3

Fiscal Outlook

Introduction

This chapter discusses the trends, influences and assumptions behind the outlook for the Crown's finances. The discussion covers:

- key components of the operating balance including tax revenue, expenses, and state-owned enterprises (SOEs) and Crown entities' (CEs) surpluses
- net worth and debt, including the relation between the operating balance and net worth and net debt, and details of the 2001/02 bond programme.

Following these sections are technical tables and sections including fiscal indicators, OBERAC methodology (Operating Balance Excluding Revaluations and Accounting policy Changes), and the Government's operating and capital provisions.

Influences on the Operating Balance

Operating surpluses will continue to rise over the forecast period with little cyclical effects.

In 2000/01, the OBERAC is $1.7 billion once the operating balance is adjusted for negative ACC and GSF revaluations of around $1.1 billion (among other smaller changes). Thereafter, both the OBERAC (see page 76) and operating balance grow from $1.4 billion in 2001/02 to $3.7 billion in 2004/05.

The following sections discuss the trends in the three main operating balance components, and any significant changes in these components since the December *Update.*

For a detailed comparison of key fiscal indicators to the December *Update*, see Table 3.2 on page 74.

Tax Revenue

Tax revenue growth peaks early in forecast period, unwinds, then tracks nominal GDP growth…

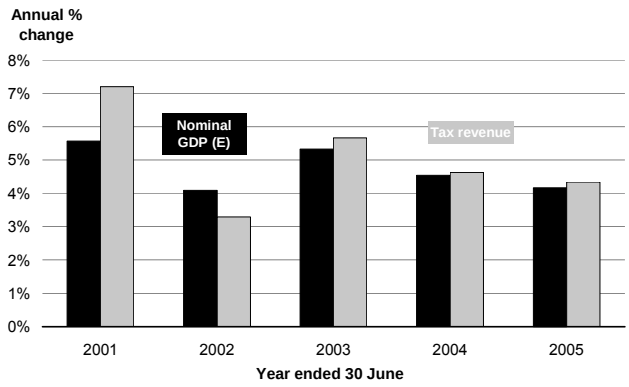
Tax revenue is expected to grow by 7.2% for the current year, considerably faster than nominal GDP. The rate of growth has been pushed up by:

- the tax rate rise on 1 April 2000
- exceptionally high growth in company taxes.

In 2001/02 tax revenue growth is forecast to be lower than nominal GDP, mostly owing to the unwinding of the growth in corporate taxes in 2000/01.

For the rest of the forecast period tax revenue grows similarly to nominal GDP.

Figure 3.1 – Tax revenue and nominal GDP growth



Source: The Treasury

…mainly because PAYE and GST grow in line with economic forecasts

Source deductions (PAYE) is tax paid on wages and salary income and is the largest single component of tax revenue. Source deductions grows in line with wages and employment growth throughout the forecast period.

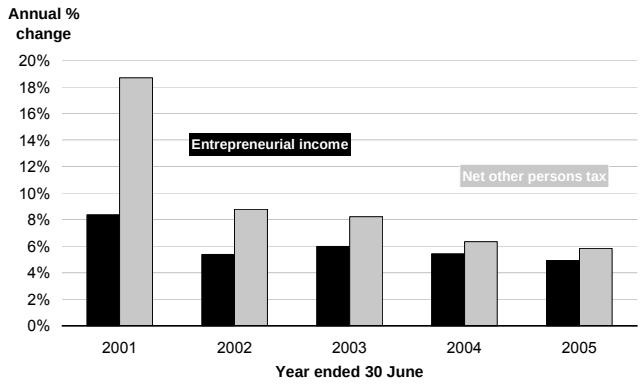
GST is the second largest component of tax revenue. In the 2000/01 year falling residential investment pulls GST growth below consumption growth. For the rest of the forecast period GST grows approximately in line with consumption.

The short-term tax peak occurs because net other persons tax is unusually high this year, then grows with entrepreneurial income…

Net other persons tax is tax paid mainly by the self-employed, farmers and investors, minus refunds paid to all individuals.

Net other persons tax is growing very strongly in the 2000/01 year. This is partly owing to the effects of the tax rate increase on 1 April 2000 but is also owing to unusually large terminal tax assessments and payments.

Figure 3.2 – Growth in entrepreneurial income and net other persons tax



Source: The Treasury

Terminal payments in the 2000/01 fiscal year are related to the 1999/2000 tax year. Two factors pushed up the terminal tax take this year:

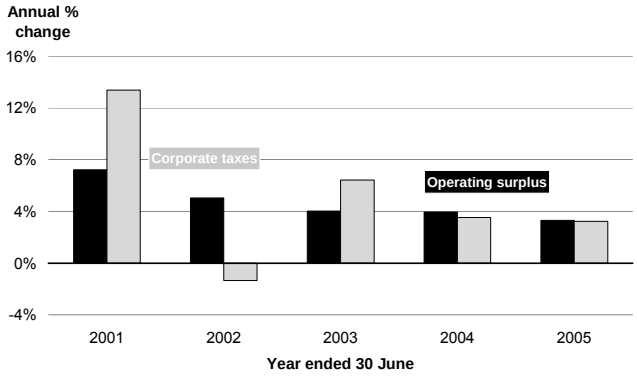
- There was high income growth for this group of taxpayers, especially farmers, in the 1999/2000 tax year. Over 80% of other persons tax is paid by people who use the "standard" provisional payment option. That means that during the tax year they make provisional payments at 105% of last year's tax. If their income has grown faster than 5% they pay the difference between what they owe and what they paid in terminal tax.
- Some income was brought forward into the 1999/2000 tax year to minimise the effects of the tax rate rise.

Such high levels of terminal tax are not expected to repeat in 2001/02, so the rate of growth falls considerably despite expected strong terminal payments from dairy farmers in 2001/02. Over the rest of the forecast period net other persons tax grows broadly in line with entrepreneurial income.

