

THE BUDGET AND MACRO-ECONOMIC POLICY

INTRODUCTION

This article follows on from Bulletin articles in earlier years entitled 'Government Expenditure and Revenue'. Firstly, it outlines the possible economic effects of fiscal policy and then discusses the relevance of different indicators of the fiscal stance of government budgets. Secondly, it examines the budget financing options available to government and their implications for the economy. Finally, the 1983 Budget and related economic policy measures, and their significance in the light of the above considerations, are discussed.

The article does not give an exhaustive analysis of the likely effects of fiscal policy as it leaves out of consideration two distinct areas of influence. The first is those effects relating to the size of the government sector and more broadly, the extent and quality of government involvement in the economy. The second is the specific distributional and allocative effects of particular budget measures. The aim of this article is instead to look at the overall income, expenditure and monetary effects of fiscal policy in aggregate.

FISCAL DEFICITS AND FISCAL INDICATORS

At the simplest level a fiscal deficit — an excess of government spending over government revenue — is normally considered to be expansionary in that the government budget deficit is adding to the sum total of expenditure in the economy and thereby boosting activity. Moreover such added expenditure can be expected to generate a more than proportionate increase in total expenditure as it circulates through the economy. This well known 'multiplier' effect arises because the initial extra expenditure represents extra income for the various sellers, workers or beneficiaries involved and enables them to increase their own expenditure levels, which in turn means increased incomes for others, and so on. The constraints on this multiplier process include savings, imports, and the tax structure, all of which represent a withdrawal from the circular flow of funds in the private sector.

Beyond this simple view, it is important to obtain an understanding of the extent to which an expansionary fiscal policy will be translated into quantity effects — i.e. increased real output — or alternatively be reflected in price increases and/or a deterioration in the balance of payments. If the economy is operating at close to full capacity for example (or even if certain key markets or industries are close to full capacity), price increases are likely and the government can increase its real expenditure and its claims on real resources only if those of the private sector are correspondingly reduced, or if the balance of payments will permit reduced exports or increased imports. The emergence of a balance of payments deficit must usually be corrected at some stage and the adjustment may itself add to domestic costs as the prices of traded goods are brought into line with domestic prices.

Yet even when the economy is not operating at close to full employment levels, there are a number of factors which may operate to inhibit the ability of fiscal policy to influence real variables in anything more than a temporary way. One possibility relates to the method by

which a fiscal deficit is financed. This is discussed in more detail in the next section of the article, but the relevant point here is that to the extent that a deficit is financed by selling government securities rather than 'monetised' — i.e. financed in a way which does not increase the liquid asset holdings of the private sector — then an effect known as 'financial crowding out' may occur. In selling securities to the public, a government generally places upward pressure on interest rates, which may tend to discourage various interest-sensitive private expenditures, especially investment. Pressure on rates occurs because, with the higher level of expenditure and incomes, the public's demand for money for transactions purposes is raised. If the money market is to clear with an unchanged money supply, interest rates must rise sufficiently to just remove the excess demand for money.

In addition, to the extent that government security issues represent additional net wealth, there can also be wealth effects on the demand for money, but whether or not such effects add any further upward pressure to interest rates depends on the relative substitutability between money, securities and real assets, such as property. Generally, if government securities are considered to be closer substitutes for real assets than for money (i.e. the less liquid the bonds are), the more likely there is to be further upward pressure on interest rates, and hence the greater is the degree of crowding out of private sector expenditure.

If interest rates do not rise so much that private sector expenditure reductions fully offset the increased government activity, the question of the extent to which increased expenditure feeds through into price or balance of payments effects, rather than real output effects, nevertheless remains. With respect to price effects, perhaps the single most fundamental factor is the expectations formed by the private sector. For example, increased economic activity may encourage producers to raise prices. This is especially likely to happen when producers do not see much probability of a permanent higher level of sales volumes resulting. Furthermore, expectations of a firming labour market due to a fiscal stimulus may enable existing workers to better their own conditions by bargaining for higher wages, thus adding to cost pressures and tending to choke off any increased output.

