



# BUDGET 2018

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## Budget Policy Statement

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Minister of Finance

14 December 2017

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New Zealand Government

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# Budget Policy Statement

## Executive Summary

This *Budget Policy Statement* (BPS) is the new Government's first action in preparing Budget 2018. It sets the broad fiscal parameters within which details for the Budget will be determined and states the Government's priorities for the Budget. The BPS also summarises the Treasury's updated economic and fiscal forecasts based on current prospects and policies, as set out in the *Half Year Economic and Fiscal Update (Half Year Update)*.

The Government will lift the incomes of families to reduce child poverty, protect the environment, create more jobs and build more affordable houses, while running surpluses and reducing net debt. We are committed to building a strong economy, to being fiscally responsible and to providing certainty to the public and markets. There will be a clear focus on sustainable economic development, supporting regional economies, increasing exports, lifting wages and reducing inequality.

This BPS reaffirms our commitment to operate within the Government's Budget Responsibility Rules. These rules include running sustainable operating surpluses across the economic cycle, reducing net debt to 20 per cent of GDP within five years of taking office and keeping government expenditure as a percentage of GDP in line with historic trends.

The BPS confirms operating allowances of \$2.6 billion per year in Budget 2018 and \$1.875 billion per year in Budgets 2019 to 2021. Capital allowances have been set at \$3.4 billion for Budgets 2018 and 2019, \$3.1 billion for Budget 2020 and \$2.7 billion for Budget 2021. Major investments will be made in housing, health, education, police and infrastructure to address the social and infrastructure deficits that have emerged in New Zealand.

The operating balance before gains and losses is expected to be in surplus of \$2.5 billion in 2017/18 (0.9 per cent of GDP), rising to \$8.8 billion in 2021/22 (2.5 per cent of GDP). These surpluses help ensure net core Crown debt reduces to 19.3 per cent of GDP in 2021/22.

## Economic and Fiscal Outlook

***While the outlook for the economy is positive, not all New Zealanders are receiving the benefits of economic growth***

The economy is growing at a solid rate and the outlook continues to be positive but many households have not shared the wealth created in recent years. This growth has been driven by high net migration levels and low interest rates supporting consumption and residential investment. Household debt has increased to near-record levels of 167 per cent of disposable income. Per capita GDP and productivity growth have been weak and over the last 30 years the share of the economy going to wages and salaries has declined. New Zealand's economy has become more geared towards speculation rather than growing the productive economy.

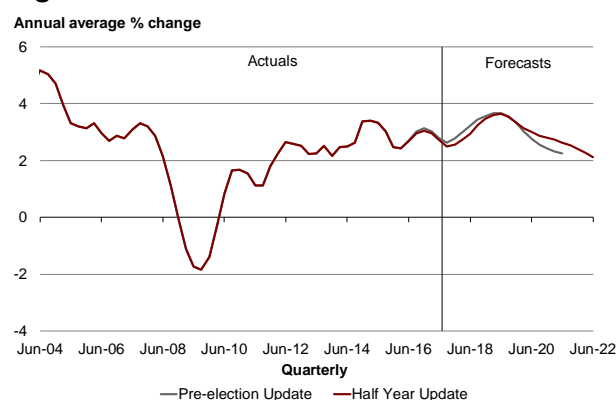
Looking forward, the Treasury in its *Half Year Update* forecasts economic growth to be supported by household income growth, continued population growth, low interest rates and a terms of trade at record levels. Growth is expected to peak at 3.6 per cent in 2018/19 as residential investment growth resumes after a temporary hiatus and as Government spending in areas such as the Families Package flow through the economy supporting consumption (Figure 1). Annual per capita GDP growth is expected to rise from 0.6 per cent in 2016/17 to 1.7 per cent in 2018/19.

Unemployment is expected to remain steady over the year ahead before falling to 4.0 per cent in late 2020, in line with the Government's target of reducing the unemployment rate to 4.0 per cent by the end of this Parliamentary term. To help achieve this, the Government will focus on lifting productivity, including through investing in skills, education, and research and development.

Wages are forecast to grow at over 3.0 per cent per year on average over the next five years. Headline inflation is expected to pick up from 1.7 per cent in 2016/17 to 2.2 per cent in 2021/22.

The Treasury assumes, as it has done in previous forecasts, that net migration levels will drop from the recent peak of 72,400 to Stats NZ's long-run average of 15,000 by 2021/22. The Government's immigration policies will help refocus the immigration system away from low-skilled workers and low-quality international education courses and towards the skills and people New Zealand needs to be more prosperous.

**Figure 1 – Real GDP Growth**



Sources: The Treasury, Stats NZ

**Table 1** – Summary of the Treasury’s economic forecasts

<b>Year ending 30 June</b>	<b>2017 Actual</b>	<b>2018 Forecast</b>	<b>2019 Forecast</b>	<b>2020 Forecast</b>	<b>2021 Forecast</b>	<b>2022 Forecast</b>
Real GDP (annual average % change)	2.7	2.9	3.6	3.0	2.6	2.1
Real GDP per capita (annual average % change)	0.6	0.9	1.7	1.4	1.4	1.1
Consumers Price Index (annual % change)	1.7	2.0	1.9	2.1	2.2	2.2
Employment growth (annual average % change)	5.2	3.3	1.9	1.5	1.3	0.9
Unemployment rate (June quarter)	4.8	4.6	4.4	4.2	4.0	4.1
Wage growth (annual % change)	1.6	2.8	3.3	3.2	3.4	3.5
Current account (% of GDP)	-2.9	-2.1	-2.3	-2.7	-3.3	-3.9

Sources: Stats NZ, the Treasury

### ***The Government’s fiscal position is strong...***

The Treasury’s economic and fiscal forecasts in the *Half Year Update* incorporate the total fiscal impacts of the 100-Day Plan (Table 2). The operating impact is broadly neutral, while the additional capital expenditure increases net core Crown debt by around \$5 billion. Page 6 specifies the progress made so far on the Government’s 100-Day Plan.

