradication of pests on selected offshore islands and a fund to clean up the soil of contaminated sites.

# Summary of the Treasury's Economic and Fiscal Forecasts

## The Economy is Expected to Grow Steadily

Following a modest contraction in 1998/99 the economy is expected to grow steadily over the forecast period. Growth is expected to be 2.9% in 1999/2000, 3.5% in 2000/2001, and 3.0% in 2001/02.

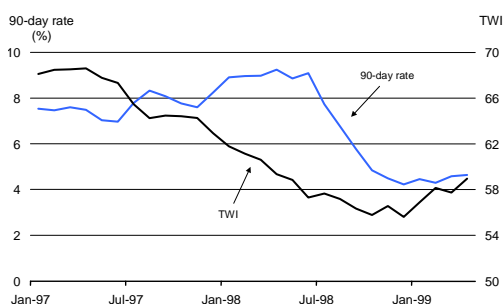
**Figure 1 - Steady Economic Growth**



Source: The Treasury

World economic prospects have improved through 1999, although compared to the mid-1990s the world environment is still not expected to be particularly strong. Trading partner growth is expected to consolidate in 1999 at around 2% before showing a mild strengthening over the forecast horizon.

**Figure 2 - Easy Monetary Conditions**



Source: The Treasury

The lagged impact of the significant easing in monetary conditions seen since mid-1997 set against a more stable world environment will help drive the economy forward over the forecast period. Tax rate reductions of recent years will also support activity.

Near-term growth will be maintained by strength in residential investment and associated consumer spending, as well as firms building up stocks as demand conditions improve. One-off events including the America's Cup and millennium celebrations add to momentum at the end of the 1999 calendar year. The lingering effects of two consecutive droughts are, however, expected to have a restraining influence on growth over the year to March 2000.

Growth throughout the forecast period reflects solid contributions from both domestic demand and exports rather than any one sector leading the way. Imports also pick up as the economy strengthens so that net exports make little contribution to growth. As a consequence the current account deficit is still around 6% of GDP by the end of the forecast period.

There are a number of influences that will make for more moderate growth than that seen in the previous recovery. These include a relatively weaker global economy, higher household debt levels, less catch-up and replacement spending, and weaker net migration.

In addition, a very gradual tightening of monetary conditions is anticipated, ensuring the economy continues to grow at a sustainable pace. Short-term interest rates are expected to rise gradually from the start of 2000 while the exchange rate shows a modest appreciation over the next three years.

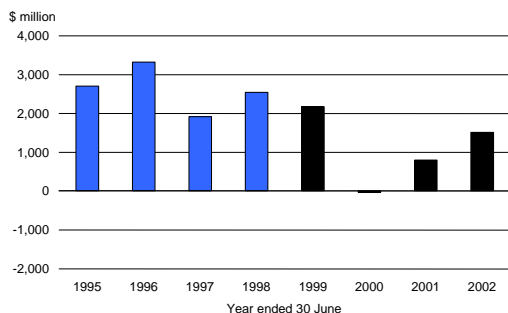
A strengthening labour market and a firming of international prices over the next three years contribute to rising inflationary pressures. However, inflation remains within the Reserve Bank's target range throughout the forecast period.

In each of the three years to March 2002 the nominal economy is expected to be larger than forecast in the *December Update*. This is a product of stronger economic growth, principally reflecting a stronger near term outlook for the world economy, as well as a stronger inflation profile.

### One-off Factors Boost the Operating Balance in 1998/99

The forecast operating balance in 1998/99 is \$2.2 billion.

**Figure 3 - Operating Balance**



Source: The Treasury

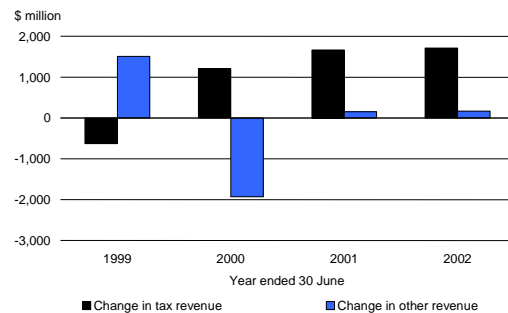
As in 1997/98, a number of items boost the 1998/99 operating balance including gains on the sale of Contact Energy Limited, (\$1,421 million), ECNZ small hydro-stations (\$115 million) and the Auckland and Wellington Airport companies (\$204 million).

