2011
BUDGET

Minister's Executive Summary

Building Our Future

Hon Bill English, Minister of Finance

19 May 2011

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New Zealand Government

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Minister's Executive Summary

Budget 2011 marks the next step in this Government's programme to tilt the economy towards exports, savings and investment and away from borrowing and consumption. It continues the responsible approach we took in the last two Budgets to build a platform for faster growth, more jobs and higher incomes.

Budget 2011 helps to lift national savings by returning to surplus sooner, increasing private savings in KiwiSaver and providing quality investment opportunities for New Zealanders. These measures reduce the need for government borrowing and support jobs and growth by reducing pressure on interest rates. They will also put the public finances in a stronger position to cope with future shocks.

With growth forecast to reach 4% next year and the economy forecast to create 170,000 new jobs over the next four years, it is appropriate to accelerate the Government's return to surplus.

The Budget achieves this while continuing to protect the most vulnerable New Zealanders, increasing investment in health and education and establishing a $5.5 billion recovery fund to help pay for rebuilding Christchurch.

The Government's responsible management of its own finances in Budget 2011, combined with the projected growth of the economy, means that despite the additional costs of the Canterbury earthquakes, net debt will remain below 30% of Gross Domestic Product (GDP) and we will return to surplus in 2014/15. This is one year earlier than previously expected. Contributions to the NZ Superannuation Fund will resume in 2016/17, two years earlier than expected.

To achieve this we have focused on getting better value from public spending. Budget 2011 identifies operating savings of $5.2 billion over five years. These savings are drawn from across the board. They include efficiency savings expected of most government agencies. They also include changes to KiwiSaver, Working for Families and student loans to make them financially sustainable and better targeted. Almost $4 billion of these savings is redirected to new initiatives – with most of it tightly focused on frontline services in health and education. The remaining savings will reduce the deficit.

Budget 2011 continues to make better use of Crown capital. It contains significant infrastructure investment, including in ultra-fast broadband and KiwiRail. The Government will look to extend the Mixed Ownership Model to four State-owned energy companies and reduce its majority shareholding in Air New Zealand. The proceeds are likely to be $5 billion to $7 billion, which will fund about a third of the Crown's investment in social infrastructure over four years. The alternative would have been to borrow the funds.

Despite recent shocks to our economy, Budget 2011 presses ahead with the Government's economic programme, putting the public finances on a sound footing and lifting national savings. This will support jobs and economic growth, while allowing continued investment in the critical public services that matter to New Zealanders.

Bill English
Minister of Finance

Achieving Higher and More Sustainable Growth

In the 15 years to the end of 2004, New Zealanders experienced significant improvements in their living standards. Real GDP increased by an average of 3.2% a year. Nearly half a million jobs were created over that time. Since then, however, the performance of the economy has declined steadily.

Budget 2011 is about ensuring we get back to a higher and sustainable growth path

The Government believes that a balanced and competitive economy can deliver materially higher growth rates and create more jobs for New Zealanders. Budget 2011 is another important step in the Government's economic plan to put New Zealand on a higher and more sustainable growth path.

Real GDP per person has not grown since 2004. The economy was in recession even before the global financial crisis. The downturn in economic performance coincided with:

- a construction and housing market boom, with the prices of existing houses increasing 115% between 2001 and 2007. Household debt as a share of disposable income rose from 105% in 2001 to almost 160% in 2009
- a significant increase in government spending. Core Crown expenses as a share of GDP are 6% of GDP (about $13 billion) above the 1994 to 2004 average
- a sustained high real exchange rate, with the average level of the real exchange rate over the five-year period ending in 2010 being the highest since the 1960s
- real export growth averaging just under 1.4% a year, compared with 5.4% in the previous 15 years, and
- a decline in national savings, reflecting an initial steep decline in household savings, followed later by a decline in government savings. This was reflected in the current account deficit averaging 8% of GDP from 2005 to 2009.

The charts on the next two pages highlight these trends.

Progress has already been made

Assisted by the steps the Government has taken already, there are signs the economy is moving onto a more sustainable footing. Households and businesses have been saving more and shifting away from an excessive reliance on borrowing for their consumption and investment.

Strong growth in emerging market economies has driven a rebound in global growth and resulted in high prices for our commodity exports. New Zealand's terms of trade are at a multi-decade high. New Zealand has strong links to Australia and China, two of the world's best-performing economies.

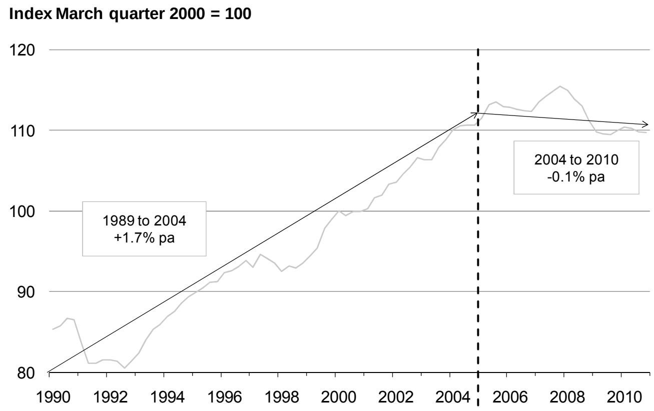
The Rugby World Cup will provide a boost to the economy in late 2011, and the rebuilding of Christchurch will significantly increase activity in 2012 and beyond. As this rebuilding gets underway, annual economic growth is forecast to rise to 4% in 2012/13.

