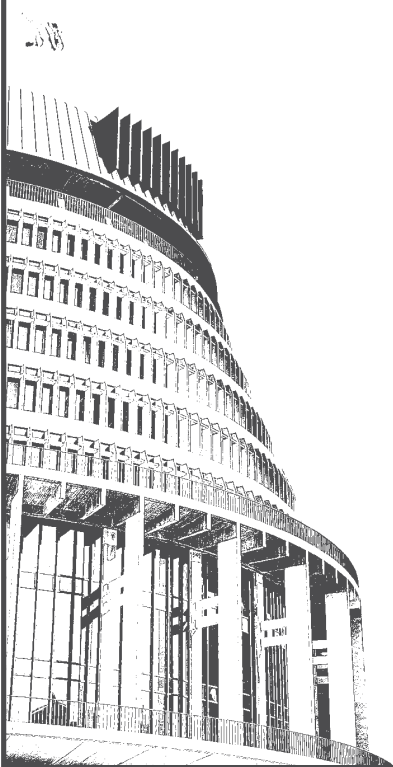


27 May 2004



budget 2004

Hon Dr Michael Cullen

MINISTER OF FINANCE

Executive Summary

- MINISTER'S STATEMENT •
- THE GOVERNMENT'S FINANCES AT A GLANCE •
- NEW SPENDING IN BUDGET 2004 •

EMBARGO

Not for communication in any form before the document is tabled in the House of Representatives by the Minister of Finance on Budget Day.

Minister's Statement

Budget 2004 is a strong financial and policy statement that reflects the results of disciplined fiscal management by allowing significant investment in future generations through the *Working for Families* package.

Strong economic growth and prudent fiscal management over the past few years have contributed to a solid fiscal position.

Ongoing momentum in the domestic economy is expected to sustain growth in the short term before the impacts of the higher exchange rate and a slowing in net migration combine to dampen growth in a year's time. Further out, continued strength in the world economy contributes to a rebound in economic growth.

The Government is in a strong fiscal position. The OBERAC (operating balance excluding revaluations and accounting changes) is expected to be \$5.7 billion in 2004/05; \$5.0 billion in 2005/06; \$5.1 billion in 2006/07; and \$5.4 billion in 2007/08.

The Government's fiscal strategy has been to rebuild the structural fiscal position so that the operating surplus is sufficient to make contributions to the New Zealand Superannuation (NZS) Fund, provide for the financing of student loans, expand the level of capital investment and manage debt at prudent levels.

The strength of the fiscal position means that the Government is able to confidently make further progress on our policy objectives.

Budget 2004 is our biggest investment yet, providing an additional \$2.4 billion in new spending in 2004/05 rising to \$3.8 billion by 2007/08.

At the same time, Budget 2004 lowers the long-term debt objective to lock in the gains that have been made over the past five years. A lower debt objective will provide a more rigorous fiscal anchor and better position future governments to deal with future spending pressures driven by demographic changes.

The centrepiece of Budget 2004 is the *Working for Families* initiative. *Working for Families* has a total cost at maturity of \$1.1 billion a year. It delivers a social dividend to low-income families and represents a significant investment in the workforce of the future.

Health and education are again big-ticket items. This is the third year of the Health Funding Package (HFP) and total health operating expenditure for 2004/05 is now \$9.4 billion. A significant additional investment of \$2 billion in education continues the Government's commitment to lift education standards of young New Zealanders and takes total education operating expenditure to \$9.2 billion by 2007/08. Budget 2004 advances the Government's objective of rebuilding capacity in the state sector and restoring realistic baseline funding for departments. The most affected agencies in this Budget are the Ministry of Foreign Affairs and Trade, the Department of Child, Youth and Family Services and the Department of Corrections.

The Budget also continues to deliver on the Growth and Innovation Framework. Budget 2004 provides \$500 million over four years of additional spending on economic development initiatives with a specific focus on assisting New Zealand firms expand offshore and promoting research collaboration.

Budget 2004 is about preparing for the future and owes a lot to the restraint of the past.