…and corporate tax growth is strong in 2000/01 but sharply lower in 2001/02

Corporate tax is predicted to grow by 13.4% in 2000/01. Growth so far this year has been very strong and appears to be well in excess of growth in underlying profits for the same period. This is partly owing to some delayed tax payments from the high income growth in 1999/2000 and some one-off factors like some large companies coming out of tax loss situations. Possible factors causing the remainder of the growth are:

Figure 3.3 – Growth in corporate operating surplus and corporate taxes



Source: The Treasury

- some overpayment of tax in the 2000/01 fiscal year. Earlier in the year the outlook was very positive, which probably pushed up companies' estimates of their profit growth. Since then the US economy has slowed down sharply, suggesting that a number of companies may not have made the profits they were expecting
- a switch from other persons tax to company tax owing to the tax rate rise on personal income over $60,000
- underlying profits may actually be considerably higher than economic factors suggest.

It is not yet known which of these factors predominates and this uncertainty has a significant impact on the rest of the forecast period. The Budget 2001 forecast estimates that much of the growth comes from overpayment of tax in 2000/01. Therefore corporate tax growth in 2001/02 is expected to be slightly negative as the previous overpayments of tax reverse. However the positive and negative risks for this forecast are large and evenly balanced. The corporate tax take could easily be much higher or lower.

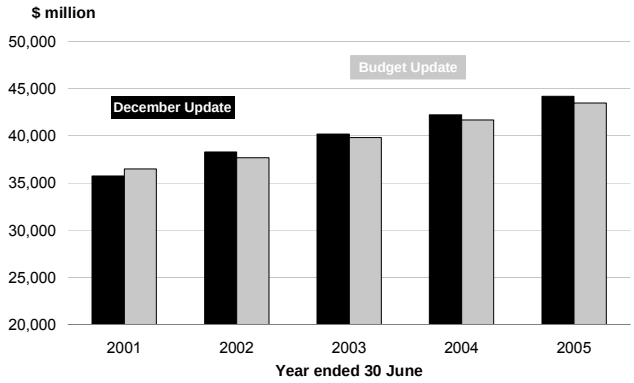
For the rest of the forecast period, corporate tax growth is expected to track growth in corporate operating surplus (a proxy for profits), apart from a one-off increase in 2002/03 from the expiry of film-related tax concessions.

Tax revenue higher than at December Update for 2000/01 year, then lower

Total tax revenue is forecast to be 2.1% higher for the year to June 2001 than at the December *Update* forecasts. This is because:

- corporate taxes have been persistently above forecast
- source deductions has been strengthened by higher employment growth
- other persons tax has had unexpectedly large terminal tax assessments.

Figure 3.4 – Tax revenue comparison between forecasts



Source: The Treasury

In 2001/02 the variance reverses so tax revenue is 1.5% below the December *Update* forecast. This is because:

- most of the strong growth in corporate tax and other persons tax is expected to unwind as explained above
- weaker economic growth compared to the December *Update* reduces nearly all the tax types.

For the rest of the forecast period the forecast varies from 0.9% to 1.6% below that at the December *Update*. Source deductions is the only major tax type to be stronger owing to employment growth being higher in 2000/01.

Risks around the tax forecasts from judgements about taxpayers' behaviour

Tax forecasts are mainly driven by forecasts of nominal income and expenditure and so many of the risks are the same as the economic forecast risks. However, tax forecasts also include judgements about taxpayer behaviour in response to policy and administrative changes. The accuracy of these judgements is another source of risk in these forecasts.

The key risk in this forecast is the underlying size of the company tax base in 2000/01, ie, determining the level of current-year overpayment relative to current-year profits.

Other particular risks in this forecast relate to uncertainties around:

- the degree of tax timing changes in response to the personal tax rate increase
- the changes to the timing and the size of refunds to individuals following the elimination of IR5 tax returns
- refunds of GST on historical imported services.

Inland Revenue's Forecasts

In line with established practice, Inland Revenue has prepared an independent set of tax forecasts, based in the short term on more detailed analysis of taxpayer information, and in the longer term reflecting the same underlying macroeconomic trends.

For the 2000/01 and 2001/02 fiscal years, Inland Revenue's forecasts of tax revenue are very similar to the Treasury's forecasts, with aggregate tax revenue $29 million more in the current year and $56 million less for next year. Over subsequent years, Inland Revenue projects total tax revenue to be between $192 million and $325 million less than the Treasury's figures. These differences are well within estimated forecast uncertainty, and are in the lower range for historical differences in forecasts between the two departments.

The two sets of forecasts are compared in Tables A.1 and A.2 on pages 152 and 153.

Expenses

Expenses as a percentage of GDP continue to trend down

Expenses fall as a percentage of GDP between 1999/2000 and 2004/05 from 33.9% to 32.6%.

Over the same period, nominal expenses grow by around 4% each year, owing to both policy spending and demand-driven factors. This represents an increase of $7.6 billion from $36.2 billion to $43.8 billion.

Around 60% ($4.6 billion) of this increase is policy driven, comprising the Government's operating provisions.

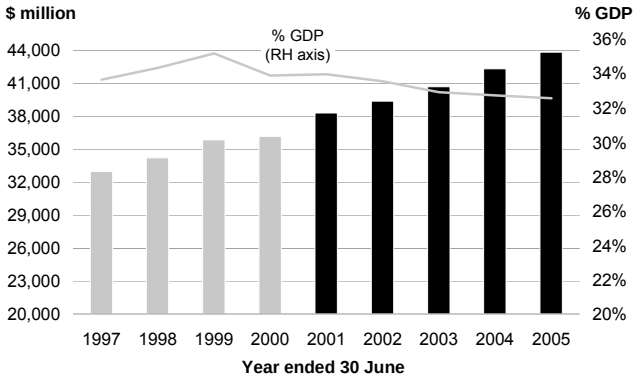
The bulk of the expenses allocated to date from the provisions has been directed towards Education, Health and Social Security and Welfare ($1.7 billion[11]). Around $2.8 billion remains unallocated[12]. These amounts are intended to fund new initiatives, while managing cost pressures the Government can directly influence. See page 80 for detailed allocations of the provisions.