What the Budget will Address

Per capita real GDP

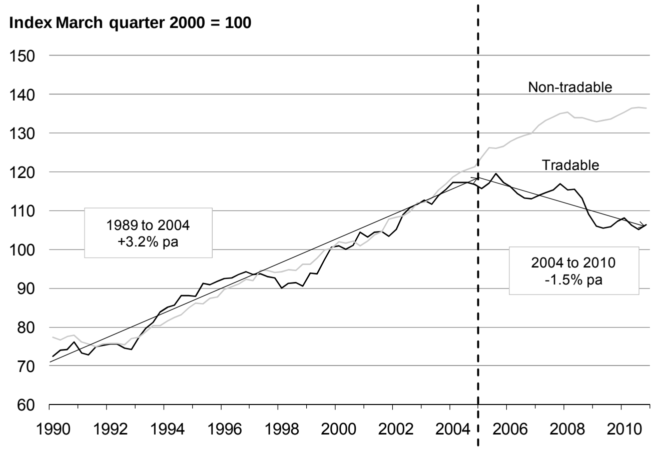
...has shown no growth since the start of 2004…

If average growth over the past six years had been the same as that of the preceding 15 years, per capita incomes would be 11% higher now.



Tradable and non-tradable output

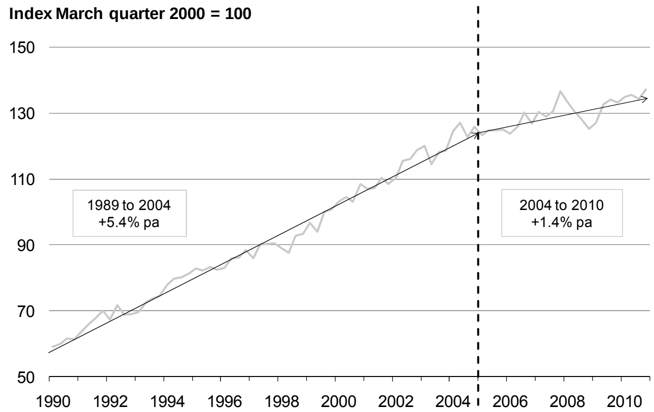
...with tradable value-add falling 10% since 2004, taking it back to 2002 levels, while non-tradable value-add, especially government, continued to grow.



Real exports of goods and services

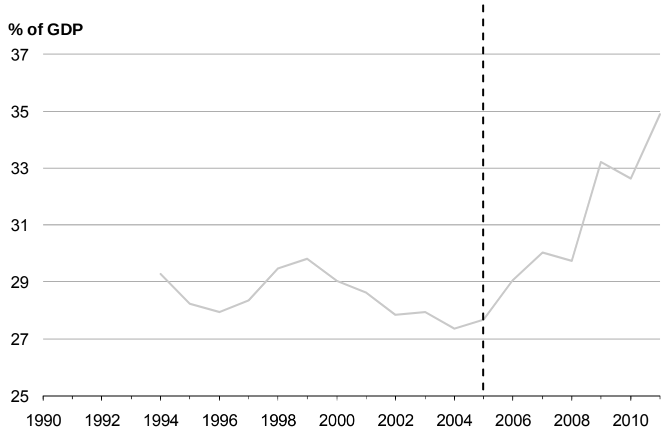
Export growth has fallen to less than one-third of the previous trend…

…and would today be $14 billion higher if the earlier trend had held.



Core Crown spending (excluding finance costs)

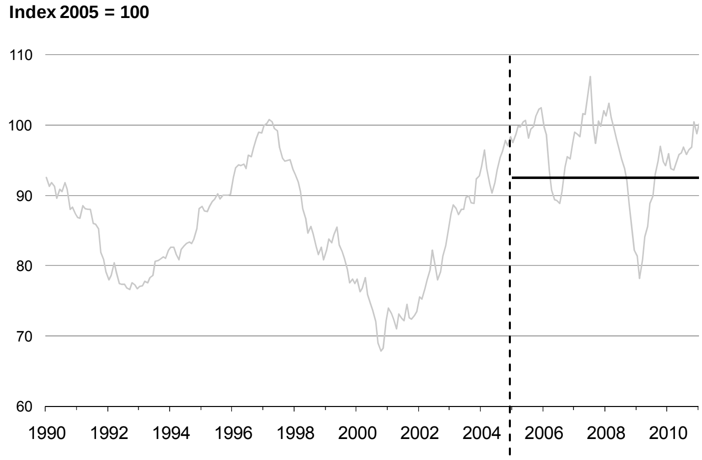
The current level is over 6% of GDP (about $13 billion) above the 1994 to 2004 average. This has put substantial indirect pressure on exports.



Real exchange rate

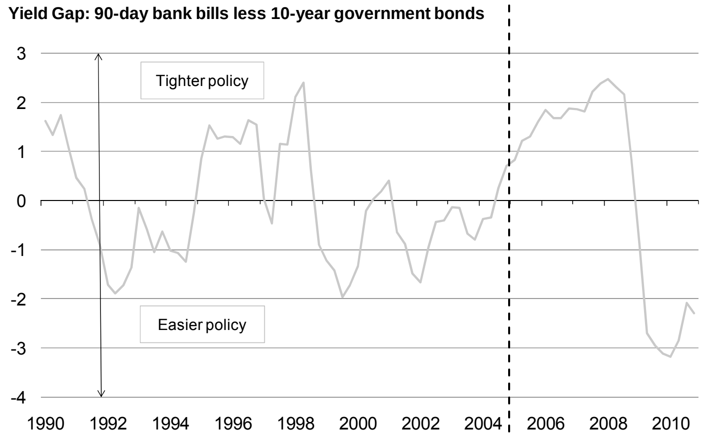
...was at its highest five-year average since the 1960s over the second half of the 2000s…

...and was the key driver of the slowdown in export and tradable value-added growth.



