Budget 1997

Treasurer's Statement & Overview
Economic & Fiscal Forecast
Summary

Hon Winston Peters
Treasurer

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Budget Overview

The 1997 Budget is the first step in the Government's three-year policy programme. It contains a mix of:

- economic initiatives aimed at promoting growth
- spending initiatives outlined in the Coalition Agreement.

The Budget also sends a message that the Government expects individuals to meet their obligations to support their families. The Government will consider policies to encourage beneficiaries to make sure their children go to school and make the most of opportunities to improve their skills.

Economic Measures to Support Growth

In this Budget, the Government is promoting four key economic measures to support growth and increase confidence. These measures are:

- improving access to international markets. The Government has recently signed an agreement with the United States which completely frees up air transport by each country's airlines. Further agreements with our trading partners will be pursued
- removing tariffs. The Government has set an objective for the 1998 Tariff Review that all remaining tariffs will be removed well within the 2010 deadline set by APEC. It is for that reason that the Government has agreed to review vehicle tariffs by the end of this year to achieve a swift removal of them from the year 2000
- improving business performance. The Government will consider, on a case-by-case basis, whether to keep non-strategic assets. It will begin this process by undertaking a study of the sale of the Government's interests in Government Property Services Ltd and Vehicle Testing NZ Ltd
- investment. The Government will support the development of an OECD multi-nation agreement on investment, clarifying countries' limits on foreign investment and obliging fair treatment within those limits.

Spending Priorities

The spending priorities in this Budget are developed from the policy and expenditure initiatives identified in the Coalition Agreement within our three-year expenditure limit of $5 billion[1]. Of the $5 billion limit, the Government has allocated $900 million in 1997/98 and a total of $3.3 billion over three years to initiatives announced in the 1997 Budget or later in 1997/98.

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[1] All figures referred to in this text are GST exclusive.

The key Budget initiatives and the three-year cost of these initiatives are:

- improving the health and well being of New Zealanders at an additional cost of $900 million
- raising the quality of education through increased funding of $355 million
- removing the superannuation surcharge at a cost of $554 million
- increasing the Accommodation Supplement at a cost of $151 million
- funding 200 additional Police positions at a cost of $36 million
- progressing the Government's employment strategy through increased funding of $44 million.

In addition to these initiatives, this Budget outlines a range of others. These include a Green Package of environmental initiatives, extra resources for the Children, Young Persons and Their Families Service, increased funding for Statistics New Zealand, a Crime Prevention Package and operating costs associated with new capital expenditure in the justice sector.

There are a number of initiatives which are not included in 1997 Budget but which the Government intends to address before the 1998 Budget. To accommodate the three-year cost of these initiatives, the Government has set aside $1 billion in this Budget as a policy contingency.

Finally, the 1997 Budget allocates $350 million of additional capital expenditure in the 1997/98 year. The additional capital is primarily for the health sector and school property with a significant allocation to the justice sector.

Better Health

Initiative ($ million)	1997/98	1998/99	1999/00	Total
Improving services and managing demand	178	178	178	534
Free doctor visits and pharmaceuticals for children under six	62	62	62	186
Elective services backlog reduction	31	31	31	93
Increased mental health funding	13	13	13	39
Enhancing the capability of Mäori health providers and improving the sharing of health information	10	10	10	30
Removal of outpatient and daypatient user part charges	6	6	6	18
Total New Expenditure	**300**	**300**	**300**	**900**

Improving the health and well being of New Zealanders is important. This year's Budget has three key components to progress this objective. Firstly, the Government has increased health funding by $900 million over the next three years. This funding will:

- provide flexibility to manage population growth and aging, fund new technology and medicines, and meet people's increasing expectations of health services
- provide free doctor visits and pharmaceuticals for all children under six years of age
- reduce existing health service waiting lists
- improve mental health services
- support improvements in Mäori health status
- remove outpatient and daypatient user part charges.

Secondly, the Budget signals planned spending levels for the health sector over the following two years of an additional $180 million in 1998/99 and $450 million in 1999/2000. These planning levels will be subject to confirmation in future budgets.

Finally, the Budget provides equity capital to Crown health enterprises (CHEs) of $210 million in 1997/98, of which $148 million are new funding. This will support safe and appropriate facilities and modern equipment.

Supporting Success in Education

Initiative ($million)	1997/98	1998/99	1999/00	Total
Strengthening schools and communities	38	49	52	139
Property initiatives (operating expenditure)	20	6	9	35
Teachers and teaching initiatives	32	40	36	108
Early childhood education resourcing	17	19	19	55
Post-compulsory education and training	4	7	7	18
Total New Expenditure	**111**	**121**	**123**	**355**

The Government's commitment to quality education is demonstrated through additional education expenditure in the 1997 Budget of $355 million over the next three years. Key themes addressed by this new expenditure are:

- strengthening schools and communities through initiatives such as a 5% increase in the school operations grant per pupil, introducing a programme to support schools with the greatest need and increased support for schools in low-income communities
- funding the significant growth being experienced in the school population
- contributing to a highly professional and responsive teaching workforce through recruiting additional teachers and teacher professional development
- increasing the hourly subsidy paid to early childhood services by 5%.