**Table 2** – Fiscal impacts of the 100-Day Plan

<b>Year ending 30 June \$millions</b>	<b>2018 Forecast</b>	<b>2019 Forecast</b>	<b>2020 Forecast</b>	<b>2021 Forecast</b>	<b>2022 Forecast</b>	<b>Total</b>
Families package	(80)	1,157	1,309	1,525	1,616	5,527
Tertiary education package	342	469	535	597	628	2,571
Other operating commitments	28	134	78	37	37	314
Reversing Budget 2017 tax cuts	(486)	(1,904)	(1,904)	(1,993)	(2,077)	(8,364)
<b>Net operating (savings)/expense</b>	<b>(197)</b>	<b>(143)</b>	<b>18</b>	<b>166</b>	<b>204</b>	<b>48</b>
KiwiBuild	100	900	1,000	-	-	2,000
New Zealand Superannuation Fund contributions	500	1,000	1,500	16	330	3,346
Tertiary education package	(155)	(123)	(86)	(44)	(26)	(434)
Other capital commitments	3	3	-	-	-	6
<b>Net capital spending</b>	<b>448</b>	<b>1,780</b>	<b>2,414</b>	<b>(28)</b>	<b>304</b>	<b>4,918</b>
<b>Net estimated fiscal cost</b>	<b>251</b>	<b>1,636</b>	<b>2,432</b>	<b>138</b>	<b>508</b>	<b>4,965</b>

Source: The Treasury

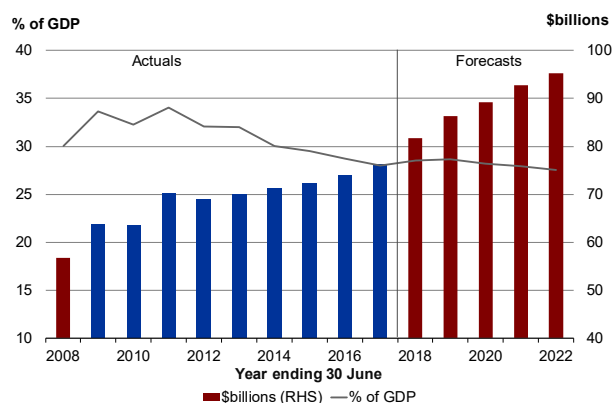
The overall size of the economy, nominal GDP, is forecast to be cumulatively \$1.5 billion higher than in the *Pre-election Economic and Fiscal Update (Pre-election Update)* over the four years to 2020/21. This, along with policy changes in the 100-Day Plan, flows through to a \$6.6 billion higher tax take over the four year forecast horizon to 2020/21 compared with the *Pre-election Update*. The majority of this revenue increase is driven by the reversal of the previous Government’s package of tax cuts, which will free up around \$8.4 billion over the five years to 2021/22.

This additional revenue will be invested into families to reduce child poverty and improve incomes under the Families Package and it will allow the Government to invest in other priority areas, including housing, health and education. The Families Package will deliver more money to families with children and help reduce child poverty.

The Treasury's current projection is that around 384,000 families with children will be better off by an average of \$66 more per week in the tax year ending 31 March 2019, rising to \$75 per week in 2021 when Best Start is fully in place. The impact of the Families Package is expected to reduce the number of children in poverty by approximately 44 per cent in 2019 rising to 48 per cent in 2021.<sup>1</sup> This equates to around 71,000 children in 2019 rising to 88,000 by 2021 – 39,000 more than under the previous Government's package.

The expenditure track is also forecast to be higher than in the *Pre-election Update*, which primarily reflects the Government's spending and investment priorities. Core Crown expenses are expected to reach \$92.7 billion in 2020/21 (Figure 2), over \$3 billion higher than in the *Pre-election Update*. The forecasts include operating and capital allowances sufficient to meet the Government's commitments and other pressures on government spending.

**Figure 2 – Core Crown expenses**

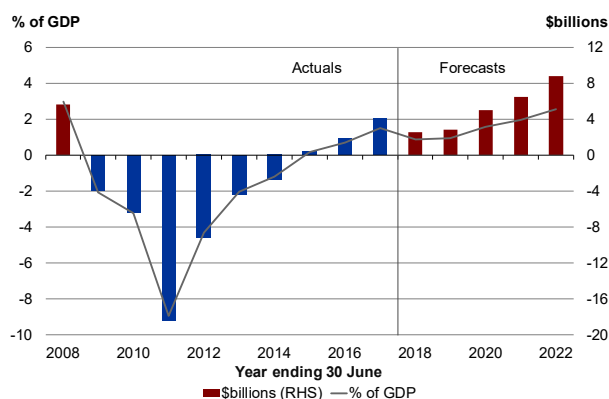


Source: The Treasury

As a percentage of GDP, core Crown expenses are expected to gradually fall from 28.5 per cent of GDP in 2017/18 to 27.6 per cent of GDP in 2021/22, well below the recent historical average of 30 per cent of GDP.

Rising operating balance before gains and losses (OBEGAL) surpluses are forecast (Figure 3), reaching \$8.8 billion in 2021/22 (2.5 per cent of GDP). These OBEGAL surpluses enable net debt to reduce as a percentage of GDP.

**Figure 3 – Operating balance before gains and losses (OBEGAL)**



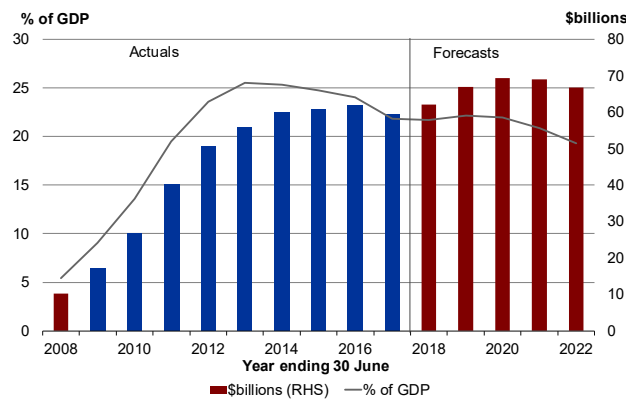
Source: The Treasury

Net core Crown debt is forecast to decline at a slightly slower pace than in the *Pre-election Update*, reflecting the new Government's spending and investment intentions. Net core Crown debt in dollar terms is expected to rise over the next few years owing to the significant additional capital investment the Government has planned for the New Zealand Superannuation Fund (NZS Fund) and KiwiBuild. It will then start falling, one year later than in the *Pre-election Update*.