In addition, large fluctuations in fiscal policy and the linkages with inflation may create uncertainty about the true underlying trends in the real economy and obscure relative price movements which would otherwise act as signals for the efficient allocation of resources.

As for balance of payments effects, two major factors influence the degree to which the external accounts may be a constraint on the real output impact of a budget deficit. The first is the extent to which the rise in import demand resulting from a fiscal stimulus may be reduced by exchange rate movements. Other things being equal, excessive fiscal stimulus is likely to put pressure on the balance of payments as the demand for imports increases, for example. If the exchange rate does not move appropriately, the increased import demand will be translated into a larger external deficit. The external deficit and rising overseas debt levels will present a greater constraint on economic management, and could constrain the extent to which expansionary fiscal policy

can be permitted.

The second factor relates to the nature of import demand. If a large proportion of imports is accounted for by capital equipment, raw materials or intermediate goods, there may be little scope for increased domestic production without a similar increase in import volumes and a consequent deterioration in the balance of payments.

In practice the division between the price, external and domestic output effects of fiscal policy is not likely to be clear, in part because of the lags inherent in the processes. In New Zealand, empirical studies show that these lags are long and variable. However, most studies indicate that the leakage from the domestic economy by way of imports is particularly strong, and the external accounts are thus frequently a major constraint on macro-economic policy.

It also seems likely on the basis of findings in overseas studies that although less expansionary than monetised deficits, deficits financed by government security sales can still have real output effects in addition to price and balance of payments effects. In other words, the constraints outlined above have not fully offset fiscal policy effects on real variables in the past. Nevertheless, such factors can be expected to become more important over time if budget deficits continue to increase in relative size or large deficits persist for some time.

BUDGET DEFICITS IN NEW ZEALAND

In considering fiscal policy in New Zealand in recent years, there are two different approaches to gauging the impact of budget deficits. The first of these involves using a full econometric model of the economy to generate the end results of the planned budgetary measures, which are then compared with a 'control' path representing what would have happened in the absence of those budget measures. This approach allows quantification of the multiplier effects of Government expenditure and revenue decisions. The second approach involves analysis and comparisons of various measures of the budget's fiscal stance, without an explicit quantification of the final effects. This is the approach adopted in this article.

The simplest example of this method is a comparison of published budget deficit figures (i.e. the 'amount to be financed from borrowing' in Table 2 of the annual New Zealand Budget). When compared to past actual deficit levels they give an indication of the extent to which the deficit is relatively expansionary or contractionary. However, no single indicator can show this adequately because of the complexity of the interactions involved. The conventional measure of the deficit is particularly suspect in this regard as it includes Government transactions which have no direct effect on the domestic economy. Consequently, as it is the fiscal impact on the domestic economy which is of interest, an 'adjusted domestic deficit' can be obtained by taking out the Government's current overseas exchange transactions and also some fairly minor capital transactions included in 'miscellaneous receipts' in the Budget accounts (involving capital gains or losses on foreign investments due to exchange rate fluctuations).

A further refinement becomes justifiable when it is recognised that not only does the deficit affect the economy but the state of the economy also effects the deficit because of the presence of 'automatic' as well as

'discretionary' elements in Government expenditure and revenue. For example, the level of income and the rate of inflation affect taxation receipts, and the level of unemployment benefits paid out depends on the number of unemployed.

One possible response to this is to compute data representing the 'full employment surplus'. This indicates how expansionary or contractionary a particular budget balance is by calculating for the particular levels of discretionary expenditure and revenue involved, the levels of automatic expenditure and revenue (and hence the deficit or surplus) which would occur if the economy was in a state of full employment. This indicator also has deficiencies, including measurement and definition problems, but perhaps most importantly because it places sole emphasis on full employment as the common base on which to measure budgets against one another. For the New Zealand economy other objectives such as reasonable balance of payments equilibrium and price stability are also important and should be considered in any comparative analysis of fiscal stance.