In addition to the above initiatives the Government is committed to:

- assisting children with high and very high special education needs by extending the Special Education 2000 policy
- acknowledging the professional skills of teachers when implementing the unified pay system by developing a pay scale that rewards excellence in the classroom.

Funding the three-year cost of these initiatives will be met from within the $1 billion policy contingency.

Finally, an additional $120 million will be provided for the Ministry of Education's school accommodation capital works programme for 1997/98. Approximately $400 million are now planned to be spent on new school accommodation over the next year.

Security in Retirement

Initiative ($ million)	1997/98	1998/99	1999/00	Total
Abolition of superannuation surcharge	25	234	295	554

As stated in the Coalition Agreement the superannuation surcharge will be abolished from 1 April 1998.

In addition to abolishing the surcharge, the Government will from 1 October 1998 remove the income and asset tests for older people in long-stay public hospital care, and remove the asset test for older people in long-stay private hospital care. Funding for this initiative is included in the planned spending levels for the health sector.

While these steps will provide immediate benefits to current retirees, we still have to address the financial pressures created by an aging population. New Zealanders will have the opportunity to have their say on this issue when the referendum on the proposed Retirement Savings Scheme is held in September of this year.

Safer Communities

Initiative ($ million)	1997/98	1998/99	1999/00	Total
Increased Police numbers	12	12	12	36
Crime prevention initiatives	2	2	3	7

The Government believes it is important for people to feel safe in their homes and communities. Since the election more than 80 additional Police have been employed to increase total Police numbers. This Budget provides the Police with the ability to employ an additional 200 Police officers in 1997/98 at a cost of $36 million over the next three years. These are key first steps towards the 500 new Police positions identified in the Coalition Agreement. The extra Police positions will enable the Police to target key objectives by:

- boosting the number of frontline Police personnel to improve officer safety and general policing services
- increasing the specialist targeting of organised crime and gang activities
- further enhancing services aimed at increasing road safety.

The Government is also progressing a number of crime prevention strategies with a particular focus on reducing juvenile offending.

Increasing the Accommodation Supplement

Initiative ($ million)	1997/98	1998/99	1999/00	Total
Increases to the Accommodation Supplement and Special Benefit	52	48	51	151

The Government has allocated an additional $151 million over three years to increase the Accommodation Supplement and change the Special Benefit with effect from 1 July 1997. The key changes involve:

- increasing the Accommodation Supplement to low-income households from 65 cents in the dollar to 70 cents in the dollar (above the eligibility baseline)
- increasing the maximum Accommodation Supplement payment that can be made in areas where rents have increased
- making the Special Benefit more accessible to those in need, by easing eligibility criteria.

The changes are a major step towards implementing the measures contained in the Coalition Agreement which will assist those households under most pressure by improving access to affordable accommodation.

Employment is the Pathway to Greater Self-reliance

Initiative ($ million)	1997/98	1998/99	1999/00	Total
Employment Strategy	14	16	14	44

The Coalition Government has re-prioritised $32 million of employment spending and committed an additional $44 million over the next three years to employment initiatives. The objective of the Government's employment strategy is to reduce the time spent in unemployment by targeting the long-term unemployed and young disadvantaged job seekers.

Initiatives in this Budget are the first step towards implementing the employment strategy outlined in the Coalition Agreement. Initiatives will:

- establish a regional delivery structure for employment assistance
- smooth access to employment, training and welfare services for job seekers
- expand the Community Taskforce programme to provide between 7,000 and 10,000 long-term job seekers at any one time with work experience
- expand Limited Service Volunteers, providing 1,250 young disadvantaged job seekers with personal development and job skills.

Economic and Fiscal Forecast Summary

Overview

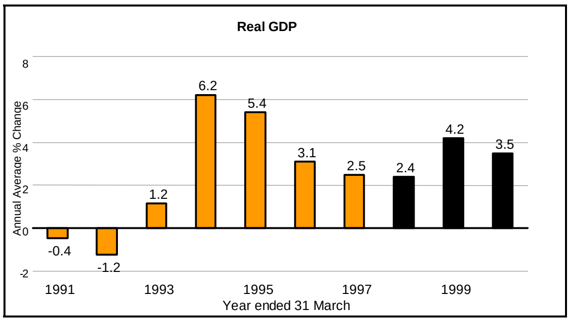
The economic and fiscal outlook for the next three years remains positive, with robust output and ongoing employment growth, and a fiscal position of ongoing operating surpluses, rising net worth and declining Crown debt. The projections are based on an assumption of existing policy.