Demand-driven factors account for 40% ($3.0 billion) of the expense increases. These factors include demographic impacts and CPI indexation of benefits. They are not met from the fiscal provisions, as the Government has little direct influence over their movement.

Over the five year forecast period:

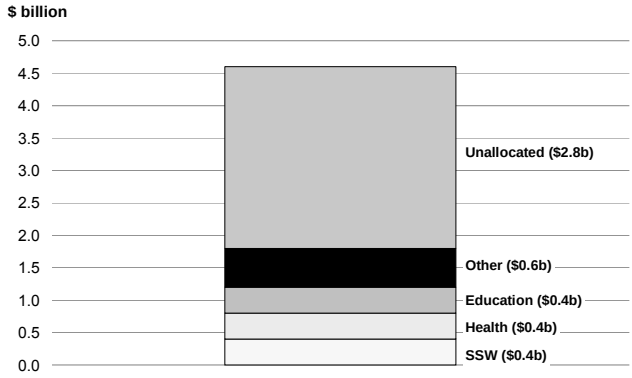
- CPI indexation averages 1.7%, increasing benefits expenses by around $900 million

Figure 3.5 – Expenses ($ and % of GDP)



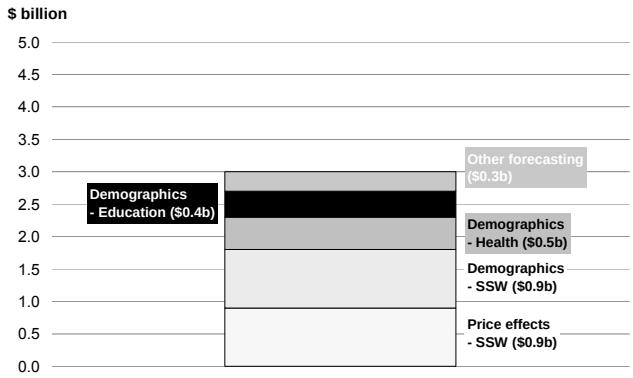
Source: The Treasury

Figure 3.6 – Expense increases owing to policy spending 2000/01 to 2004/05



Source: The Treasury

Figure 3.7 – Expense increases owing to demand-driven and other factors 2000/01 to 2004/05



Source: The Treasury

11 Comprises $1.2 billion allocated in the Budget 2000 package, and $0.5 billion in the Budget 2001 package.

12 Comprises the 2001/02 contingency $160 million, the $815 million 2002/03 fiscal provision and $900 million 2003/04 and 2004/05 indicative provisions.

- population ageing increases the number of invalids and superannuitants by 38,000, being the main demographic drivers for Social Security and Welfare
- population ageing is also the main driver for health demographics
- school and tertiary rolls increase by around 36,000[13].

Other expense categories remain relatively static[14]. Finance costs are stable, as decreasing interest rates broadly offset higher nominal debt levels over the forecast period.

Policy spending increases since December Update impact from 2002/03

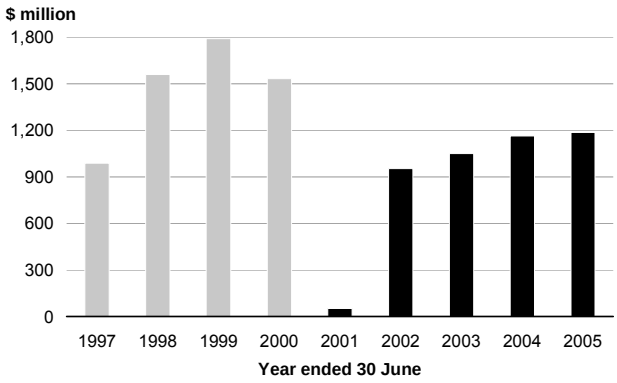
Expenses are relatively unchanged over the early part of the forecast horizon relative to the December *Update* (see Table 3.4 page 78). From 2002/03 expenses grow from being higher by $75 million, to $465 million higher in 2004/05. These increases are due to:

- Policy changes increasing expenses towards the end of the forecast horizon. Changes in provisions increase expenses by $250 million in 2002/03, growing to $450 million by 2004/05, the largest component being a $245 million higher 2002/03 fiscal provision (see page 78). The impact of these policy changes are partly offset by
- Changes in other forecasting items, mainly lower transport expenses, benefit expense indexation[15] and demand changes, and the impact of lower interest rates on finance costs. These forecasting items reduce the impact of policy increases until 2004/05 when higher debt levels begin to increase interest expenses.

SOEs' and Crown Entities' Surpluses

In 2000/01, SOEs' and Crown entities' gross surpluses decrease to $53 million. This largely reflects the negative impact of a $707 million increase in the ACC liability revaluation owing to a 0.6% decrease in the discount rate and increases in inflation assumptions ($400 million), and forecast increases to both claims incidence and average cost of claims, partially offset by lower premium revenue ($300 million).

Figure 3.8 – SOEs' and Crown entities' gross surpluses



Source: The Treasury

13 See expense tables (pages 155 and 157) for detailed breakdown of beneficiary and school roll numbers.

14 The Crown incurs expenses for maintaining highway sections falling within local authorities' boundaries. As has been signalled for some time, these sections have now been recorded as an asset on the Crown's balance sheet ($1.7 billion) as the Crown is responsible for their maintenance.

The associated expense is forecast to decrease, because a portion of it will be capitalised instead, as it is enhancing the value of the asset. This is partially offset by higher depreciation expenses. The net decreases in expenses are $37 million, $42 million, $85 million, $104 million, and $104 million each year from 2000/01 to 2004/05.

15 The forecast inflation track is lower than was expected at the time of the *December Update,* which reduces benefit indexation increases. This reduction is partly offset by actual CPI for 2000 being 0.5% higher than anticipated. In addition, the New Zealand Superannuation (NZS) wage floor is now forecast to be hit in April 2004, a year earlier than anticipated.

