Hon Bill English

Minister of Finance

Speech to the Wellington Employers' Chamber of Commerce

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Good afternoon and thank you to the Wellington Employers' Chamber of Commerce for inviting me back to speak to you this year.

To say that a lot has happened since I spoke to you 12 months ago is something of an understatement.

Throughout 2010, aftershocks from the global financial crisis continued to ripple around the world.

And here in New Zealand, over the past two years, New Zealand has experienced the two earthquakes, the collapse of finance companies, blizzards in Southland, drought in Northland, PSA in the Kiwifruit industry, the costs of leaky homes and schools, loss of life in the Pike River mine and now potentially the support package for AMI policyholders.

This leaves many of us asking "what's next?"

The need for perspective

These events are newsworthy, but they do not materially change our economic programme.

We remain confident about our wider programme, which includes:

- Building stronger economic growth based on savings, investment and exports.
- Getting back to surplus as soon as possible and starting repaying debt.

There's certainly no need to change that direction.

The Budget next month will be about pressing on with our programme.

It will focus on increasing savings and investment, as well as the rebuilding of Christchurch. It will be a balanced and responsible Budget for the times.

The earthquakes, finance company collapses and potential support for AMI policyholders certainly come at a considerable cost to taxpayers, but they are one-off costs.

We are responding to them. However, it's important that we don't over react.

To put them into perspective, they amount to a several billion dollars over the next four or five years – whereas the Government currently spends about $70 billion a year.

We've also had a number of large positive surprises, which don't get the same headlines.

Reasons to be optimistic

I'm confident that we are on the right track and there are some good reasons to be optimistic for the next few years.

Let's remind ourselves of some of the positives.

First, the global crisis has not brought Armageddon. Two years on, our financial system is sound and the economy is growing.

Export prices are at record levels, up 30 per cent over the past year according to the ANZ Commodity Price Index.

Overall our trading partner growth remains strong. We have been well served by our strong ties with Australia, and our strong and growing links with Asia.

Our trade is moving quickly towards Asia. In the year 2000, the United States took 15 per cent of New Zealand's exports, and China 3 per cent. By 2015, it will be almost the other way round. Exports to China have almost doubled since the free trade agreement took effect in 2008, with dairy and forest products to the fore.

To sum it up, the merchandise terms of trade jumped 10 per cent in 2010. This equates to a lift in national income of more than $4 billion – a boost to the economy equivalent to the full annual value of the October personal income tax cuts.

Our competitiveness with Australia is near an all time high. This is primarily because the New Zealand-Australian exchange rate is at a 20 year low.

In turn, this largely reflects the strength of Australia's minerals boom. So we are an indirect beneficiary of that boom.

We have reinforced that advantage through the changes to our tax system; a better regulatory system; through our infrastructure programme; via our new financial markets framework; and around our policy process which will continue to make progress year after year.

We also note that:

- Floating mortgage interest rates are at 45 year lows (5.7 per cent) and have halved in the past three years.
- Inflation remains low – setting aside the GST rise, for which everyone was at least compensated.

I appreciate things are tight for many families. But the facts are that after tax wages, as measured by the Quarterly Employment Survey, rose 6.8 per cent last year, compared with annual inflation of 4 per cent.

Since September 2008, real after tax wages have risen a total of 10 per cent. This is very significant, when you consider that in the nine years before that, real after tax wages rose only 4 per cent in total.

And let’s not forget that despite all of our significant global and domestic challenges, the economy has grown in six of the past seven quarters – albeit pretty modestly.

Current situation

From the start the Government’s strategy has emphasised lifting national savings and making the economy competitive.

This recovery is fundamentally different to previous recoveries in New Zealand.

It is not built around consumption, taking on more debt or increased Government spending.

It is built around lifting national savings rates and reducing debt, including the Government’s debt. This will shift resources back towards sectors where we have a competitive advantage and activities we are good at – allowing us to earn our way in the world.

We have genuine competitive advantages in agriculture and other primary industries. We are a great destination for tourists and we have world-class companies in high-tech manufacturing, education, software, film and other industries.