An alternative approach is to calculate the 'cyclical effect of the budget'.¹ This is arrived at by comparing the adjusted deficit with one which would have been 'cyclically neutral' given trends in the economy. The cyclically neutral balance is the budget deficit or surplus that would result if (adjusted) Government expenditure increased over time, with reference to some base year, in proportion to the growth of potential domestic output; and Government revenue (adjusted) changed in proportion to actual domestic output. This concept has similar measurement deficiencies to those of the full employment surplus, and also requires the arbitrary choice of a cyclically neutral base year. However, it does allow the balance of payments and the inflation rate objectives to be taken into account through the selection of an appropriate base period.

Table A compares the conventional budget with the adjusted domestic deficit and with the cyclical effect of the (adjusted) budget, calculated using 1971/72 as the base year. 1971/72 is chosen as cyclically neutral (the budget for that year therefore having a cyclical effect of zero in the analysis, by definition) because in that period there was moderate economic growth and reasonable balance of payments equilibrium, unemployment was low, inflation was under 10 per cent, and the terms of trade were favourable but not at their peak.

It is immediately apparent that for the years shown the removal of budget transactions which do not directly affect the domestic economy leads to a significantly lower measure of the domestic deficit, and that the conventional budget deficit, by itself, may therefore be a rather misleading indicator of the expansionary nature of a particular deficit. The cyclical effect of the budget indicates that the budgets for 1971/72 to 1976/77 were rather more expansionary than the adjusted domestic deficit suggests, while those for 1977/78 to 1982/83 were less expansionary given the underlying economic conditions. Neutral budget balances would, according to this measure, have been surpluses in 1971/72 to 1976/77, and neutral balances in subsequent years would have been deficits smaller than those actually occurring.

¹ This approach, along with other alternative measures of the fiscal deficit, is described in more detail in *The Stabilisation Role of Fiscal Policy*, by R.S. Deane and R.G. Smith, NZ Planning Council, Planning Paper No. 5, April 1980.

TABLE A: FISCAL INDICATORS
(Deficit (—), Surplus (+))

March Year	Conventional Budget Deficit		Adjusted Budget Deficit		Cyclical Effect of Adjusted Budget	
	\$m.	% of GDP	\$m.	% of GDP	\$m.	% of GDP
1972	- 72.3	-1.1	- 25.6	-0.4	- 0.0	-0.0
1973	- 206.0	-2.6	- 92.4	-1.2	- 153.8	-1.9
1974	- 241.7	-2.6	- 25.0	-0.3	- 142.4	-1.6
1975	- 390.5	-3.9	- 250.2	-2.5	- 423.4	-4.2
1976	-1,001.7	-8.7	- 789.1	-6.9	- 903.3	-7.9
1977	- 506.1	-3.7	- 199.2	-1.4	- 318.7	-2.3
1978	- 694.5	-4.6	- 360.7	-2.4	- 252.9	-1.7
1979	-1,445.9	-8.2	- 977.1	-5.6	- 816.3	-4.7
1980	-1,026.9	-4.9	- 410.7	-2.0	- 22.3	-0.1
1981	-1,524.9	-6.3	- 942.7	-3.9	- 605.6	-2.5
1982	-1,818.3	-6.4	-1,143.9	-4.0	- 839.9	-2.9
1983	-1,767.0	-5.5	- 954.3	-3.0	- 467.6	-1.5
1984(e)	-3,169.0	-9.3	-2,169.0	-6.4	-1,428.3	-4.2

(e) — using NZIER estimate of GDP.

However, because of the weaknesses in all three measures more attention should be paid to the relative movements in each indicator than to their absolute levels. Although each suggests a rather different absolute net impact on the domestic economy, and also a somewhat different pattern year by year, there are three features common to all of the indicators in Table A. The first common feature is the large and sudden shifts in the stance of fiscal policy over the years considered, which have a clear cyclical pattern. Although the budget was already strongly expansionary in 1974/75, it became even more expansionary in 1975/76 (with a cyclical effect as a proportion of GDP almost double that of 1974/75). In the following two years the cyclical effects of the budget were more mildly expansionary, but then increased sharply again in 1978/79. This three year cycle was then repeated starting with a much less expansionary stance in 1979/80, but increasing to another peak in 1981/82.