Relative to the flat SOE/Crown entity surplus profile forecast in the December *Update* beyond 2000/01, the surpluses now rise. This rise reflects changes to how the Non-earners' Account is funded, increasing ACC surpluses. Overall, this change is fiscally neutral, as the extra funding (higher Health expenses) has led to a corresponding increase in ACC surpluses.

Influences on Net Worth and Debt

Operating surpluses increase net worth and generate cash…

Net worth increases by $12.5 billion from $8.6 billion to $21.1 billion between 1999/2000 and 2004/05. This increase mainly reflects:

- operating balances over the forecast period of $11.2 billion
- the inclusion of previously unrecognised sections of state highways of $1.7 billion.

Table 3.1 below shows how the forecast operating surpluses translate through to the Statement of Financial Position over the five-year forecast period.

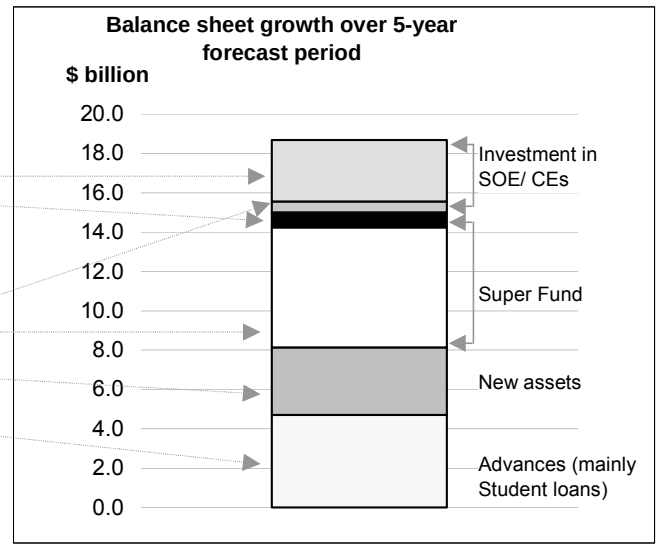
Some portions of the operating surplus are non-cash in nature, including:

- depreciation of $4.5 billion, for which a broadly equivalent amount of cash is earmarked for maintaining existing physical asset levels; offset partly by
- SOE/Crown entity net surpluses of $3.1 billion, which are retained by the SOEs and Crown entities and increase the Crown's investment in this asset
- NZS Fund returns (after tax) of $0.6 billion, which are retained by the NZS Fund, and increase the Crown's investment in this asset.

Adjusting for these items, the rising operating surplus profile generates a similar level of operating cash flows ($11.7 billion). The Crown can use this cash to either invest in assets, or repay debt.

Table 3.1 – Impact of operating surpluses on the balance sheet

	$ billion
Total Operating Balances	11.2
Add	
Depreciation	4.5
Less	
Retained net SOE/CE surplus	(3.1)
Retained NZS Fund returns	(0.6)
Other	(0.3)
Operating cash flows	11.7
Invested in	
SOE/CE net capital injections	(0.8)
NZS Fund contributions	(6.1)
Increase asset base	(3.4)
Maintain existing asset base	(4.5)
Advances	(4.7)
Other	0.1
Requiring Finance	(7.6)



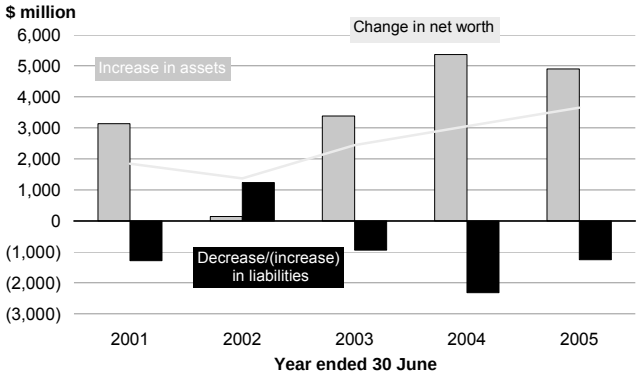
Source: The Treasury

…investment claims outweigh available cash surpluses

The Crown invests $19.3 billion cash ($7.6 billion more than its operating cash flows) over the forecast period[16]:

- maintaining and improving the existing asset base ($7.9 billion)
- investing in the NZS Fund ($6.1 billion)
- funding advances ($4.7 billion), the majority of which are student loans ($3.3 billion). The remainder ($1.4 billion) relates to refinancing Crown entity private sector debt (District health boards and Housing New Zealand).

Figure 3.9 – Assets and liabilities



Source: The Treasury

To fund the difference of $7.6 billion between operating cash flows and investment, the Crown runs down existing marketable securities and deposits (MSDs) and raises debt. The result is an increase in nominal gross debt and a decrease in MSDs.

Gross debt increases by around $4.8 billion and MSDs decrease by around $2.3 billion over the forecast horizon. The change in these financial assets and liabilities, together with other working capital movements (for example, movements in accounts payable), funds the $7.6 billion additional investment in the balance sheet.

The increase in net debt over the forecast period is lower ($2.9 billion), as net debt is not influenced by movements in advances or foreign exchange revaluations of overseas debt (which is fully hedged by movements in foreign currency denominated financial assets)[17].

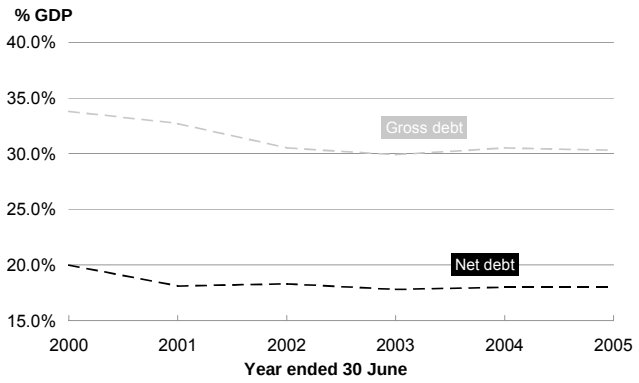
Debt falls as a percentage of GDP, before stabilising in the outyears

While both gross and net debt increase in nominal terms over the forecast period, of more relevance is how they track with growth in the economy.