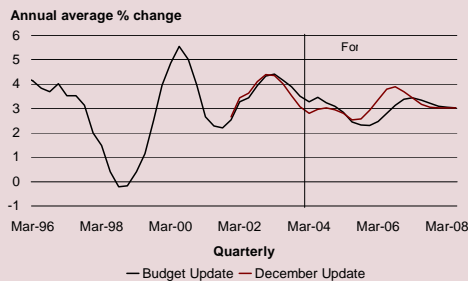
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Hon Dr Michael Cullen
Minister of Finance

20 May 2004

The Government's Finances at a Glance

Real GDP growth

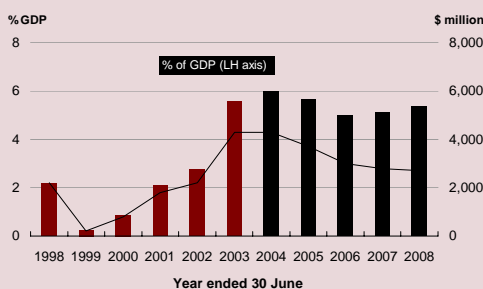


Sources: Statistics New Zealand, The Treasury

New Zealand's Economy

- New Zealand was one of the fastest growing economies in the OECD in calendar 2003, growing by 3.5% against an OECD average of 2.2%.
- The economy continues to show strength, but growth is forecast to slow to 2.8% in the year to March 2005, and to 2.5% in the year to March 2006, before rebounding to above 3%.
- Growth is forecast to become more balanced as the current strength in domestic demand moderates, import growth slows and exports rebound.
- The unemployment rate is expected to remain low and CPI inflation moderate.

OBERAC



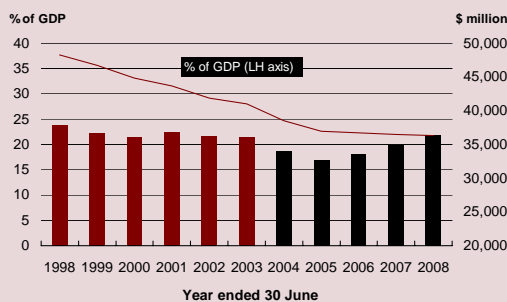
Source: The Treasury

The Government's Fiscal Position

Operating Balance

- The Government's OBERAC is forecast to be \$6.0 billion in 2003/04, which is ahead of the \$5.2 billion forecast in December.
- Looking ahead, the OBERAC is forecast to remain high despite easing to \$5.7 billion in 2004/05 and then to \$5.0 billion in 2005/06.
- Over the forecast horizon to 2007/08, the core Crown generates operating cash surpluses of around \$22 billion. This cash is used to fund the Government's investment activity (including contributions to the NZS Fund).

Gross sovereign-issued debt

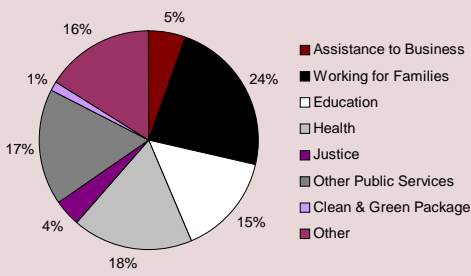


Source: The Treasury

Government Debt

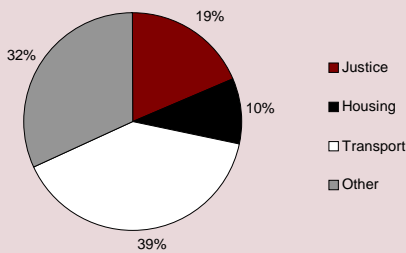
- Gross sovereign-issued debt is forecast to fall from 28% of GDP in 2002/03 to 21.8% of GDP by 2007/08, although it rises slightly in dollar terms.
- Net debt together with assets of the NZS Fund is forecast to fall to zero in 2007/08.

New operating spending (% over four years)



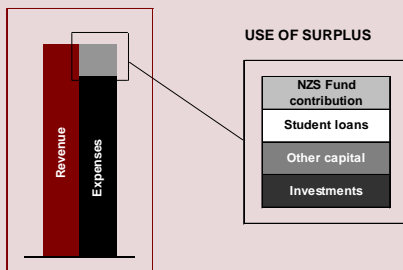
Source: The Treasury

New capital spending (% over four years)



Source: The Treasury

Use of the operating surplus



Source: The Treasury

Fiscal Impact of Budget 2004

- \$2.4 billion new operating spending in 2004/05, rising to \$3.8 billion in 2007/08.
- \$1.3 billion new capital spending over the next four years.
- \$2.1 billion contribution to the NZS Fund for the 2004/05 year.