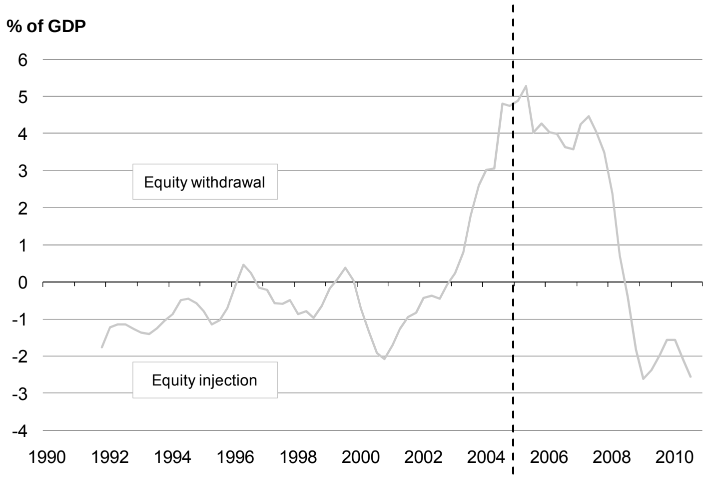
Gap between short- and long-term interest rates

Interest rates rose, with the Official Cash Rate (OCR) peaking at 8.25%, putting upwards pressure on the New Zealand dollar.



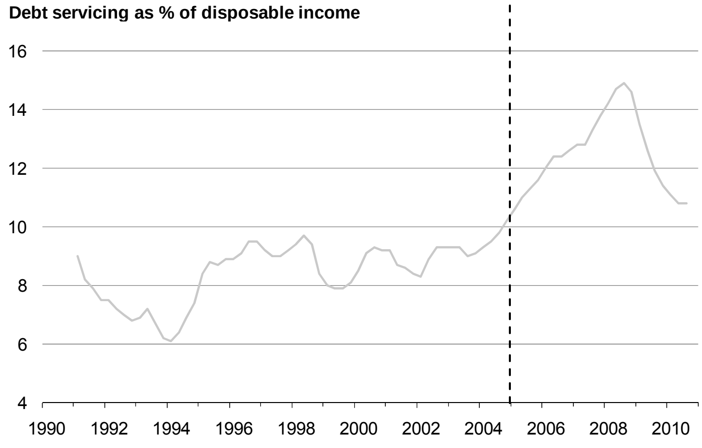
Housing equity withdrawal

The surge in borrowing went further than just financing housing. It spilled over into general debt-fuelled consumption.



Household debt servicing

Rising debt levels along with high interest rates meant more and more income went to debt servicing.



Sources: Statistics New Zealand, the Treasury, Reserve Bank of New Zealand, Bank for International Settlements

Building on what we have achieved in the last two years to support higher and sustainable growth…

Budget 2011 is the next step in our long-standing economic growth agenda, which is based on six drivers of economic performance: providing better and smarter public services; removing red tape and unnecessary regulation; investing in productive infrastructure; strengthening our tax system; lifting education and skills; and improving performance across science, innovation and trade.

Over the last two years, we have achieved significant progress against these drivers. To name just a few examples, the Government has put in place a multi-billion dollar infrastructure programme, implemented major changes to the tax system and undertaken significant regulatory reform. Budget 2011 makes further progress by continuing investment in infrastructure and public services while setting out a credible path back to surplus.

Continued investment in infrastructure will support higher productivity growth in the export sector. A reformed public service will meet New Zealanders' needs as well as lifting productivity in the government sector, freeing up resources to move to the export sector. A tighter fiscal track that absorbs the earthquake costs will reduce cyclical pressures on interest and exchange rates as the economy grows.

…Budget 2011 strengthens the Government's fiscal position…

The significant increase in government spending since 2005 provided substantial stimulus to domestic demand both before and after the global crisis. In light of the need to support the economy in the depths of the recession, the Government maintained spending and ran large deficits in the past two Budgets. With the economy expected to get back onto a solid growth track from late this year, it is appropriate to start reversing this increase in spending.

Budget 2011 achieves an operating balance (before gains and losses) that will return to a meaningful surplus in 2014/15 – one year earlier than forecast at the *2010 Half Year Economic and Fiscal Update*. Net debt will be kept below 30% of GDP.

This is a significant achievement. It means that, despite the impact of the February earthquake and the slower economic recovery, the public finances are now in a stronger position than they were in December 2010.

Exercising greater spending restraint will ensure the Government is in a stronger financial position ahead of future shocks to the economy. The earlier return to surplus will be achieved by restraining spending growth in a way that allows for the rebuilding of Christchurch, maintains core public services and protects vulnerable New Zealanders.

We will continue to seek efficiencies in the public sector, which could result in an even earlier return to surplus. Any further changes would be made in a way that continues to protect the vulnerable, as we have done in this and previous Budgets.

…by continuing our drive to get better value out of existing spending…

The operating allowance is used to control the level of discretionary new spending in each Budget. Last December, the Government signalled that the future operating allowance would be $1.1 billion a year, or $4.4 billion over four years.

Budget 2011 contains new operating spending of about $4 billion over the next four years, most of which is tightly focused on frontline health and education services.

At the same time, the Budget identifies $5.2 billion of savings from existing government spending over five years. The net result is a reduction of $1.2 billion in discretionary new operating spending over the next four years.

Compared with the Government's previous intentions, we have therefore reduced our debt requirement by $5.6 billion over the next four years.

Overall, however, core Crown expenses are still forecast to increase from $72.8 billion in 2010/11 to $77.1 billion in 2014/15, up from $64 billion in 2009/10. This is the result of other increases in spending outside the allowance for discretionary spending, such as the costs of the Canterbury earthquakes, and the rising cost of existing policies such as New Zealand Superannuation. A detailed breakdown of these changes can be found in the *Economic and Fiscal Update.*

…and moderating future spending growth

As well as reducing spending in Budget 2011, the Government has reduced the size of planned discretionary spending increases in future years to ensure a return to surplus in 2014/15.

We are reducing the operating allowance to $800 million for Budgets 2012 and 2013, and will continue to shift existing funding to higher priority areas to get better value from government spending. From Budget 2014 onwards, the operating allowance will return to $1.19 billion growing at 2% a year.

