NEW ZEALAND PUBLIC DEBT

This article presents details of New Zealand's external and internal public debt, updating an article which appeared in the August 1980 edition of the *Bulletin* on the same topic. As in the previous article, the two components of public debt are examined separately in the sections which follow. Recent trends are reviewed for each and brief comments offered on the importance of their impact on the economy.

EXTERNAL DEBT

This section details the scope of official overseas capital transactions in recent years, the amount of official overseas debt outstanding and trends in servicing costs. It also comments on the impact which the growth of official overseas debt has had on the economy. Official overseas debt, as discussed in this article, includes overseas debt of the Reserve Bank in addition to that of the Government. By including the Reserve Bank the presentation differs from that contained in the Public Accounts and the Budget.

Table 1 sets out official capital transactions derived from the overseas exchange transactions statistics for the past decade. It shows both the gross capital flows and the net official capital flow in addition to the current account balances and official overseas reserves at the end of each year. Official overseas borrowing and changes in reserves can be regarded as 'residual' items necessary to balance the external accounts, after current account transactions and private capital flows are accounted for. The statistics show the net proceeds of overseas loans and repayments recorded at the exchange rates ruling at the time the transaction took place.

TABLE 1
OFFICIAL OVERSEAS CAPITAL TRANSACTIONS[1]
($ million)

Year ended March	*Total Receipts*	*Total Payments*	*Net Official Capital Flow*	*Current Account Balance*	*Official Overseas Reserves*
1972	107.3	56.0	+ 51.3	+ 95.0	629.9
1973	30.7	90.4	− 59.7	+ 285.9	917.2
1974	2.6	72.0	− 69.4	− 30.0	778.5
1975	525.2	35.8	+ 489.4	− 992.6	541.1
1976	905.5	276.2	+ 629.3	− 814.5	684.8
1977	565.1	291.0	+ 274.1	− 590.5	720.6
1978	908.9	436.6	+ 472.3	− 509.5	983.6
1979	695.0	418.7	+ 276.3	− 426.4	803.9
1980	923.6	604.2	+ 319.4	− 481.8	783.6
1981	1,193.0	633.6	+ 559.4	− 715.6	759.7
1982	1,830.4	623.3	+ 1,207.1	− 1,140.5	836.2

1. Includes Reserve Bank transactions.

The two most commonly used measures for assessing the relative size of official overseas debt are the ratio of debt to gross domestic product (GDP) and the cost of debt servicing (in terms of interest payments) as a proportion of export receipts or total current receipts. Details of these ratios are given in tables 2 and 3. The debt figures given in table 2 are valued at the exchange rates which applied at the end of each March year.

TABLE 2
RATIO OF OFFICIAL OVERSEAS DEBT TO GDP
($ million)

Year ended March	*Official Debt Government*	*Official Debt Reserve Bank*	*Official Debt Total*	*Gross Domestic Product*	*Ratio of Total Official Debt to GDP %*
1972	653.5	—	653.5	6,863	9.5
1973	564.0	—	564.0	7,892	7.1
1974	465.2	—	465.2	9,135	5.1
1975	862.8	218.4	1,081.2	10,028	10.8
1976	1,463.2	520.3	2,163.5	11,484	18.8
1977	1,826.6	736.7	2,563.3	13,792	18.6
1978	2,446.7	809.1	3,255.8	15,217	21.4
1979	2,920.1	756.3	3,676.4	17,541	21.0
1980	3,567.5	729.3	4,296.8	20,966	20.5
1981	4,236.1	572.9	4,809.0	24,127	19.9
1982	5,549.4	1,227.5	6,776.9	28,832	23.5

TABLE 3
RATIO OF OFFICIAL OVERSEAS DEBT INTEREST TO CURRENT RECEIPTS

Year ended March	*Official Overseas Debt Interest Payments ($m)*	*Total Export Receipts ($m)*	*Official Overseas Debt Interest as a % of Export Receipts*	*Total Current Receipts*	*Official Overseas Debt Interest as a % of Current Receipts*
1972	32.8	1,332.5	2.5	1,579.9	2.1
1973	37.3	1,652.7	2.3	1,980.0	1.9
1974	34.0	1,813.7	1.9	2,228.2	1.5
1975	50.5	1,656.6	3.0	2,139.5	2.4
1976	103.6	2,209.5	4.7	2,801.6	3.7
1977	159.0	3,120.9	5.1	3,783.1	4.2
1978	194.6	3,395.1	5.7	4,142.5	4.7
1979	243.6	3,849.9	6.3	4,661.6	5.2
1980	303.7	4,941.3	6.1	5,933.3	5.1
1981	331.4	5,866.5	5.6	7,093.6	4.7
1982	449.7	6,707.8	6.7	8,282.3	5.4