The second feature in common is that there has been a tendency for the level of deficit indicators throughout this three-year cycle to rise over time. This upward ratcheting of deficit levels has important longer term consequences, with each increasing addition to the level of public debt involving accelerating debt service charges, which increases the difficulties policymakers face in containing or reducing future deficit levels. The process can become self-reinforcing, with increasingly adverse effects on monetary growth, prices, interest rates, the external accounts and private sector activity.

The third feature is that the fiscal deficit forecast for 1983/84 is not only substantially higher than in 1982/83 it is also apparently more expansionary than in most of the peak years in the previous cycles of fiscal policy. This is discussed further in the last section of this article.

MONETARY EFFECTS OF THE BUDGET — FINANCING THE DEFICIT

The indicators discussed above can essentially only be taken as measures of the relative strength of the income and expenditure effects of Government's budget balance. There can also be monetary effects which are closely related to the way the budget balance is financed. As noted earlier, a fiscal deficit which is 'monetised' — i.e. financed in a way which adds to the private sector's holdings of liquid assets — generally has

a stronger expansionary effect than a deficit which is not monetised. A monetised deficit will tend to push (real) interest rates down and encourage further additional private expenditure. Also, the deposits and reserves of financial institutions are increased, which may enable them to increase their lending, further increasing the money supply and stimulating expenditure. Because the expansionary effects of a monetised deficit are stronger than those of a non-monetised one, the effects on inflation and the balance of payments are also stronger.

There are several ways in which the Government can finance a budget deficit. It can borrow from the Reserve Bank or run down its balances at the Reserve Bank, or it can borrow from overseas. If the Reserve Bank buys securities from the Treasury, for example, it credits the proceeds to the Government's account which is run down to pay for the excess of the Government's expenditure over its receipts. When the Government borrows overseas, New Zealand's overseas assets are increased (at least initially), and the Government's account at the Reserve Bank is credited with the proceeds when the Government sells the overseas funds to the Reserve Bank. The effects are much the same as when the deficit is financed by borrowing from the Reserve Bank, although foreign borrowing does have the advantage, in the short term, of also helping to finance the overseas deficit.

In practice, in New Zealand, neither of these two methods is likely to be important in any but the shortest term. In either case, most of the money injected by the Government's net domestic expenditure will be deposited with banks or other financial institutions, giving rise to increased reserves in the financial system. These reserves usually take the form of Government securities, which are of course a form of Government borrowing. This effectively reduces Government's indebtedness to the Reserve Bank by adding extra funds to the Government's account at the Bank.

Increased private sector holdings of money and other liquid balances arising from the net Government injection (most of which are covered in the definition of M3 — the wide monetary concept) may not be offset by Government borrowing from financial institutions. As noted, the reserves of the financial institutions also increase. The credit they grant to domestic borrowers may also rise as a result, as financial institutions expand their lending on the basis of the higher level of reserves

they are then holding. Thus Government borrowing from financial institutions has usually been regarded as expansionary in New Zealand. It then becomes the task of monetary policy to contain or offset the expansionary consequences.

In some ways, ratio policy² can help in this regard, particularly by influencing the ability of financial institutions to expand credit. But Government borrowing from the remaining private sector (i.e. apart from financial institutions), and borrowing from financial institutions where the securities are voluntarily held by them and likely to remain so, is the preferred method.

Borrowing from the private sector offsets the initial increase in deposits and reserves of financial institutions resulting from the budget deficit. This occurs because the private sector uses its deposit balances to fund its purchases of Government securities. The ultimate effectiveness of this approach, however, depends on the liquidity of the Government securities involved — the more illiquid they are, the more effectively is the spending potential of the private sector reduced.