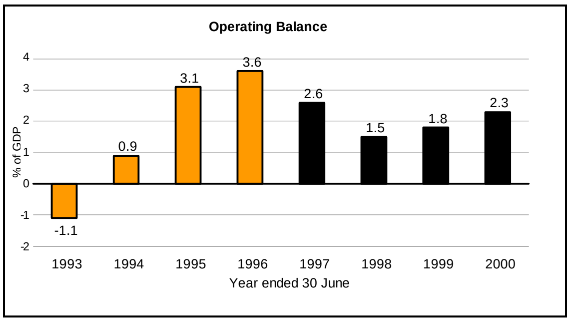
- The economic outlook over the next three years is for sustained growth, averaging just above 3% each year. After growth in 1996/97 of 2.5% and 2.4% in 1997/98, the economy expands by 4.2% in 1998/99, boosted by government spending, the second round of tax reductions, lower interest rates and strong world economic growth. Growth moderates to around 3.5% in 1999/2000.

- The Crown continues to run operating surpluses over the three years. The operating surplus declines in 1997/98 relative to 1996/97, largely reflecting low revenue growth and changes in welfare and debt servicing forecasts. Beyond 1997/98 the surplus rises as economic growth accelerates and revenue grows at a faster rate than total expenses.

- As a result of these surpluses, net worth continues to rise and Crown debt continues to fall. Net worth is projected to reach $12.1 billion by the end of the forecast period, and net Crown debt falls from 31.5% of GDP in 1995/96 to 27.1% in 1996/97 and then to 20.5% in 1999/2000.

- This forecast is regarded as being most likely, but alternative scenarios are possible, if the underlying judgments are changed. These judgments particularly revolve around the speed at which activity accelerates.

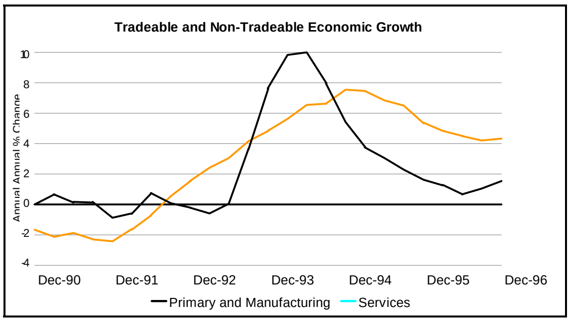


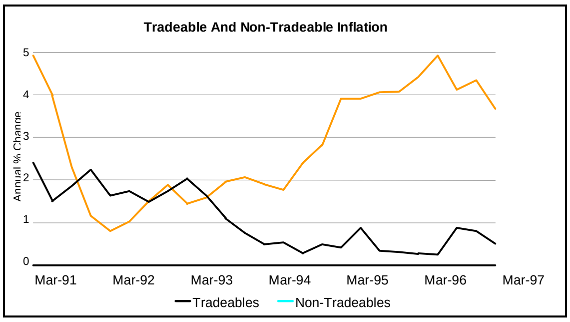


Economic Outlook

1996 Saw Steady Economic Growth

- The economy enjoyed steady growth last year, growing by 2.7% in the year to December. This was in line with the December forecasts.
- Growth however was not evenly spread between sectors. The non-tradeables sector expanded by 4.3% over the year, much faster than the tradeables sector. Inflationary pressures were also much stronger in the non-tradeables sector.
- The rate of economic growth was faster in the second half of 1996 than in the first half.
- However, this stronger growth looked somewhat at odds with weaker employment growth, weak consumer spending and muted business confidence.
- The explanation lies in the fact that some of the growth in the second half of the year was owing to increasing dairy exports.
- In addition, residential construction also picked up towards the end of last year and the July tax reductions were helping to underpin activity.
- For many firms, trading conditions were difficult. Companies in the tradeables sector were already feeling the strain imposed by the strong dollar at the start of 1996, but by the end of the year some service firms were also facing more testing times owing to the downturn in consumer spending.





Early 1997 has Seen Signs of Slower Growth

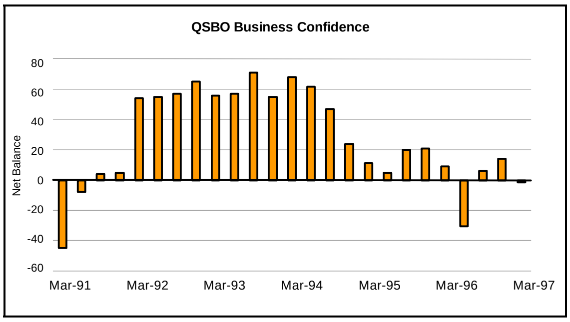
- The completion of the government formation process and lower interest rates (which have been falling since October 1996) could have been expected to boost confidence and spending in early 1997. However, an acceleration in growth failed to materialise and employment growth was virtually flat in the six months to March.

