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' and Crown entities' surpluses
- net worth and debt, including the relation between the operating balance and net worth and debt, and details of revisions to the 2001/02 and 2002/03 bond programme.

Each section starts with a summary table of the relevant indicators under the current presentation of the Crown forecasts and how, in future, they will look under the full consolidation of SOEs and Crown entities. A detailed section is provided at the end of the chapter (pages 97 to 105) that outlines how the Crown financial statements presentation is changing, what the impacts will be, and what drives the change in each of the key fiscal indicators.

In this time of transition, the discussion in the body of this chapter is based on the existing presentation of the forecasts.

Following the main body of the chapter are technical tables and information including fiscal indicators, a reconciliation of the operating balance since the *December Update*, the Government's budget decisions, a box on the Crown's investment in Air New Zealand, and the NZS Fund assumptions. Further detailed tables are also provided on the Treasury's website.[11]

11 These tables include expense tables that cover a longer time period than those within this chapter and details of the OBERAC calculation.

Tax Revenue

Table 3.1 – Tax and sovereign revenue indicators

Taxation and total sovereign revenue (% of GDP)	2001 Actual	2002 Forecast	2003 Forecast	2004 Forecast	2005 Forecast	2006 Forecast
Taxation revenue						
Current presentation	32.2%	31.9%	32.1%	32.1%	32.1%	31.9%
Future presentation of Core Crown	30.7%	30.3%	30.5%	30.4%	30.4%	30.2%
Future presentation of Total Crown	30.4%	30.1%	30.3%	30.1%	30.1%	29.9%
Total sovereign revenue (taxation plus other fees, fines and levies)						
Current presentation	32.5%	32.3%	32.5%	32.4%	32.4%	32.2%
Future presentation of Total Crown	32.4%	32.2%	32.3%	32.1%	32.0%	31.8%

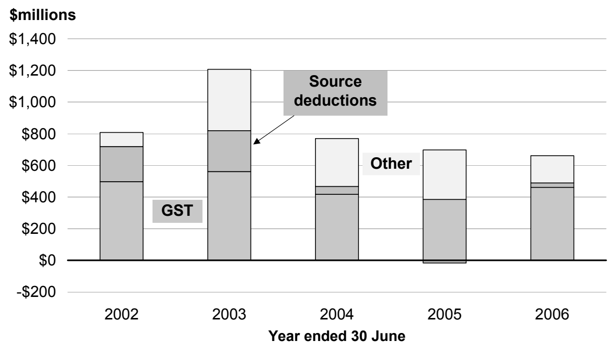
Source: The Treasury

Treasury forecasts have improved since the December Update*…*

The total tax forecasts have been increased by at least $600 million in each year compared with the *December Update*, with the biggest forecast increase of around $1.2 billion occurring in 2002/03. The changes primarily comprise:

- increases to the GST forecasts in the order of $400 million to $500 million
- increases to the source deductions' forecasts of around $200 million in 2001/02 and 2002/03
- additional tax revenue resulting from revenue initiatives such as the Transport package and improved IRD audit coverage.

Figure 3.1 – Changes since *December Update*



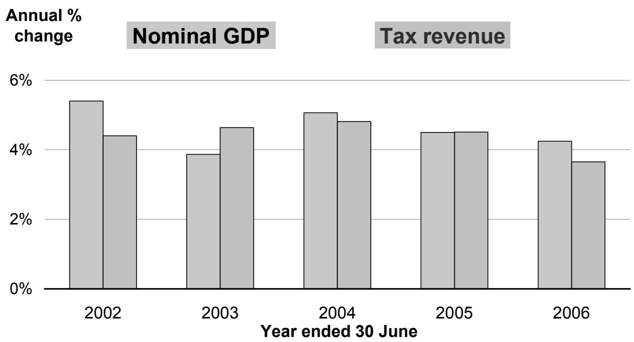
Source: The Treasury

Ignoring the effects of the revenue initiatives, the increases to the forecast broadly represent an unwinding of the downward revisions of the *December Update* plus a significant increase to the GST forecast for 2001/02.

…broadly tracking GDP through the forecast period.

Consistent with the last two forecast updates, tax revenue growth is forecast to be slightly below nominal economic growth for 2001/02. While the two largest tax types, source deductions and GST, are growing strongly, aggregate tax growth is moderated by the unwinding of the strong growth in business taxes in 2000/01.

