Analysing New Zealand's Operating Balance Deficit

Since 2009, the NZ government's operating budget has been in deficit. The level of deficit has grown in each of the last three years and in 2011 reached $10.5 billion. Legislation (The Public Finance Amendment Act) requires the NZ government to adopt the principles of responsible fiscal management. Because of this, the NZ government is legally required to return the NZ operating balance back to surplus. The NZ government has signalled its intention to achieve a surplus by the end of the 2014/15 financial year. The operating balance deficit has mainly been caused by four major events between 2008 and 2010. These contributing factors are the NZ recession in 2008; underlying policies and issues in 2008; the Global Financial Crisis and global recession; and the 2010 Christchurch earthquake. 1

[Student explained in detail these causes using economic concepts and integrated changes shown on an AS/AD model and Circular Flow model]

Major Cause

The major cause of the operating balance deficit in NZ is the impacts of the global recession. Each of the four events affected the operating balance in NZ negatively; the Christchurch earthquake increased government expenditure due to increased (Tr) and (G) and reduced revenue. The government will have to cover about $5 billion of the combined $20b cost, and emergency assistance for businesses and workers hardest hit by the earthquake will cost between $100 million and $120 million. However, this did not affect NZ as much because just Christchurch lost employment and population, not all the rest of NZ. 2

Policies already in place in 2008 affected the operating balance by increasing expenditure on paying for schemes like Kiwisaver subsidies, Working for Families and 20 hours free early childhood education, but this increase in expenditure was not significant compared to the impacts of the global recession.

The existing recession in NZ in 2008 meant government expenditure increased to pay for increased (Tr) because employment fell and "tax revenue is expected to be $3,148 million lower in aggregate over the next four years". When the Global Financial Crisis hit and led to the global recession it affected all sectors of the NZ economy, government revenue fell from $56.7b in 2008 to $54.6b in 2009, a 3.7% decrease in revenue in just one year.

Comparing how different groups in New Zealand have been affected by the government's policy changes to eliminate the operating balance deficit by 2014/15

The Government plan to achieve an Operating balance surplus by 2014-15 with a thin surplus of $197 million. The Government is faced with the problem of scarcity, there is limited resources like tax revenue to fund necessary expenditure, and therefore they have to make economic decisions that will create an opportunity cost. The Government made the economic decision to make major budget cuts and increase taxes. They are reducing the operating balance deficit by increasing the tax on tobacco, freezing the funds on childhood care subsidies, becoming stricter on student loans and deferring the auto-enrolment of employees to Kiwisaver, childcare/housekeeper, income under $9,880 and the children's income credit funds will be frozen. 3

To reduce the deficit Government has decided to increase taxes on tobacco "The hardest hit from yesterday's announcements will be smokers, who will be paying $20.50 for a pack of 20 cigarettes within four years because of a progressive rise in tobacco excise – part of $1.4 billion forecast in new revenue." With the cost of tobacco rising the group that will be majorly affected by this rise in tax will be households that are on low incomes and smoke "Users of loose tobacco tend to be younger, of lower socio-economic status and be Maori or Pacific peoples. These groups are the most sensitive to price increases of tobacco products, hence their greater use of loose tobacco. This is especially evident among young people: 61% of smokers aged 15-19 years report smoking roll-your-owns." This tax means that the lower income earners will be the most affected by this tax increase.

To return to an operating balance surplus government will freeze the funds on early childhood subsidies "Parents of pre-schoolers could be facing higher fees for childcare because of a freezing of government subsidies, which are usually adjusted for inflation." "Unless a childcare centre absorbs all the cost rises, they will be passed on to parents." This means that parents of young children will have to pay more now for childcare fees, this will impact on the households with middle and low incomes, the increased cost will mean

3

that households with young children will now have less disposable income. This is the opportunity cost of freezing the funds on childhood care subsidies.

Early childhood care used to be a large cost for the Government, Ms Parata said, “recent research had shown the current rates more than meet the average cost of delivering high-quality ECE. Government subsidies for ECE had already doubled from $617 million in 2006/07 to $1.3 billion this year.” The cost of early childcare increasing will have a large financial impact on families reliant on two incomes to survive.

The Government is also raising the price of prescriptions “Prescription charges rise from $3 to $5 per item” this is because the Government will now receive more revenue from tax on prescriptions. “Prescription charges rise from $3 to $5 per item with a cap of 20 items, raising $20m in first year and $40m in subsequent years.” Additionally, the Government has raised GST; they raised it from 12.5% to 15%, meaning consumers pay more for goods and services. The middle and low-income earners will be the most affected by this because when they go to purchase goods they will now have to spend more to buy the same goods or reduce their spending. This type of tax is a regressive tax and takes proportionally more of low and middle-income wage and salary earners disposable income, but with the rise in GST, the Government will receive more revenue.

The Government budget has stated that to cut down costs so it can return to an operating balance surplus it will be deferring the auto-enrolment of employees to Kiwisaver. One of the main ways the Government was able to keep to its surplus deadline was by delaying the automatic enrolment of employees into Kiwisaver, which would have meant automatic Government payments.

With the automatic enrolment to Kiwisaver being cut back it meant that people who start a career won’t get the start-up fund of $1000, and it may be harder for new employees to start saving for retirement, as they have to enrol themselves voluntarily. This is the opportunity cost for individuals of the government not going ahead with auto-enrolment into Kiwisaver, and the loss of potential savings that could have been invested with NZ businesses and banks by the fund managers, and the foregone tax on investment income, is the opportunity cost for the government and the economy.

3

The Kiwisaver scheme was deferred because “the plan was expensive not only because of the member tax credits, the 50c the Government contributed for every dollar from the saver, but also because of the $1000 kick start for each saver who joined.” If Kiwisaver was kept going “auto-enrolment was expected to cost $514 million over four years but most of that would fall in the first year.” To try to get back to a surplus in his budget speech Mr English said, “auto-enrolment is now not possible without putting the updated forecast surplus at risk”. They will also get tougher on student loans “student loans are to be paid back more quickly, and they will freeze the parental income threshold for allowances for four years, and Masters and PhD students no longer have access to allowances, saving about $60m to $70m a year.”

4

Conclusion

Graduate students who find a full-time job will face reduced disposable income as more of their income is taken by the IRD to repay their student loans. They face reduced retirement savings, because they will have to join the Kiwisaver scheme voluntarily when they start work, to receive the $1000 kick-start and tax credit from IRD and any time delay affects the amount of future retirement savings. The groups who will be most affected by these changes are the low to middle-income wage and salary earners who now have to pay more for goods and services because of the increase in GST, and also face higher prescription charges and increased childcare costs and no tax rebates. Therefore, overall the changes are having a greater impact on groups who already have the least amount of money to spare, and are carrying most of the burden of the cost cutting measures and tax increases by the Government.