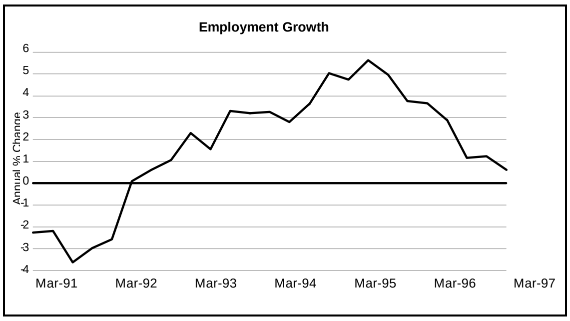
- Confidence and activity levels have been dampened in early 1997. A number of reasons have been publicly given including increased concerns over job security, the tight monetary conditions of 1996 and the delay to the tax reductions originally scheduled for July 1997.

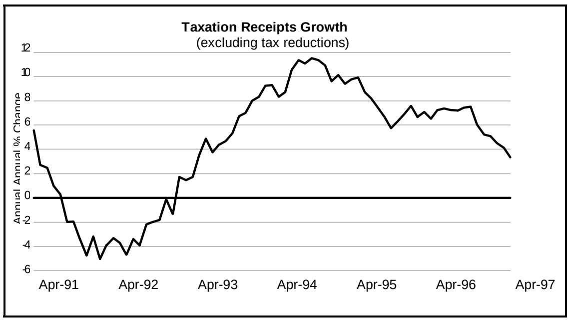
- Signs of weaker activity have already been seen in 1997, including a fall-off in tax receipts, building consents and employment growth. This suggests activity will be slower in the early part of this year than was envisaged at the time of the December forecasts.

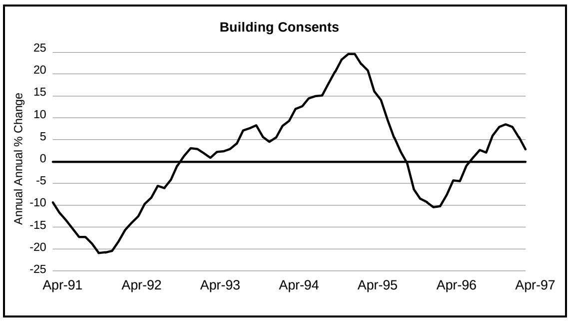
- Inevitably this pulls down growth for the year as a whole relative to the December forecasts, with growth of 2.4% projected for the year to March 1998. Firms are expected to cut back on hiring and the unemployment rate rises to 6.8%.

- Slower growth will help reduce inflationary pressures in the short term with underlying inflation expected to fall to 1% by March 1998.



