

Chapter Four

Fiscal Position 1984/85

Introduction

This paper sets out the fiscal position forecast for 1984/85, on the basis of decisions made to date (Cabinet decisions up to and including 25 June 1984 in the case of expenditure, and the existing structure of the taxation system in the case of revenue).

Summary of Forecast

	1983/84 Outturn	1984/85 Forecast	Change	
	\$m	\$m	\$m	%
Net expenditure	14,250	15,020	770	5.4
R e v e n u e	11,266	12,500	1234	11.0
Deficit before borrowing	2,984	2,520	-464	-15.6
Forecast deficit range	..	2,300-2,800		
Deficit as percent of GDP	..	6.7	6.2-7.6	

Although the combination of our expenditure and revenue forecasts results in an "exact" deficit forecast, the potential for forecast error and variation indicates that a forecast range, as given above, is more useful as a guide to the potential outcome. For example, a change of 1 percent on both expenditure and revenue from our forecast in 1984/85 could alter the deficit by \$275 million. The range is not symmetrical because in our view the risks are weighted towards a higher deficit-on the expenditure side, for instance, the Rural Bank and Housing Corporation may seek additional Loans Account funding should they be unable to raise sufficient from the private sector.

It should be noted that the expenditure and deficit figures given above are not strictly comparable between years as an indication of the scale of Government activity. The decision to allow the Housing Corporation and the Rural Bank to seek private sector funding explains some of the forecast drop in the deficit. The Rural Bank raised \$25 million in 1983/84 by commercial stock issue and is forecast to raise \$50 million in 1984/85, while the Housing Corporation will seek private sector funding of \$183.5 million in 1984/85. If these amounts were met by Loans Account borrowings as was the case previously, the forecast deficit in 1984/85 would be \$2754 million compared with \$3009 million in 1983/84, a drop of \$255 million or 8.5 percent.

While the Budget Table 2 format is useful for the purposes for which it was designed, namely accounting for the borrowing transactions necessary to finance the calculated deficit, it has limitations as a tool of economic and financial analysis. For monetary policy purposes it is necessary also to explicitly take account of Reserve Bank financial activities as, for example, Reserve Bank loans to the Producer Boards have similar implications for monetary conditions as do public account advances to the Rural Bank.

Secondly, for other economic analyses it is desirable to distinguish between current and capital expenditure and transfers and lending activities. Finally from the perspective of financial analysis some items currently excluded from the deficit might be more appropriately treated as expenditure items since, as with other expenditure, they must be financed by revenue or borrowing. These include the Reserve Bank indemnity in respect of foreign exchange operations, purchases of capital equipment under credit arrangements, and various costs associated with borrowing. The IMF system of classification records these as expenditure items. We are currently examining a variety of measurements of the impact on the economy of the Government's fiscal operations.

The following section summarises the main elements of the forecast. Appendix I provides a detailed forecast of 1984/85 expenditure and revenue compared with 1983/84. Appendix II discusses critical factors underlying these forecasts. Appendix III explains the major reasons for change since our last forecast of the 1984/85 deficit of \$2359 million.

A Expenditure

Total net expenditure on a Table 2 basis is forecast to increase by 5.4 percent between 1983/84 and 1984/85, compared with a forecast average annual increase in the Consumers Price Index of 6 percent over the period. However, the increase in net expenditure has been reduced by the decision to allow the Housing Corporation and Rural Bank to seek private sector funding. If the Housing Corporation and Rural Bank were to meet their full borrowing requirements by Loans Account funding in both years, the net expenditure forecast for 1984/85 would have been around \$15,250 million compared with \$14,275 million in 1983/84, an increase of 6.8 percent.

There are several components of the expenditure increase between 1983/84 and 1984/85 which vary significantly from the average. These are as follows:

- *Land Use*: Forecast to decline by \$86 million, or 8.7 percent

Spending on Supplementary Minimum Prices is forecast to decline from \$504.8 million in 1983/84 to \$336 million in 1984/85.

- *Education*: Forecast to increase by \$30.5 million, or 1.8 percent

A variety of factors have contributed to this lower rate of growth, including the achievement of cost reductions in areas affected by falling school rolls.

- *Debt Services*: Forecast to increase by \$378.1 million, or 18.5 percent

The major factor influencing the strong growth in debt servicing costs is the growth in public debt last year of 16.8 percent.

- *Miscellaneous Investment Transactions*: Forecast to decline by \$90.4 million or 45.5 percent

Spending on this function consists of a variety of equity purchases and advances. An important factor in the decline was the purchase last year of \$45.5 million of IMF reserve assets.

- *Miscellaneous Financing Transactions*: Forecast to decline by \$228.4 million, or 58.5 percent

As explained earlier, the Rural Bank and Housing Corporation will this year seek private sector funding of \$50 million and \$183.5 million respectively.

B Revenue

Total revenue on a Table 2 basis is forecast to increase by \$1,234 million or 11.0 percent in 1984/85. Of this change, 95 percent comprises taxation receipts which are forecast to grow by \$1,169 million or 11.2 percent to \$11,600 million. Components of the 1983/84 outturn and 1984/85 tax forecasts are analysed in Appendices I and II of this report.

Higher income tax receipts account for 84 percent or \$977 million of the expected growth in tax revenue, with persons and companies contributing about 50 and 34 percent of the total respectively. Indirect taxes comprise the balance with a rise of \$191 million or 16 percent of the total 1984/85 growth.

Within the personal income tax category, the forecast increase in collections from source deductions of \$548 million is by far the largest element, due mainly to higher wage and salary payments. Collections from 'other persons' (self-employed and investment income-earning individuals) are expected to provide an additional \$51 million, while refunds to persons are forecast to increase by \$16 million. The significant growth of \$397 million in forecast tax receipts from companies reflects a strong improvement in profits in 1984/85, the termination of some investment allowances, and changes in the tax treatment of life insurance companies and of expenditure on forestry. Assumed increases in nominal private final consumption and imports are the major factors contributing to the expected \$191 million rise in indirect and highways taxation.

Conclusion

The deficit for 1984/85 is forecast to be around \$2,500 million within a range of \$2,300-\$2,800 million. This forecast makes no allowance for new policy initiatives on the expenditure side, or for any changes to the current structure (rates and thresholds) of the taxation system. The width of the range given above-\$500 million-indicates the difficulty in providing an exact forecast of the consequences of the Government's expenditure and revenue decisions. In particular, the impact of changes in forecast economic activity on the taxation revenues can be substantial. The deficit is the difference of two large numbers, and a small percentage change on either expenditure or revenue from that forecast will have a major impact. A 1 percent deviation from forecast on both expenditure and revenue in 1984/85 could, for example, affect the deficit by up to 11 percent from the forecast (\$275 million in either direction).