<sup>1</sup> Using the 50 per cent of median equivalised income before housing costs measure.

As a proportion of the economy, the Treasury forecasts net core Crown debt to reduce to 19.3 per cent of GDP in 2021/22 (Figure 4), in line with the Government's target to reduce net core Crown debt to 20 per cent within five years of taking office. Crown net worth is forecast to continue to increase in line with the reduction in net debt and increase in Crown assets.

**Figure 4 – Net core Crown debt**



Source: The Treasury

**Table 3 – Summary of the Treasury's fiscal forecasts**

Year ending 30 June	2017 Actual	2018 Forecast	2019 Forecast	2020 Forecast	2021 Forecast	2022 Forecast
<b>\$billions</b>						
Core Crown tax revenue	75.6	78.2	82.8	87.8	93.0	97.8
Core Crown expenses	76.3	81.7	86.3	89.2	92.7	95.3
Total Crown OBEGAL	4.1	2.5	2.8	5.0	6.5	8.8
Core Crown residual cash	2.6	(2.6)	(4.7)	(2.6)	0.3	2.3
Net core Crown debt	59.5	62.1	66.8	69.4	69.0	66.8
Net worth attributable to the Crown	110.5	116.6	122.5	131.1	141.5	154.6
<b>% of GDP</b>						
Core Crown tax revenue	27.7	27.3	27.5	27.7	28.0	28.3
Core Crown expenses	28.0	28.5	28.6	28.2	28.0	27.6
Total Crown OBEGAL	1.5	0.9	0.9	1.6	2.0	2.5
Core Crown residual cash	0.9	(0.9)	(1.5)	(0.8)	0.1	0.7
Net core Crown debt	21.8	21.7	22.2	21.9	20.8	19.3
Net worth attributable to the Crown	40.5	40.7	40.6	41.4	42.7	44.7

Source: The Treasury

**...however, social and infrastructure deficits need to be addressed.**

Too many children live in poverty and, in a lot of cases, without adequate food, healthcare and housing. Evidence shows that childhood poverty, particularly in the early years, costs the country significantly each year. More importantly, it is unjust. Households on low and middle incomes are struggling to get ahead. Home ownership rates are the lowest in over 60 years and rents are rising. More than half a million New Zealanders did not go to a doctor last year because of the cost. This Government is committed to addressing these social deficits, starting with putting child wellbeing at the heart of what we do.

The Government is also facing significant pressure for infrastructure investment following under-investment in core public services in previous years. This is affecting our hospitals, housing, schools and transport system. Our schools have an average age of 42 years and a significant proportion of them require modernisation. Recent transport investment has been overly focused on a handful of expensive roading projects selected for political reasons, rather than on improving the whole transport system as an integrated, multimode network.

### 100-Day Plan

The Government has an ambitious Plan for its first 100 days in office and has already made significant progress on a number of key initiatives:

- The first year of post-secondary education or training will be fees free from 1 January 2018.
- Student allowances and living cost loans will increase by \$50 a week from 1 January 2018.
- Legislation will soon be introduced to reverse the previous Government's planned tax cuts and to pass this Government's Families Package, including the Winter Fuel Payment and Best Start, and separate legislation has been passed to increase Paid Parental Leave, to take effect from 1 July 2018.
- The Healthy Homes Guarantee Act 2017, requiring all rentals to be warm and dry, has been passed by Parliament.
- Legislation will soon be introduced to ban overseas speculators from buying existing houses, and a directive has been issued to tighten criteria on purchases of rural land.
- Instruction will soon be issued to Housing New Zealand to stop the State house sell off.
- Work has begun on establishing a Housing Commission and starting the KiwiBuild programme.
- A Ministerial Inquiry is being established to fix our mental health crisis.
- Legislation will soon be introduced to make medicinal cannabis available for people with terminal illnesses or in chronic pain.
- Contributions to the New Zealand Superannuation Fund will resume on 15 December 2017 to help safeguard the provision of universal superannuation at age 65.
- Legislation will soon be introduced to require the Government to set and measure progress towards meeting child poverty reduction targets and to amend the Public Finance Act 1989 so that the Budget reports on progress to reduce child poverty.
- The minimum wage will increase to \$16.50 an hour, to take effect from 1 April 2018, and legislation will be introduced to improve fairness in the workplace.
- The Chair of the Tax Working Group has been appointed and the Group will start to meet soon.
- Cabinet has agreed to establish the Pike River Recovery Agency.
- An inquiry will soon begin into the abuse of children in State care.
- Work is under way to set up the independent Climate Commission and to establish the process for setting a net zero carbon emissions goal.
- The Electoral (Integrity) Amendment Bill will stop Members of Parliament switching political parties between elections, without seeking a new mandate.

As previously mentioned, the total fiscal impact of all of the 100-Day Plan policies have been included in the Treasury's economic and fiscal forecasts in the *Half Year Update*.



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## Budget Priorities

As outlined in the Coalition Agreement between the New Zealand Labour Party and the New Zealand First Party, and the Confidence and Supply Agreement between the New Zealand Labour Party and the Green Party of Aotearoa New Zealand, we will work to provide New Zealand with a transformational Government, committed to resolving the greatest long-term challenges for the country, including sustainable economic development, increased exports and decent jobs paying higher wages, a healthy environment, a fair society and good government. We will reduce inequality and poverty and improve the wellbeing of all New Zealanders and the environment we live in.