Figure 3.2 – Tax Revenue and GDP



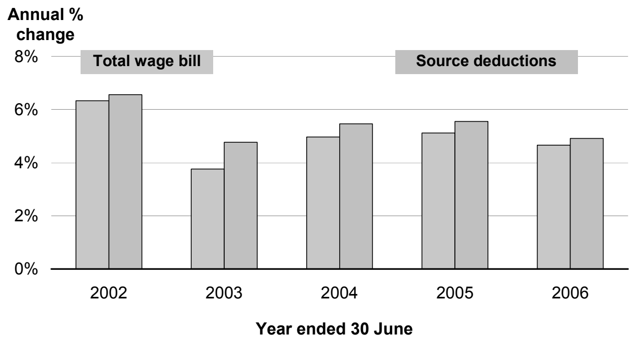
Source: The Treasury

Tax revenue growth accelerates in 2002/03 as corporate taxes start to grow again. Thereafter, tax growth is similar to economic growth, although the growth is not uniform across all tax types.

Income growth drives source deductions…

Source deductions (mainly PAYE) are forecast to grow slightly ahead of growth in the underlying wage bill, chiefly a result of the progressivity of the personal income tax scale. The current robust growth in the labour market is pushing source deductions up by more than 6% in 2001/02. Income growth slows a little in later years so that source deductions' growth drops to around 5% for 2002/03 and later years.

Figure 3.3 – Source deductions and wage bill

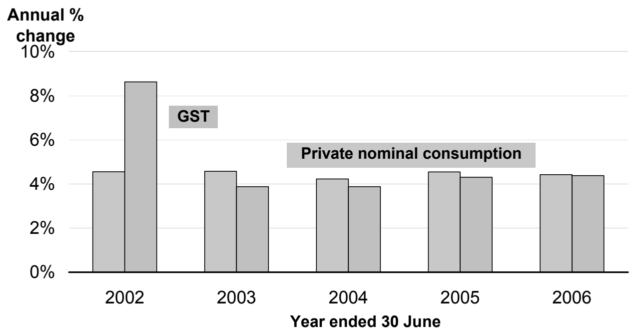


Source: The Treasury

…and flows through to GST

The large growth in the wage bill is putting more money into the pockets of New Zealanders. This is fuelling strong growth in spending which, in turn, translates into growth in GST. It is now expected to grow by more than 8% in 2001/02, after a relatively slow start to the year. A tailing off in income growth results in more modest GST growth in later years.

Figure 3.4 – GST and consumption



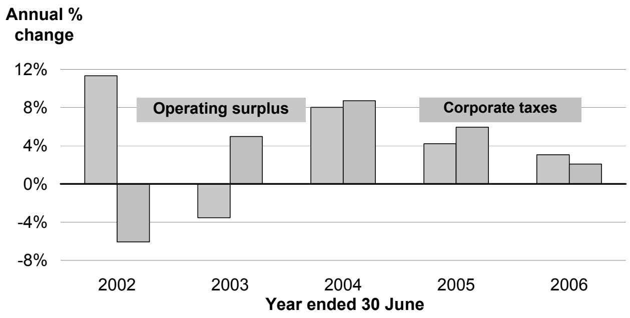
Source: The Treasury

GST outturns in recent months have been unusually high, especially in April. The forecasts of GST incorporate judgements around how much of this growth is due to one-off factors and how much of it is genuine growth in the consumption base that will persist into later years. Not all of the recent high growth has been included in outyear forecasts so there are both upside and downside risks to the GST forecasts.

Corporate tax take reduces…

Coming off a couple of years of high growth, corporate tax is declining in 2001/02 as conditions for exporters are not quite as favourable as they were in 2000/01 and the investment sector is experiencing a prolonged period of poor returns. Growth is expected to resume in 2002/03 as the savings and investment sector rebounds off the back of a global economic recovery.

Figure 3.5 – Corporate taxes and operating surplus



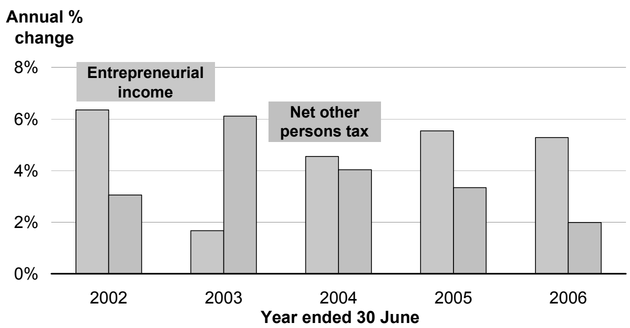
Source: The Treasury

This presents what is probably the biggest risk to the corporate tax forecast: continued poor investment returns could retard corporate tax growth. Also, there may have been some significant tax losses built up within investment funds over the last couple of years that may take some time to work their way through the tax system. On the positive side, a swifter than expected global upturn could see company profits, and hence corporate taxes, exceed expectations.