APPENDIX I

FORECAST EXPENDITURE, REVENUE AND DEFICIT 1984/85

EXPENDITURE	1983/84	1984/85	Change	
	Outturn \$m	Forecast \$m	\$m	%
General Administration	386	420	34	8.9
Law and Order ..	271	288	17	6.2
Government Services ..	165	188	22	13.4
Miscellaneous Services	8	12	3	32.2
Stabilisation	10		-10	
<u>A d m i n i s t r a t i o n</u>	841	907	66	7.9
Defence	660	730	70	10.6
Foreign Affairs	169	177	8	4.6
Foreign Relations	829	907	77	9.3
Land Use.	986	900	-86	-8.7
Fuel and Power	341	418	77	22.5
Other Industrial Services	555	614	58	10.5
<u>Development of Industry</u>	1,882	1,931	49	2.6
<u>Education</u>	1,674	1,705	31	1.8
Social Welfare	3,974	4,323	349	8.8
Other Social Services	76	84	9	11.3
<u>Social Services</u>	4,049	4,407	357	8.8
H e a l t h	1,805	1,906	101	5.6
Transport	537	567	30	5.6
Communications		-1	-1	
<u>Transport and Communications</u>	537	566	29	5.4
<u>Debt Services</u>	2,042	2,420	378	18.5
Miscellaneous Investment Transactions	199	108	-90	-45.5
<u>Miscellaneous Financing Transactions</u>	391	162	-228	-58.5
<u>Total Net Expenditure</u>	<u>14,250</u>	<u>15,020</u>	<u>777</u>	<u>5.4</u>
<u>REVENUE</u>				
I n c o m e T a x	7,453	8,430	977	13.1
C u s t o m s D u t y	606	650	44	7.2
Beer Duty	199	200	1	
Sales Tax.	1,312	1,400	88	6.7
H i g h w a y s T a x	242	260	18	7.3
Motor Spirits Tax	224	225	1	
Other Taxation	394	435	41	10.5
<u>T o t a l T a x a t i o n</u>	10,431	11,600	1,169	11.2
<u>Interest, Profits and Miscellaneous Receipts</u>	835	900	65	7.9
<u>T o t a l R e v e n u e</u>	<u>11,266</u>	<u>12,500</u>	<u>1,234</u>	<u>11.0</u>
<u>Deficit Before Borrowing</u>	<u>2,984</u>	<u>2,520</u>	<u>-464</u>	<u>-15.6</u>

NB: Totals may not add due to rounding.

APPENDIX II

I EXPENDITURE

The following section discusses a number of components of the expenditure forecast. It concentrates on special factors, outside of the normal reviews of new and existing policies and draft estimates, which have contributed significantly to the forecasts, and sets out critical assumptions.

— *Administration* (\$66.1 million, 7.9 percent)

Spending on Administration is forecast to increase by 7.9 percent. This is influenced by the decision to abolish Vote : Stabilisation and pay the subsidy on milk (the only remaining item in the Vote) directly from Vote : Agriculture and Fisheries (which is included in the function Land Use). The milk subsidy is forecast to cost \$19 million in 1984/85. Had it remained in Administration, as in 1983/84, the overall increase in spending on that function would be 10.1 percent.

— *Foreign Relations : Defence* (\$69.7 million, 10.6 percent)

The increase of 10.6 percent in Vote : Defence reflects some major underexpenditure in 1983/84 which was in part related to the Defence review conducted last year. The 1984/85 allocation is in accord with the Cabinet decision to maintain Defence spending at 1982/83 levels.

— *Development of Industry : Land Use* (-\$86.0 million, -8.7 percent)

The major factor affecting spending is SMP payments, which are forecast to drop from \$504.8 million in 1983/84 to \$336.0 million in 1984/85. The 1983/84 outturn includes an additional \$150 million brought forward from 1984/85, while the 1984/85 forecast includes additional "lump sum" payments arising from the termination of the SMP scheme.

Components of the forecast are as follows:

		<i>1983/84</i>			<i>1984/85</i>		
		Meat \$m	Wool \$m	Total \$m	Meat \$m	Wool \$m	Total \$m
"Ordinary"							
	SMPs	296.5	208.3	504.8	137.0	47.0	184.0
	Lump sum				132.0	20.0	152.0
	SMPs						
	TOTAL	296.5	208.3	504.8	269.0	67.0	336.0

— *Development of Industry: Fuel and Power* (\$76.8 million, 22.5 percent)

Much of the increase in net funding requirements reflects expansion in the department's trading activities, particularly in State Coal Mines. The forecast is also affected by significant underspending in 1983/84.

— *Development of Industry: Other Industrial Services* (\$58.1 million, 10.5 percent)

Spending on job creation schemes is forecast to increase by \$24.9 million, or 8.9 percent, between 1983/84 and 1984/85. The forecast includes the cost of the decision to extend the private job creation scheme, in the form of a partial employment subsidy, for a further year.

Components of the forecast are as follows:

<i>Cost</i>	1983/84 \$m	1984/85 \$m
Partial subsidy (private sector)	34.5	44.5
Full subsidy (public sector)	244.1	258.8
Other'	—	0.1
TOTAL	278.6	303.5
Average numbers enrolled†	Nos	Nos
Partial subsidy	15900	22340
Full subsidy	21750	22600
T O T A L	37650	44940

'Assistance for the disabled, redeployment assistance

†Excludes vacation workers

— *Education* (\$30.5 million, 1.8 percent)

The impact of cost reductions in primary education and teacher training arising from falling rolls has contributed to the low increase in expenditure in 1984/85. Other factors contributing to the low forecast are the effect of the "tail-end" of the 3 percent exercise on universities and a transfer of the Young Persons Training Programme to Vote : Labour.

— *Social Services* (\$357.3 million, 8.8 percent)

Spending on Social Welfare benefits constitutes 94.2 percent of net expenditure on Social Services in 1984/85. Spending on benefits is forecast to increase by 8.9 percent between 1983/84 and 1984/85. Details of the forecast are set out below.

In the following tables, the 1984/85 base adjusts the 1983/84 outturn to take account of the extra payout day for fortnightly benefits this year compared with last. The 1983/84 price change represents the effect in 1984/85 of last year's price changes, while the 1984/85 price change indicates the forecast cost of price changes occurring this year.

	\$m
<i>National Superannuation</i>	
1983/84 O u t t u r n	2 5 2 6 . 0
Base for 1984/85 forecast	2602.0
Volume change	70.0
1983/84 price change	21.0
1984/85 price change	63.0
1984/85 f o r e c a s t	2756.0
Average number of beneficiaries 1983/84	443986
Average number of beneficiaries 1984/85	455900
<i>Domestic Purposes Benefit</i>	
1983/84 O u t t u r n	380.8
Base for 1984/85 forecast	394.0
Volume change	38.0
1983/84 price change	8.0
1984/85 price change	11.9
1984/85 forecast	451.9
Average number of beneficiaries 1983/84	50510
Average number of beneficiaries 1984/85	55250
<i>Unemployment Benefit</i>	
1983/84 O u t t u r n	315.8
Base for 1984/85 forecast	316.0
Volume change	0.5
1983/84 price change	6.0
1984/85 price change	8.7
1984/85 forecast	331.2
Average number of beneficiaries 1983/84 approx	49280
Average number of beneficiaries 1984/85 approx	49350
<i>Family Benefit</i>	
1983/84 O u t t u r n	289.7
Base for 1984/85 forecast	287.6
Volume change	-2.0
1983/84 price change	
1984/85 price change	
1984/85 f o r e c a s t	285.6
Average number of beneficiaries 1983/84	941292
Average number of beneficiaries 1984/85	935600
<i>Other</i>	
1983/84 O u t t u r n	299.8
Base for 1984/85 forecast	306.6
Volume change	3.0
1983/84 price change	6.3
1984/85 price change	8.6
1984/85 forecast	324.5

— *Debt Services* (\$378.1 million, 18.5 percent)

Total debt outstanding increased by 16.8 percent between 31 March 1983 and 31 March 1984 (internal debt 24.5 percent, external debt 5.9 percent). Servicing costs at this level of debt are estimated to be \$2,187 million in 1984/85, an increase of \$172 million on 1983/84. New internal and external debt sales are forecast to add a further \$210 million to debt servicing costs for the year. The level of administration charges is expected to fall by \$5 million because of the change in the calculation of brokerage paid on retail stock issues.