FAQ: Is the Surplus Available for Spending?

An operating surplus of \$6 billion might indicate that there is a lot of cash available for additional spending. This is not the case.

Why? Basically, the operating surplus does not take account of other government commitments such as new capital spending.

In “household budget” terms, the operating surplus is like a family’s income after everyday expenses. As with many families, that “spare” cash is already committed.

Say the household is planning for the future – it has decided to build up savings for later life, and has made a decision not to spend the earnings on this investment. This is similar to the Government making *contributions to the NZS Fund* and retaining earnings on the Fund.

The family has a daughter at university, and is lending her money to help with her education costs. This loan will be repaid to the family once the daughter is in the workforce. Analogous to this, the Government has a policy of making *advances to fund student loans*.

As the family grows, they have decided to build an extension to their home. In the same way, the Government is committed to *capital purchases* such as new roads and state houses.

The family runs a small business and is constantly looking to maintain and expand that business. This takes up another portion of the “spare” cash. Similarly, the Government is also committed to maintaining the entities it owns, and does this via *investment in State-owned Enterprises* (such as Air New Zealand) and *Crown entities* (such as district health boards).

Taking all these commitments into account, the household’s spare cash – in the same way as the Government’s operating surplus – is fully utilised and at times may not be enough. Further spending would be funded by increasing the mortgage.

New Spending in Budget 2004

Responsible fiscal management is still a top priority for this Government...

Budget 2004 continues this Government's record of responsible fiscal management.

Over the past year, the economy has performed ahead of expectations and growth is forecast to remain strong in the short term. The strong economy and sound fiscal management flow through to a strong fiscal position, characterised by a falling debt-to-GDP ratio.

Against this background, Budget 2004 is this Government's largest policy investment yet (with an ongoing operating impact of \$3.8 billion). The Government is delivering a social dividend to low- and middle-income families, continuing to invest in health and education and rebuilding public sector capability, while continuing to prepare for the future.

Budget 2004 will deliver benefits across New Zealand's urban, regional and business communities.

Overview of New Spending

... and Budget 2004 is consistent with sustainable fiscal policy looking ahead.

The Government's total new operating spending in Budget 2004 is \$2.4 billion in 2004/05, rising to \$3.8 billion in 2007/08. We are also committing \$1.3 billion new capital spending over the next four years, plus investing \$1.9 billion to increase the Reserve Bank's foreign exchange reserves.

Contribution to the NZS Fund

On top of new spending, the Government continues to put money aside to assist with the costs of an ageing population via the NZS Fund.

At 30 June 2005, the NZS Fund is forecast to total \$6.3 billion. Next year, 2004/05, transfers into the Fund will be \$2.1 billion. We expect earnings of around \$330 million (after tax) to add to the value of the Fund during 2004/05.

New operating spending since Budget 2003

(\$ million) GST incl	2003/04	2004/05	2005/06	2006/07	2007/08	Total
Assistance to Business	24	181	169	170	170	714
Support for Working Families	-	221	664	900	1,125	2,909
Strong Public Service	443	1,469	1,661	1,734	1,972	7,279
Clean and Green Package	3	41	44	39	39	166
Progressive Coalition Package	-	6	5	5	4	20
Overseas Development Assistance	-	15	15	15	15	60
Between-budget contingency	1	459	505	499	496	1,959
Total 2004 Budget Operating	471	2,391	3,063	3,361	3,821	13,108

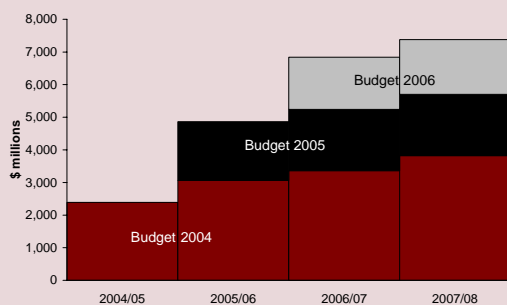
New capital spending since Budget 2003

(\$ million) GST N/A	2003/04	2004/05	2005/06	2006/07	2007/08	Total
Assistance to Business	101	158	92	140	140	631
Strong Public Service	148	308	183	161	11	812
Clean and Green Package	(64)	54	19	19	13	40
Foreign Exchange Reserves	-	500	500	500	400	1,900
Total 2004 Budget Capital	186	1,020	795	820	563	3,384

Note: the numbers in this document may not add due to rounding.