The commodity price boom in 1972 and 1973 provided exceptionally favourable market conditions for New Zealand's exports and as a result the current account was in surplus in those years. An associated rapid build-up in official overseas reserves occurred, reaching a peak level of $1,094 million at the end of June 1973. The terms of trade which had risen sharply through the boom period declined by more than 40 per cent in the following two calendar years and as a consequence the current account deficit deteriorated from $30 million in the year ended March 1974 to $993 million in 1975. The policy response to what was perceived initially as a short-term downturn in the terms of trade was to borrow overseas, while at the same time allowing the level of official overseas reserves to be run down.

In succeeding years a range of policies aimed at encouraging exporting and import substituting activities was put in place, including a move in June 1979 towards increased flexibility in the determination of the exchange rate. Progress was made in reducing the current account deficit and this is reflected in the debt/GDP ratio which stabilised and even fell a little in the late 1970s. However, the second oil shock in 1979/80 and the current international recession have combined with a period of significant growth in import volumes in 1981/82 to boost the level of official overseas borrowing required and the debt to GDP ratio moved upwards rather sharply again in the year ended March 1982.

Total official overseas debt has risen from $465 million in March 1974 to $6,777 million at the end of March 1982. When expressed as a percentage of GDP this represents an increase from 5.1 per cent to 23.5 per cent. Similarly the cost of debt servicing has risen substantially over the decade, as indicated by the ratio of debt interest payments to export receipts which increased from 2.5 per cent in 1971/72 to 6.7 per cent in 1981/82. This has been caused predominantly by the increased stock of debt, although increased interest rates in international markets have also played their part.

Illustrative of the trend in interest rates is the simple average of long term Government bond yields for the United States, United Kingdom, Germany, Switzerland and Japan, these being the countries from which New Zealand normally borrows. Based on information contained in an IMF publication the average yield across these countries in the early 1970s was around 7 per cent. By 1981 it had risen to 10.6 per cent, the highest average yield for the decade. In 1982 the yield came back to 9.7 per cent primarily because falling rates of inflation internationally over the past year, or so, have been reflected in lower interest rates. If the trend continues this will assist in reducing the debt servicing burden.

As already noted, public borrowing overseas and utilisation of overseas reserves can be regarded as residual items after current account transactions and private capital flows are accounted for. While there is currently no official record of the level of total private sector overseas debt there is information available on private capital flows. This is presented in table 4 along with related series. The information is based on Reserve Bank statistics on overseas exchange transactions and shows the cash proceeds of loans received through the banking system and loan repayments by the private sector — they do not record private capital flows that are not transacted in cash, such as long term credits to finance the import of capital goods.

In the past, private capital flows have generally fluctuated in response to domestic monetary conditions and the relative cost and availability of overseas capital. In general the flows have usually been small relative to transactions in current account goods and services, a situation which in part can be attributed to the existence of controls which can inhibit private capital flows to some degree for New Zealand residents. The relatively large inflows between the March years ending 1975 and 1978 were largely attributable to substantial borrowing by Government owned corporations to finance capital projects, such as loans raised by Offshore Mining Company for Maui gasfield development.

In the last six months the net private capital inflow has expanded very rapidly, reaching $867.9 million in the year ended December 1982. Reasons for this increase include offshore borrowing to finance on-site development work on a number of the major projects, borrowing by the Producer Boards to finance their trading operations and a growing tendency for larger companies to borrow offshore due to the recent relatively tight domestic monetary conditions and possibly influenced also by relative interest rates. While this recent private capital inflow may be seen as a benefit, since it reduces the need for Government to borrow overseas, monetary injections of this size can complicate economic policy, particularly in periods when a firm monetary policy is required.

TABLE 4
(NZ$ million)

Year Ended March	*Official Capital Flow*	*Private Capital Flow*	*Current Account Balance*	*Official Overseas Reserves*
1972	+ 51.3	+ 71.1	+ 95.0	629.9
1973	− 59.7	+ 108.7	+ 285.9	917.2
1974	− 69.4	− 0.5	− 30.0	778.5
1975	+ 489.4	+ 216.9	− 992.6	542.1
1976	+ 629.3	+ 205.3	− 814.5	684.8
1977	+ 274.1	+ 211.1	− 590.5	720.6
1978	+ 472.3	+ 259.9	− 509.5	983.6
1979	+ 276.3	− 51.1	− 426.4	803.9
1980	+ 255.5	+ 98.9	− 481.8	783.6
1981	+ 559.3	+ 79.9	− 715.6	759.7
1982	+ 1,207.1	+ 143.4	− 1,140.5	836.2

Overseas borrowing has a useful role to play in facilitating the development of the economy and in reducing the immediate impact of external shocks. In addition, as a means of financing projects which would otherwise strain domestic financial resources, such borrowing has a positive role to play in developing the industrial structure of the economy. On the other hand, borrowing is in part a reflection of the current account deficit. The current account has been in deficit since 1974 and this has been a major constraint on finding an acceptable solution to the low growth, high inflation and high unemployment problem which New Zealand has experienced in recent years.