In the past, the purchase of Government securities by financial institutions has for the most part simply been a reflection of their compulsory Government security ratio requirements. The introduction of tendering for Government securities in September this year changes this, in that the market will be setting the yield it requires to hold a given amount of Government securities. Financial institutions should therefore become important voluntary holders of Government securities. Given that there will probably also be greater emphasis on increasing the term and reducing the liquidity of securities sold,³ the importance of distinctions formerly made between sales of securities to financial institutions vis-a-vis the remaining private sector will be reduced. The purchase of Government securities by the financial institutions, together with the flow-on effects on interest rates, should reduce the likelihood of second round monetary effects through credit expansion. The institutions' concern to maintain a reasonable balance between the maturity structure of their assets and liabilities may also lead them to try and tie their additional deposit liabilities into longer term and relatively illiquid types of deposit. Looking at all this another way, it is hoped that the tendering system will enable the budget deficit to be financed in a way which reduces any spill-over into inflation or the balance of payments by reducing private sector expenditure and increasing long-term private sector savings sufficiently to match the fiscal deficit. Although a role for debt instruments such as Kiwi Stock will remain, tendering represents some switch in emphasis from retail to wholesale markets, and a broadening of the debt policy approach.

With these qualifications in mind, the sources which have been used to finance recent budget deficits in this country are shown in table B. It should be noted that figures for 1979/80 and subsequent years are compiled on a somewhat different basis from earlier years. The figures for borrowing from the non-M3 private sector

for the earlier years are calculated as a residual after the other items in the table have been identified. For the last four years, figures for non-M3 borrowing are determined directly and, as with figures for borrowing from the Reserve Bank, trading banks and the other M3 financial institutions, they show the net change in the nominal value of holdings of Government securities. For various reasons these figures do not match up with the changes in figures for registered holdings of public debt shown elsewhere in this *Bulletin*. Nor do they exactly tally with the Budget table 2 figure for Government borrowing (net of repayments) in New Zealand. A residual item is therefore included in 'Other Transactions' for these years.

The table is set out so as to show more clearly the domestic monetary effects of the financing transactions. Since this involves the adjusted domestic deficit rather than the conventional deficit before borrowing from Budget table 2, the adjustment item used to obtain the former is included under 'Other Financing Transactions'. The table then reconciles with the Budget table 2 cash surplus or deficit. The deficit or surplus after non-M3 private sector borrowing — i.e. the amount to be financed by the Reserve Bank, the trading banks, the other M3 financial institutions or overseas — is of particular importance for the period up to 1983 since it indicates the degree to which the Government has found it possible or desirable to offset the monetary effects of the domestic deficit. (In the absence of figures for borrowing from other captive institutions before 1980, the M3/non-M3 distinction is used, rather than the broader captive/non-captive distinction, as a measure of the extent of 'monetisation' of the deficit.)

As with the fiscal indicators, an obvious feature of the table is the sharp fluctuations in deficit financing policies adopted. For example, in 1976 non-M3 borrowing was just over \$100 million, but with a large domestic deficit before borrowing of \$789 million, the proportion of the deficit 'monetised' was a large 5.9 per cent of GDP. In the following year, non-M3 borrowing was again just over \$100 million, but the adjusted domestic deficit had been sharply reduced to \$199 million, so that the proportion 'monetised' represented only 0.7 per cent of GDP. The balance after non-M3 borrowing was slightly more expansionary in 1978 than in 1977, and then increased sharply to 2.7 per cent of GDP in 1979. The position was reversed again in 1980, when most of the reduced domestic deficit was financed by non-M3 borrowing. This was followed in 1981 by a significant increase in the domestic deficit which far outweighed the increase in non-M3 borrowing in that year, giving a balance after non-M3 borrowing equivalent to 1.9 per cent of GDP. In 1982, the domestic deficit before borrowing rose by about \$200 million, while borrowing from the non-M3 private sector rose by some \$230 million to \$711 million. An important element in this was the increase from \$68 million to \$387 million in borrowing from the 'remaining private sector'. This mainly reflected increased sales of inflation adjusted bonds. The resulting balance after non-M3 borrowing was somewhat less expansionary than in the previous year, representing 1.5 per cent of GDP. Finally, in 1983 the domestic deficit was reduced by \$190 million but non-M3 borrowing increased to \$905 million, leaving only a small amount representing 0.1 per cent of GDP to be financed from trading banks, the Reserve Bank, other M3 institutions, and overseas. Within the total of non-M3 borrowing, borrowing from the remaining private sector was a little lower than in 1982, while borrowing from other captives, and especially from Government corporations increased.