Budget 2018 will confirm our commitment of putting child wellbeing at the heart of what we do, which will lift the wellbeing of all New Zealanders. The *Speech from the Throne* sets out the Government's overarching policy goals for the next three years. The Government is committed to building a strong economy, to being fiscally responsible and to providing the public and markets with certainty. There will be a clear focus on sustainable economic development, supporting regional economies, increasing exports, lifting wages, and reducing inequality. The Budget will also confirm our commitment to deliver strong public services across health, education, housing and police.

Our economic strategy, to be set out more fully alongside Budget 2018, will reflect the fact that wellbeing is determined by sustainable, productive and inclusive growth. This means the Government will be focused on improving productivity in the economy to enable environmentally sustainable growth that delivers wellbeing for all New Zealanders. This will include progress towards becoming a net zero carbon emissions economy.

We need to move beyond narrow measures of economic growth and broaden the scope and definition of progress. Our economic strategy will focus on how we improve the wellbeing and living standards of all New Zealanders. We will build off the work the Treasury has done on its Living Standards Framework, as summarised on page 9, to develop a comprehensive set of environmental, social and economic sustainability indicators. These indicators will better show how we are performing as a country.

Significant progress is already under way in the 100-Day Plan across housing, health, education, support for families and the environment. Budget 2018 will continue this momentum to ensure that all New Zealanders have equality of opportunity and have the resources they need to deliver on their potential, wherever they live. This Government knows that the economy cannot be looked at separately from its impacts on the environment and society.

The policy programme progressed in Budget 2018 will be based on the policies advanced in the Labour Party's pre-election Fiscal Plan, the Coalition Agreement and the Confidence and Supply Agreement.

Budget 2018 will make progress on a wide range of priorities, including:

- Building quality public services for all New Zealanders and improving access to core services, such as health and education.
- Taking action on child poverty and homelessness.
- Supporting families to get ahead and sharing the wealth generated by our economy with a wide range of New Zealanders.

- Sustainable economic development and supporting the regions.
- Managing our natural resources and taking action against environmental challenges, such as climate change.

As part of Budget 2018, and beyond, the Government will realign existing spending to better reflect our priorities and to help address New Zealand's social and infrastructure deficits.

We also expect to manage a number of cost pressures across the public service in Budget 2018 arising primarily from the underfunding of core public services in recent years. We are still uncovering the scale of these pressures. Our commitment as a government includes extra resources for health, education, increasing police numbers and a significant funding increase for conservation.

Addressing child poverty is at the heart of this Government's agenda. Child poverty imposes considerable social and economic costs. There is robust evidence that growing up in poverty can harm children in multiple, predictable, substantial and often sustained ways. These effects are particularly evident when poverty is severe and persistent and when it occurs during early childhood. The harmful effects of child poverty ripple across society, impairing the country's economic performance and damaging its social fabric.

It need not be this way. For a country with relative abundance, this Government believes that New Zealand has the opportunity and moral obligation to do better. We are committed to achieving a significant and sustainable reduction in child poverty and will create a framework that is durable enough to allow future Governments to do the same. Legislation will soon be introduced that will require:

- greater focus on the issue of child poverty across government and society more generally
- transparent and robust reporting on the levels of child poverty and material hardship in New Zealand
- greater commitment to action on the part of current and future Governments, and
- Governments to be held accountable for the results they achieve.

We will change the Public Finance Act 1989 so that in every Budget New Zealanders will hear about how many children have been lifted out of poverty and we can all see clearly what more needs to be done. Budget 2018 will be the first Budget to report on this.

This Government has an ambitious programme for housing. The establishment of KiwiBuild as part of the 100-Day Plan will be added to by significant boosts to social housing, improvements in rental housing standards, policies to reduce homelessness and innovative approaches to unblock barriers to sustainable urban development.

Climate change is the greatest challenge facing the world and has the potential to undermine our primary industries. Our response to it is an opportunity to develop new high-wage jobs. The Government's commitment is to sustainable development that allows for a just transition to a low-carbon economy. Work is already under way, under the Minister for Climate Change's leadership, to develop a Zero Carbon Act and an independent Climate Commission. Through the \$100 million Green Investment Fund, agreed with the Green Party of Aotearoa New Zealand, we aim to stimulate \$1 billion of new investment in low-

carbon industries by 2020. This will contribute to both New Zealand’s climate targets and to the sustainability of our economy.

It is essential that the regions of New Zealand thrive. Long-term under-investment and intergenerational poverty are undermining areas of the country that have enormous economic potential. The cornerstone of this Government’s response to this is the \$1 billion per year Provincial Growth Fund agreed with the New Zealand First Party as part of the Coalition Agreement. This Fund, as outlined on page 13, will invest in regional rail, support the planting of a billion trees over the next 10 years, investigate the future of the upper North Island ports, and provide for investment in local, regional and large-scale capital projects.


**Improving living standards and wellbeing**

It is the Government's intention to report against a wider set of wellbeing indicators in future Budgets, in line with the Confidence and Supply Agreement with the Green Party of Aotearoa New Zealand, which provides a commitment to work on new sustainable development indicators. The reporting framework is still being developed, but the Government sees this approach as a core element of how we will create our future Budgets and measure the success of our work. To assist with this, the Government has asked the Treasury to further develop and accelerate the world-leading work it has been doing on the Living Standards Framework (LSF).

The LSF is based on an OECD framework that organises indicators of sustainable intergenerational wellbeing. It focuses on measuring New Zealand’s success in developing four capitals – financial and physical, human, social and natural. The LSF gives a rounded measure of success and of how government policy is improving New Zealanders’ wellbeing.


### The Four Capitals

Intergenerational wellbeing relies on the growth, distribution, and sustainability of the Four Capitals. The Capitals are interdependent and work together to support wellbeing.




#### Natural Capital

This refers to all aspects of the natural environment needed to support life and human activity. It includes land, soil, water, plants and animals, as well as minerals and energy resources.




#### Human Capital

This encompasses people's skills, knowledge and physical and mental health. These are the things which enable people to participate fully in work, study, recreation and in society more broadly.