— *Miscellaneous Investment Transactions* (-\$90.4 million, -45.5 percent)

A number of factors have contributed to the drop in forecast spending on this function. They are : the purchase of \$45.5 million of IMF reserve assets in 1983/84; a decline in advances to New Zealand Steel Development Limited of \$25.0 million; no share purchase in connection with the BNZ in 1984/85 compared with spending of \$19.3 million last year; and a receipt in 1984/85 of \$14.6 million representing proceeds from the sale of the Government's preference shares in Winstone-Samsung together with accumulated dividend payments.

— *Miscellaneous Financing Transactions* (-\$228.4 million, -58.5 percent)

The decision to allow the Housing Corporation and the Rural Banking and Finance Corporation to seek funding from the private sector explains the forecast drop in net expenditure. The Housing Corporation is expected to seek funding of \$183.5 million from the private sector, while the Rural Bank has approval to borrow \$50 million, and borrowed \$25 million last year. If these amounts were funded from the Loans Account, as in previous years, net spending in this function would be \$395.8 million in 1984/85, a decrease of \$19.9 million (-4.6 percent) over 1983/84.

II REVENUE

Taxation receipts account for by far the greatest proportion-93 percent-of total revenue in 1983/84 and 1984/85. This section focuses on the composition of taxation revenue forecasts for 1984/85, on significant variations against the 1983/84 outturn and on possible sources of uncertainty.

Components of the Taxation Forecasts

Appendix I details on a Table 2 basis the 1983/84 outturn and current 1984/85 forecast for receipts from income and other principal categories of taxation. These data may be further analysed as follows:

	1983/84	1984/85	Change	
	Outturn (\$m)	Forecast (\$m)	(\$m)	(%)
Source deductions	5402	5950	+548	+10.1
Other persons	1724	1775	+51	+3.0
Refunds to other persons	<u>(419)</u>	(435)	<u>(+16)</u>	+3.8
Persons (net)	6707	7290	+583	+8.7
Companies (net)	703	1100	+397	+56.5
M i s c e l l a n e o u s	44	<u>40</u>	<u>- 4</u>	-9.1
Total income tax	7453	8430	+977	+13.1
Other direct taxation	69	<u>70</u>	+1	+1.4
Total direct taxation	7522	8500	+978	+13.0
Indirect (including highways) taxation	<u>2909</u>	<u>3100</u>	<u>+191</u>	+6.6
Total Taxation	<u>10,431</u>	<u>11,600</u>	<u>+1169</u>	+11.2

NB: Totals may not add due to rounding

Basis of the Forecasts

The taxation forecasts are based mainly on income, price and output assumptions derived from the latest current economic situation report.

General Comment

Several points may be noted from the table above. Total taxation receipts for 1984/85 are forecast to rise 11.2 percent to \$11600 million over the 1983/84 outturn. Of this change, 84 percent reflects higher income tax receipts to which persons contribute \$583 million (50 percent of the total) and companies \$397 million (34 percent). Other direct taxation receipts (land tax and estate and gift duty) are forecast to remain static. The balance of the increase comprises a rise in indirect taxation of \$191 million (16 percent of the total 1984/85 increase).

Comment on Components of the Forecast

a Personal income Tax

Collections from source deductions are forecast to grow 10.1 percent in 1984/85 to \$5,950 million. Approximately 85 percent of this rise is attributable to wage and salary payments which are forecast to increase by 7.5 percent. This change is due to contributions from wage rates of

5.1 percent and hours worked of 2.3 percent. The forecast increase in wage rates is due to the \$8 general wage order and assumed quarterly wage drift of 0.3 percent for central government and 0.5 percent in other sectors.

Receipts from 'other persons' (self-employed and investment income-earning individuals) for 1984/85 are expected to be \$1775 million, 3.0 percent up on the outturn for 1983/84. This forecast is based on income growth assumptions of 2.7 percent and 10.9 percent in 1983/84 for the farm and non-farm sectors respectively. Refunds to persons are assumed to grow at the same rate as assessable incomes.

b Company Tax

Net company tax collections are estimated to amount to \$1100 million in 1984/85, which compares with actual receipts of \$703 million in 1983/84. Company profits are estimated to have grown strongly in 1983/84 because of an increase in corporate operating surplus and a decrease in interest payments. Other factors affecting the forecast amount of collections include the termination of some investment allowances, the 1983/84 changes to the tax treatment of life insurance companies and building societies, and the abolition of tax deductibility for most forestry expenditure.

c Indirect Taxation

Indirect tax receipts as a whole are forecast to rise by 6.6 percent on the outturn for 1983/84. Major items which are expected to grow are:

- Customs duty, by \$44 million, based on a forecast increase in the nominal value of imports of 21 percent;
- Sales tax, by \$88 million, due to growth in the nominal value of personal consumption (estimated at 7.1 percent).

Smaller changes are expected in instrument duty (as a result of a relatively buoyant property market), the energy resources levy (higher use of natural gas) and motor vehicle fees and charges (strong growth in new vehicle registrations).

Sources of Possible Variation in Forecast

The taxation forecasts for 1984/85 have been made on an existing policy basis. In the case of income tax the major source of uncertainty is potential variation from the assumed growth in wage and salary payments. Another wage adjustment in 1984/85 would result in higher collections from source deductions and 'other persons'. In addition, these collections could be

affected by at least two policy options. Indexation of the main elements of the personal tax system might be considered so as to remove the effects of fiscal drag arising in 1984/85. A second option would be to remove the 'temporary' surtax on incomes in excess of \$24,000. These measures would entail revenue losses estimated at \$72 million and \$36 million respectively in 1984/85.

In the case of indirect taxes, no allowance has been made for indexation of specific duties and sales tax. Since 1982 it has been an explicit policy to maintain the real value of specific indirect taxes on consumption. Indexation by the CPI movement in the year to June 1984 could produce extra revenue of about \$11 million in 1984/85. The 1984/85 forecasts include some reduction in customs duty and consequentially sales tax, reflecting recent announcements under the motor vehicle plan. Decisions have yet to be made on associated changes in the level of sales tax per se. On one scenario these could add about \$13 million to revenue in 1984/85. It must also be noted that fairly strong import growth underlies the 1984/85 forecasts. Should this not continue, there would be some fall in indirect revenue, particularly in customs duty.