The rest of this document provides more detail on the spending summarised above.

New Budget spending



Source: The Treasury

FAQ: Is Budget Spending Rising?

Why does the Budget cost more in 2008 than it does next year?

Each Budget commits “new” money for policy initiatives. Sometimes the costs of these initiatives rise as some policy takes time to be fully implemented.

Several 2004 Budget initiatives (eg, the *Working for Families* package) have such a funding profile.

If next year’s Budget is less than this year’s Budget, does that equate to a “spending” cut?

No. In most cases, new operating funding creates a permanent increase to an organisation’s baselines.

New funding the following year (although it may be a smaller amount) is *on top of* that increase. For example, say a department receives \$100 million new funding in Budget 2004; and then receives \$50 million new funding in Budget 2005. Total funding from 2005 will have increased from the pre-2004 amount by \$150 million a year.

The chart at left shows total new operating spending for Budget 2004, plus planned new operating amounts for Budgets 2005 and 2006.

Budget 2004 puts a high focus on supporting New Zealand's business sector...

... including a package focused on developing New Zealand's international connections...

Assistance to Business

Assistance to business: Where are the dollars going?

Operating

(\$ million) GST incl	2003/04	2004/05	2005/06	2006/07	2007/08	Total
Growth and Innovation Package	23	151	148	148	151	621
Commerce and Communications	2	8	3	3	3	20
Crown Research Institutes	-	3	-	-	-	3
Economic, Industry and Regional Development	(1)	2	2	2	-	5
Research, Science and Technology	-	15	15	15	15	60
Other Assistance to Business	-	1	1	1	1	5
Total Operating	24	181	169	170	170	714

Capital

(\$ million) GST N/A	2003/04	2004/05	2005/06	2006/07	2007/08	Total
Assistance to Business Capital	-	14	2	-	-	16
Rail Decisions	99	72	40	40	40	290
Transport Package	3	73	50	100	100	325
Total Capital	101	158	92	140	140	631

Growth and innovation: What are the benefits?

Budget 2004 commits funding to support initiatives aimed at increasing New Zealand's growth potential. Around one third of the package supports initiatives to assist exporters.

Stronger international connections will strengthen New Zealand's position as a smart and innovative place to do business, helping us to achieve higher living standards and a bright future for our kids.

More than half of the package comprises initiatives that support international connections – of firms, individuals and our research and innovation system. Key initiatives include (over four years):

- export development assistance to help firms develop links with offshore businesses and customers (\$35 million)
- assistance for specialised business sectors to promote joint approaches to offshore market development (\$26 million)
- supporting the New Zealand international education sector to further develop connections in key markets (\$40 million including funding from the Education package)

... and substantial investment in Auckland infrastructure and rail networks.

- finding more offshore companies to partner growing New Zealand companies (\$43 million)
- significant additional support for *Research for Industry* to develop new processes, products and services (\$75 million)
- building a New Zealand brand that firms can leverage – including New Zealand’s presence at Aichi (\$12 million).

Auckland transport package: What are the benefits?

Budget 2004 commits this Government’s contribution to investing in Auckland Transport. This investment – over the next 10 years – will help cope with increasing demand on roads and passenger transport in Auckland. This funding will mean that a key barrier to better economic growth is removed, with a knock-on effect on the rest of New Zealand.

The Government’s transport package aims to deliver an unparalleled long-term investment by central government, and a clear, fair solution to the confused lines of responsibility that have inhibited Auckland’s transport development in the past.

This investment will deliver the benefits of a modern transport system in Auckland both to New Zealanders and to visitors.

In addition to the Crown contribution provided, the Government announced in December an increase to fuel excise rates and other measures to fund additional transport activity, both in Auckland and across New Zealand.

Broadly, the revenue from increased excise rates rises to \$270 million per annum by 2007/08. This revenue has been included in Transport spending plans (although the impact is neutral in respect of the operating balance and gross debt).