The Government's debt objectives set gross and net debt constraints of 30% and 20% of GDP respectively.

Net and gross debt fall as a percentage of GDP from around 34% and 20% respectively, to around 30% and 18% by 2001/02, and remain around these levels for the rest of the forecast period.

Figure 3.10 – Gross and net debt as % of GDP



Source: The Treasury

16 The capital provisions are allocated across purchases of assets, SOE/Crown entity capital injections, and advances (see Tables 3.7 and 3.8 on page 81).

17 Table 3.9 on page 82 outlines the relationship between the operating balance and net debt in detail.

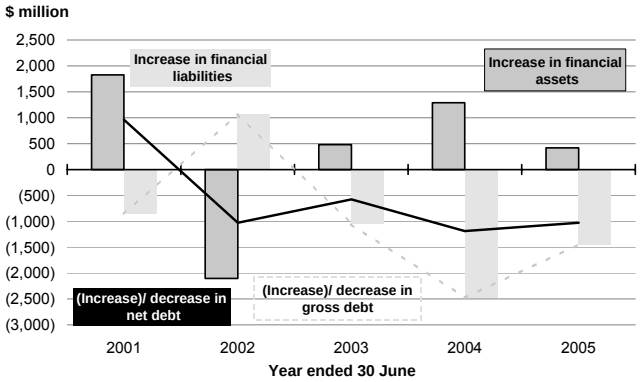
Gross and net debt tracks diverge

Generally, the key reason explaining why nominal gross debt increases relatively faster than net debt is net student loan[18] capital requirements, which average around $700 million per year.

However, there are additional factors causing the tracks to diverge over the forecast horizon:

- The bulk of the existing Housing and Health sector private sector debt refinancing takes place in 2001/02 (around $700 million) and 2003/04 (around $500 million), which only impacts on gross debt.

Figure 3.11 – Financial assets and financial liabilities



Source: The Treasury

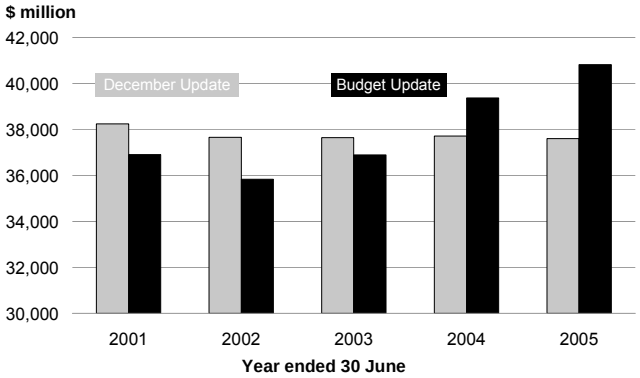
- In 2001/02, funding requirements are partially met through a decrease in holdings of MSDs, which only impacts on net debt
- 2000/01 foreign exchange losses on liabilities of around $0.5 billion only impact on gross debt (net debt neutral).

Changes in debt relative to the December Update

Both gross and net debt increase relative to the December *Update*. The key changes in funding requirements are:

- lower forecast cash generated from operating balances ($2.6 billion)
- higher forecast demand for student loans, in tandem with revised forecast requirements to fund Crown entity debt refinancing ($1.9 billion)
- increases in the capital provisions ($1 billion); partly offset by

Figure 3.12 – Gross debt comparison



Source: The Treasury

- a lower forecast NZS Fund contribution requirement in 2004/05, reflecting a change in fund asset return assumptions from the Government's cost of debt of 7% to market-based expected returns on the fund of 9% ($0.4 billion).

18 These are neutral from a net debt perspective as advances are included in the definition of "financial assets".

These funding requirement changes are partly met by a reduction in MSDs relative to the December *Update* ($1.3 billion). In addition, lower foreign exchange losses on financial liabilities impact positively on gross debt ($0.5 billion). Gross debt therefore increases by $3.2 billion over the forecast horizon.

There is a similar increase in net debt relative to the December *Update* ($3 billion).

Net debt ($ and % of GDP) is, on average, slightly higher in all years from the December *Update*.

Net debt and the domestic bond programme

The domestic bond programme for 2001/02 has been set at $3.5 billion. The bond programme finances the Crown's operating, investing and financing cash flows.

During 2001/02, the Crown will:

- repay maturing domestic bonds of around $2.6 billion
- finance operating and investing (excluding MSDs activity) cash flows of around $2.3 billion[19]
- undertake other financing activity of around $1.9 billion.

The overall funding requirement is reduced by around $3.2 billion, being a net reduction in MSDs.

[19] The $2.3 billion incorporates cash flows from operations, net purchase of physical assets, net increase in advances, net purchase of investments (essentially capital injections/(withdrawals) to SOEs and Crown entities) and the capital provision.

Fiscal Indicators – Comparison to December *Update*

Table 3.2 – Fiscal indicators – compares key fiscal information to the December *Update*