We will also direct capital expenditure to the highest priorities. From Budgets 2012 to 2016, we will use existing sources of funding on the Crown balance sheet to finance capital investments. As discussed further below, the proceeds from extending the Mixed Ownership Model will be important to achieve this, but we will also look carefully at the Crown's balance sheet to identify other areas where capital expenditure could be redirected to higher priorities.

Economic and Fiscal Data at a Glance

Economic data

March years	2011	2012	2013	2014	2015
Real GDP growth (annual average % change)	1.0	1.8	4.0	3.0	2.7
Inflation (annual % change March quarter)	4.5	3.1	2.4	2.5	2.6
90-day interest rate (March quarter)	3.0	3.0	3.9	4.7	5.0
Unemployment rate (March quarter)	6.8	5.7	4.8	4.8	4.6

Fiscal data

June years	2011	2012	2013	2014	2015
Core Crown expenses ($b)	72.8	73.0	72.6	74.1	77.1
Core Crown revenue ($b)	57.0	61.1	66.4	71.5	76.4
Operating balance before gains and losses ($b)	-16.7	-9.7	-4.1	-0.7	1.3
Operating balance before gains and losses (% of GDP)	-8.4	-4.7	-1.8	-0.3	0.5
Net debt ($b)	41.5	54.9	63.6	69.0	72.9
Net debt (% of GDP)	20.8	26.2	28.5	29.5	29.6
Gross sovereign-issued debt ($b)	71.6	77.8	79.2	88.7	86.2
Gross sovereign-issued debt (% of GDP)	35.8	37.2	35.5	37.9	35.0

Rebuilding Christchurch

Rebuilding Christchurch is a major goal of Budget 2011

Supporting those affected by the tragic earthquakes in Canterbury by rebuilding Christchurch is a major goal of Budget 2011. Christchurch is not only our second-largest city; it is also a major industrial, tourism and regional hub, and is therefore essential to the performance of the wider economy.

The Treasury estimates the damage caused by the two earthquakes is around $15 billion, which is about 8% of GDP. To put this in context, the March earthquake off the north-east coast of Japan is estimated to have caused damage equivalent to around 3% to 5% of Japan's GDP.

The direct cost that central government will face is estimated at $8.8 billion

The fiscal cost faced by central government as a result of the earthquakes remains uncertain. The Treasury's estimate of the direct impact on Crown expenses from the two earthquakes is $8.8 billion, including:

- $3.3 billion to recognise the Crown's Earthquake Commission (EQC) obligation ($1.5 billion for each event) and Accident Compensation Corporation (ACC) costs, and
- $5.5 billion for central government's costs, such as its share of local government infrastructure, roads, insurance excesses on schools and hospitals, temporary housing and other policy responses.

Budget 2011 establishes a Canterbury Earthquake Recovery Fund

The Government is establishing a Canterbury Earthquake Recovery Fund as part of Budget 2011 to account for its share of the estimated recovery costs. The Fund will ensure transparency and control over the cost of the earthquakes.

The Fund will initially be $5.5 billion, which will cover central government's costs as outlined above. It excludes the Crown's EQC obligation and ACC costs as these are funded by levies. A provision of $5.5 billion has been included in Budget 2011, with $740 million being funded from government agencies' existing budgets.

Table 1 – Earthquake costs and funding sources

Instrument	Canterbury Earthquake Recovery Fund		EQC + ACC
Estimated costs	$5.5 billion		$3.3 billion
Funding source	$4.8 billion new funding including from Canterbury Earthquake Kiwi Bonds	$740 million from existing funding	Reserves (levy funded)

We have recognised this $5.5 billion as an expense in the Crown accounts. The eventual cost of the earthquakes will be determined as the Fund is drawn down and used, which will take several years.

Cabinet will make decisions about how the Canterbury Earthquake Recovery Fund is used. The status of the Fund (including decisions taken and funding remaining) will be disclosed at each *Economic and Fiscal Update* (normally published in May and December).

Since the financial costs associated with the earthquakes are one-off and largely fall in the short term, it is appropriate to let these flow through to debt. We are creating a new Canterbury Earthquake Kiwi Bond to give New Zealand residents the opportunity to assist Christchurch by investing in a new four-year maturity bond, which will be added to the existing Kiwi Bond programme. Funding generated from Canterbury Earthquake Kiwi Bonds will contribute to the Canterbury Earthquake Recovery Fund.

Reprioritising Towards Front-line Public Services

Delivering better, smarter public services is a critical part of the Government's economic programme. Over the last two years, we have signalled the need for the public sector to become more efficient following large increases in spending over the past decade. In Budgets 2009 and 2010, we reprioritised $3.8 billion in public sector spending towards front-line services.

Budget 2011 directs spending towards front-line services

Budget 2011 achieves further savings of $5.2 billion over five years. Of this, we have redirected almost $4 billion towards new initiatives – primarily front-line services such as health and education. The remaining savings will be used to reduce the deficit.

In addition to this $5.2 billion, agencies have reprioritised a further $1.5 billion from within existing budgets towards higher priorities. This reprioritisation has allowed the Government to continue investing in front-line services, while constraining the increase in debt.

Health

The health sector will receive $1.7 billion new operating and $40 million capital funding over the next four years.

District Health Boards (DHBs) will receive an additional $1.6 billion to manage price and demographic pressures and widen access to newly subsidised medicines. Additional funding is also being provided to deliver better public health services, including $68 million for more elective surgery, $130 million for disability support services and $55 million for mothers and babies.

In addition to the $1.7 billion in new operating funding, a further $500 million has been reprioritised within Vote Health to help deliver these priorities. Total funding in Vote Health will be almost $14 billion in 2011/12.

Education

Budget 2011 provides an additional $1.3 billion new operating and $109 million capital funding for the education sector.