#### Social Capital

This describes the norms and values that underpin society. It includes things like trust, the rule of law, the Crown-Māori relationship, cultural identity, and the connections between people and communities.



#### Financial & Physical Capital

This includes things like houses, roads, buildings, hospitals, factories, equipment and investments. These are the things which make up the country's physical and financial assets which have a direct role in supporting incomes and material living conditions.

Source: The Treasury

## Fiscal Strategy

The Government will ensure that the Budgets it produces are not just narrow fiscal documents. Success will be measured in terms of how we improve the wellbeing of all New Zealanders, how we are reducing child poverty and how we are improving sustainability. The Government's fiscal strategy, as outlined below, is the means to the end of supporting New Zealanders to have lives of dignity, security and hope.

Improving the fiscal position makes New Zealand more resilient to future economic shocks and natural disasters, and helps to deal with the costs associated with an ageing population such as higher superannuation and healthcare costs.

The Government's five Budget Responsibility Rules are to:

- 1 Deliver a sustainable operating surplus across an economic cycle.
- 2 Reduce the level of net core Crown debt to 20 per cent of GDP within five years of taking office.
- 3 Prioritise investments to address the long-term financial and sustainability challenges facing New Zealand.
- 4 Take a prudent approach to ensure expenditure is phased, controlled and directed to maximise its benefits. The Government will maintain its expenditure to within the recent historical range of spending to GDP ratio.
- 5 Ensure a progressive taxation system that is fair, balanced and promotes the long-term sustainability and productivity of the economy.

Each of these Budget Responsibility Rules is discussed further below.

**The Government will deliver a sustainable operating surplus across an economic cycle.** In recent years, the previous Government created surpluses by running down expenditure in key areas. This is not a sustainable surplus. A sustainable surplus is one that exists once policy objectives have been met, and is not artificially generated by underfunding key public services.

The Government recognises that the size of the surplus will fluctuate with the strength of the economy. Instead of focusing on delivering a surplus in a particular (or every) year, we will deliver a surplus, on average, over the economic cycle. Running a deficit when shocks occur can be good for the economy and reduce the impact on people's lives. By maintaining tax and expenditure settings – and letting the so-called 'automatic stabilisers' work – the Government can help maintain demand in the economy and reduce the long-term impacts on economic and social outcomes from a downturn.

The Government is also mindful of ensuring fiscal policy does not place undue pressure on monetary policy. Running a larger surplus when the economy is strong would help to reduce upward pressure on the exchange rate and interest rates, thereby supporting exporters and households.

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**The Government will reduce the level of net core Crown debt to 20 per cent of GDP within five years of taking office.** Reducing government debt will give future generations more options and provide a buffer to help manage future risks or shocks.

New Zealand has low government debt by international standards but is vulnerable to shocks, such as natural disasters, and household debt has been increasing to record levels. By setting this target the Government is able to make responsible debt reductions, while also investing in housing and infrastructure that strengthens New Zealand and helps prepare us for future challenges.

**The Government will prioritise investments to address the long-term financial and sustainability challenges facing New Zealand.** Responsible investments that enhance the long-term wellbeing of New Zealanders will be prioritised – such as restarting contributions to the New Zealand Superannuation Fund (NZS Fund). In addition, we will invest in infrastructure to support our growing population, develop our regions and reduce the long-term fiscal and economic risks of climate change.

The first priority for our investment will be in those areas that will promote long-term fiscal sustainability. New discretionary expenditure will focus on programmes that will reduce future costs that the Government faces in the future. For example, spending on primary health saves spending on emergency health; spending on social housing saves spending on emergency housing in motels and hostels.

**The Government will take a prudent approach to ensure expenditure is phased, controlled and directed to maximise its benefits. The Government will maintain its expenditure to within the recent historical range of spending to GDP ratio.** On average for the last 20 years, core Crown spending has been around 30 per cent of GDP. This Government will manage expenditure carefully to continue this trend. The quality of public spending by the Government is important to improve the wellbeing of New Zealanders. We will take a responsible and balanced approach to implementation of new policies. This includes the appropriate phasing of expenditure. We will continue to look closely at all current government expenditure to ensure it is best directed to improving productivity, security and opportunity.

**The Government will ensure a progressive taxation system that is fair, balanced and promotes the long-term sustainability and productivity of the economy.** Taxation is an important tool for rebalancing the economy and setting New Zealand on a path to an environmentally and economically sustainable future. The Government believes that we need a better balance in our tax system to support the productive sector and ensure all taxpayers are paying their fair share.

The best taxation systems have some key characteristics – they ensure taxes are efficient, fair, simple and collected. The current taxation system needs reform. The Government has established a Tax Working Group to examine tax changes that would be positive for the economy and New Zealanders.

Further details on the Government's specific short-term intentions and long-term objectives, as required by the Public Finance Act 1989, can be found in the Annex.

## Strategy for Managing Expenses, Assets and Liabilities

***A prudent approach will be taken to ensure expenditure is phased, controlled and directed to maximise its benefits***

The Government is continuing the fiscal management approach of fixed nominal baselines with Budget allowances for new funding that has been in place since 2003. The policy of fixed nominal baselines means that funding for most departments does not automatically increase every year to adjust for inflation. Budget allowances are the pool of new funding available each Budget (for both operating and capital expenditure) to fund cost increases and new initiatives.

Budget allocations will be tightly focused on our key priorities, as outlined on page 7. The Government is committed to properly funding core public services, in particular health, education, housing and police and not artificially generating surpluses through underfunding.

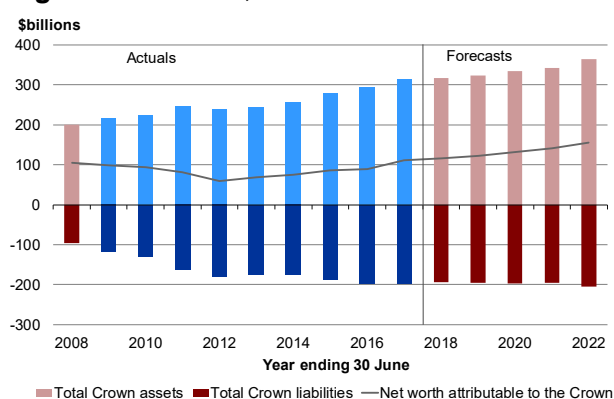
The Government is actively focusing on reprioritising expenditure that is not aligned with its priorities or is of low value. This approach will continue in future Budgets to ensure that spending better reflects the Government's priority of improving the wellbeing of all New Zealanders.