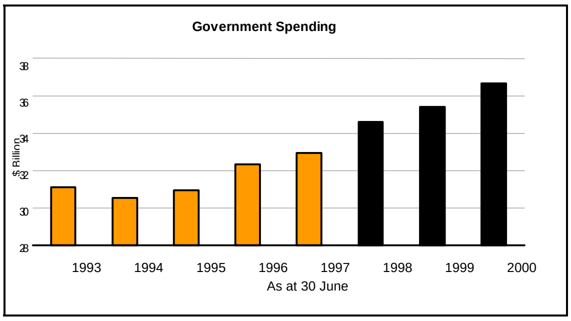


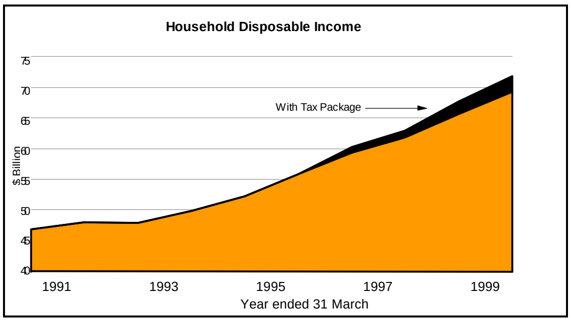


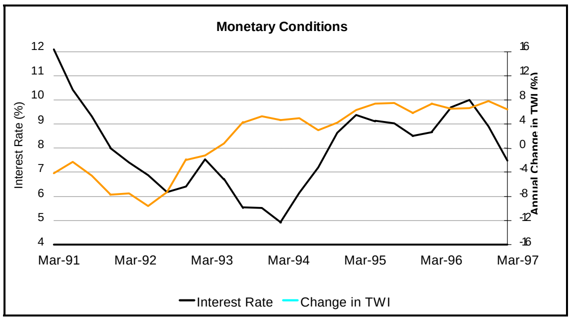


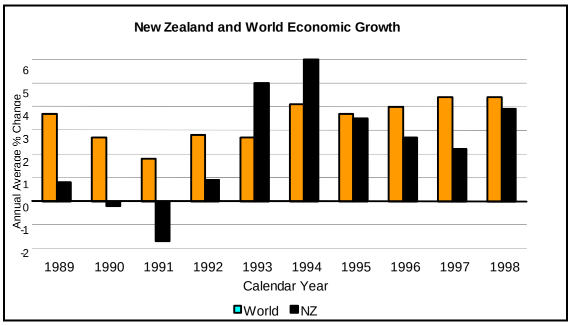
Growth Picks Up Strongly in 1998

- Towards the end of 1997 a rebound in growth is expected, kick-started by previous interest rate falls and increasing government spending.
- Momentum strengthens in 1998/99 as a number of factors combine to fuel growth. These include:
  - tax reductions in July 1998 which stimulate consumer spending
  - a further increase in government spending
  - the abolition of the superannuation surcharge in April 1998
  - the fall in interest rates which has a lagged impact on investment spending
  - strong world growth which supports exports.
- The combined effect is to push economic growth up to 4.2% in the year to March 1999.









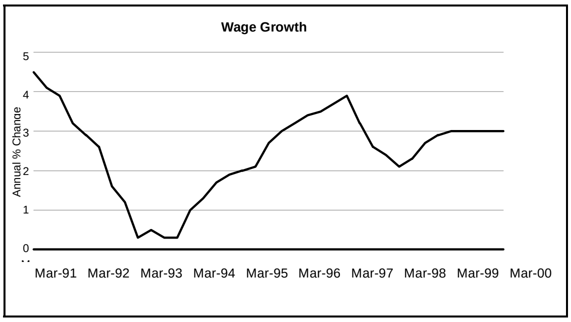
Inflationary Pressures are Contained

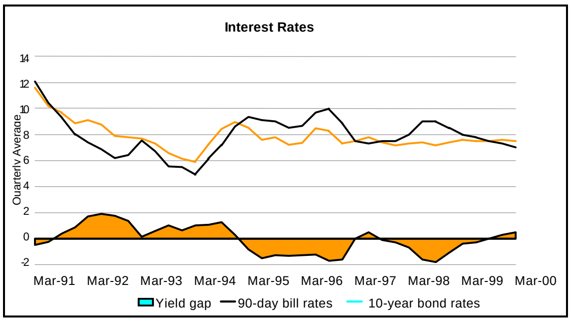
- The strong growth in 1998/99 will increase the risk of inflation. While strong productivity growth will prevent significant inflationary pressures flowing from the labour market, a climate of strong demand will encourage firms to raise prices to expand profit margins.

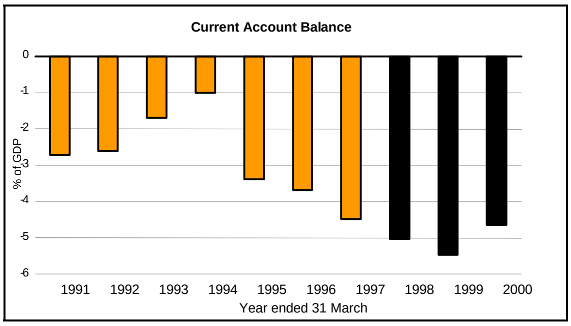
- These inflation concerns will lead to interest rates rising from early 1998. This tightening in monetary conditions slows growth and ensures inflation stays within the 0% to 3% band throughout the forecast period.

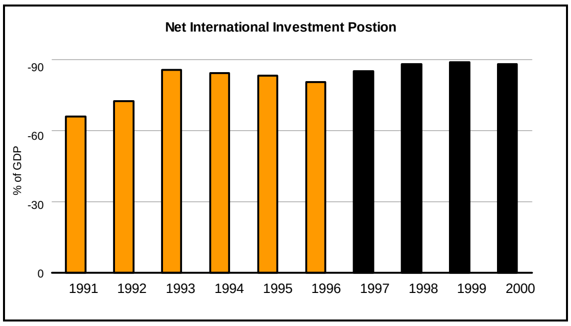
- In the absence of higher interest rates, growth would accelerate to a rate well beyond 4%, running the risk that inflation would be significantly higher.

- Strains on the economy's productive capacity will also be reflected in accelerating import growth. This contributes to a widening current account deficit. However, the debt servicing position is expected to remain stable over the forecast period.