New Zealand has not been alone in experiencing these problems but the difference between New Zealand and some other similarly afflicted nations is to be found in the speed with which necessary adjustment policies have been implemented. As noted, part of New Zealand's initial policy response was to utilise existing overseas reserves and to borrow abroad. This was followed by the introduction of policies aimed at effecting a gradual restructuring of the economy. While overseas borrowing undoubtedly helps moderate the impact of sudden changes in the external economy which might otherwise have a volatile and destabilising effect on the domestic economy, borrowing is not a substitute for adequate domestic adjustment if the overseas changes are not quickly reversed. In essence the economic effect of such borrowing may be to support domestic demand at a level higher than that which is warranted by the medium-term balance of payments prospects. This cannot be sustained without appropriate policies designed to facilitate a domestic and balance of payments adjustment.

Whether the approach adopted has produced a reasonable result for New Zealand is a subject for debate. Certainly New Zealand has managed to avoid the more extreme examples of unemployment and business cycle fluctuations arising from the external shocks of the 1970s experienced by some countries, though the level of unemployment has grown rapidly of late and is now very high by New Zealand's historical standards. However, in the areas of inflation and growth, the economy has performed poorly by comparison with a number of similarly placed developed and developing countries. It can be argued that some of the kinds of policies adopted (export incentives, supplementary minimum price schemes etc.) by interfering with the price mechanism, may have introduced distortions and restrictions into the economy. These can reduce the ability of the economy to react to changing economic circumstances. Thus, they could affect detrimentally the economy's development in the future.

In summary, New Zealand has a considerable history of overseas borrowing. Such borrowing has played an important role in fostering the development of the economy and in helping smooth out the cyclical fluctuations in the country's external earnings. Over the last decade, in the face of major external shocks, the country has chosen to make a gradual adjustment to the structural imbalance existing in the economy by maintaining a reasonable level of domestic economic activity and financing it by borrowing overseas. As a result the level of external debt and the cost of servicing it have risen quite rapidly during the period. While the country has an enviable record as a reliable and responsible borrower, the level of uncertainty which currently exists in international financial markets makes it very important that New Zealand continues to safeguard its reputation in this respect.

INTERNAL DEBT

This section details trends in the growth of internal public debt, servicing costs and the relationship between internal public debt and GDP over the last decade. It then outlines the nature of the ownership and role of public debt in the economy. Internal public debt is that part of the total debt of the New Zealand Government held in New Zealand. Table 5 sets out for the past decade details of the total public debt of New Zealand. This is broken down to show that part of the debt held overseas and that part held within New Zealand. It should be noted however that the overseas debt in this table does not include that of the Reserve Bank (see table 2 for details). The table also shows details of GDP for the period and shows the relationship of the internal and total public debt to GDP.

Public debt servicing costs are outlined in table 6 with internal debt interest and total debt service costs also expressed as a percentage of internal debt and total public debt respectively.

TABLE 5
PUBLIC DEBT OF NEW ZEALAND[1]

March Year	*Public Debt* Held Overseas ($m.)	Held in N.Z. ($m.)	Total ($m.)	G.D.P. ($m.)	*Public Debt as a % of G.D.P.* Internal	Total
1972	653.5	2,533.1	3,186.6	6,863	36.9	46.4
1973	564.0	2,939.1	3,503.1	7,892	37.2	44.4
1974	465.2	3,269.3	3,734.3	9,135	35.8	41.0
1975	862.8	3,336.9	4,199.7	10,028	33.3	41.9
1976	1,463.2	4,094.7	5,557.9	11,484	35.7	48.4
1977	1,826.6	4,462.7	6,289.2	13,792	32.4	45.6
1978	2,446.7	5,037.0	7,483.7	15,217	33.1	54.3
1979	2,920.2	5,899.4	8,819.5	17,541	33.6	50.3
1980	3,567.5	6,778.9	10,346.4	20,966	32.3	49.3
1981	4,236.1	7,381.0	11,617.1	24,127	30.6	48.1
1982	5,549.4	8,832.0	14,381.4	28,832	30.6	49.9