Overall, the technical forecasting risks are probably evenly balanced. The policy uncertainties outlined above are more liable to reduce than increase revenue.

APPENDIX III

COMPARISON OF JULY 1984 FORECAST OF 1984/85 DEFICIT WITH PREVIOUS FORECAST

The following table summarises the last (May 1984) and present forecasts of the 1984/85 deficit before borrowing:

	<i>1984/85</i>		
	<i>May 1984 Forecast</i>	<i>July 1984 Forecast</i>	<i>Change</i>
	\$m	\$m	\$m
Net expenditure	14900	15020	+120
R e v e n u e	12541	12500	-41
Deficit	2359	2520	+161

The major changes between the two forecasts result from a revision to the debt servicing forecast of \$114 million, on the expenditure side, and from changed assumptions on the revenue side.

Chapter Five

Debt, Reserves and Borrowing

The Public Debt

The total Public Debt at 31 March 1984 was \$21,878.7 million, of which \$13,652.4 million is internal and \$8,226.3 million is external.

The change in the composition of the debt since 1974 is shown in Appendix I and the maturity dates of the public debt outstanding at 31 March 1984 in Appendix II. The average maturity of the external debt has declined from 6.5 years in 1974 to 5.8 years in 1979 to 4.2 years in 1984.

It cost \$2,042 million to service this debt in 1983/84, broken down as follows:

	<i>\$M</i>
I n t e r n a l	1,395
E x t e r n a l	620
Administration and Management	27
	<u>2,042</u>

The increasing percentage of interest to net government expenditure is shown in Appendix III and to total taxation receipts in Appendix IV.

Official Debt

In addition to the Government's external debt recorded in the Public Accounts, \$1,161.6 million was held by the Reserve Bank at 31 March 1984 making the total official external debt \$9,387.9 million at that date, including Railways debt.

The ratio of official external debt to GDP over the last 10 years is shown in Appendix V and the percentage of exports of goods and services required to service this debt in Appendix VI.

Quasi-Government Debt

The external debt of the quasi-Government organisations as at 31 March 1984 is estimated at \$2,800 million.

Overseas Reserves

The level of official reserves stood at \$1,128.1 million at 31 March 1984. A table showing the level held each year since March 1974 and the number of months coverage of current payments it represents is contained in Appendix VII.

The Official Reserves are held jointly by the Reserve Bank and Treasury. The amount of the split between the two institutions has not been formalised but the Treasury has recently held more than half the total. In general, the Bank has held funds in liquid form to meet the foreign exchange outflow while the Treasury has held higher yielding securities to obtain a better return than is available on short term instruments. Our official reserves have been maintained at a relatively low level because of the high cost of borrowing required to maintain them during long periods of balance of payments deficits.

Additional Facilities

In addition to the published reserves (i.e. the actual investments held) both the Treasury and the Reserve Bank have flexible facilities which are drawn upon to supplement our foreign currency position when required. The two facilities administered by Treasury are the Lloyds Revolving Credit Agreement, (US\$500 million, NZ\$800 million), and the Citicorp Syndicated Euro Note Facility, (US\$750 million, NZ\$1.2 billion). Under these two facilities, drawings can be made for any period required and repaid at a later date when there is a more favourable foreign exchange position. The Reserve Bank has additional standby arrangements for smaller amounts with a number of banks. The Bank's facilities are essentially short term i.e. one or two months, and are not used as a source of long term foreign exchange requirements.

Position at 1 June 1984

At the beginning of June 1984, Treasury held the equivalent of NZ\$1,011 million in its portfolio, of which \$127 million **was** held on deposit and \$884 million was invested in bonds in the following currencies:

Yen	US\$	(Ng"million)	Stg	Other	Total
506	205	196	66	38	1,011
50%	20%	19%	7%	4%	

The Reserve Bank held \$374 million in liquid funds.

All but US\$100 million was drawn down on Treasury's flexible facilities, but all the Reserve Bank's facilities were available.

Events Since 14 June 1984

The announcement of a snap election caused an immediate foreign exchange outflow. To meet the outflow, the following steps were taken to maintain the value of the dollar at the existing rate:

- a the Reserve Bank used all its existing liquid funds;
- b the Bank borrowed US\$380 million under its short term facilities;
- c Treasury drew the remaining amounts available on the Lloyds and Citicorp facilities;
- d Treasury redeemed all deposits that were held as at 31 May;
- e Treasury commenced liquidating its medium term bond holdings;
- f some borrowing planned to meet the OET deficit to June 1985 was brought forward to boost the current liquid funds available;
- g forward exchange contracts totalling NZ\$1222.6 million have been written. The premium received in respect of these contracts is approximately NZ \$26 million. The contracts fall due as follows:

	1	9	8	4	NZ \$m
J	u	l	y		186.8
August			....		825.8
September			....		210.0

If there were to be a devaluation, each percentage point would cost NZ \$12.2 million to honour these contracts, offset by the premiums received.

Position at 13 July 1984

—	Treasury Held Reserves	..	..	..	NZ\$m
	Cash balances plus deposits	..	..	..	240
	Bonds	Y	e	n	266
		US\$			172
		D	M		56
		Stg			59
		O	t	h	9
		e	r		562
	Total Treasury Reserves			—	802
	Plus Reserve Bank Liquid Funds				700
	TOTAL OFFICIAL RESERVES				1502

External Borrowing Programme to June 1985

Funds are borrowed externally to fund the deficit in our overseas exchange transactions (OET's). A detailed OET forecast for the year to June 1985 is included elsewhere in this brief. It is based on the assumptions that:

- a present policies, which include a domestic debt sales programme which is constrained by interest rate objectives, will remain in operation for the rest of the year; and
- b the unusual outflow which occurred after the announcement of the snap election was a combination of import payments brought forward and delayed repatriation of export earnings i.e. it is a timing difference not an increase in the annual OET deficit.

On this basis, the deficit before borrowing in the year to June 1985 is forecast to be \$3,365 million, which implies a borrowing programme for the year as follows:

		<i>\$NZ Million</i>
1 July 1983-30 June 1984		
Current Account Deficit	1,995	
Official Capital Account Deficit	710	
Private Capital Inflow ..	-225	
Overall Deficit Before Official Borrowing ..		2,480
Less Government Overseas Borrowing*	2,049	
IMF Drawings	45	
Reserve Bank Borrowing	603	
		<u>2,697</u>
Excess Borrowing Over Deficit		217
Less Increase in Overseas Reserves ..		15
Excess Borrowing Carried Forward to 1984/85		<u>202</u>
1 July 1984-30 June 1985:		
Current Account Deficit ..	1,475	
Official Capital Account Deficit ..	2,040	
Private Capital Inflow	-150	
Overall Deficit Before Official Borrowing		3,365
Less: Carry Forward from 1983/84		202
Borrowing Required		3,163
Borrowing Undertaken		
Yen Bank Loan (Yen 1008)	666	
Bulldog Issue (Pnds 93M)	200	
Euroguilder Issue (Dfl. 100M),	51	
Swiss Franc Private Placement (SF 250M)	<u>208</u>	
		1,125
Further Borrowing Needed to maintain Reserves at 30 June 1984 level		<u>2,038</u>

• See Appendix VIII

Internal Borrowing to 31 March 1985

The fiscal deficit for the year to 31 March 1985 is forecast to be about \$2,500 million if current policies are maintained. In addition, some further

borrowing may be required to fund Reserve Bank domestic lending activity. The extent to which the combined borrowing requirement is funded internally is dependent on the monetary policy stance adopted for the rest of the year. One of the crucial decisions facing the Government this year, and until the fiscal deficit can be reduced, will concern the need to fund a much higher proportion of this total borrowing requirement by an active public debt sales programme in order to achieve better external balance and more effective control over domestic inflation. These issues are discussed more fully in the macroeconomic papers. The split of the financing of the fiscal deficit between local and external borrowing for the past 10 years is contained in Appendix IX. Cash from external borrowing not required to fund the fiscal deficit is added to the overseas or internal reserves.