We have previously signalled significant investment to upgrade New Zealand’s rail network.

**Budget 2004
delivers a social
dividend to
working families...**

**... making work
more attractive...**

**... and benefiting
thousands of
New Zealand
households.**

Supporting Working Families

The most significant component of Budget 2004 is the *Working for Families* package.

Working for families: Where are the dollars going?

(\$ million) GST incl	2004/05	2005/06	2006/07	2007/08	Total
Increasing Family Incomes and Making Work Pay	96	503	765	1,008	2,372
More Affordable Housing	63	129	142	146	480
More Help with Childcare Costs	19	31	34	35	119
Changes to Hardship Assistance	(7)	(45)	(76)	(91)	(219)
Better Access to Assistance	50	46	35	28	158
Total Operating	221	664	900	1,125	2,909

Working for families: What are the benefits?

Working for Families has three aims:

- To make work pay by supporting families with dependent children, so that they are rewarded for their work effort.
- To ensure income adequacy, with a focus on low- to middle-income families with dependent children.
- To ensure people get the assistance they should to support them into and to remain in work.

These objectives will be achieved in a number of stages, beginning on 1 October 2004 and concluding on 1 April 2007. As a result:

- nearly 300,000 households will receive direct assistance by 1 April 2007
- from 2007, over 60% of families with dependent children will benefit from increases in Family Income Assistance. The average gain for these families is \$66 per week
- families will benefit from increases in Childcare Assistance and changes to the Accommodation Supplement,
- using a poverty value measure of 60% of median household income, there is expected to be a 30% reduction in child poverty by 2007/08.

This Government is committed to building strong services to the public...

... with the public service having the capacity to deliver high quality services now and in the future.

Strong Services to the Public

Budget 2004 shows commitment to providing strong services to the public. Included within this, the Government is continuing to ensure that the public sector has the core capability that it needs to deliver essential services.

Strong services to the public: Where are the dollars going?

Operating

(\$ million) GST incl	2003/04	2004/05	2005/06	2006/07	2007/08	Total
Health	5	495	549	571	609	2,229
Education	54	319	442	501	662	1,978
Justice	7	55	132	152	154	500
Social Development	(3)	34	29	25	23	108
ACC	-	12	22	20	20	75
Arts, Culture and Heritage	-	12	11	11	11	44
Customs	-	9	12	8	8	36
Defence and Security	-	48	50	51	51	200
Food Safety	-	4	4	4	4	15
Foreign Affairs and Trade	-	7	8	6	6	28
Housing	-	7	2	2	2	12
Immigration	-	(5)	(2)	7	7	7
Internal Affairs	3	13	-	-	-	17
Labour	-	5	5	5	5	18
Māori Affairs	-	25	25	25	25	99
Offices of Parliament	1	3	4	4	4	17
Archives and National Library	-	4	6	8	8	27
Sport and Recreation	-	7	4	9	10	30
State Services	6	21	19	17	17	80
Statistics	-	12	23	12	15	62
Transport	2	7	4	2	1	16
Other Public Services	2	35	52	62	62	211
Revenue	-	7	(25)	(57)	(57)	(132)
In-Year Decisions	365	335	288	289	325	1,602
Total Strong Public Services	443	1,469	1,661	1,734	1,972	7,279

Capital

(\$ million) GST N/A	2003/04	2004/05	2005/06	2006/07	2007/08	Total
Justice	9	107	116	19	-	251
Education	55	69	(3)	(37)	(53)	32
Housing	-	30	42	54	-	126
Other Public Services	84	102	28	125	64	402
Total Capital	148	308	183	161	11	812

In addition to the key spending areas outlined above, Budget 2004 commits \$60 million over the next four years in Overseas Development Assistance, and a package of initiatives totalling \$20 million over four years that particularly support Progressive Coalition policies.

Budget 2004 provides ongoing commitment to a fair and efficient health system...

... as part of a medium-term funding path.

Strong services to the public: What are the benefits?

