# The Treasury

## Budget 2011 Information Release

## Release Document

## June 2011

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[2] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[3] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

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[8] 9(2)(h) - to maintain legal professional privilege

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[10] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand

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Date: 17 December 2010 BM-1-1-2

THE TREASURY
Kaitohutohu Kaupapa Rawa

To: Minister of Finance

**AIDE MEMOIRE: ADDITIONAL FISCAL SCENARIOS**

This note is a follow-up to the discussion at last week's Fiscal Issues where you asked Treasury to provide additional options for you to consider to reduce government borrowing by $10 billion by 2015. The options presented below are in addition to those proposed by Treasury and Budget Ministers, which are included as a point of comparison.

All of the new options, which are presented in Table 1 below, alongside existing options, assume that capital allowances reduce to $0 for three Budgets between Budgets 2012 and 2014. From Budget 2015 onwards, both the Operating Allowances (OA) and Capital Allowances (CA) revert back to the HYEFU 2010 track.

Table 1: Options to achieve a reduction in government borrowing of $10 billion by 2015

| in $ million | | Option 1 | Option 2 | Option 3 | Option 4 | Budget Ministers' option | No baseline expenditure cut option | Treasury's earlier scenario |
|---|---|---|---|---|---|---|---|---|
| **Operating Allowances (*)** | from Budget 11 to Budget 14 | 950 | 850 | 750 | 650 | 750 for Budget 11; then HYEFU track for other | 700 for Budget 11; 500 for Budgets 12, 13 & 14 | 900 from Budget 11 onwards |
| **Capital Allowances** | from Budget 12 to Budget 14 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 700 from Budget 12 onwards |
| **Expense reduction** | in Budget 12; **OR** | 1320 | 1000 | 650 | 300 | 0 | 0 | 2000 |
| | over 2 Budgets: B12 & B13 | 2 x 800 | 2 x 600 | 2 x 400 | 2 x 200 | 0 | 0 | N/A |
| **Reduction in ACC expenses (**)** | from Budget 11 onwards | 100 | 100 | 100 | 100 | 0 | 100 | 0 |
| **Debt reduction by 2015 ($ billion) (***)** | | **10.0** | **10.0** | **10.0** | **10.0** | **5.3** | **9.9** | **9.8** |

(*) The figures quoted in the table for Operating Allowances are for Budget 2011. Operating Allowances from Budget 2012 to Budget 2014 are assumed to grow from the indicated amount in Budget 2011 for each option at 2% per annum.
(**) This figure (i.e. $100 million of lower ACC expenses) assumes that the Non-Earners Account forecasts will result in a lower fiscal cost. This will be confirmed in February.
(***) Table 2 details the breakdown of savings by source

The numbers in Table 1 have been modelled with an unchanged set of HYEFU 2010 economic forecasts behind them. In reality, it is likely that, to varying degrees, the various options would impact on economic variables like inflation, consumption etc.

The effect on economic growth from 2012, when the major fiscal savings occur for most of the options depicted, will most likely see a slightly slower recovery, rather than a contraction of GDP. Advance announcement will allow interest rates and exchange rates to be lower than otherwise, thereby mitigating negative effects. Despite this, it is fair to say that there are always uncertainties around how the economy will respond to any significant change in public spending.

However, over the longer term, the various options depicted, in combination with wider reforms, will help shift the economy onto a more balanced (in terms of tradables/non-tradables, saving/investment), and higher growth path.

All of the options depicted in Table 1 employ a phased multi-year approach to decreasing public spending. This has the advantages of:

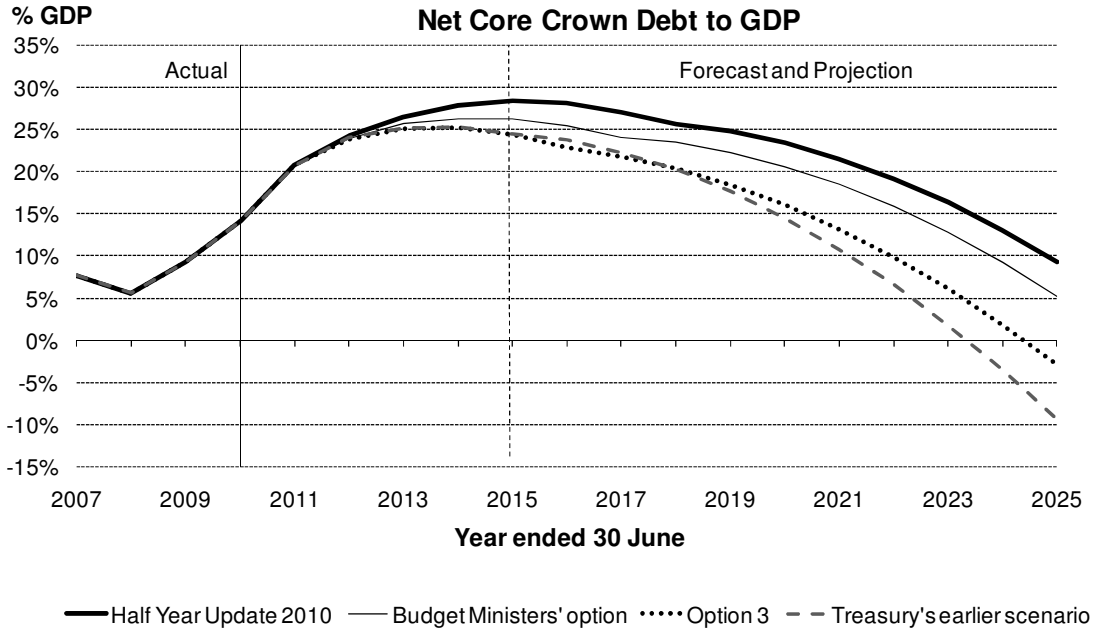
- allowing time for planning the most appropriate and enduring areas in which to make savings;
- providing an adequate period in which to make adjustments to plans if circumstances change significantly; and
- signalling changes early to the Reserve Bank to assist in monetary policy decision-making.

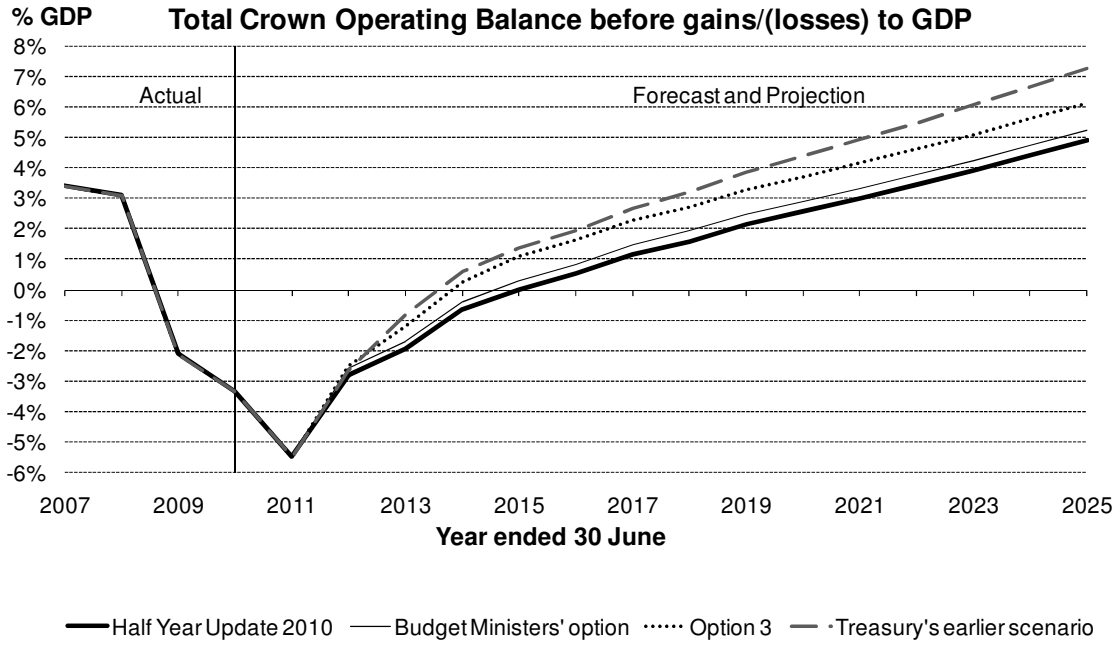
In all of these options, a reduction in the Operating Allowance will reinforce the need for Ministers and departments to continue to prioritise and switch expenditure to fund government priorities. This would be in addition to the expense reductions shown in the table above.