***Total assets are forecast to increase from \$314 billion to \$365 billion in 2021/22***

The Government's assets support the delivery of valuable public services. Its liabilities help to fund these services and consist mostly of debt issued by the Crown. The most recent year-end results show the Crown currently owns \$314 billion of assets and has \$197 billion of liabilities. The difference between these numbers represents the Crown's net worth, which is forecast to grow from \$111 billion in 2016/17 to \$155 billion in 2021/22 (Figure 5).

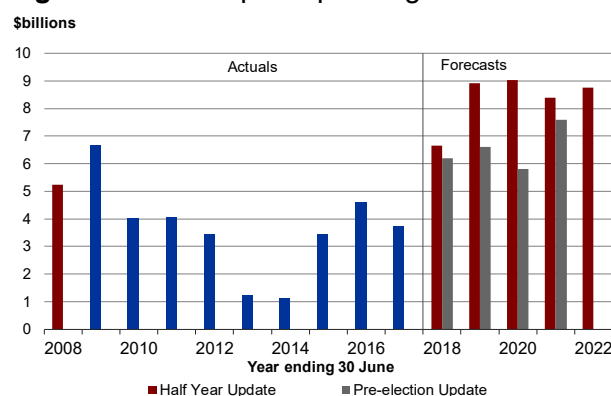
The Government is acutely aware of the infrastructure deficit in New Zealand, which needs to be addressed. Capital investments will be a key focus of our Budgets, in particular, ensuring that infrastructure and services are in place to support improved wellbeing and that as a country we are actively planning for our future. In addition, we will work with local government and the private sector to design and deploy innovative mechanisms to finance and fund necessary infrastructure.

**Figure 5 – Assets, liabilities and net worth**



Source: The Treasury

**Figure 6 – Net capital spending**



Source: The Treasury



The level of future capital spending is significantly higher than planned under the previous Government, with just under \$42 billion forecast to be spent on capital investments over the next five years (Figure 6). The Government is committed to driving value from these investments. There will be significant investment in regional infrastructure, particularly from the \$1 billion per year Provincial Growth Fund described further below. Investing in infrastructure relating to housing (through KiwiBuild), integrated urban development and sustainable transport will also be key priorities for the Government.

### **The Provincial Growth Fund**

The Government will significantly increase the level of investment in regions to enable greater regional economic growth. As provided for in the Coalition Agreement between the New Zealand Labour Party and the New Zealand First Party, we are establishing a \$1 billion per year Provincial Growth Fund (PGF). The objectives of the PGF will be to support the Government's overall goal of productive, sustainable and inclusive growth. Funding will come from unallocated capital and operating allowances and some reprioritisation of spending (for example, in transport relating to rail).

Investments will need to achieve at least one of the following objectives:

- *Jobs and sustainable economic development:* investments that support increased jobs and sustainable economic development over the long term, particularly in regions and sub-regions where unemployment is high and there are significant social challenges.
- *Social inclusion and participation:* investments that support increased social inclusion through effective training, work preparation and support that enables more people to fully participate in work and society.
- *Climate change and environmental sustainability:* investments that support opportunities to achieve New Zealand's climate change commitments and encourage more sustainable and productive use of land, water and other resources.
- *Resilience:* investments that increase regional and national resilience by improving critical infrastructure and focusing on opportunities to grow and diversify our exports and economy.

We envisage, at this stage, that the PGF will comprise three tiers of investment:

- 1 small-scale investments (building on the Regional Growth Initiatives fund)
- 2 medium- to large-scale sector-based investments (such as the 1 billion Trees Programme), and
- 3 large infrastructure investments.

**Total liabilities are forecast to increase from \$197 billion to \$205 billion in 2021/22**

The Crown has many liabilities requiring careful management. These can arise owing to contractual arrangements, such as government employee superannuation schemes or insurance obligations, such as ACC. In addition, the Crown is exposed to contingent liabilities such as Crown guarantees, and a range of commitments consistent with existing policy settings, the largest of which is New Zealand superannuation.

The Government will prioritise responsible investments that enhance the long-term wellbeing of New Zealanders. To help manage future superannuation costs, contributions to the New Zealand Superannuation Fund (NZS Fund) will resume on 15 December 2017 (Table 4). Restarting contributions is projected to increase the size of the Fund to over \$63 billion by 2022/23 and will help to keep superannuation at age 65 sustainable.

**Table 4** – Contributions to the NZS Fund

<b>Year ending 30 June \$billions</b>	<b>2018 Forecast</b>	<b>2019 Forecast</b>	<b>2020 Forecast</b>	<b>2021 Forecast</b>	<b>2022 Forecast</b>
NZS Fund contributions - <i>Half Year Update</i>	0.5	1.0	1.5	2.2	2.5

Source: The Treasury

As Table 4 shows, contributions to the NZS Fund will increase gradually over the next five years. This ensures that the Government can continue to meet its fiscal commitments, while responsibly investing for the future.

New Zealand Government Bonds (NZGBs) account for the vast majority of gross core Crown debt and are the Government's main debt funding tool.

As included in the *Fiscal Strategy Report 2017*, the Government will continue to recognise the importance of maintaining a sustainable NZGB market. Even if net core Crown debt falls below 20 per cent of GDP, the Government intends to maintain levels of NZGBs on issue at not less than 20 per cent of GDP over time. This is necessary to:

- ensure ongoing government access to debt funding, supporting fiscal resilience in the event of future economic shocks or natural disasters
- reduce volatility of government borrowing programmes through economic cycles, and
- provide wider capital markets benefits, including reliable pricing benchmarks for other issuers.