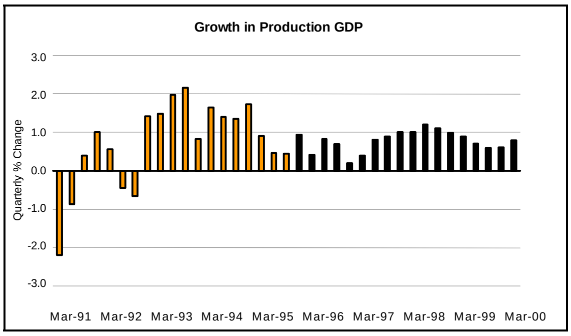


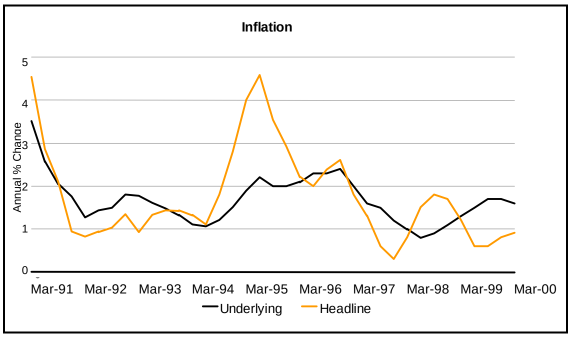


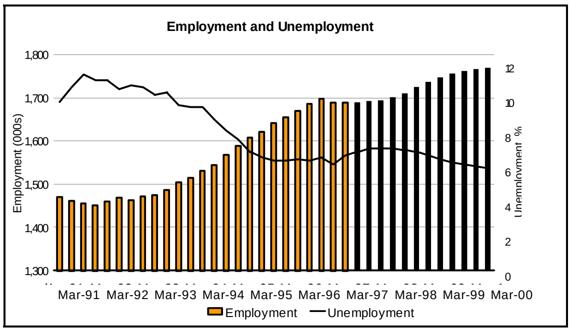


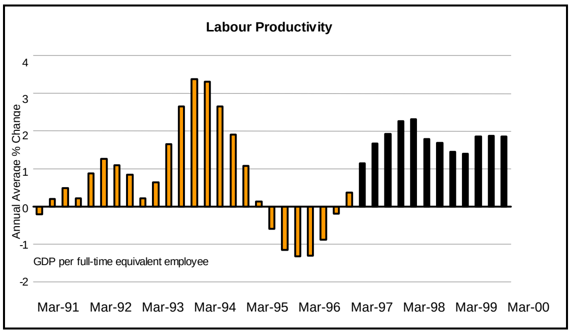
Broad-based Growth Continues Over the Medium Term

- In the final year of the forecast, growth is expected to fall back from the strong pace of 1998/99 to a more sustainable 3.5%.
- Spending by firms and households remains the main driver of growth, but activity becomes more broadly based. Exports grow steadily, boosted by strong activity in Australia.
- Monetary conditions will need to remain firm to ensure inflation remains low.
- Over the medium term, the Treasury's analysis suggests that the economy should be able to sustain growth rates of around 3% to 3.5% per annum. In part this reflects the ongoing benefits of a more open and competitive environment created by the extensive reforms of last decade.









Fiscal Outlook

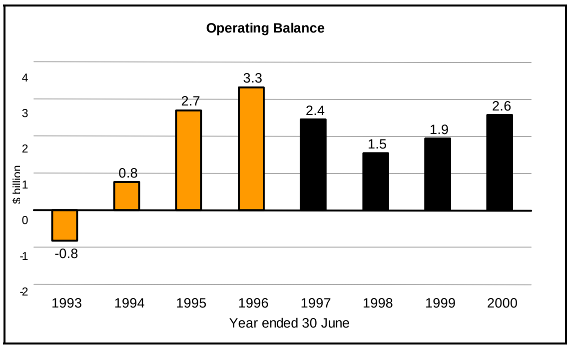
Fiscal Outlook Shows Ongoing Operating Surpluses

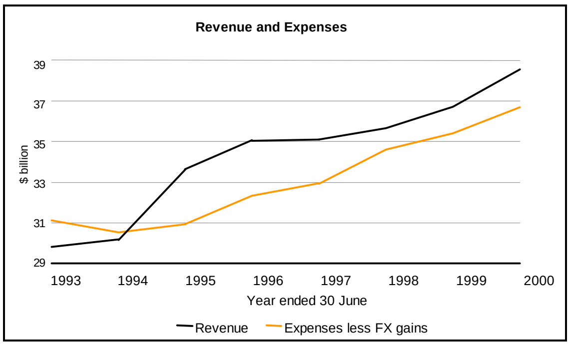
- The fiscal forecasts show operating surpluses, of 1.5% of GDP rising to 2.3%, over the forecast period. Steady growth in revenue is broadly matched by increases in priority spending areas, particularly health, education and social welfare.

- The fiscal forecasts in this *Update* also incorporate, for the first time, expense provisions for initiatives to be announced in the next two Budgets, up to the Coalition Agreement's $5 billion spending cap.

- The surplus declines in 1997/98 relative to 1996/97. While deferral of tax reductions more than offsets the Coalition Agreement's additional spending of $900 million in 1997/98, revenue growth is lower than in recent years because of slower growth in the economy. In addition, the deferral of the forecast settlement of the Ngai Tahu claim from 1996/97 to 1997/98 increases the surplus in 1996/97 and reduces it in 1997/98.