$ million, year ended 30 June	2000 Actual	2001 DEFU	2001 Budget	2002 DEFU	2002 Budget
Statement of Financial Performance					
Revenue					
Taxation revenue	34,035	35,748	36,486	38,274	37,685
Other revenue	2,491	2,405	2,715	2,419	2,311
Total Revenue	**36,526**	**38,153**	**39,201**	**40,693**	**39,996**
Ratio to GDP (%)	**34.2%**	**34.9%**	**34.8%**	**34.7%**	**34.1%**
Tax ratio to GDP (%)	**31.9%**	**32.7%**	**32.4%**	**32.7%**	**32.1%**
Expenses					
Functional expenses	33,860	35,567	35,829	36,008	36,810
Finance costs	2,373	2,527	2,484	2,588	2,395
Net foreign exchange gains	(62)	(43)	(33)	..	-
Provision for future initiatives	-	60	-	670	160
Total Expenses	**36,171**	**38,111**	**38,280**	**39,266**	**39,365**
Ratio to GDP (%)	**33.9%**	**34.9%**	**34.0%**	**33.5%**	**33.6%**
Contribution of SOEs and CEs					
Surplus attributable to SOEs and CEs	1,532	989	53	1,013	953
Dividends and other distributions	(438)	(266)	(333)	(235)	(208)
Net Contribution of SOEs and CEs	**1,094**	**723**	**(280)**	**778**	**745**
Operating Balance	**1,449**	**765**	**641**	**2,205**	**1,376**
Ratio to GDP (%)	**1.4%**	**0.7%**	**0.6%**	**1.9%**	**1.2%**
Statement of Financial Position					
Assets (excluding NZS Fund assets)	60,423	63,667	63,707	64,512	63,233
NZS Fund assets	-	-	-	613	617
Liabilities	51,840	54,317	53,126	53,570	51,893
Crown Balance (net worth)	**8,583**	**9,350**	**10,581**	**11,555**	**11,957**
Ratio to GDP (%)	**8.0%**	**8.6%**	**9.4%**	**9.9%**	**10.2%**
Statement of Borrowings					
Crown Debt					
Gross debt	36,041	38,239	36,904	37,664	35,831
less financial assets	(14,645)	(16,140)	(16,472)	(15,545)	(14,368)
Net Crown Debt	**21,396**	**22,099**	**20,432**	**22,119**	**21,463**
Net Crown debt to GDP (%)	**20.0%**	**20.2%**	**18.1%**	**18.9%**	**18.3%**
Gross debt to GDP (%)	**33.8%**	**35.0%**	**32.7%**	**32.1%**	**30.5%**
Net debt repayment/(increase)	305	(703)	964	(20)	(1,031)
Nominal GDP	106,771	109,337	112,717	117,213	117,323

Source: The Treasury

Table 3.2 – Fiscal indicators (continued)

$ million, year ended 30 June	2003 DEFU	2003 Budget	2004 DEFU	2004 Budget	2005 DEFU	2005 Budget
Statement of Financial Performance						
Revenue						
Taxation revenue	40,195	39,818	42,224	41,661	44,186	43,468
Other revenue	2,519	2,469	2,718	2,770	2,953	3,085
Total Revenue	**42,714**	**42,287**	**44,942**	**44,431**	**47,139**	**46,553**
Ratio to GDP (%)	**34.8%**	**34.2%**	**35.1%**	**34.4%**	**35.1%**	**34.6%**
Tax ratio to GDP (%)	**32.8%**	**32.2%**	**32.9%**	**32.3%**	**32.9%**	**32.3%**
Expenses						
Functional expenses	36,845	37,385	37,532	38,026	38,231	38,633
Finance costs	2,512	2,334	2,446	2,409	2,285	2,431
Net foreign exchange gains	-	-	-	-	-	-
Provision for future initiatives	1,240	955	2,040	1,855	2,840	2,755
Total Expenses	**40,597**	**40,674**	**42,018**	**42,290**	**43,356**	**43,819**
Ratio to GDP (%)	**33.1%**	**32.9%**	**32.8%**	**32.7%**	**32.3%**	**32.6%**
Contribution of SOEs and CEs						
Surplus attributable to SOEs and CEs	976	1,050	979	1,163	975	1,185
Dividends and other distributions	(264)	(222)	(281)	(247)	(283)	(267)
Net Contribution of SOEs and CEs	**712**	**828**	**698**	**916**	**692**	**918**
Operating Balance	**2,829**	**2,441**	**3,622**	**3,057**	**4,475**	**3,652**
Ratio to GDP (%)	**2.3%**	**2.0%**	**2.8%**	**2.4%**	**3.3%**	**2.7%**
Statement of Financial Position						
Assets (excluding NZS Fund assets)	66,021	65,351	67,679	68,753	68,707	70,844
NZS Fund assets	1,869	1,888	3,797	3,852	6,940	6,665
Liabilities	53,506	52,841	53,470	55,150	53,166	56,402
Crown Balance (net worth)	**14,384**	**14,398**	**18,006**	**17,455**	**22,481**	**21,107**
Ratio to GDP (%)	**11.7%**	**11.7%**	**14.0%**	**13.5%**	**16.7%**	**15.7%**
Statement of Borrowings						
Crown Debt						
Gross debt	37,641	36,887	37,714	39,368	37,608	40,815
less financial assets	(15,605)	(14,846)	(16,306)	(16,138)	(16,373)	(16,555)
Net Crown Debt	**22,036**	**22,041**	**21,408**	**23,230**	**21,235**	**24,260**
Net Crown debt to GDP (%)	**18.0%**	**17.8%**	**16.7%**	**18.0%**	**15.8%**	**18.0%**
Gross debt to GDP (%)	**30.7%**	**29.9%**	**29.4%**	**30.5%**	**28.0%**	**30.3%**
Net debt repayment/(increase)	83	(578)	628	(1,189)	173	(1,030)
Nominal GDP	122,656	123,573	128,191	129,179	134,327	134,563

Source: The Treasury

Operating Balance Excluding Revaluations and Accounting policy Changes (OBERAC)

The OBERAC is an additional fiscal indicator that strips out revaluation movements and accounting policy changes to provide a measure of underlying financial stewardship. The OBERAC is not a measure of the controllable portion of the operating balance. As such, it does not isolate aspects of the operating balance (such as tax revenue and unemployment benefits) that arise from cyclical factors.

Revaluations have significantly affected the operating balance as it is a relatively small balancing item between two large numbers: total revenue and total expenses. Revaluation effects are not forecast beyond the current year as a matter of policy given their inherent uncertainty.

The OBERAC is calculated by adjusting for the following revaluation effects (unless the revaluation is a result of a policy decision):

- Net Present Valued assets and liabilities such as the GSF pension liability, ACC outstanding claims liability and NZS Fund assets.
- Market-valued financial assets and liabilities, such as tradeable marketable securities and deposits.
- Gains or losses on sale. Selling an asset for greater (or less) than its book value is a terminal revaluation.
- Changes in accounting policy around the recognition of assets and liabilities. For example the recognition of the Public Trust reserves in 1999/2000 would be adjusted for had they met the materiality limit outlined below.