## Setting Budget Allowances

Budget allowances provide an envelope of new expenditure to help the Government meet its fiscal priorities. The overall spending commitments as outlined in the Labour Party's pre-election Fiscal Plan, the Coalition Agreement, and the Confidence and Supply Agreement, have been translated into the allowance framework. The Government has set allowances that provide for the commitments made. These commitments are now being put through the full Budget process to ensure the highest levels of value for money and efficient and effective implementation mechanisms.

These operating and capital allowances do not include the expenditure related to the 100-Day Plan as this is already reflected in the Treasury's forecasts. The total levels of additional expenditure, as phased in the allowances below, are consistent with the Government's target of reducing net core Crown debt to 20 per cent of GDP within five years of taking office. The Government will use these allowances to prioritise responsible investments that enhance the long-term wellbeing of New Zealanders.

**Table 5** – Budget allowances

<b>\$billions</b>	<b>Budget 2018</b>	<b>Budget 2019</b>	<b>Budget 2020</b>	<b>Budget 2021</b>
Operating allowances (per year)	2.600	1.875	1.875	1.875
Capital allowances (total)	3.400	3.400	3.100	2.700

Source: The Treasury

The operating allowance for Budget 2018 has been set at \$2.6 billion per year. Future Budget operating allowances have been set at \$1.875 billion per year. These operating allowances provide the fiscal space required to make much-needed investments in areas such as housing, health, education and police.

There is pressure on Government-owned infrastructure, driven primarily by population growth and previous under-investment. The capital allowances of \$3.4 billion for Budgets 2018 and 2019, \$3.1 billion for Budget 2020 and \$2.7 billion for Budget 2021 provide room to help deal with the infrastructure deficit and meet the needs of the New Zealand public. As capital expenditure can be lumpy in nature, we will keep under review the phasing of the capital allowances, within the total expenditure envelope, to effectively manage demand.

### ***The commitments made in the Coalition and Confidence and Supply Agreements can be managed within these Budget allowances***

As outlined above, Budget allowances provide for the commitments made in the New Zealand Labour Party's pre-election Fiscal Plan, the Coalition Agreement between the New Zealand Labour Party and the New Zealand First Party, and the Confidence and Supply Agreement between the New Zealand Labour Party and the Green Party of Aotearoa New Zealand, whilst meeting the Government's Budget Responsibility Rules. Over the next four Budgets, operating allowances provide for \$21.7 billion of new expenditure and capital allowances provide for \$12.6 billion of new capital investments. The costs of the 100-Day Plan are already fully accounted for in the Treasury's *Half Year Update* and therefore are outside of these allowances.

### *Operating commitments*

Outside of the 100-Day Plan costs, the remaining operating expenditure from the Fiscal Plan, the Coalition Agreement, and the Confidence and Supply Agreement, totals \$15.1 billion (on current estimates) over the forecast period. The operating allowances therefore provide \$6.6 billion of headroom for additional operating expenditure over the forecast period. In addition, the Government is looking to reprioritise existing expenditure that does not meet its priorities or is low value for money. The savings from reprioritisation will be added to the operating allowances to help meet cost pressures and any other new initiatives that align with the Government's priorities.

### *Capital commitments*

The allocated capital commitments in the 100-Day Plan are to restart NZS Fund contributions and KiwiBuild, and are already included in the *Half Year Update*. Initial estimates of the additional capital expenditure from the Coalition Agreement and Confidence and Supply Agreement total approximately \$3.7 billion over the next four years, which can be accommodated within the available capital allowances. This comprises \$3.6 billion for the Provincial Growth Fund and \$100 million for the Green Investment Fund.

All operating and capital commitments outside of the 100-Day Plan are now being put through the full Budget process and initial estimates may change as this process runs its course (for example, as departments finalise specific costings).

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## Conclusion

This *Budget Policy Statement* highlights a strategy that balances our vision for a better and fairer New Zealand with a responsible and disciplined approach to managing the country's finances.

This Government's economic approach will provide all New Zealanders with opportunity and security. There will be a clear focus on sustainable economic development, supporting regional economies, increasing exports, lifting wages and reducing inequality.

The Government understands New Zealanders' desire for a balance between ambition, inclusion, certainty and responsibility. We will deliver both a clear programme for shared prosperity to improve all New Zealanders' wellbeing and the responsible fiscal management to go with it.

Budget 2018 will be a key milestone in delivering on this programme.



Hon Grant Robertson  
Minister of Finance

14 December 2017

## Annex

### Long-term Fiscal Objectives and Short-term Fiscal Intentions

The Government's long-term objectives relate to the next 10 years. These long-term objectives have been amended since the *Fiscal Strategy Report 2017* (FSR) reflecting the new Government's fiscal strategy.

**Table A1** – Long-term fiscal objectives

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#### **Budget Policy Statement 2018**

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##### **Operating balance**

The Government will deliver a sustainable operating surplus across an economic cycle.

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##### **Operating expenses**

The Government will maintain its expenditure to within the recent historical range of spending as a ratio of GDP.

The Government will take a prudent approach to ensure expenditure is phased, controlled and directed to maximise its benefits, in particular prioritising investments to address the long-term financial and sustainability challenges facing New Zealand.

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##### **Operating revenues**

The Government will ensure a progressive taxation system that is fair, balanced, and promotes the long-term sustainability and productivity of the economy.

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##### **Debt**

Maintain total debt at prudent levels.

The Government will reduce the level of net core Crown debt to 20 per cent of GDP within five years of taking office and maintain it at prudent levels thereafter.

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##### **Net worth**

The Government will strengthen net worth consistent with the debt and operating balance objectives.

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The Government's short-term fiscal intentions (in Table A2 below) include changes since the FSR 2017 reflecting the new Government's fiscal strategy. The *Half Year Update* forecasts include the impact of the Government's proposed budget allowances.