…and other business taxes are only slightly better

Growth in net other persons tax is relatively subdued for 2001/02 with the growth in terminal tax being nowhere near as high as it was in 2000/01. A continuing trend toward incorporation, as formerly self-employed taxpayers form companies in response to the 39% tax rate, is also subduing other persons tax growth in 2001/02, although it is contributing to growth in the tax paid by small companies.

Figure 3.6 – Other persons tax and entrepreneurial income



Source: The Treasury

Farm incomes have continued to grow rapidly through 2001/02, but much of the tax on this income is not expected to crystallise until 2002/03 with under-payment of tax being picked up at terminal tax time. A fall-off in returns to agriculture later in the forecast period means that other persons tax growth gradually decelerates.

Collectively, farmers make up one of the biggest groups within other persons tax. Thus, a fluctuation in farm incomes could mean that the other persons tax forecasts are either under- or over-stated. Also, as we have seen over the last couple of years, tax planning activity can have a marked effect on other persons tax. Although the tax planning environment has been addressed through legislation and enforcement activity, it still has the potential to cause some volatility in other persons tax throughout the forecast period.

Inland Revenue's tax forecasts are close to the Treasury's

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 that underpin the Treasury's tax forecasts.

In aggregate, the two sets of forecasts are close to each other in 2001/02. From 2002/03 onwards, the forecasts differ by less than $300 million each year, with the Treasury's forecasts being slightly higher than Inland Revenue's. The main area of difference is the estimate of GST. In 2003/04 and 2004/05, there are also significant differences in company income tax estimates.

The two sets of forecasts are compared in Table A.1 and A.2 on pages 193-194.

Expenses

Table 3.2 – Total expenses indicators

Total expenses (% of GDP)	**2001 Actual**	**2002 Forecast**	**2003 Forecast**	**2004 Forecast**	**2005 Forecast**	**2006 Forecast**
Current presentation	33.5%	32.5%	33.0%	32.7%	32.4%	32.3%
Future presentation of Core Crown	32.2%	31.2%	31.7%	31.4%	31.0%	30.9%
Future presentation of Total Crown	39.7%	40.3%	41.4%	41.0%	40.5%	40.3%

Source: The Treasury

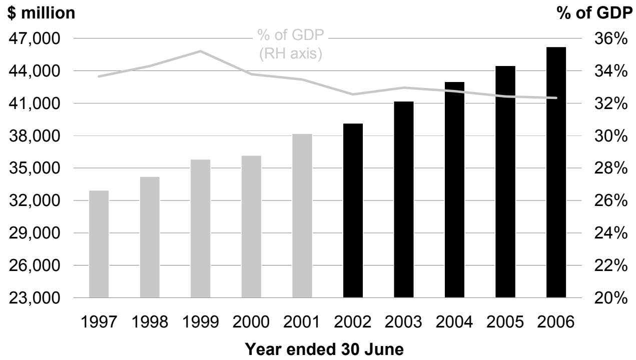
Expenses as a percentage of nominal GDP continue to trend down

Expenses fall as a percentage of GDP from 33.4% in 2000/01 to 32.3% in 2005/06.

Over the same period, nominal expenses grow by an average of 4% each year, owing to both new Budget spending and demand-driven factors. This represents an increase of around $8 billion from $38.2 billion in 2000/01 to $46.2 billion in 2005/06.

The $8 billion forecast new spending over the forecast period is made up of a number of key factors.

Figure 3.7 – Expenses ($ and % of GDP)



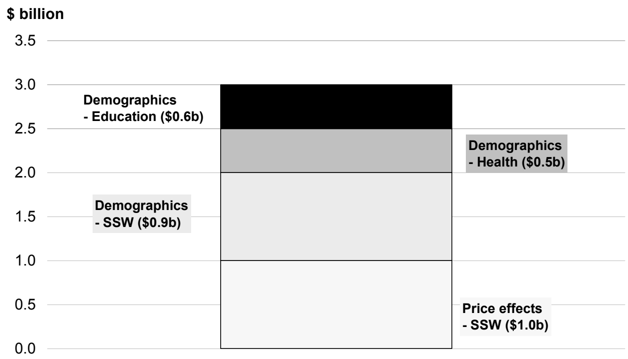
Source: The Treasury

Demand-driven factors outlined in Figure 3.8 account for around 40% ($3 billion) of the forecast increase. These factors include demographic impacts and CPI indexation of benefits.