The health sector

Budget 2004 continues this Government's commitment to a fair, comprehensive and efficient health system. Spending includes \$400 million in 2004/05 as part of the HFP. The HFP continues advances in primary health care, including lower cost primary care visits and \$3 prescriptions being extended to all people aged 65 and over from 1 July 2004. New funding will also:

- improve people's quality of life by doubling the number of publicly funded hip and major joint replacements (\$70 million a year, when fully implemented; partly funded from Budget 2004 and partly from Vote Health)
- continue to implement the Mental Health Blueprint (\$250 million over the next four years).

FAQ: How Does the Health Funding Package Work?

What is the Health Funding Package (HFP)?

In 2002 the Government agreed a three-year funding package for the health sector. Agreeing a package in advance (rather than making annual adjustments) provides greater certainty to the sector.

The initial package was \$400 million (operating) each year for the first three years. We are now in the third year. The package has since been extended to maintain its three-year horizon.

In addition, the sector receives funding to deal with changes in demographics (eg, more older patients requiring treatment). This year this amount is \$150 million. From 2005/06 onwards, demographic funding is included within the package. Therefore, future packages will be larger, (ie, the HFP amounts are higher, but additional demographic funding will no longer be provided).

How much money is the Health Sector getting in Budget 2004?

The total operating expenditure in Vote Health has increased from \$8.64 billion in 2003/04 to \$9.37 billion in 2004/05. This increase includes:

- new funding in Budget 2004 of \$495 million, which includes \$400 million for the HFP, \$23 million in demographic funding and \$25 million for mental health initiatives
- transfers from previous years and increases in funding for initiatives from previous budgets (such as \$127 million for demographics, and funding for the meningococcal vaccine programme announced in Budget 2002)
- new funding that does not impact on the Government's operating balance (as it is funded from other sources) of approximately \$50 million in 2004/05.

**Budget 2004
continues this
Government's
commitment to value
and invest in future
generations...**

**... and supports a
commitment to a fair,
safe society.**

The education sector

The 2004 Budget provides around \$2 billion funding for the education sector over the next four years. This includes \$1 billion operating funding for new initiatives and a further \$957 million operating funding to cover changes in demand (such as higher student numbers). We are also investing a further net \$32 million capital in this sector. Initiatives include (over four years):

- three- and four-year-olds in community-based centres will be entitled to 20 hours a week free early childhood services from mid-2007, via a new early childhood education funding and regulatory system (\$307 million)
- helping to lift student achievement through the National Qualifications Framework and the National Certificate in Educational Achievement (\$18 million)
- more domestic and international students will receive scholarships and benefit from other initiatives to boost international education (\$40 million, including funding from the Growth and Innovation package)
- tertiary education will be more affordable, through Budget funding for tertiary education institutions to implement the fee/course costs maxima (\$246 million)
- 12,000 more students will become eligible for a full student allowance and 28,000 more students for a partial allowance (\$223 million for increasing the student allowance parental income thresholds).

The justice sector

Budget 2004 includes around \$750 million (net) for the justice sector over the next four years. This includes around \$500 million operating and \$250 million capital. The package is key to this Government's ongoing commitment to working towards a fair, safe society, and will deliver many benefits, including (over four years):

- targeting organised crime, with new funding for extra Police resources to enforce drug and alcohol laws (\$40 million)
- strengthening national security, with dedicated investigators and an identity fraud unit (\$15 million)
- helping those New Zealanders affected by domestic violence, by enhancing the responsiveness of Police and other government agencies to family violence (\$15 million)

The Budget package also boosts the Government's provision of state housing.

- improving the speed with which complex criminal cases are processed through the courts system, via investment in evidence recording systems (\$30 million)
- bringing four new prisons into service in response to forecast increases in the prison population (\$199 million).

Housing

In addition to the housing aspects of the *Working for Families* package, Budget 2004 makes significant further injections to Housing New Zealand Corporation. From a package that includes \$126 million capital over the next three years, benefits will include:

- assistance to low-income Aucklanders in serious and urgent housing need – with the addition of 500 more state houses
- providing essential housing repairs for New Zealanders in rural communities living in sub-standard housing.

In-year decisions

Also summarised in the table overleaf are the costs of decisions taken during the year. Many of these decisions reflect this Government's ongoing commitment to building core capability in public services.