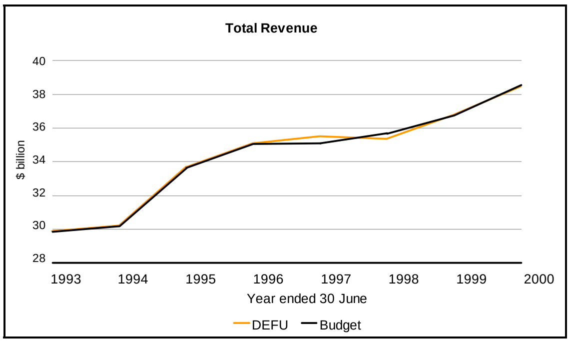
- Operating surpluses rise in 1998/99 and 1999/2000, as growth in the economy accelerates resulting in an increase in tax revenues (even with a tax rate reduction from 1 July 1998), and expense growth slows.

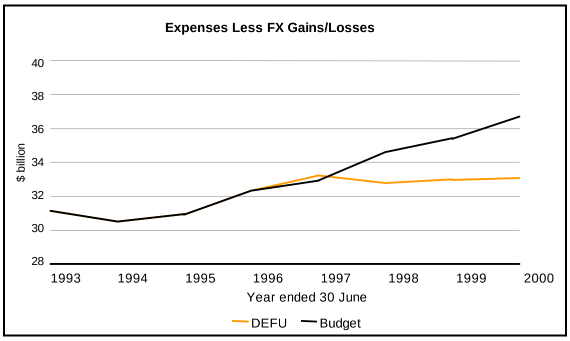




Operating Balance Track has Changed Since the December Update

- The operating balance track is lower than forecast in December. Major influences include:
  - the Coalition Government's 1997 Budget initiatives and the inclusion, for the first time, of provisions for initiatives to be announced in the 1998 and 1999 Budgets
  - significant unfavourable forecasting changes in expenses, including higher welfare benefit projections from corrected demographic projections and higher CPI indexation, unfavourable Government Superannuation Fund (GSF) unfunded pension liability movements, and higher finance costs
  - tax revenue is largely unchanged from the *December Update*. Lower growth in the economy in the short term and revised judgments on the tax base, (following 1996/97 outturns) have reduced tax revenues in 1997/98, largely offsetting the effect of deferring the 1 July 1997 tax reductions by one year
  - beyond 1997/98, economic growth is expected to be stronger than projected in December, nearly bringing tax revenues back to the *December Update* levels
- As a result of the lower operating balance track, net worth is lower than forecast in December. Net worth is projected to reach $12.1 billion by 30 June 2000 (compared with a *December Update* projection of $19.7 billion).





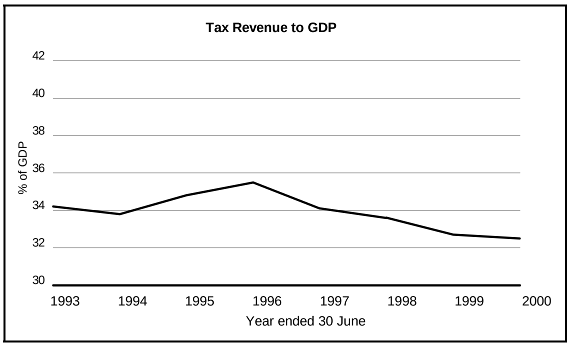
Growth in Revenue Broadly Matches Expense Growth

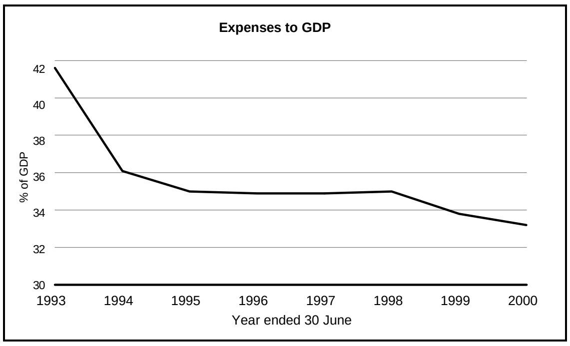
Revenue

- In nominal terms, overall revenue has grown very little in 1996/97 reflecting the impact of the tax rate reductions and weak corporate tax flows. Revenue growth picks up only slightly in 1997/98 as economic growth remains subdued.
- Tax revenue grows more strongly beyond 1997/98 as growth in the economy re-accelerates. In 1998/99 strong growth in the economy is offset partly by the tax rate reduction deferred from the previous year.
- Tax revenue declines as a percentage of GDP in each year from 1995/96, mainly owing to the tax rate reductions in 1996/97 and 1998/99, and abolition of the New Zealand Superannuation surcharge.