2 Ratio policy covers both the reserve asset ratio system applied to trading banks and the public sector security ratio applied to other financial institutions.

3 The reference to reduced liquidity should be read to mean that the securities may not be readily redeemed or sold to the Reserve Bank. Secondary market transactions, however, will be encouraged.

TABLE B: GOVERNMENT FINANCING TRANSACTIONS
(\$ million)

Year ended March	1976	1977	1978	1979	1980	1981	1982	1983
Adjusted Domestic Deficit (as in table A)	- 789	- 199	- 361	- 977	- 411	- 943	- 1144	- 954
<i>Government Borrowing from:</i>								
Other Captive Institutions	..	..	..	..	+ 146	+ 173	+ 96	+ 120
Government Corporations	..	..	..	..	+ 134	+ 242	+ 228	+ 420
Remaining Private Sector	..	..	..	..	+ 113	+ 68	+ 387	+ 365
Total Non-M3 Private Sector:	+ 106	+ 108	+ 219	+ 496	+ 393	+ 483	+ 711	+ 905
Domestic Deficit (1) or Surplus (2) after borrowing from the Non-M3 Private Sector	- 683	- 91	- 142	- 481	- 18	- 460	- 433	- 49
(% GDP)	(- 5.9)	(- 0.7)	(- 0.9)	(- 2.7)	(- 0.1)	(- 1.9)	(- 1.5)	(- 0.1)
<i>Other Financing Transactions:</i>								
Borrowing from Trading Banks ¹	+ 261	- 119	+ 720	+ 101	+ 96	- 18	- 139	+ 1445
Borrowing from Reserve Bank	+ 246	+ 256	- 471	- 49	+ 191	- 151	+ 597	- 528
Borrowing from 'Other M3' Institutions	+ 160	+ 133	+ 116	+ 300	+ 218	+ 273	+ 204	+ 316
Net Overseas Borrowing and Investment	+ 287	+ 130	+ 266	+ 444	+ 328	+ 754	+ 609	+ 642
Net Government Overseas Exchange Transactions ²	- 213	- 307	- 334	- 469	- 617	- 582	- 674	- 813
Other Transactions ³	- 71	-	- 150	+ 150	- 193	+ 188	- 166	- 1009
BUDGET TABLE 2 CASH SURPLUS (+) OR DEFICIT (-):	- 12	+ 2	+ 6	- 4	+ 5	+ 4	+ 3	+ 4

1 The introduction of the Compensatory Deposits Scheme in March 1978 enabled trading banks to maintain their government security holdings at the end of March at a higher level than in the past.

2 This is the adjustment item used to obtain the adjusted domestic deficit from the conventional 'deficit before borrowing'. The major component is the Government's current OET deficit.

3 This item frequently reflects Government time deposits with the Reserve Bank. For example, at the end of March 1983, the Government had a short term deposit of \$555m with the Reserve Bank. A second major component in 1982 and 1983 is payments to the Reserve Bank on account of the Reserve Bank Indemnity, the amounts involved being \$208m and \$391m respectively (see the Report of the Controller and Auditor General, Parliamentary Paper BI [Pt II], for more details.) Thirdly, the item also includes domestic expenses of, raising or repaying loans — mainly discounts on tap stock issues and premiums on redeemed inflation bonds. A case can be made for netting these expenses off Other Financing Transactions, rather than considering them as current expenditure which would increase the measured domestic deficit correspondingly and this has been the traditional treatment in the Budget accounts. The same treatment has also been used in this table, but adjustments can readily be made if desired to the adjusted domestic deficit and the domestic deficit after borrowing from the non-M3 private sector. The amounts involved in the last four years are as follows: 1980, \$0.1m; 1981, \$0.5m; 1982, \$32m; 1983, \$61m.