We are actively restoring realistic baselines for departments. For example:

- boosting Corrections capability, targeting areas such as staff training, property maintenance and prison health services (the output pricing review has led to a \$148 million increase in funding over the next four years)
- increasing the Ministry of Foreign Affairs and Trade's ability to respond to work demands in areas affecting New Zealand's security and prosperity interests (with funding increased by \$76 million over four years)
- implementing initiatives to improve the contribution that the Department of Child, Youth and Family Services makes to reducing the recurrence of abuse and to reducing reoffending (with a funding increase of up to \$260 million over four years from the baseline review).

Budget 2004 supports a substantive environment and biosecurity package...

... that will help keep New Zealand free from pests...

... and help to conserve and protect the environment.

A Clean, Green New Zealand

A clean, green New Zealand: Where are the dollars going?

Operating

(\$ million) GST incl	2003/04	2004/05	2005/06	2006/07	2007/08	Total
Agriculture and Forestry	-	6	3	3	2	14
Biosecurity	2	11	12	12	12	48
Climate Change, Energy Efficiency	-	3	3	3	1	9
Conservation	-	5	7	8	9	29
Environment	-	5	4	4	5	18
Fisheries	2	6	6	7	7	28
Lands and Other	-	6	8	3	3	19
Total Operating	3	41	44	39	39	166

Capital

(\$ million) GST N/A	2003/04	2004/05	2005/06	2006/07	2007/08	Total
Clean Green Capital	(64)	54	19	19	13	40
Total Capital	(64)	54	19	19	13	40

A clean, green New Zealand: What are the benefits?

Benefits to maintaining and improving New Zealand's natural environment include (over four years):

- preventing the arrival and spread of land and marine pests, with additional Biosecurity funding of \$40 million
- surveillance for, and early response to, southern saltmarsh mosquito infestations (\$6 million in Vote Biosecurity: Health)
- restoring Secretary and Resolution Islands in Fiordland National Park, by removing animal pests and reintroducing threatened species (\$4 million)
- improving the energy efficiency of homes (over \$12 million assistance, including some funding from Vote: Health)
- improving conservation and recreational opportunities, via administration of the Tenure Review Process and the purchase of South Island high country land within the Tenure Review Process (\$32 million operating and \$48 million capital)
- increasing investment in environmental research, including research to assist compliance with the air quality national environmental standards, increased research effort on marine biosecurity and enhancements to New Zealand's environmental databases and collections of species (\$21 million within Vote Research Science and Technology)
- protecting and enhancing Lake Taupo (\$7 million).

Guide to the Budget Documents

A number of documents are released on Budget day. The intent of these documents is to provide information about the Government's spending intentions; its performance; and the wider fiscal and economic picture.

The budget documents, ordered from widest to most specific coverage, are as follows:

Executive Summary

The *Executive Summary* is the overview of all the Budget information and contains the key points for the media and general public. It summarises the Government's spending decisions and generally focuses on issues raised in the Budget Speech, the *Budget Economic and Fiscal Update* and the *Fiscal Strategy Report*.

Budget Speech

The Budget Speech is the Minister of Finance's speech at the start of Parliament's debate about the Estimates. The Speech generally focuses on the overall fiscal and economic position, and how the Government will fund its policy priorities.

Fiscal Strategy Report

The *Fiscal Strategy Report* measures how the Government is going against its overall goals in areas such as achieving debt objectives. It includes:

- fiscal trends covering at least the next 10 years
- a comparison with the long term fiscal objectives set out in the *Budget Policy Statement*.

The Government must explain any changes between the *Fiscal Strategy Report*, the *Budget Policy Statement* and the previous year's *Fiscal Strategy Report*.

Budget Economic and Fiscal Update

This document includes the Treasury's overall economic and fiscal forecasts. The *Update* includes the implications of government financial decisions and other information relevant to the fiscal and economic position.

The Estimates of Appropriations

The Estimates outline how much money the Government plans to spend on each specified area or "Vote". The Supplementary Estimates outline the additional money required to cover the previous year's spending.

Departmental Statements of Intent

The *Statement of Intent* provides information about how each government department intends to manage for outcomes over the next three to five years. The *Statement of Intent* contains annual financial and output class information required under the Public Finance Act 1989.

Internet

These documents will be made available on the New Zealand Treasury's Internet site.

The URL for this site is www.treasury.govt.nz.