Debt Servicing Costs to 31 March 1985

Assuming an internal deficit of \$2,500 million and an external borrowing requirement of \$3,200 million, it is estimated that \$2,420 million will be required to service the public debt in 1984/85 broken down as follows

I n t e r n a l	\$m
E x t e r n a l	1625
Administration and Management	773
	22
	<u>2420</u>

As well as variation in the level of the internal and external deficits, the forecast is subject to fluctuations in the level of interest rates, both internally and externally, and exchange rate variations.

Conclusion

The level of debt and its servicing cost is the result of a complex interaction of reserves management and fiscal, monetary and exchange rate policies over a number of years. Under a fixed exchange rate regime there is no alternative than to borrow externally if the combined current and capital accounts are constantly in deficit and a certain level of reserves must be maintained to support the fixed exchange rate. Persistent internal fiscal deficits and the associated monetary policy stances have led to the present levels of internal and external debt, the servicing costs of which in turn put further upward pressure on the size of the deficit.

The interaction of fiscal, monetary and exchange rate policies and their effects are discussed in the macroeconomic overview paper.

APPENDIX I

COMPOSITION OF THE DEBT 1974-1984

	31 March 1974		31 March 1979		31 March 1984	
	Amount (NZ\$000)	(%)	Amount (NZ\$000)	(%)	Amount (NZ\$000)	(%)
<i>External Debt</i>						
Pounds Sterling			164,490	5.6	1,115,667	13.6
Deutschemark			838,903	28.7	1,076,212	13.1
Netherlands Guilders	351,908	75.6	244,424	8.4	139,594	1.7
Japanese Yen ¹			227,365	7.8	1,476,558	17.9
Swiss Francs ..			887,827	30.4	1,923,226	23.4
United States \$..	57,698	12.4	442,758	15.2	2,432,533	29.6
IBRD	55,604	12.0	40,953	1.4	4,680	—
O t h e r			73,396	2.5	57,830	0.7
	465,210	100.0	2,920,116	100.0	8,226,300	100.0
<i>Internal Debt—</i>						
Long-term Debt	3,268,718		5,416,578		13,107,870	
Treasury Bills	600		482,825		544,495	
TOTAL ..	3,734,528		8,819,519		21,878,665	

- Only a minimal amount of the debt at 31 March 1974 was in Japanese Yen, for capital equipment credits.

APPENDIX II

MATURITY DATES OF PUBLIC DEBT OUTSTANDING AS AT
31 MARCH 1984

<i>Loans Maturing in financial Year Ending 31 March</i>	<i>New Zealand</i>			<i>Total Debt (Nominal Amount) (NZ\$000)</i>
	<i>Overseas (NZ\$000)</i>	<i>Public (NZ\$000)</i>	<i>Departmental and Other (NZ\$000)</i>	
1985	1,458,545	705,730	240,026	2,404,301
1986	1,061,435	1,488,565	701,528	3,251,528
1987	676,066	707,428	589,855	1,973,349
1988	1,475,321	685,539	1,281,548	3,442,408
1989	1,501,374	1,792,920	1,393,981	4,688,275
1990	502,890	147,170	82,250	732,310
1991	278,973	179,385	77,944	536,302
1992	395,451	238,044	111,712	745,207
1993	466,182	178,674	203,293	848,149
1994	165,456	56,902	98,560	320,918
1995	24,231			24,231
2000		6,850	55,000	61,850
2009	220,376			220,376
Treasury Bills		502,495	42,000	544,495
Inflation Adjusted Savings Bonds . .		774,502		774,502
Premium Stock		275,883	21,992	297,875
Kiwi Savings stock'		993,761	18,828	1,012,589
	<u>8,226,300</u>	<u>8,733,848</u>	<u>4,918,517</u>	<u>21,878,665</u>

Source: Budget Table 12

APPENDIX III

DEBT SERVICING COSTS-PUBLIC DEBT

Year Ended 31 March	Interest Costs		Total Interest Costs (NZ\$m)	Administration and Management Expenses (NZ\$m)	Total Debt Servicing (NZ\$m)	Total De. Servicing as % of N Governme Expenditu (%)
	NZ (NZ\$m)	Overseas (NZ\$m)				
1975	179.7	41.3	221.0	0.7	221.8	6.
1976	201.2	68.8	270.0	2.7	272.8	6.
1977	256.7	110.4	367.0	4.3	371.3	8
1978	331.3	133.2	464.5	6.8	471.3	8.
1979	415.9	174.2	590.1	5.7	595.8	8
1980	537.6	220.1	757.8	8.6	766.4	10
1981	635.2	256.3	891.5	5.4	896.9	9.
1982	786.7	416.3	1202.9	8.1	1211.0	10.
1983	960.8	515.0	1475.8	16.8	1492.6	11.
1984	1394.7	620.2	2014.9	27.0	2041.9	14.
1985'	1625.0	773.0	2398.0	22.0	2420.0	16.

. Estimated.

Source: Public Accounts and Budget Table 2

APPENDIX IV
INTEREST ON PUBLIC DEBT

<i>Year Ended 31 March</i>	<i>Overseas (NZ\$000)</i>	<i>Interest NZ (NZ\$000)</i>	<i>Total (NZ\$000)</i>	<i>Interest on O/seas Debt as % of Export Income (%)</i>	<i>Recovery of Interest from Government Enterprises & Investments* (NZ\$000)</i>	<i>Net Interest Cost (NZ\$000)</i>	<i>Net Cost as a % of Total Taxation (%)</i>
1975	41,309	179,721	221,030	2.6	150,725	70,305	2.5
1976	68,817	201,196	270,013	3.4	191,746	78,267	2.5
1977	110,359	256,678	367,037	3.6	278,027	89,010	2.3
1978	133,204	331,320	464,524	4.0	367,188	97,336	2.1
1979	174,243	415,868	590,111	4.5	452,725	137,386	2.8
1980	220,149	537,644	757,793	4.5	543,375	214,418	3.6
1981	256,345	635,152	891,497	4.5	605,794	285,703	4.1
1982	416,265	786,663	1,202,928	6.2	677,770	525,158	6.0
1983	514,955	960,837	1,475,792	6.8	740,189	735,603	7.3
1984	620,199	1,394,676	2,014,875	5.7	815,197	,199,678	11.5