New funding is targeted toward initiatives that support our education system, lift student achievement and engage young people in study options that lead to worthwhile qualifications. Over the next four years this includes an increase of $118 million in new operational funding for schools, $550 million for early childhood education and $67 million to increase the number of Trades Academies and Service Academies.

In addition to the $1.3 billion in new operating funding, a further $356 million is being reprioritised within Vote Education to fund higher-priority initiatives. Total funding in Votes Education and Tertiary Education combined will be $12.2 billion in 2011/12.

Supporting State sector efficiency

Rebalancing the economy towards the tradable sector means that the public sector will need to make up a smaller part of the economy than it does at present. This means that the public sector will face tight spending constraints for some time to come.

To support our drive for better, smarter public services, the Government is seeking efficiency savings across the State sector of $980 million over three years.

This initiative will ensure that the State sector faces the same pressures that the private sector faces to improve efficiency and productivity. The aim is to reduce costs across the public sector while ensuring that the Government continues to provide the critical services that are important to New Zealanders. These savings will provide a catalyst for making significant changes to agencies' business models.

A key component of this initiative is a new requirement on State sector employers to meet the costs of KiwiSaver, the State Sector Retirement Savings Scheme (SSRSS) and the Teachers' Retirement Savings Scheme (TRSS) from within their own budgets. At present, many State sector employers are centrally funded for the costs of these schemes.

Budget 2011 terminates this central funding effective from 1 July 2012, which will place State sector employers on the same footing as other employers.

Insulating State sector employers from these costs is inconsistent with the Government's efforts to rebalance the economy towards the tradable sector. It is important that State sector employers face the same personnel costs as private sector employers.

Savings generated by the removal of central funding for KiwiSaver, SSRSS and TRSS equate to $650 million over three years. A further $330 million in efficiency savings will be sought from core government agencies.

The Government has been developing a range of tools to assist agencies to achieve these savings, such as improvements to procurement and capital management processes. The Better Administrative and Support Services (BASS) programme's recent benchmarking exercise has identified significant savings that can be achieved by improving efficiency across agencies, in the areas of human resources, information and communication technology and finance. This comes alongside the Government's sustained focus on addressing the long-term cost drivers in key areas such as welfare and law and order.

Better Managing Taxpayers' Assets

The Government is determined to get better use out of its existing assets. This means both improving capital disciplines, and redirecting capital to where it is most needed. The Government's balance sheet has trebled in the past 15 years – from $69 billion in 1995 to $223 billion in 2010. In part this growth reflects lack of scrutiny of capital spending, as well as inability to redeploy capital once it is no longer needed.

Our investment will be targeted to priority areas

The Government remains committed to its long-term capital spending programme. The Budget includes a range of new capital spending, mostly focused around improving New Zealand's infrastructure.

Budget 2011 allocates a further $942 million of capital funding to ultra-fast broadband, as Crown Fibre Holdings completes negotiations for the roll-out. This brings the total invested over the past three years to $1.4 billion. A further $28 million has been allocated for ultra-fast broadband in schools.

The Budget includes the second $250 million tranche of the Government's intended $750 million investment over three years as its contribution to KiwiRail's $4.6 billion turnaround plan. An additional $88 million over eight years has been included to complete the upgrade and renewal of the Wellington Metro rail network. The New Zealand Transport Agency (NZTA) continues to invest over $1 billion a year in State highway improvements, including the seven Roads of National Significance and a number of other significant regional projects.

These capital commitments are part of a larger programme of investment in public assets. The Government will increase its assets by a gross total of $78 billion between 2010 and 2015. Some of this extra investment will occur within the State-owned Enterprises (SOEs) and Crown Financial Institutions, but about $21 billion of core Crown funding will be invested in core social infrastructure and student loans.

The Government's objective is to maintain investment in core public assets without increasing debt. This highlights the need for the Government to prioritise where its capital is used, and to redeploy capital, rather than borrow, where possible.

The Mixed Ownership Model

At present, our portfolio of commercial assets presents the greatest scope to change the Government's asset mix. Earlier this year the Government announced it would explore extending the Mixed Ownership Model for some of its commercial assets. This model frees up Crown capital, opens up new investment opportunities, provides the companies involved with wider access to capital and imposes greater transparency and commercial discipline.

The Government believes there is significant merit in extending the Mixed Ownership Model to four State-owned electricity companies – Mighty River Power, Meridian, Genesis and Solid Energy – and reducing its majority shareholding in Air New Zealand.

Meeting the five tests for proceeding…

The Government has decided to seek a mandate to pursue the Mixed Ownership Model for these companies, having been assured the following tests can be met:

- The Government will maintain a majority shareholding stake by owning more than 51% of each company.
- New Zealand investors will be at the front of the queue for shareholdings, and the Government is confident of widespread and substantial New Zealand share ownership.
- The companies involved will provide good opportunities for investors.
- The capital freed up will be used on behalf of taxpayers to fund new public assets and thereby reduce the pressure on the Government to borrow.
- The Government is satisfied that industry-specific regulations will adequately protect New Zealand consumers.

…and taking the policy to the election in November

The Government will take its mixed ownership policy for these companies to the election in November. It will not proceed until it receives a mandate from voters.

In the meantime, the Treasury will undertake preliminary work to prepare for a programme of share offerings in the five companies identified and undertake initial steps to develop a plan for commencing the programme.

Expected proceeds of $5 billion to $7 billion

We anticipate the combined proceeds are likely to be between $5 billion and $7 billion, which could increase the New Zealand sharemarket's capitalisation by up to 10%.

It will also allow the Government to pay for about one-third of the expected increase in core Crown assets over the next five years, without adding to government debt.

We expect implementation of the Mixed Ownership Model across the four energy companies, and a reduction in the Government's majority stake in Air New Zealand, to take place over three to five years from 2012.

Initial public offerings (IPOs) are our preferred method for extending the Mixed Ownership Model.