In addition, a reduction in the valuation of the GSF (Government Superannuation Fund) pension liability adds \$217 million to the operating balance.

### The Operating Balance Recovers after Falling in 1999/2000

Despite a pick-up in tax revenue from higher nominal economic growth, the operating balance falls significantly to around balance in 1999/2000.

**Figure 4 - Change in Revenue Components Between Years**

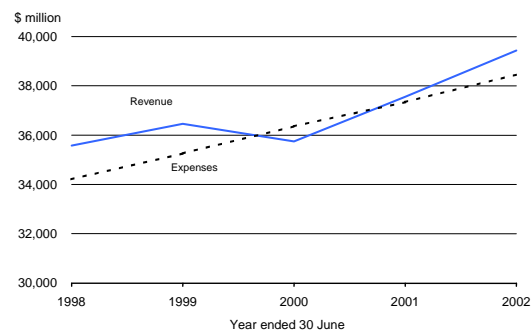


Source: The Treasury

This reflects the absence of one-off factors that boosted the operating surplus in 1998/99, lower SOE and Crown Entity surpluses from the recognition of the ARCIC outstanding claims liability (\$500 million) and higher expenses of around \$1.1 billion.

Beyond 1999/2000, the operating balance rises, with revenue growth outpacing expense growth.

**Figure 5 - Revenue and Expense Tracks**



Source: The Treasury

Revenue growth averages 5.1%, reflecting tax revenue growth from the improving nominal economy.

Expense growth averages 2.9%, reflecting a combination of CPI, demographic changes and policy initiatives.

Net debt falls from 24.6% of GDP in 1997/98 to 22.5% in 1998/99, largely reflecting asset sale proceeds.

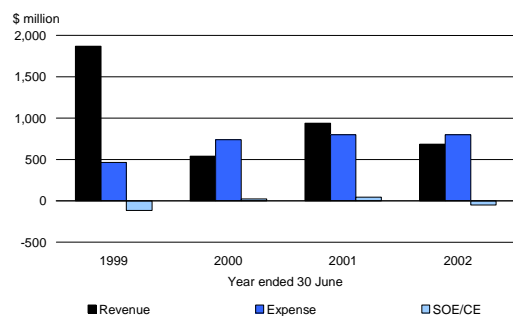
In 1999/2000 net debt rises slightly, reflecting an operating cash deficit and increased capital investment.

Net debt falls to around 20% of GDP in 2001/02 as operating cash-flows improve.

## Operating Balance Forecasts are Higher than in the *December Update*

The operating balance is over \$1 billion higher than in the *December Update* in all years reflecting economic and other changes.

**Figure 7** – Contributions to the Operating Balance: Change since December



Source: The Treasury

The revised economic forecasts result in:

- higher tax revenue from upward revisions to nominal GDP

- lower benefit spending from lower unemployment forecasts
- lower finance costs reflecting lower net debt levels and lower interest rates.

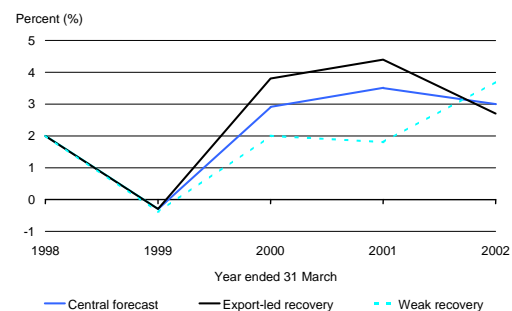
From 1999/2000 increases in total revenue and reductions in total expenses contribute relatively evenly to the operating balance improvement. Other forecasting changes since the *December Update* also contribute, including:

- the gain on sale of Contact Energy Limited of \$1.4 billion in 1998/99
- a devaluation of the GSF unfunded pension liability, which improves the operating balance by \$275 million in 1998/99 with a flow-on effect in following years.
- a reduction in benefit expense forecasts as recent outturns suggest lower take-up rates for the Domestic Purposes, Invalids and Community Wage-Sickness benefits.