So
* R

APPENDIX V
EXTERNAL DEBT

Year Ended 31 March	Official Overseas Debt			Gross Domestic Product	Ratio of Debt to GDP
	Government Reserve Bank		Total		
	\$m	\$m	\$m		
1974	465.2		465.2	9199	5.1
1975	862.8	218.4	1081.2	10117	10.7
1976	1463.2	520.3	1983.5	11669	17.0
1977	1826.6	736.7	2563.3	14105	18.2
1978	2446.7	809.1	3255.8	15424	21.1
1979	2920.1	756.3	3676.4	17510	21.0
1980	3567.5	729.3	4296.8	21092	20.4
1981	4236.1	572.9	4809.0	24461	19.7
1982	5549.4	1227.5	6776.9	29296	23.1
1983	7690.7 ¹	1487.0	9177.7	32240	28.5
1984	8174.8	1161.6	9336.4	34313	27.2

* The Government debt figures above differ from the published figures for 1982/83 and 1983/84. The above figures exclude NZ\$74.0 million in 1982/83 and \$51.5 million in 1983/84 which represents outstanding debt commitments undertaken prior to 1 April 1982 by the Crown for the Railways Department. The Railways Corporation, which commenced business on 1 April 1982, is now meeting the obligations under these loans and accordingly the debt is now included in the quasi-government sector.

Source: Audited Government and Reserve Bank Accounts

APPENDIX VI

OFFICIAL EXTERNAL DEBT SERVICING PAYMENTS

Year ended 31 March	Official Interest Payments NZ\$m	Interest as % of Exports %	Official Capital Repayments NZ\$m	Total Official	
				External Debt Servicing Payments NZ\$m	Official Debt Servicing as % of Exports %
1975	50.5	2.4	40.3	90.8	4.2
1976	109.0	4.0	281.1	390.1	14.5
1977	167.5	4.4	374.5	542.0	14.2
1978	197.9	4.7	431.0	628.9	15.0
1979	223.0	4.7	419.6	642.6	13.4
1980	290.8	4.8	548.9	839.7	13.9
1981	342.6	4.9	610.3	952.9	13.6
1982	507.3	6.1	557.1	1064.4	12.9
1983	687.2	7.5	1539.7	2226.9	24.3
1984	805.5	7.4	1160.3	1965.8	18.2
1985'	930.2	8.0	2174.6	3104.8	26.8

'Estimated

Source:

Interest on Public Debt--Budget Table 14.

Interest on Reserve Bank Debt-Reserve Bank.

Repayments of Public Debt-Public Accounts "Transactions in Connection with the Public Debt"

Repayments of Reserve Bank Debt (including IMF repurchases)—Reserve Bank *Bulletin*, "Overseas Exchange Transactions"

Exports of Goods and Services-Department of Statistics

APPENDIX VII

RATIO OFFICIAL RESERVES TO CURRENT PAYMENTS

At 31 March	Total Official Reserves \$m	Annual Current Payments March Years \$m	Ratio Reserves/ Current Payments Months Coverage
1974	730.6	2,258	3.9
1975	481.8	3,132	1.8
1976	587.3	3,616	1.9
1977	603.3	4,374	1.6
1978	842.5	4,652	2.2
1979	609.4	5,088	1.4
			1.0
1980	592.6	7,809	0.8
1982	562.7	9,423	0.7
1983	1,666.2	10,468	1.9
1984	1,128.1	11,110	1.2

Source: Reserve Bank Bulletin

APPENDIX VIII

ACTUAL OVERSEAS BORROWING 1 JULY 1983-30 JUNE 1984

		<i>\$NZ million</i>
18 August 1983	Lloyds drawing SWFR 217.6M(US\$100M)	155
15 September 1983	Domestic Sterling Issue Pnds 63.98M	160
15 September 1983	Citicorp drawing US\$50M	75
23 September 1983	Citicorp drawing US\$50M	75
7 October 1983	Citicorp drawing US\$100M	150
25 October 1983	Citicorp drawing US\$50M	75
26 October 1983	Lloyds drawing SWFR 105.275M(US\$50M)	75
16 November 1983	Citicorp drawing US\$50M	75
17 November 1983	Lloyds drawing SWFR 108.85M(US\$50M)	75
22 November 1983	Sterling Private Placement Pnds 10M	22
22 December 1983	Lloyds drawing US\$200M	300
22 Februarv 1984	Samurai issue Yen 20BIL	130
9 April 1984	Deutschemark Issue DM 250M	140
19 April 1984	Eurosterling Issue Pnds 100M	220
23 May 1984	Euroyen Issue Yen 15BIL	100
30 May 1984	Reserve Bank Middle East Loan	62
21 June 1984	Lloyds drawing US\$50M	80
25 June 1984	Citicorp drawing US\$50M	80
		2,049

APPENDIX IX

FINANCING THE FISCAL DEFICIT

<i>Year Ended</i> 31 March		<i>Net Borrowing</i> <i>in New Zealand</i>	<i>Net Borrowing</i> <i>Overseas</i>	<i>Cash Surplus (+)/</i> <i>Deficit (-)</i>	<i>Deficit Before</i> <i>Borrowing</i>
		\$M	\$M	\$M	\$M
1 9 7 4	..	176.3	-14.2	+7.0	155.1
1 9 7 5	..	139.9	246.1	-4.4	390.4
1976 ..		702.2	287.1	-12.4	1,001.7
1 9 7 7		378.0	129.8	+1.7	506.1
1 9 7 8		434.4	265.8	+5.8	694.4
1 9 7 9		997.6	444.0	-4.3	1,445.9
1 9 8 0		703.9	327.7	+4.7	1,026.9
1 9 8 1		774.8	753.8	+3.7	1,524.9
1 9 8 2		1,212.1	609.2	+3.0	1,818.3
1 9 8 3		1,128.6	641.8	+3.5	1,766.9
1 9 8 4		2,265.3	720.8	+2.2	2,984.0

Source: Budget Table 2

Chapter Six

Income Distribution

Introduction

This paper reviews developments in income distribution over recent years. It concludes that the household's share of national income is largely unchanged. Within the household sector, however, quite marked changes in income distribution have occurred, reflecting market factors such as the recent decline in farm incomes as well as the impact of the Government's tax and transfer policies.

Background

There are two main aspects to this examination of changes in income distribution:

- a the extent to which the household sector's share of the national cake has changed;
- b how the distribution of income has changed within the household sector.

Household Sector's Share

Table 1 shows our estimates of the household sector's share of national disposable income growth in each of the years from 1973 to 1984.