Better Targeting of Government Programmes

Another part of the adjustment needed to support the economy is examining programmes where costs have increased rapidly in ways that were not anticipated, and that have not provided commensurate benefits to the community or taxpayers. KiwiSaver, Working for Families, student loans and ACC are all examples where cost escalation has occurred.

The Government is committed to all of these programmes. With modest adjustments they will be more effective, better targeted to those who really need them and more sustainable in the long term.

KiwiSaver

Budget 2011 includes changes that will see KiwiSaver funds continue to grow rapidly, but with a larger share of contributions coming from members and employers, and a lower share from the Government. This is expected to raise national savings, as government borrowing to fund private savings will be reduced.

KiwiSaver's contribution to national savings

The main purpose of KiwiSaver is to help people save for their retirement. As at December 2010 KiwiSaver balances totalled $7.9 billion. There are close to 1.7 million members, with around another 20,000 joining each month.

Just over 43% of all contributions to date have been funded by the Government, primarily through Member Tax Credit (MTC) and Kick-Start payments. This figure does not include the Employer Superannuation Contribution Tax (ESCT) exemption which, if counted, would bring the Government's share closer to 50%. In 2010/11 alone the Government will contribute around $1.2 billion.

National savings is simply the sum of public and private savings. At present, KiwiSaver's contribution to national savings is mixed. It helps individuals to save for their retirement, and thus lifts private savings. But it lowers public savings. It means the Government is borrowing, mostly from foreigners, to contribute to private savings.

The total impact on national savings depends upon what portion of the private contributions is additional saving, versus redirected saving that would have occurred anyway. Given the high public contribution, it is not clear that national savings have benefited greatly.

Budget 2011 includes changes to KiwiSaver to improve national savings

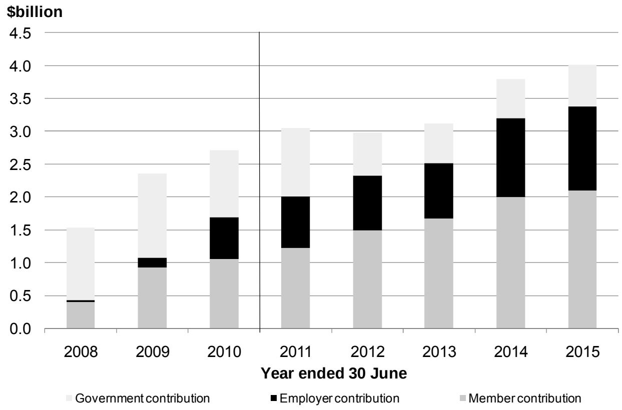
The Government believes that a better approach is to have New Zealanders actually saving for their future. This approach entails retaining KiwiSaver, with voluntary participation, but shifting the balance more towards private contributions.

The initial Kick-Start payment of $1,000, which is a factor in many members joining the scheme, will remain unchanged.

The Budget includes the following measures:

- From the year ending 30 June 2012, the MTC is to be halved. The Government will now contribute 50 cents for each dollar contributed by individual KiwiSaver members, up to a maximum of $521.43 per year, equivalent to $10 per week.
- From 1 April 2012, all employer contributions to employees' KiwiSaver accounts will be subject to ESCT. ESCT will be applied at a rate equivalent to an employee's marginal tax rate. This change will therefore have more impact on higher income earners who pay higher tax rates.

Figure 1 **–** Projected contributions to KiwiSaver funds



Source: The Treasury

- From 1 April 2013, the minimum employee contribution rate will rise from 2% to 3% for all members. The default contribution rate for new employees will also be 3% beginning at the same date.
- From 1 April 2013, compulsory employer contributions will rise from 2% to 3%.

The combined impact of these changes is fiscal savings to the Government of $2.6 billion over four years.

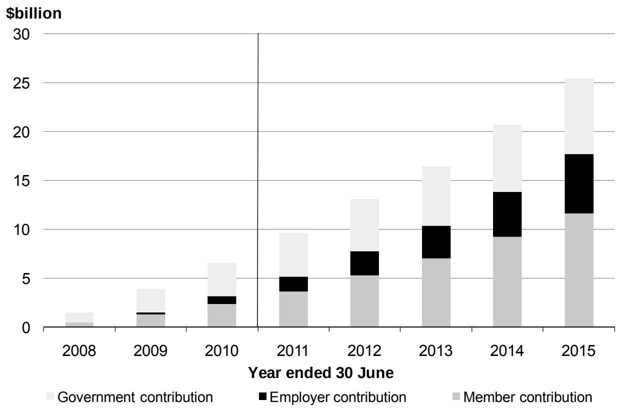
Changes made in Budget 2011 put the scheme on a sustainable footing. KiwiSaver remains an attractive savings option for New Zealanders. The Government will contribute close to $650 million to KiwiSaver accounts next year and $2.5 billion over the next four years.

KiwiSaver is building a large pool of local capital

KiwiSaver funds will continue to accumulate rapidly. Current projections are for total funds to rise from $7.9 billion currently, to around $25 billion by 2015, and almost $60 billion in 10 years' time.

KiwiSaver funds are well placed to participate in the Mixed Ownership Model which the Government will look to introduce from next year. Where SOEs raise outside equity, New Zealand investors will be at the front of the queue to invest. KiwiSaver funds are likely to become substantial long-term holders of these investments.

Figure 2 – Projected cumulative KiwiSaver contributions



Source: The Treasury

The decisions to lift default contribution rates, to keep KiwiSaver membership voluntary and to remove the ESCT exemption, were all recommendations of the Savings Working Group.

How the Changes to KiwiSaver Affect People

- Blair is 18 and earns the minimum wage – currently $27,144 a year. Blair joins KiwiSaver on 1 April 2013 and contributes the new minimum rate of 3% of his gross salary – $15.60 a week. Blair's employer contributes 3%, or $12.87 a week after tax. He receives $7.80 a week from the MTC. By age 65, Blair would have about $195,000, which would be enough to provide gross income of more than $11,500 a year in retirement over and above the single rate of New Zealand Superannuation – currently $17,676 a year after tax.