The short-term intentions and long-term objectives are consistent with each other and with the principles of responsible fiscal management as set out in the Public Finance Act 1989. That is, they aim to:

- reduce total debt to prudent levels and achieve and maintain levels of total net worth so as to provide a buffer against adverse economic shocks
- ensure that, on average, total operating expenses do not exceed total operating revenues
- take into account the impact of fiscal policy on monetary policy
- prudently manage the fiscal risks facing government
- have regard for present and future generations, and
- ensure the Crown's resources are managed effectively and efficiently.

More detailed information about the principles of responsible fiscal management can be found at: [www.treasury.govt.nz/publications/guidance/publicfinance/fiscalframework/](http://www.treasury.govt.nz/publications/guidance/publicfinance/fiscalframework/)

**Table A2 – Short-term fiscal intentions**

<b>Budget Policy Statement 2018</b>	<b>Fiscal Strategy Report 2017</b>
<p><b>Debt</b></p> <p>Our intention is to reduce the level of net core Crown debt to 20 per cent of GDP within five years of taking office (subject to any significant shocks to the economy).</p> <p>Gross sovereign-issued debt (including Reserve Bank settlement cash and Reserve Bank bills) is forecast to be 27.1 per cent of GDP in 2021/22.</p> <p>Net core Crown debt (excluding NZS Fund and advances) is forecast to be 21.9 per cent of GDP in 2019/20, 20.8 per cent of GDP in 2020/21 and 19.3 per cent in 2021/22.</p> <p>This assumes new capital allowances of \$3.4 billion in Budgets 2018 and 2019, \$3.1 billion in Budget 2020 and \$2.7 billion in Budget 2021.</p>	<p><b>Debt</b></p> <p>Our intention is to reduce net debt to around 20 per cent of GDP in 2020 and to between 10 per cent and 15 per cent of GDP by 2025.</p> <p>Gross sovereign-issued debt (including Reserve Bank settlement cash and Reserve Bank bills) is forecast to be 26.3 per cent of GDP in 2020/21.</p> <p>Net core Crown debt (excluding NZS Fund and advances) is forecast to be 20.6 per cent of GDP in 2019/20 and 19.3 per cent in 2020/21. It is projected to be 13.3 per cent in 2024/25 and 11.8 per cent in 2025/26.</p>
<p><b>Operating balance</b></p> <p>Our intention is to deliver operating surpluses (before gains and losses) to ensure net debt falls to 20 per cent of GDP within five years of taking office.</p> <p>The operating balance (before gains and losses) is forecast to be 0.9 per cent of GDP in 2017/18, rising to 1.6 per cent of GDP in 2019/20 and 2.5 per cent of GDP in 2021/22. This is consistent with the long-term objective for the operating balance.</p> <p>The operating balance is forecast to be 3.8 per cent of GDP in 2021/22.</p>	<p><b>Operating balance</b></p> <p>Our intention is to maintain rising operating surpluses (before gains and losses) so that net core Crown debt begins to reduce in dollar terms (subject to any significant shocks to the economy).</p> <p>The operating balance (before gains and losses) is forecast to be 0.6 per cent of GDP in 2016/17, rising to 1.0 per cent of GDP in 2017/18 and 2.2 per cent of GDP in 2020/21. This is consistent with the long-term objective for the operating balance.</p> <p>The operating balance is forecast to be 3.3 per cent of GDP in 2020/21.</p>
<p><b>Expenses</b></p> <p>Our intention is to ensure expenses are consistent with the operating balance objective.</p> <p>Core Crown expenses are forecast to fall from 28.5 per cent of GDP in 2017/18 to 27.6 per cent of GDP in 2021/22.</p> <p>Total Crown expenses are forecast to be 35.5 per cent of GDP in 2021/22.</p> <p>This assumes new operating allowances of \$2.6 billion per year in Budget 2018 and \$1.875 billion per year in each budget thereafter.</p>	<p><b>Expenses</b></p> <p>Our intention is to support fiscal surpluses by restraining the growth in core Crown expenses and reducing these to below 30 per cent of GDP.</p> <p>Core Crown expenses are forecast to fall from 28.8 per cent of GDP in 2016/17 to 27.5 per cent of GDP in 2020/21.</p> <p>Total Crown expenses are forecast to be 35.2 per cent of GDP in 2020/21.</p> <p>This assumes new operating allowances of \$1.7 billion per year in Budget 2018, growing at 2 per cent per Budget until Budget 2020.</p>
<p><b>Revenues</b></p> <p>Our intention is to ensure sufficient revenue to meet the operating balance objective.</p> <p>Total Crown revenues are forecast to be 38.2 per cent of GDP in 2021/22.</p> <p>Core Crown revenues are forecast to be 30.4 per cent of GDP in 2021/22.</p> <p>Core Crown tax revenues are forecast to be 28.3 per cent of GDP in 2021/22.</p>	<p><b>Revenues</b></p> <p>Our intention is to support fiscal surpluses by growing revenue in dollar terms, although maintaining it at broadly the same proportion of GDP.</p> <p>Total Crown revenues are forecast to be 37.6 per cent of GDP in 2020/21.</p> <p>Core Crown revenues are forecast to be 29.8 per cent of GDP in 2020/21.</p> <p>Core Crown tax revenues are forecast to be 27.7 per cent of GDP in 2020/21.</p>

<i><b>Budget Policy Statement 2018</b></i>	<i><b>Fiscal Strategy Report 2017</b></i>
<p><b>Net worth</b></p> <p>Our intention is to increase net worth consistent with the operating balance objective.</p> <p>Total net worth attributable to the Crown is forecast to be 44.7 per cent of GDP in 2021/22.</p> <p>Total Crown net worth is forecast to be 46.4 per cent of GDP in 2021/22.</p>	<p><b>Net worth</b></p> <p>Our intention is to strengthen the Crown's balance sheet as a buffer against future adverse shocks.</p> <p>Total net worth attributable to the Crown is forecast to be 40.9 per cent of GDP in 2020/21.</p> <p>Total Crown net worth is forecast to be 42.7 per cent of GDP in 2020/21.</p>