## Forecasting Risks

There are a number of risks surrounding the economic and fiscal forecasts. If some of these risks were to develop differently from the judgements that we have included in the central outlook then the growth path that emerges could look quite different.

**Figure 8** - GDP Scenarios



Source: The Treasury

For example, export volumes may respond more favourably to the significant reduction in the exchange rate seen over the past couple of years.

Examples of a high growth scenario (Export-led Recovery) and low growth (Weak Recovery) scenario help to illustrate some of these risks.

On the other hand, risks arise from the possibility of a sharp slowdown in the global economy and the adverse effect of two consecutive droughts.

Mainly because nominal GDP is the key determinant of tax revenue, the different scenarios for economic growth lead to different fiscal outcomes outlined below.

*Alternative Scenarios: Operating Balance*

<b>Operating Balance</b>	<b>1997/98</b>	<b>1998/99</b>	<b>1999/00</b>	<b>2000/01</b>	<b>2001/02</b>
<b>(\$ billion, June years)</b>	<b>Actual</b>	<b>Estimated Actual</b>	<b>Forecast</b>	<b>Projection</b>	<b>Projection</b>
Central Outlook	2.5	2.2	(0.0)	0.8	1.5
Export-led Recovery	2.5	2.2	0.3	1.7	2.8
Weak Recovery	2.5	2.1	(0.6)	(0.7)	(0.3)

## Economic Outlook<sup>1</sup>

(Annual average % change, March years)	1997/98 Actual	1998/99 Forecast	1999/00 Projection	2000/01 Projection	2001/02 Projection
Private Consumption	3.1	1.5	2.0	2.8	2.7
Public Consumption	6.4	(1.0)	5.6	(3.0)	(0.1)
Total Private Investment	0.0	(0.8)	3.9	6.3	8.1
Exports	3.6	1.0	4.5	5.6	4.4
Imports	4.8	2.5	6.2	3.9	5.3
<b>GDP (Production Measure)</b>	<b>2.0</b>	<b>(0.3)</b>	<b>2.9</b>	<b>3.5</b>	<b>3.0</b>
Unemployment Rate <sup>2</sup>	7.1	7.6	7.4	6.7	6.0
90-day Bill Rate <sup>3</sup>	8.9	4.5	4.8	5.8	6.5
CPIX Inflation <sup>4,5</sup>	1.7	1.0	1.7	1.8	2.0
Nominal GDP (Expenditure)	3.3	0.4	3.8	5.2	4.6
Current Account Balance					
- % of GDP	(6.6)	(6.3)	(6.9)	(6.0)	(5.9)
TWI <sup>3</sup>	61.2	57.6	59.0	59.8	60.5

## Fiscal Outlook<sup>1</sup>

(\$ million, June years)	1997/98 Actual	1998/99 Estimated Actual	1999/00 Forecast	2000/01 Projection	2001/02 Projection
Total Revenue	35,581	36,462	35,741	37,559	39,438
Ratio to GDP (%)	36.3	36.7	34.5	34.5	34.6
Total Expenses	34,211	35,256	36,358	37,345	38,463
Ratio to GDP (%)	34.9	35.5	35.1	34.3	33.8
Contribution from SOEs and CEs	1,164	958	581	576	529
<b>Operating balance</b>	<b>2,534</b>	<b>2,164</b>	<b>(36)</b>	<b>790</b>	<b>1,504</b>
Ratio to GDP (%)	2.6	2.2	(0.0)	0.7	1.3
Crown Balance	9,921	5,456	5,420	6,210	7,714
Net Crown Debt	24,069	22,369	23,607	23,756	22,990
Ratio to GDP (%)	24.6	22.5	22.8	21.8	20.2

Sources: Statistics New Zealand, The Treasury

- Notes:
- 1 Economic projections were finalised on 27 April 1999, fiscal projections on 10 May 1999.
  - 2 Percentage of the labour force, March quarter, seasonally adjusted.
  - 3 Quarterly average.
  - 4 Annual percentage change, March quarter.
  - 5 CPIX refers to the Consumer Price Index excluding credit services.