- Nick is 30 and works full-time earning $40,000 a year. He is already a member of KiwiSaver, having joined in July 2007, and contributes 4% of his gross salary. His employer contributed 1% from 1 April 2008, 2% from 1 April 2009 and will contribute 3% from 1 April 2013. Nick also receives the MTC. By July 2011, Nick will have around $14,500 in his KiwiSaver account and if he continues contributing 4% he can expect to have a balance of around $215,000 when he turns 65.

- Tama and Lisa are both 45. Tama earns $80,000 a year and Lisa earns $40,000 a year. They both join KiwiSaver on 1 April 2013 and contribute the new minimum rate of 3% of their gross salary. Tama contributes $46.03 a week and his employer contributes 3%, or $32.22 a week after tax. He receives $10 a week from the MTC. Lisa contributes $23.01 a week and her employer contributes 3%, or $18.99 a week after tax. She receives $10 a week from the MTC. By age 65 Tama and Lisa would have about $200,000, which would be enough to provide gross income of about $12,000 a year in retirement over and above the married rate of New Zealand Superannuation – currently $27,194 a year after tax.

- Emma is 50 and works full-time earning $50,000 a year. She joined KiwiSaver in July 2007 and at first contributed 4% of her gross salary. From 1 April 2009 she decided to reduce her contribution rate from 4% to 2%. Her employer contributed 1% from 1 April 2008 increasing to 2% from 1 April 2009. Emma also receives the MTC. By July 2011, Emma would have around $14,000 in her KiwiSaver account. From 1 April 2013, Emma and her employer must both increase their contribution rates to 3%. If Emma leaves her contribution rate unchanged at 3% her balance when she turns 65 will be around $75,000.

Working for Families

Budget 2011 includes changes to Working for Families (WFF) that simplify the scheme and put it on a more sustainable financial footing, while at the same time minimising the impact on families and lessening any effects on work incentives.

The cost of WFF has increased rapidly over the last five years as shown in Figure 3. This year, WFF tax credits will cost almost $2.8 billion – roughly twice what they cost in 2005/06.

As a result of Budget 2011, WFF will be altered over time so that the scheme has:

- a slightly lower abatement threshold of $35,000, compared to the current $36,827
- a slightly higher abatement rate of 25 cents in the dollar, compared to the current 20 cents in the dollar, and
- an alignment between the Family Tax Credit (FTC) payments for children aged 16 years and over and the FTC payments for those aged 13 to 15.

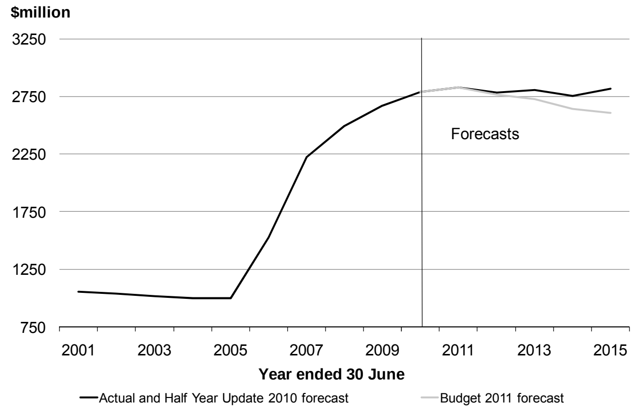
As a result, WFF will be better targeted to the most vulnerable families. A number of families higher up the WFF income scale will receive a little less than they currently do now, or will no longer qualify.

Changes will not be made in one go. To minimise the impact on families, the changes will be gradually introduced, each time the FTC payments for children under 16 are adjusted upwards for inflation, which in practice happens every second or third year.

A total of four adjustments will be required to transition WFF to the new abatement threshold and rate, starting on 1 April 2012.

These changes will generate fiscal savings of $448 million over the next four years.

Figure 3 – Cost of Working for Families



Source: The Treasury

Note: Prior to 2004, WFF was known as "Family Assistance".

As a result of these savings, the total cost of WFF will reduce from $2.8 billion in 2011/12 to $2.6 billion in 2014/15.

How the 1 April 2012 Changes to Working for Families Affect People

On 1 April 2012, 387,000 families will be affected by the changes to WFF. Overall, there are more families who will receive an increase in WFF tax credits on 1 April 2012 than families who will receive less. Families receiving more are concentrated at the lower end of the income scale, with those families below the new income threshold of $36,350 receiving on average approximately $7 extra per week. Only families with incomes above the new abatement threshold of $36,350 will receive less WFF tax credits on 1 April 2012 and more than 70% of these families have an income of $60,000 or more.

- Michael and Kiri's combined family income is $40,000 per year. They have three children aged 10, 13 and 16. They currently receive $280.76 a week in WFF tax credits. From 1 April 2012, this will go up to $284.88 a week – an increase of $4.12.
- Chris is a sole parent. He earns $90,000 a year and has two children aged 11 and 16. His income is right near the top of the WFF scale for a two-child family. Chris currently receives $18.66 a week in WFF tax credits. From 1 April 2012, as a result of the slightly lower abatement threshold, a slightly faster abatement rate and the fact that there is no inflation increase in the FTC rate for 16-18-year-olds, Chris will receive $7.12 a week – a reduction of $11.54.
- Elaine and Mataio's combined family income is around $61,000 per year. They have two children, aged 8 and 10. Elaine and Mataio currently receive $116 a week in WFF tax credits. From 1 April 2012, they will continue to receive $116 in WFF tax credits.