But collectively, their output has fallen 10 per cent since 2005. We have halted this slide, but we need to accelerate the process and get them growing faster.

The economy is now part way through this adjustment. Private savings rates have lifted sharply and New Zealanders’ appetite for more debt has diminished.

We can see this from looking at credit growth, which is close to zero even though the economy has been growing for eighteen months.

In the short term, higher savings is a headwind. In the longer term, it is required for faster and enduring growth.

I was pleased to see this neatly set out recently by Bank of New Zealand economists. They said gross household savings as a proportion of disposable income is on track to reach more than 5 per cent in the current March year – the best result since 1992.

As BNZ’s economists noted, the process will be a bit painful in the short term, but it is laying the foundations for lasting, quality economic growth over the medium to long term.

Improving the operations of Government

Let me now turn to the Government’s role.

We have had a broad economic programme over the past two years. We have put in place a significant infrastructure building programme, structural improvements in the tax system, better regulation and a host of other policies.

We are also pressing on with the macroeconomic aspects of the programme, including making the economy less reliant on public spending, private sector credit growth and debt.

Between 2005 and 2007, private sector debt grew by about 15 per cent a year. In the year to February 2011, it grew by only 1.5 per cent.

So households have pulled back on debt. Now it's the Government's turn.

Government spending to GDP has lifted sharply in recent years, from 29.1 per cent in 2005 to 34.9 per cent this year. This was driven by an expansion of entitlements, higher costs of delivery and shrinking GDP.

Some of that spending has occurred to pay for large programmes and to protect New Zealanders from the sharp edges of the recession.

If this rate of increased spending continues, it would continue to harm the economy by pushing up interest rates and the exchange rate, and squeezing exporters.

We maintained spending growth while the economy was in recession. But now that it is showing signs of life, we need to withdraw the stimulus and head back towards normal.

In the Budget next month, we will restrain new spending and prioritise it towards health and education. New spending initiatives will total almost $1 billion. However, this will be substantially offset by reducing lower priority spending in other areas.

Underlying spending, even aside from Christchurch, will still rise. This reflects areas such as New Zealand Superannuation, welfare benefits and finance costs – which fall outside the operating allowance - continuing to grow.

The decisions we will make will continue to be balanced and to protect the most vulnerable. There will be no wholesale scaling back of income support measures, and the direct impact on disposable incomes will be modest.

Looking at the mix of assets we own

The second area the Government will consider is capital spending – traditionally overlooked by successive governments.

Our first Investment Statement, published in December, shows the Government, on behalf of taxpayers, owns $223 billion of assets.

This covers a vast array - everything from hospitals, roads, schools, police stations, conservation land, state houses, and military hardware, to the Super Fund, electricity companies and coal mining operations.

By 2015, the Crown expects to acquire an additional $70 billion of assets, or more than the value of the entire New Zealand sharemarket. This figure includes many high-priority areas, including new schools, hospital operating theatres, ultra-fast broadband and roads.

As the Prime Minister outlined, this reinforces the need for the Government to prioritise where its capital is used.

After all, that's what any business or household does all the time – they sell some things they own, they buy others, or they use the money to pay down debt.

At present, looking at the mix of our commercial assets presents the greatest scope to change the Government's asset mix.

This makes sense. It frees up Crown capital, provides the companies themselves with wider access to capital, and imposes greater transparency and commercial discipline.

At the same time, we want to provide Kiwi investors with opportunities to put their money in solid, New Zealand-controlled companies.

So we have asked Treasury for advice on the merits and viability of extending this mixed-ownership model.

Ministers will consider Treasury's advice and make their position clear to New Zealanders well before the election in November.

Impact of the quakes

The earthquakes, and similar shocks, actually impact on the Government's economic programme less than might be imagined.

They do not fundamentally change our economic situation or the Government's programme. They simply make the task of returning to surplus, and getting on top of the Government's debt, a little more difficult.

Businesses in Christchurch are on a recovery path. Last week, Paymark, which processes all EFTPOS transactions, noted that weekly sales were only 3 per cent below last year's levels, as compared with 31 per cent down immediately after the quake.