Finally this item also includes net residual amounts of \$35m for 1980, \$21m for 1981, \$22m for 1982 and \$2m for 1983. These amounts are probably unidentified loan receipts or payments.

THE 1983 BUDGET

The 1983 Budget was presented to Parliament by the Right Hon. R.D. Muldoon on 28 July 1983. In describing the economic problems confronting New Zealand internally and externally, Mr Muldoon emphasised the prolonged fall in the terms of trade which had occurred and noted that no Government can maintain the incomes of its citizens beyond the nation's capacity to provide that income. He said the wage and price freeze and associated economic conditions over the last year had been successful in reducing inflation with much lower social costs than had been apparent in some other countries, and that the primary aim of economic policy over the next year would be to consolidate the gains made so far. The thrust of the Government's medium-term policies had continued to be directed towards increasing the flexibility and competitiveness of the New Zealand economy.

The Government announced a variety of specific policy measures in the Budget. The more significant of these were a job-programme aimed at providing 3,000 to 4,000 jobs of varying duration, and an increase in tax relief for low income families funded by a small increase in the marginal tax rate for the majority of income earners. Other tax changes included an increased level of exemption from estate duty, an increase in the tax free limit on gift duty, an accelerated depreciation allowance for the first five years of new rental accommodation, and increased indirect taxes on alcoholic beverages and tobacco products. Outside the

taxation field, it was announced that supplementary minimum price levels would remain unchanged and that temporary protection would be given to the Railways Corporation while it adjusted to deregulation. Finally, changes to the regional development assistance programme were announced.

Government expenditure and revenue for the 1983/84 financial year are budgeted at \$14,335.7 million (a 13.1 per cent increase on last year) and \$11,167.0 million (an increase of only 2.4 per cent), respectively. These amounts represent 42 per cent and 32.7 per cent of forecast GDP. This leaves an unusually large estimated deficit before borrowing of \$3,168.7 million (about 9.5 per cent of GDP) as compared with the deficit actually recorded in 1982/83 of \$1,766.9 million (5.5 per cent of GDP).

Mr Muldoon said that the growth areas in Government spending reflected a desire to diversify the economy while at the same time cushioning the worst effects of the international recession; and that the small increase in Government revenue mainly reflected the full year effects of the tax changes in last year's Budget and the effect of the freeze in restraining nominal income growth. Table C shows Government expenditure, revenue, and deficit levels (as published in the Budget accounts) since 1972, and the structure of expenditure and revenue in the last two years and as budgeted for 1984.

In analysing the fiscal impact of the 1983/84 budget deficit, it will be recalled that the fiscal indicators

discussed earlier in this article suggest that this deficit will be expansionary in nature, even after some allowance is made for the state of the economy. The implication is also that there is a significant structural element within the deficit, and that specific policy measures will need to address this if future deficit levels are to be controlled.

As for the monetary effects of the 1983/84 fiscal deficit, borrowing of around \$2,200 million (assuming net Government current external transactions of about \$1,000 million) will be required to finance the adjusted domestic deficit, a very large amount by historical standards. Something like a net \$1,100 million has already been raised domestically (outside the Reserve Bank) this financial year, mainly through the very successful first Kiwi Savings Stock. As previously noted, a large amount of borrowing from trading banks and other M3 institutions, instead of the non-M3 sector, may still be consistent with non-monetisation of the

deficit if the new tendering scheme works as hoped. [It should be noted in this context that Government debt sales relate to more than just the financing of the current domestic deficit. The Government's total gross debt sales target will differ from the domestic deficit financing requirement according to the extent to which maturing or redeemed debt needs to be refinanced, and according to the extent to which debt sales are used to offset other monetary influences, particularly the overall balance (current and capital) of the private sector's external transactions.]