TABLE 1

PERCENTAGE CONTRIBUTION OF GROWTH IN HOUSEHOLD DISPOSABLE INCOME TO NATIONAL INCOME GROWTH

1 9 7 3	..	69
1 9 7 4	..	54
1 9 7 5	..	46
1 9 7 6	..	84
1 9 7 7	..	43
1 9 7 8	..	65
1 9 7 9	..	79
1 9 8 0	..	62
1 9 8 1	..	56
1 9 8 2	..	54
1 9 8 3	..	73
1 9 8 4	..	46

Average Value 1973-1984 = 59

Despite cyclical fluctuations, the share of households has tended to average around 60 percent of the total national income with no discernible trend. In 1983/84 the household sector's share of national disposable income growth was below the mean value for the whole period. This reflects more rapid growth in the economy as a whole (nominal national disposable income is estimated to have grown by 5.7 percent) relative to the growth in household incomes (4.8 percent). Over the whole period, nominal household disposable income is estimated to have grown by 388 percent, while national disposable income is estimated to have grown by 392 percent. We chose 1972 as the base for this comparison, since it was a year of reasonable internal and external balance, but the conclusion is not markedly affected by the choice of a different base date.

Distribution Within the Household Sector

While the share of the national cake going to the household sector has not significantly altered over the period reviewed, marked changes in the distribution of income have occurred within the household sector. For example, real disposable farm incomes are estimated to have declined by around 10 percent between 1982 and 1984, while real disposable benefit incomes are estimated to have increased over the corresponding period by 8.5 percent.

Up to date data on changes in the distribution of disposable income within the household sector by income type, household characteristic, etc. are not available. The only available official data are the Department of Statistics quarterly series of the real disposable incomes of full-time wage and salary earners covering the period from March 1980 to March 1984. The distinctive features of this series are that it enables the impact of the tax system in particular on the different income levels to be assessed, and it splits wage and salary earners into five (quintile) fractions. Details of the income ranges in March 1984 for the quintile fractions are shown as an Appendix. Treasury has used a similar methodology to prepare its own estimates of this series from June 1974. This series is not entirely satisfactory as it does not include the effect of changes in the composition of the labour force (e.g. changes in the numbers on unemployment benefit) and does not adequately deal with the transition in 1977 from the old age benefit/universal superannuation to national superannuation. As such, it is an unofficial series which should be regarded as indicative of trends only.

Graph 1 attached shows the quarterly track of the real disposable income for households where the principal income earner is a full-time wage and salary earner. The data on the average household income for wage

and salary earners from 1980 to 1984 are an actual Department of Statistics series, while the rest of the data are derived from unofficial Treasury estimates.

Table 2 shows the percentage change in the annual average level of real disposable incomes for the different quintile fractions between a number of different starting points and 1983/84.

TABLE 2
FULL-TIME WAGE AND SALARY EARNERS-HOUSEHOLD REAL
DISPOSABLE INCOME

<i>% Change Between 1983/84</i>	<i>First Quintile</i>	<i>Second Quintile</i>	<i>Third Quintile</i>	<i>Fourth Quintile</i>	<i>Fifth Quintile</i>	<i>Average</i>
1976/77	3.4	2.4	3.6	3.7	5.3	4.4
1979/80	0.3	-0.7	1.2	2.3	3.9	2.3
1981/82	-5.2	-4.2	-2.5	-1.2	0.6	-1.4
1982/83	-1.0	-0.7	0.0	0.7	1.5	0.8

While the lower income households in this series were slightly worse off in 1983/84 compared with 1982/83, over the longer time period (from 1976/77) the change in relative position is much less marked. It is notable that the real disposable incomes of all groups were around 3 to 5 percent higher in 1983/84 than they were in 1976/77.

Full-Time Wage and Salary Earners

Graph 2 attached shows a similar historical profile for individual full-time wage and salary earners as that for households, but with a more skewed relative distribution in real disposable incomes following the 1982 tax changes.

One of the aims of the 1982 tax policy was to lower the difference in tax treatment of similar income households where that income was earned by different members of the household. As an example, Table 3 below indicates that, prior to October 1982, a single-income household with a taxable income of \$400 per week would have had a substantially higher tax liability than a two-income household with otherwise identical circumstances. That difference was greatly reduced by the 1982 tax changes. The means by which this improvement in tax equity was achieved was through reductions in the tax liabilities of primary income earners relative to secondary income earners.

TABLE 3
RELATIVE WEEKLY TAX LIABILITY OF HOUSEHOLDS

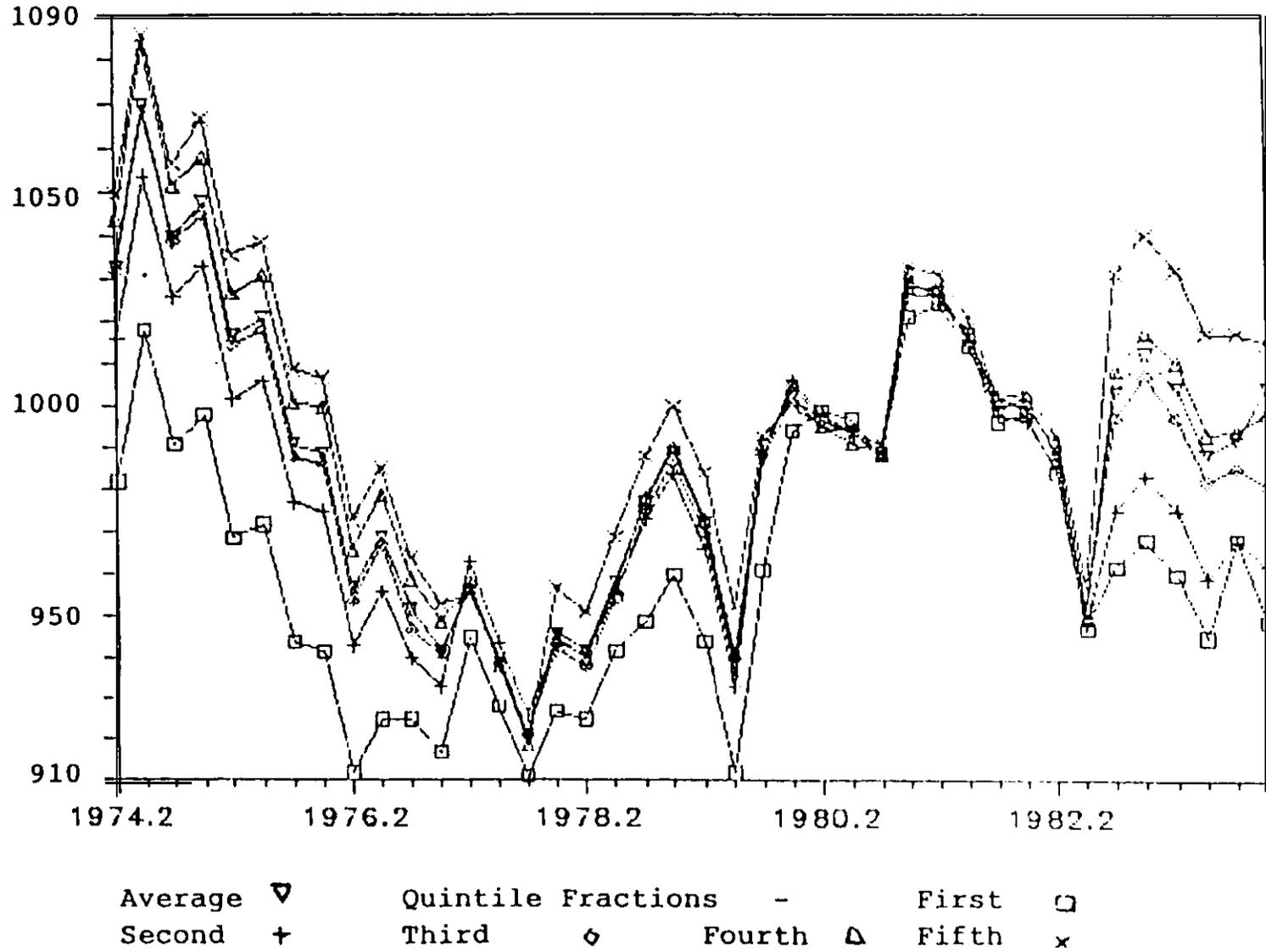
	<i>Single-Income Family 1 Child Under 5 \$400 per week (A)</i>	<i>Two-income Family 1 Child Under 5 \$300 per week and \$100 per week (B)</i>	<i>Difference (A)–(B)</i>
Tax paid before October 1982	\$139.58	\$99.94	\$39.64
Change in Tax Liability	–\$28.58	–\$0.16	—
Tax Paid After October 1982	\$111 .00	\$99.78	\$11.22