1. Government debt, does not include Reserve Bank debt.

TABLE 6
PUBLIC DEBT SERVICING COSTS

March Years	*Interest* Debt Held in N.Z. ($m.)	Debt Held overseas ($m.)	Other[1] Charges ($m.)	Total Debt Service Costs ($m.)	Internal Debt Interest as % of N.Z. Held Debt	Total Debt Service as % Total Public Debt
1972	130.5	36.3	1.5	168.3	5.2	5.3
1973	146.5	38.3	1.9	186.7	5.0	5.3
1974	166.2	34.1	2.2	202.5	5.1	5.4
1975	179.7	41.3	3.1	224.2	5.4	5.3
1976	201.2	68.8	3.3	273.4	4.9	4.9
1977	256.7	110.4	4.3	371.3	5.8	5.9
1978	331.3	133.2	7.8	472.3	6.6	6.3
1979	415.9	174.2	7.1	596.2	7.0	7.4
1980	537.6	220.1	9.2	767.0	7.9	7.4
1981	635.2	256.3	14.3	905.8	8.6	7.8
1982	786.7	416.3	39.8	1,242.8	8.9	8.6

1. Includes administrative and management charges against loans raised and repaid.

Although the ratio of internal public debt to GDP has become smaller over the decade (from 36.9 per cent in 1972 down to 30.6 per cent in 1982), the ratio of total public debt to GDP has become larger (from 46.4 per cent in 1972 up to 49.9 per cent in 1982). As with external debt, the cost of servicing internal debt has risen. As a proportion of total internal debt, interest payments increased from 5.2 per cent in 1972 to 8.9 per cent in 1982, reflecting the higher nominal yields on government securities now prevailing compared to a decade ago. The latter ratio is understated to the extent that premiums due on Inflation Adjusted Savings Bonds are paid only when bonds are redeemed and so only enter the debt servicing ratio calculation at that point in time. In the 1982 Budget it was stated that at 31 March 1982 the obligation yet to be met in respect of premiums on redemptions of Inflation Bonds was $70.2 million.

In considering the internal public debt and its economic significance, the absolute size of the debt and its servicing costs may be of less importance than the size of annual increments and the methods adopted to finance deficits. The implications of various methods of financing the Government's deficit before borrowing were covered in detail in 'The Stabilisation Role of Fiscal Policy' published by the New Zealand Planning Council in 1980 and more recently in the article 'Government Revenue and Expenditure' in the October 1982 *Bulletin*.

Briefly, there are four major ways in which the Government can finance a budget deficit. If the Government borrows from the non-M3 private sector[1] this may reduce the public's holdings of liquid assets, depending on the nature of the financial instruments the Government use. It will, however, curtail the growth in reserves of the M3 financial institutions and should thus impact on their lending. These developments help offset the expansionary effect of the budget deficit. Alternatively, if the Government borrows from the other three major groups, namely, the Reserve Bank, the trading banks and other M3 institutions, or from overseas (spending the proceeds domestically), this effectively monetizes the deficit. That is, the

1. The non-M3 private sector includes all holders of government stocks excluding the M3 institutions. M3 institutions are the Reserve Bank, trading banks, savings banks, finance companies, stock and station agents and official money market dealers.

expansionary effects arising from the initial fiscal expansion would not be offset, as financing the deficit in this way does not result in a reduction in the money supply and reserve assets of the financial institutions.

A detailed breakdown of Government financing transactions on a March year basis is presented in table 7. For various reasons the figures do not quite match up with figures for registered holding of public debt shown elsewhere in the *Bulletin*.[2] The table shows more clearly the domestic monetary effects of the financing transactions. The deficit after non-M3 private sector borrowing is particularly important since it indicates the degree to which the Government has found it possible or desirable to offset the monetary effects of the deficit. Reference should be made to the October 1982 *Bulletin* article (especially pages 414, 415) for a detailed commentary on the table.

The essential points are these. If a budget deficit is to be financed in a relatively non-inflationary way, with the least potential for monetary expansion, then borrowing from the non-M3 private sector is the preferred method. This may involve increased interest rates on Government securities which in turn may place pressure on interest rates generally. Against this problem must be weighed the disadvantages of financing the deficit by other means, each of which in varying degrees is likely to be of a more inflationary character than non-M3 private sector borrowing. Borrowing from the banking system, from other financial institutions, and from overseas monetizes the fiscal deficit by adding to the money supply and increasing the financial system's reserve base. This may, in the short run at least, place less pressure on interest rates, but it results in less control over the growth of money and credit and, ultimately, to a higher rate of inflation and a larger external deficit.