More details about the changes to WFF can be found at: http://taxpolicy.ird.govt.nz/

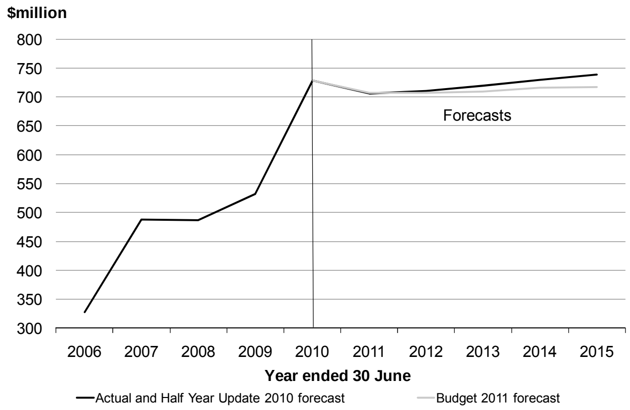
Student Loans

Encouraging personal responsibility and getting better value for taxpayers are key features of Budget 2011 changes to the student loan scheme.

The changes will direct lending to those who most need it, while preserving the essential features of the current scheme. Key initiatives include:

- restricting student loan eligibility for those with an overdue student loan repayment obligation of $500 or more who are in default for more than one year
- restricting borrowing for people aged 55 and over to tuition fees only
- removing the entitlement for part-time full-year students to borrow for course-related costs
- suspending inflation adjustments to the student loan repayment threshold until 1 April 2015, and
- shortening the repayment holiday for overseas-based borrowers from three years to one year, and requiring borrowers to apply for the repayment holiday and provide a New Zealand-based contact person before they go overseas.

Figure 4 – Cost of student loans



Source: The Treasury

The changes result in operating savings of $277 million over five years and capital savings totalling $170 million. This compares with the $1.58 billion in student loans the Government is lending in 2010/11.

ACC

Over the past two years, ACC has been successful in managing its quickly escalating costs. This has resulted in the Government needing to contribute $638 million less to the non-earners' account over the next four years than previously projected.

ACC members in other accounts will also benefit over time, with future levies also being lower as a result of the cost savings within the scheme.

The ACC scheme has not yet reached maturity, which means that more claims are entering the scheme than exiting, and therefore it is expected to grow above CPI inflation. However, ACC is continuing to develop initiatives targeting the most significant cost drivers that they consider will have potential to further reduce costs and lower the growth rate.

Summary of New Spending and Savings Initiatives in Budget 2011

Table 2 – Summary of savings and new spending (excluding earthquake costs)

$ million, June years	2011	2012	2013	2014	2015	Total
Savings in Budget 2011						
KiwiSaver: reduced government subsidies and increased private contribution	-	512	682	698	720	2,612
Efficiency savings: reducing costs across the State sector	-	-	320	330	330	980
ACC non-earners' account savings	-	178	133	164	164	638
Working for Families	-	25	101	125	197	448
Tertiary Education (including student loans)	79	(34)	34	57	56	192
Foreign Affairs and Trade / Official Development Assistance	-	45	60	25	-	130
Change to thin capitalisation rules for foreign-owned banks	-	8	31	31	31	101
Social Development	66	(34)	(23)	29	28	67
Total savings	145	700	1,338	1,459	1,526	5,168
Allocation of New Spending in Budget 2011						
Health	(115)	483	438	437	436	1,680
Education	178	248	354	170	350	1,300
Contingencies (including $100 million p.a. in a between budget contingency)	-	201	140	111	111	563
Justice sector	46	111	-	-	-	157
In-year revisions to expenses	-	-	-	31	31	62
Tourism	-	15	15	15	15	60
Statistics 2020	-	14	18	14	12	58
i-Govt	-	12	16	-	-	28
Irrigation investment	-	4	5	8	9	26
Other		8	4	1	1	15
Total spending	110	1,096	990	787	966	3,948
Net savings in Budget 2011	**35**	**(396)**	**348**	**671**	**560**	**1,219**

Note that numbers may not add exactly due to rounding

More detail about these initiatives can be found at: http://www.treasury.govt.nz

Investment Opportunities

Part of lifting private savings involves creating a better environment for investors. This has been highlighted by both the Capital Markets Development Taskforce and the Savings Working Group.

Even though local capital markets have generally performed well over the past decade, investor confidence is not as high as it could be. Considerable wealth has been destroyed via finance company failures and other fallout from the global financial crisis. One consequence is that New Zealand households continue to hold poorly diversified portfolios, dominated by housing and bank deposits. A better functioning market would leave households less vulnerable to any downturn in house prices, and leave the economy less dependent on external capital.

A good investment environment, where New Zealanders can invest with confidence, will include both clear and effective rules and good-quality investment opportunities.

Over the past two years, the Government has overseen a substantial improvement in the regulatory environment. This has included the creation of the Financial Markets Authority, an overhaul of securities legislation, extension of Reserve Bank prudential supervision and capital adequacy requirements to non-bank deposit takers, introduction of a prudential supervision regime for the insurance sector, and licensing of financial advisors.

New initiatives will provide a broader range of investment opportunities

Budget 2011 continues progress towards better functioning capital markets with several initiatives which will present both equity and debt investment opportunities:

- The Mixed Ownership Model extension will create new investment opportunities for New Zealanders.
- The Government will consider facilitating creation of broadly diversified, listed passive debt and equity vehicles. These would offer easy, one-stop access to the local capital markets. This suggestion was raised by the Savings Working Group.
- The creation of a Canterbury Earthquake Kiwi Bond. Revenue from this Kiwi Bond will be used to partially finance the Canterbury Earthquake Recovery Fund.
- The New Zealand Debt Management Office will issue a new long-term inflation-indexed bond. This will cater to an expressed need for long-duration real assets, particularly from longer-term investors who at present have no direct means of eliminating inflation risk.
- The local government funding agency will begin operation in 2011. This will be a collective debt vehicle, issuing securities backed jointly by most large local authorities. This will provide cheaper funding for local projects, as well as more liquid, better diversified assets for investors.