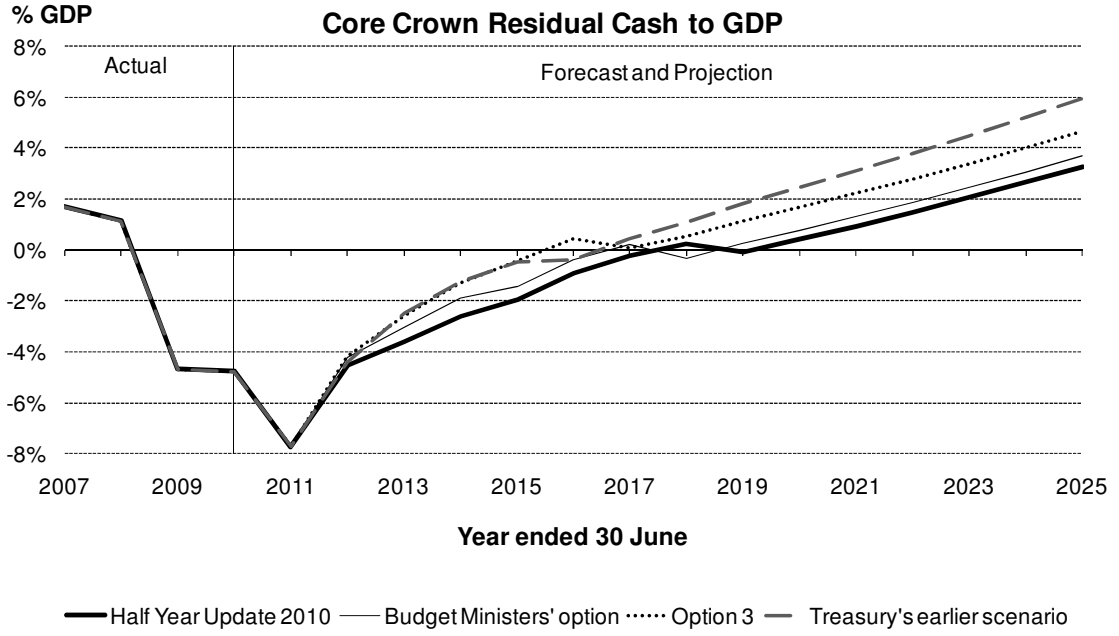
**Main findings:**

- In all of the new options (options 1 to 4, plus the "*No baseline expenditure cut*" option), the Total Crown Operating Balance before gains and losses returns to a surplus of around 0.3% of GDP in 2013/14, two years earlier than forecast at HYEFU 2010.

- The Core Crown Operating Balance before gains and losses returns to a surplus of around 0.3% of GDP in 2014/15 and is of sufficient size to start making contributions to the New Zealand Superannuation Fund by 2016/17, two years earlier than forecast at HYEFU 2010.






Note: In the projection years, Core Crown Residual Cash are proxies of the changes in the level of net Core Crown debt. Also, the kinks in the Core Crown Residual Cash lines in the projected years represent the first year the contributions to the New Zealand Superannuation start again.

Table 2: Accumulated savings from 2010/11 to 2014/2015 – Breakdown by source

| $ billion | Option 1 | Option 2 | Option 3 | Option 4 | Budget Ministers' option | No baseline expenditure cut option | Treasury's earlier scenario |
|---|---|---|---|---|---|---|---|
| | Accumulated savings over 5 years to 2015 | Accumulated savings over 5 years to 2015 | Accumulated savings over 5 years to 2015 | Accumulated savings over 5 years to 2015 | Accumulated savings over 5 years to 2015 | Accumulated savings over 5 years to 2015 | Accumulated savings over 5 years to 2015 |
| Capital Allowances | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 0.7 |
| Operating Allowances | 1.8 | 2.8 | 3.9 | 4.9 | 1.8 | 5.7 | 2.3 |
| ACC Expenses | 0.4 | 0.4 | 0.4 | 0.4 | 0.0 | 0.4 | 0.0 |
| Expense reduction | 4.0 | 3.0 | 2.0 | 0.9 | 0.0 | 0.0 | 6.0 |
| Finance cost | 0.8 | 0.8 | 0.8 | 0.8 | 0.5 | 0.8 | 0.7 |
| **Total savings ($ billion)** | **10.0** | **10.0** | **10.0** | **10.0** | **5.3** | **9.9** | **9.8** |

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