The materiality limit for adjustments is $100 million. Materiality is from a Crown-wide, rather than an individual department perspective, and applies for any one year.

The graph below indicates the extent to which the OBERAC has differed from the operating balance reported in the accounts over the past seven years.

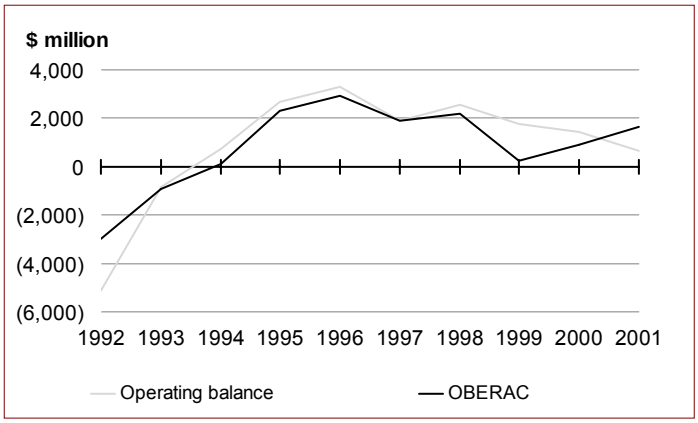


Table 3.3 – Detail of OBERAC calculation

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Operating balance	**(5,149)**	**(819)**	**755**	**2,695**	**3,314**	**1,908**	**2,534**	**1,777**	**1,449**	**641**
Adjustments										
GSF pension liability movements	420	664	111	155	226	(4)	(233)	429	(201)	462
ACC revaluation	-	-	-	-	-	-	-	-	(519)	707
Gain on sale of assets										
Contact	-	-	-	-	-	-	-	(1,421)	-	-
Airport companies	-	-	-	-	-	-	-	(204)	-	-
Hydro stations	-	-	-	-	-	-	-	(195)	-	-
Spectrum licences	-	-	-	-	-	-	-	-	-	(140)
Other sales (BNZ, TVNZ shares, etc)	-	(283)	(129)	-	-	-	-	(140)	-	-
Write-downs (Police and Defence)	-	-	-	-	-	-	-	-	155	103
(Gains)/losses on marketable securities and deposits	-	-	-	-	-	-	(110)	-	-	(123)
Unrealised forest revaluations	-	(766)	292	-	-	-	-	-	-	-
Exchange rate movements	1,764	296	(898)	(551)	(603)	-	-	-	-	-
Total adjustments	2,184	(89)	(624)	(396)	(377)	(4)	(343)	(1,531)	(565)	1,009
OBERAC	**(2,965)**	**(908)**	**131**	**2,299**	**2,937**	**1,904**	**2,191**	**246**	**884**	**1,650**

Operating Balance Changes since the December *Update*

Table 3.4 – Operating balance reconciliation (explains changes to the operating balance since the December *Update*)

$ million	2000/01 Forecast	2001/02 Forecast	2002/03 Forecast	2003/04 Forecast	2004/05 Forecast
Operating Balance *December Update*	**765**	**2,205**	**2,829**	**3,622**	**4,475**
Policy changes					
Revenue initiatives	-	85	85	85	85
Expense initiatives	(52)	(617)	(611)	(626)	(612)
Drawdown from Government's operating provisions	52	532	526	541	527
Increase in technical provisions	-	-	-	(100)	(200)
Increase in the Government's operating provisions	10	(30)	(245)	(245)	(245)
Total Policy Changes	**10**	**(30)**	**(245)**	**(345)**	**(445)**
Forecasting changes					
Tax revenue forecasting changes	738	(667)	(455)	(641)	(796)
Gain on spectrum sale	140	-	-	-	-
Other revenue changes[1]	104	(88)	(15)	79	141
Welfare benefit indexation increases	(14)	(20)	101	143	158
Welfare benefit forecasting increases	56	120	48	66	110
Valuation changes (GSF and ACC liability movements)	(1,090)	57	63	63	67
Finance expenses	43	193	178	37	(146)
Lower Transport expenses[2]	37	42	85	104	104
Defence write-down	(103)	-	-	-	-
Other	(45)	(436)	(148)	(71)	(16)
Total Forecasting Changes	**(134)**	**(799)**	**(143)**	**(220)**	**(378)**
Operating Balance - 2001 *Budget Update*	**641**	**1,376**	**2,441**	**3,057**	**3,652**

1 In 2000/01 the change includes gains on marketable securities and deposits ($103 million).

2 See transport expense footnote in the Expenses section.

Source: The Treasury

Budget Policy Decisions

This section explains changes to the Government's operating and capital provisions.

Fiscal and indicative provisions

The Government has allocated $1.11 billion of the $5.9 billion three-year fiscal provision as part of the Budget 2001 process. This is in addition to the $251 million allocated as part of the 2000 Contingency (as detailed in the December *Update*). The Government has also set aside $160 million in 2001/02 and $140 million from 2002/03 onwards as a contingency provision for further initiatives in 2001/02.

This left $550 million remaining as the 2002 Budget provision. However, the Government has decided to increase the three-year fiscal provision by $265 million to $6.125 billion. This means the revised 2002 Budget provision is $815 million.

Table 3.5 – The Government's fiscal provisions

Fiscal provisions ($m, GST inclusive)	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**Total**
Budget 2000 decisions	420	1,050	1,060	1,120	3,650
2000 contingency decisions	-	99	74	78	251
Budget 2001 decisions	-	52	532	526	1,110
2001 contingency provision	-	-	160	140	300
Budget 2002 provision	-	-	-	550	550
Increase to 2002 Budget provision	-	-	-	265	265
Total	420	1,201	1,826	2,679	6,126

Source: The Treasury

At the time of the December *Update*, the Government's three-year fiscal provision was $5.86 billion. Since the December *Update*, the provision has been increased by $265 million to $6.125 billion. This reflects:

- an underspend in the 2000 Budget ($10 million)
- an increase in the 2001 Budget ($30 million)
- an increase in the 2002 Budget ($245 million).