Expenses

- In nominal terms, expenses rise steadily over the forecast period, reflecting a combination of factors including additional Coalition Agreement spending, the indexation of benefits and demographic factors such as population growth.
- Expense growth slows from 1998/99, and expenses are forecast to decline as a percentage of GDP in the final two forecast years.
- Finance costs continue to fall over the period, reflecting ongoing cash surpluses and correspondingly lower debt levels.
- The fiscal forecasts in this Budget incorporate expense provisions for future initiatives. These reflect both provisions for 1997 Budget initiatives which have yet to be fully developed, and provision for the 1998 and 1999 Budgets - up to the Coalition's $5 billion spending cap.

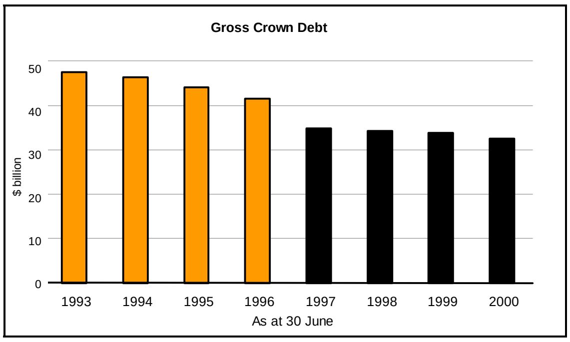


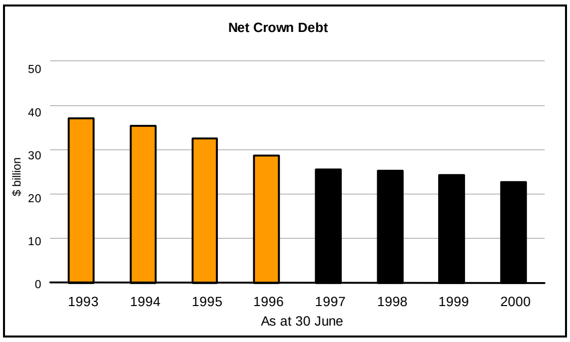


Crown Debt Continues to Decline

- Both gross and net Crown debt continue to decline over the next four years, reflecting the ongoing application of cash surpluses to debt repayment. Net Crown debt falls from 27.1% of GDP at 30 June 1997 to 20.5% of GDP at 30 June 2000, and gross debt falls from 36.9% of GDP to 29.4% over the same period.

- The decline in Crown debt is slower and the debt profile higher than projected in the *December Update*, primarily as a result of the lower operating surpluses discussed earlier.





Economic Outlook[1]

(Annual average % change March years)	1995/96 Actual	1996/97 Estimate	1997/98 Forecast	1998/99 Projection	1999/2000 Projection
Private consumption	4.0	3.1	1.9	4.5	3.5
Private investment	8.5	1.5	2.9	10.2	7.4
Exports	1.7	4.9	2.8	5.8	5.3
Imports	6.8	6.0	5.2	8.9	4.9
GDP[2]	**3.1**	**2.5**	**2.4**	**4.2**	**3.5**
Unemployment rate (%)[3]	6.2	6.4	6.8	6.2	5.7
90-day bill rate (%)[4]	8.8	9.0	7.6	8.6	7.4
Underlying inflation (%)[5]	2.1	2.0	1.0	1.3	1.6
Current account balance[6]	(3.3)	(4.2)	(4.9)	(5.7)	(5.0)
Ratio to GDP (%)	(3.7)	(4.5)	(5.0)	(5.5)	(4.6)

Fiscal Outlook[1]

$ billion June years	1995/96 Actual	1996/97 Estimate	1997/98 Forecast	1998/99 Projection	1999/2000 Projection
Total revenue	35.1	35.1	35.7	36.7	38.6
Ratio to GDP (%)[7]	38.6	37.2	36.1	35.0	34.8
Total expenses	31.7	33.0	34.6	35.4	36.7
Ratio to GDP (%)	34.9	34.9	35.0	33.8	33.2
Operating Balance	**3.3**	**2.4**	**1.5**	**1.9**	**2.6**
Ratio to GDP (%)	3.6	2.6	1.5	1.8	2.3
Net worth	3.3	6.0	7.6	9.5	12.1
Ratio to GDP (%)	3.7	6.4	7.6	9.0	10.9
Gross Crown debt	41.5	34.8	34.3	33.8	32.5
Ratio to GDP (%)	45.7	36.9	34.7	32.3	29.4
Net Crown debt	28.6	25.6	25.2	24.3	22.7
Ratio to GDP (%)	31.5	27.1	25.5	23.2	20.5

1 Economic forecasts were finalised on 21 May 1997, fiscal projections on 10 June 1997.

2 Production-based measure (March years).

3 HLFS unemployment as a percentage of the labour force, seasonally adjusted, March quarter.

4 Average for year to March.

5 Annual percentage change, March quarter.

6 $ billion.

7 All ratios are of nominal GDP on an expenditure basis, March years for the economic outlook, June years for the fiscal outlook.