2. Figures in the table 'Ownership of New Zealand's Internal Public Debt' published regularly in the *Bulletin* relate to registered debt holdings as at the dates shown at the top of the table. The nominal value of actual debt holdings of the various ownership categories can differ (sometimes significantly) from registered holdings at the same date. The main reason for this is the delay between the time that public debt transactions actually take place and the time when they are recorded in the Reserve Bank's computerised debt ledgers. Furthermore, transfers of debt after the date of issue can affect the comparison. The Government financing transactions shown in table 7 of this article represent estimated changes in the actual holdings of internal public debt (derived from balance sheet information and data on government security sales and purchases) rather than changes in registered holdings.

For some holders of the internal public debt, a major proportion of their government stock holdings involve a prudential or legislative obligation to hold assets in this form. In recent years, as a consequence of the adoption by Government of a policy of offering yields on some securities that are more closely in line with market interest rates (over the last year only Premium Stock and Inflation Adjusted Savings Bonds have been competitive), the proportion of public debt held for other (voluntary) reasons has grown. But it still remains relatively small. This is evident from government stock holdings (including Inflation Adjusted Savings Bonds) of 'Other Non-Financial Businesses, Social and Charitable Institutions, and All Other Holders'. From a level of $129.2 million as at the end of March 1973 or 4.4 per cent of the total internal public debt, these groups' holdings rose to $895.2 million in 1982 representing 10.1 per cent of the total.

Inflation Adjusted Savings Bonds were introduced by the Government in the 1977 Budget in recognition of the difficulties small savers had been facing in protecting their savings against inflation. This instrument was specifically aimed at small savers and was designed to help preserve the purchasing power of their savings. Although it took some time for small savers to recognise the relative merits of these bonds as compared to alternative small savings investments, the $911.4 million held by bondholders as at 31 December 1982 is indicative of the present widespread acceptance of this comparatively new form of investment.

Although debt policy has a positive role to play in contributing to economic activity and economic stability more generally, a number of problems can develop if inappropriately handled. These include: inflationary pressure and external current account deterioration if too large a proportion of the fiscal deficit is financed by methods which result in monetary expansion; excessive upward pressure on interest rates if the Government needs to compete vigorously for funds in the domestic financial market; and reduced scope for discretionary fiscal policy if public debt becomes too large and the associated servicing commitment, along with other automatic expenditure items, becomes too dominant in relation to overall government expenditure. It is the balance between maintaining an appropriate level of economic activity and preventing the emergence of these problems that is at the heart of fiscal policy and public debt policy.

TABLE 7
GOVERNMENT FINANCING TRANSACTIONS
($ million)

Year ended March	*1975*	*1976*	*1977*	*1978*	*1979*	*1980*	*1981*	*1982*
Adjusted Domestic Deficit	−250	−789	−199	−361	−977	−410	−943	−1144
Government Borrowing from:								
Other Captive Institutions	..	..	..	..	..	+146	+301	+ 304
Government Corporations	..	..	..	..	..	+134	+114	+ 20
Remaining Private Sector	..	..	..	..	..	+113	+ 68	+ 387
Total Non-M3 Private Sector:	+ 4	+106	+108	+219	+496	+393	+483	+ 711
Domestic Deficit (−) or Surplus (+) financed by trading banks, the Reserve Bank and Overseas	−246	−683	− 91	−142	−481	− 17	−460	− 433
Other Financing Transactions:								
Borrowing from Trading Banks[1]	− 52	+261	−119	+720	+101	+ 96	− 18	− 139
Borrowing from Reserve Bank	+167	+246	+256	−471	− 49	+191	−151	+ 597
Borrowing from 'Other' M3 Institutions	+ 21	+160	+133	+116	+300	+218	+273	+ 204
Net Overseas Borrowing and Investment	+246	+287	+130	+266	+444	+328	+754	+ 609
Net Government Overseas Exchange Transactions[2]	−140	−213	−307	−334	−469	−617	−582	− 674
Other Transactions[3]	—	− 71	—	−150	+150	−194	+188	− 161
BUDGET TABLE 2 CASH SURPLUS (+) OR DEFICIT (−):	− 4	− 12	+ 2	+ 6	− 4	+ 5	+ 4	+ 3

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. In the past, this item has mainly reflected Government time deposits with the Reserve Bank. In 1982, this entry also includes payment to the Reserve Bank on account of the Reserve Bank Indemnity (see the Report of the Controller and Auditor General, Parliamentary Paper, B1 [Pt.II] P.75, 96). This item also includes residual items of $35 million for 1979/80, $21 million for 1980/81, and $22 million for 1981/82. These residuals are mainly unidentified loan receipts.