Paymark estimated that, nationally, transactions appeared down about 1 per cent in February and March compared with what would otherwise have occurred.

More broadly, Treasury has estimated that the direct impact of the quake will be to lower New Zealand's GDP by about 1.5 per cent in the year to June 2011.

And Treasury last month suggested the resulting loss of tax revenue, as a result of the earthquakes and lower growth, could be between $3 billion to $5 billion over the next five years, based on its preliminary assessment a month ago.

However, the good news is that on current forecasts this loss of tax revenue is likely to be a bit less than $3 billion, though we are still awaiting final Budget forecasts.

In addition, the Crown faces direct costs to help rebuild Christchurch.

At this stage, we estimate the direct costs to the Crown at around $5.5 billion. We will fully provide for this in Budget 2011.

About $3 billion relates to our share of local government infrastructure, roads, insurance excesses on schools and hospitals, temporary housing and land remediation, demolition costs in the CBD, ACC costs and the business support package.

The remaining $2.5 billion will cover expected costs of decisions we have yet to make – the biggest cost is likely to be land remediation of damage from the February quake. The final cost of land remediation is still to be determined.

In addition, the direct cost to EQC of meeting residential property damage of the two quakes will be at least $3 billion, making a total direct cost to Government of around $8.5 billion.

This figure needs to be placed in context. It sounds a lot. In fact it is a lot. But New Zealand's annual GDP is around $200 billion a year; the Government spends around $70 billion a year; and it has assets of over $220 billion.

Meeting the Government's share of the immediate earthquake costs will require a quite substantial front loading of Crown debt in the next year or two. That's because we need to get the rebuild underway quickly and therefore we need the money immediately.

AMI policyholder support package

Within the Government's overall response to help rebuild Christchurch, last week I announced a support package for AMI policyholders.

This support received near unanimous support in Parliament. No one wanted to see Christchurch householders, whose homes were destroyed or badly damaged, not receiving full insurance payouts. That was a very real prospect if we did not act.

Any cost to the Crown of supporting AMI policyholders, when added to the other earthquake costs, is still manageable within the Budget. And it does not change our overall approach to the economy.

Taken together, all of these factors – many of them large one-offs - will mean that this year's operating deficit before gains and losses could be more than 8 per cent of GDP, or more than $16 billion. This is up from the $11.1 billion forecast in the December update.

It's therefore important that we get net Crown debt back to pre-earthquake levels so we can absorb future economic shocks when they come along – as they surely will.

Why we do not favour an earthquake levy

It has been suggested that we should raise taxes or introduce a new levy to fund the quake.

As we've said, our strong and clear preference is not to do that: The last thing hard-working Kiwis with tight budgets need right now is a new tax.

If you look at the numbers, we don't need a levy and it wouldn't help much:

The Greens have proposed a 1.5 per cent levy on annual income between $48,000 and $70,000; and 3 per cent on income above $70,000. That would mean $600 a year for someone earning $80,000; and $900 a year for someone earning $90,000.

The Greens levy alone would raise only $600 million a year, so it would have to remain for over a decade to pay for the quake.

So they are now saying they would also raise the company tax rate back up to 30 per cent, which combined with the levy would raise about $1 billion a year.

We're not interested in reversing our company tax cuts, which leave New Zealand competitively placed with the rest of the world.

To repeat, we believe we can get back to surplus within an acceptable timeframe without a levy.

Conclusion

In closing, I'm confident that New Zealanders understand the challenges we face. They are supporting the Government's direction to be more sensible and disciplined because it is what they are doing themselves.

The challenge now is to build confidence and get on with building a faster-growing economy. The global financial crisis was a major shock.

But on closer inspection the glass is more than half full. For example, by world standards we have:

- low tax rates and generally a sound tax structure
- a flexible labour market
- generally improved regulatory regimes

- certainty about our emissions trading regime
- a financial sector that has remained sound

And on top of this we have strong terms of trade and solid growth in key trading partners.

Now is the time to build on this early momentum. The next year or two will be about getting out of a survival mentality and into growth mode.

Thank you.