In reviewing income maintenance measures the Government has tended to focus on the relative positions of households rather than individuals. For this reason it has placed greater emphasis on the trends shown in Graph 1, rather than those shown in Graph 2.

Base 1000
= 1980/81

Graph 1: Real Disposable Income Indices

HOUSEHOLD WAGE & SALARY EARNERS

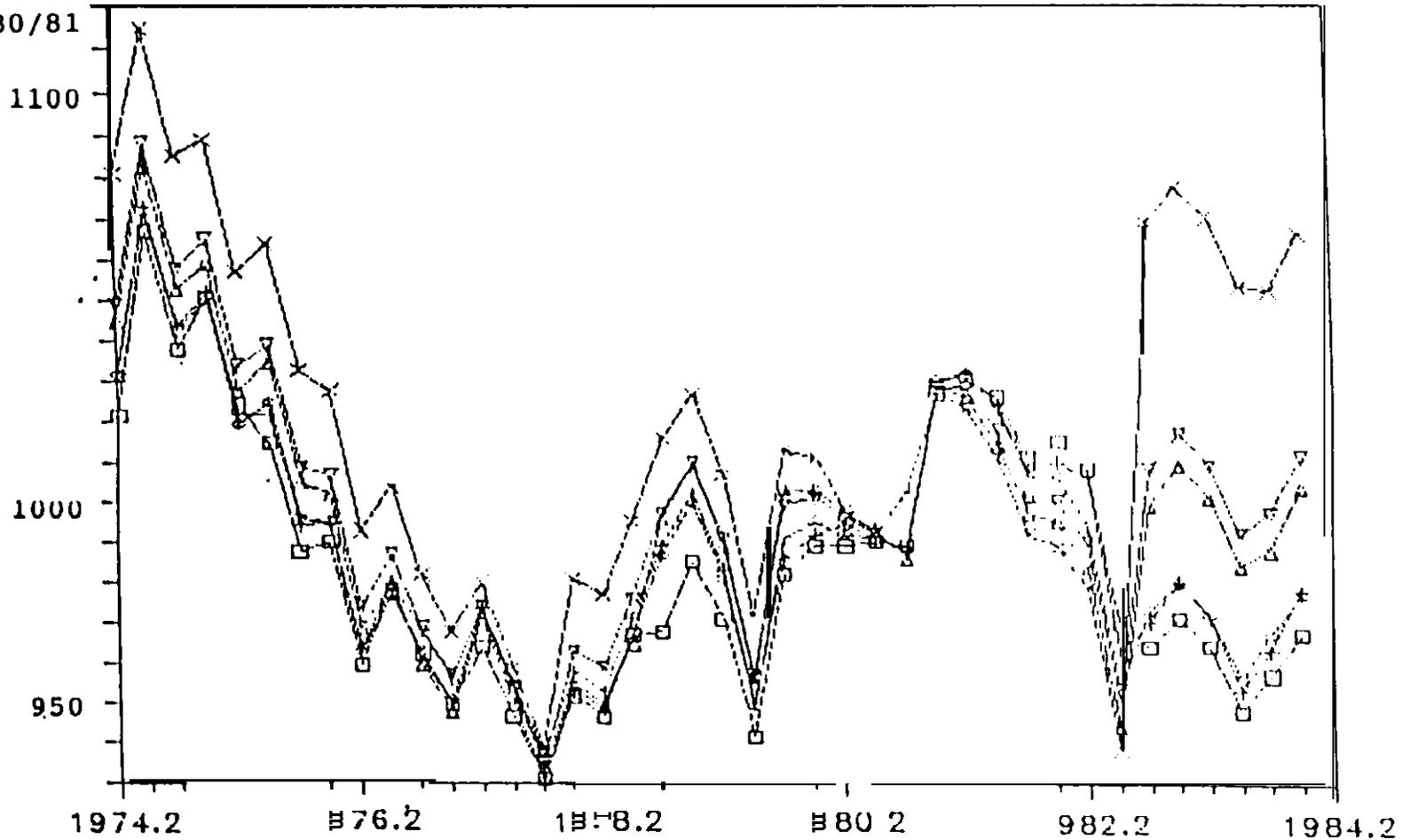


Source: Unofficial Treasury Series

Graph 2: Real Disposable Income Indices

FULL-TIME WAGE & SALARY EARNERS

Base 1000
= 1980/81



Average	▽	Quintile Fractions	-	First	□
Second	+	Third	◇	Fourth	△
				Fifth	×

Source: - Dept. of Statistics series from March 1980 to March 1984

APPENDIX

TREASURY ESTIMATES OF PRE-TAX INCOMES AS AT MARCH 1984

Individuals-Full-Time Wage and Salary Earners

<i>\$ Income pa.</i>	<i>Lower Bound</i>	<i>Average</i>	<i>Upper Bound</i>
1st Quintile Fraction	61	6,210	9,990
2nd Quintile Fraction	9,991	11,936	13,579
3rd Quintile Fraction	13,586	15,217	17,011
4th Quintile Fraction	17,013	19,180	21,956
5th Quintile Fraction	21,967	28,981	103,194
A v e r a g e	61	16,304	103,194

Households-The Principal Income Earner is a Full-Time Wage and Salary Earner

<i>\$ Income pa.</i>	<i>Lower Bound</i>	<i>Average</i>	<i>Upper Bound</i>
1st Quintile Fraction	1,272	12,684	16,682
2nd Quintile Fraction	16,725	19,485	22,357
3rd Quintile Fraction	22,386	25,309	28,213
4th Quintile Fraction	28,218	32,042	36,203
5th Quintile Fraction	36,249	47,036	122,897
A v e r a g e	1,272	27,301	122,897

The source for this series is Household Expenditure survey data, scaled up to be expressed in March 1984 terms. The low level of income reported by some individual full-time wage and salary earners is the cause of some concern and casts some doubt on the reliability of the data at the bottom end of the income scale. For example, \$6,210 is below the minimum adult award wage rate. Because of this, the bottom quintile fraction of full-time wage and salary earners has not generally been used in discussions with trade unions and employers on low income earners.