The Budget acknowledged that the role of monetary policy in containing inflation would have been easier had the fiscal deficit been lower, but nevertheless stated that the Government is determined to adhere to a policy of monetary restraint while continuing moves over the medium term towards a more competitive and flexible financial sector.

TABLE C: GOVERNMENT EXPENDITURE AND REVENUE

March Year	Government Expenditure ¹ \$m	Annual % Change	% of GDP	Government Revenue ¹ \$m	Annual % Change	% of GDP	Deficit Before Borrowing
1972	1,903	16.3	27.7	1,830	17.7	26.7	72
1973	2,262	18.9	28.7	2,056	12.3	26.1	206
1974	2,679	18.5	29.3	2,438	18.6	26.7	242
1975	3,462	29.2	34.5	3,072	26.0	30.6	390
1976	4,444	28.4	38.7	3,443	12.1	30.0	1,002
1977	4,578	3.0	33.2	4,072	18.3	29.5	506
1978	5,669	23.0	37.3	4,974	22.2	32.6	694
1979	6,848	20.8	39.0	5,402	8.6	30.8	1,446
1980	7,587	10.8	36.2	6,560	21.4	31.3	1,027
1981	9,133	20.4	37.9	7,609	16.0	31.5	1,525
1982	11,197	22.6	39.2	9,378	23.2	32.8	1,818
1983	12,673	13.2	39.8	10,906	16.3	34.2	1,767
1984(f)	14,336	13.1	42.0	11,167	2.4	32.7	3,169

March Year	1982		1983		1984 (budgeted)	
	\$m.	% Change	\$m.	% Change	\$m.	% Change
EXPENDITURE						
Administration	914.2	16.3	832.5	- 8.9	907.0	8.9
Foreign Relations	719.9	24.6	803.2	12.3	871.0	7.8
Development of Industry	1,182.6	48.5	1,429.8	20.9	1,832.2	28.1
Education	1,493.2	15.6	1,638.8	9.8	1,670.4	1.9
Social Services	3,042.3	17.5	3,744.2	23.1	3,955.7	5.6
Health	1,601.2	18.1	1,766.1	10.3	1,834.2	3.9
Transport and Communications	460.6	38.5	495.6	7.6	573.2	15.7
Debt Services and Miscellaneous Investment Transactions	1,375.0	38.8	1,549.4	12.7	2,208.0	42.4
<i>Sub-Total</i>	10,790.0	23.7	12,264.6	13.7	13,851.7	13.8
Miscellaneous Financing Transactions	406.5	- 1.1	407.9	0.3	374.0	- 8.3
TOTAL NET EXPENDITURE	11,196.5	22.6	12,672.5	13.2	14,335.7	13.1
<i>Financed From</i>						
Income Tax	6,514.7	22.9	7,455.5	14.4	7,500.0	0.6
Customs, Sales Tax and Beer Duty	1,633.5	37.4	1,872.7	14.6	2,020.0	7.9
Motor Spirits Tax	147.2	5.5	233.0	58.3	240.0	3.0
Highways Tax	211.6	11.8	184.4	- 12.9	255.0	22.0
Other Taxation	291.0	24.4	351.9	20.9	370.0	5.1
<i>Total Taxation</i>	8,798.0	24.8	10,097.5	14.8	10,355.0	2.6
Interest, Profits and Miscellaneous Receipts	580.2	4.0	808.1	39.3	812.0	0.5
TOTAL RECEIPTS	9,378.2	23.3	10,905.6	16.3	11,167.0	2.4
DEFICIT BEFORE BORROWING	1,818.3		1,766.9		3,168.7	

¹ In the 1978 Budget N.Z. Railways and the Ministry of Energy were for the first time placed outside of the Public Account. This move resulted in Government revenue and expenditure being slightly higher, but left the deficit before borrowing unchanged. Figures above for Government expenditure and revenue for earlier years are on the same basis.

f Forecast.