The forecasts also include "indicative" (previously called "technical") provisions in 2003/04 and 2004/05. Since the December *Update* these have been revised upwards $100 million to $900 million in each year.

The $1.1 billion allocated as part of Budget 2001 is summarised in the following table:

Table 3.6 – Allocation of 2001/02 fiscal provision

Budget 2001 decisions ($m, GST inclusive)	**2000/01**	**2001/02**	**2002/03**	**Total**
Revenue initiatives				
Taxation	-	(78)	(78)	(156)
Justice	-	(7)	(7)	(14)
Total revenue initiatives	-	(85)	(85)	(170)
Expense and savings initiatives				
Health	-	246	239	485
Education	-	76	131	207
Social Security and Welfare	-	87	84	171
Defence	24	45	58	127
Police	12	33	31	76
Biosecurity	3	29	30	62
Corrections	7	19	23	49
Research, Science and Technology	-	20	15	35
Inland Revenue	-	13	13	26
Conservation and Environment	-	11	14	25
Arts, Culture and Heritage	-	6	7	13
Housing	-	7	7	14
Maori Television	-	-	10	10
East Timor	-	17	-	17
Other	13	55	50	118
Social Security and Welfare	3	(22)	(76)	(95)
GSF diversification	-	(25)	(25)	(50)
Other savings	(10)	-	-	(10)
Total allocated expenses	52	617	611	1,280
Total 2001 Budget	**52**	**532**	**526**	**1,110**

Source: The Treasury

Capital Provisions

In the December *Update* the Government increased its three-year capital spending provision to $3.2 billion, of which $1,320 million remained for the 2001 and 2002 Budgets. Following the December *Update* the remaining capital provision was boosted by $135 million by the receipts from the radio spectrum auction.

As part of the 2001 Budget, the Government has allocated $578 million of capital spending. This leaves $877 million remaining in the capital spending provisions.

This provision has been re-phased over the remaining three-year period to better reflect anticipated capital spending. As a result, $200 million of the provision has been transferred to 2003/04 and 2004/05, reducing the three-year capital provision for 1999/2000 to 2002/03 to $3.0 billion.

Table 3.7 – The Government's capital provisions

Capital Provisions ($m, GST inclusive)	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**Total**
Capital provision		**1,000**	**1,100**	**1,100**	**3,200**
Budget 2000 decisions	(54)	827	576	568	1,917
December Update 2000 decisions	(15)	(58)	(4)	40	(37)
Receipts from spectrum sale	-	(135)	-	-	(135)
Budget 2001 decisions	-	5	369	204	578
Total Decisions to Date	**(69)**	**639**	**941**	**812**	**2,323**
Provision following Budget 2001 decisions	-	430	159	288	877
Re-phasing of provision	-	(430)	156	72	(202)
Remaining provision	-	-	315	360	675
Total Provision	**(69)**	**639**	**1,256**	**1,172**	**2,998**

Source: The Treasury

Capital spending in Budget 2001 (across the forecast horizon) is detailed in the table below.

Table 3.8 – Capital spending in Budget 2001

Budget 2001 Capital Decisions ($m, GST inclusive)	**2000/01**	**2001/02**	**2002/03**	**2003/04**	**2004/05**	**Total**
NZ Post banking proposal	-	78	-	-	-	78
Health - capital contributions to hospitals	(43)	57	38	154	-	206
Health - new debt funding for hospitals	-	45	100	100	-	245
Education	28	98	(28)	(31)	(33)	34
Housing	-	50	50	50	50	200
Corrections	21	30	21	4	-	76
Child, Youth and Family	-	-	23	2	-	25
RS&T - seed capital fund	-	100	-	-	-	100
Withdrawals from CRIs and SOEs	-	(100)	-	-	-	(100)
Purchase of light armoured vehicles	-	-	-	35	-	35
Other	(1)	11	-	-	-	10
Total Capital Decisions	**5**	**369**	**204**	**314**	**17**	**909**

Source: The Treasury

Table 3.9 – Relationship between the operating balance and net debt

($ million)	2000 Actual	2001 Forecast	2002 Forecast	2003 Forecast	2004 Forecast	2005 Forecast
Operating balance	1,449	641	1,376	2,441	3,057	3,652
Less/(plus) valuation items	(565)	1,009	-	-	-	-
OBERAC	884	1,650	1,376	2,441	3,057	3,652
Less NZS Fund contributions	-	-	(600)	(1,200)	(1,800)	(2,510)
Less after-tax income of the NZS Fund	-	-	(17)	(71)	(164)	(303)
Available after NZS Fund requirements	884	1,650	759	1,170	1,093	839
Decrease/(increase in net debt)	305	964	(1,031)	(578)	(1,189)	(1,030)
Difference	**(579)**	**(686)**	**(1,790)**	**(1,748)**	**(2,282)**	**(1,869)**
This difference comprises:						
Non-cash elements of the operating balance						
SOE/CE retained surplus net of dividends (excluding valuation issues)	(575)	(427)	(745)	(828)	(916)	(918)
Depreciation	791	856	879	909	921	926
(Gain)/loss on sale of assets	(7)	3	-	-	-	-
Commercial forests and net FX movements	(66)	(33)	-	-	-	-
Other one-off non-cash items	155	103	-	-	-	-
Student loan influences	(16)	(71)	(99)	(103)	(110)	(111)
Cash elements not in the operating balance						
Circulating currency	275	334	-	-	-	-
Net purchase of physical assets including capital contingency provision	(910)	(1,217)	(1,512)	(1,557)	(1,941)	(1,696)
Asset sale receipts	-	204	-	-	-	-
Net capital injections	(130)	(119)	(294)	(163)	(207)	(38)
Other working capital movements	(96)	(319)	(19)	(6)	(29)	(32)
	(579)	**(686)**	**(1,790)**	**(1,748)**	**(2,282)**	**(1,869)**

Source: The Treasury