Over the five-year forecast period:

- CPI indexation averages 1.8%, increasing benefits expenses by around $1 billion
- increases in the number of invalids beneficiaries and superannuitants of around 51,000 are the main demographic drivers for Social Security and Welfare (SSW) expenses
- demographic changes in invalids benefit and superannuation are offset by reductions in unemployment benefit.
- population ageing is the main driver for health demographics
- school and tertiary rolls increase by around 68,000. This is an increase of 43,000 on the *December Update* owing to revised population projections anticipating much higher net migration, combined with strong participation growth in the tertiary education sector. This flows through to a total extra cost of $705 million over the forecast period since the *December Update.*

Figure 3.8 – Expense increases owing to demand-driven factors 2001/02 to 2005/06



Source: The Treasury

Policy decisions already announced during the forecast period constitute 35% or $2.8 billion of the $8 billion forecast new spending.

Health ($1.6 billion), education ($500 million) and welfare ($100 million) are the main components of the $2.8 billion already committed for policy spending over the forecast period. Other key features of new Budget spending over the forecast period include:

- the transport package ($175 million), which adds to expenses relative to the *December Update* forecasts
- economic transformation initiatives ($33 million)
- paid parental leave ($41 million).

The remaining 25% ($2.2 billion) of the forecast increases in expenses is made up of forecasts for future new spending to manage future Budgets and future changes to demographic forecasts. This includes a $230 million contingency to manage risks and essential additional spending between the 2002 and 2003 Budgets.

Beyond 2002/03, expense growth will be managed using a revised provisions framework that ensures the focus is on the operating and debt tracks and their consistency with the fiscal objectives. This compares with the current focus on a set nominal limit for the electoral term.

Under current operating balance projections, the Government could accommodate core operating expense growth of around 2.5% per year. This is consistent with making contributions to the NZS Fund as planned. The forecasts reflect the amounts for forecast future new spending consistent with this approach.

SOE and Crown Entity Surpluses

Gross SOE and Crown entity surpluses ($ million)	2001 Actual	2002 Forecast	2003 Forecast	2004 Forecast	2005 Forecast	2006 Forecast
Current presentation						
Gross surplus of SOEs and Crown entities	424	1,015	984	1,284	1,408	1,560
Less dividends	(321)	(403)	(461)	(363)	(323)	(351)
Net surplus of SOEs and Crown entities	103	612	523	921	1,085	1,209
Future presentation						
Gross revenues	20,164	25,084	26,859	28,105	28,971	29,845
Gross expenses	19,740	24,069	25,875	26,821	27,563	28,285
Gross surplus of SOEs and Crown entities	424	1,015	984	1,284	1,408	1,560

Table 3.3 – Gross SOE and Crown entity surplus indicators

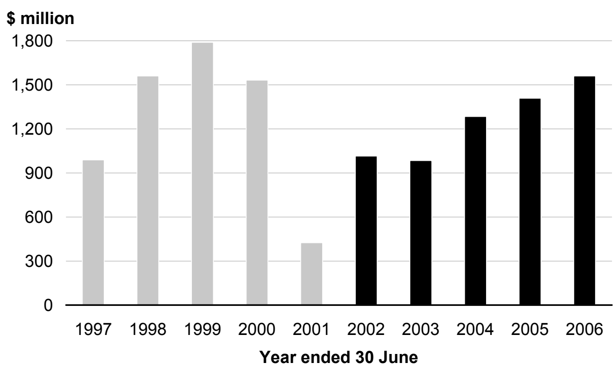
Source: The Treasury

SOE and Crown entity surpluses have generally decreased from prior years. In 2000/01, the surplus was affected by increases in the ACC outstanding claims liability ($420 million).

Gross SOE and Crown entity surpluses are around $1 billion in 2001/02, rising over the forecast period to $1.6 billion in 2005/06.

SOE and Crown entity surpluses are higher than the *December Update* forecasts. This is primarily due to two factors:

Figure 3.9 – SOEs' and Crown entities' gross surpluses



Source: The Treasury

- The forecast change in 2001/02 of the ACC outstanding claims liability is now $42 million ($205 million in the *December Update*).
- Better than expected surpluses across a number of SOEs and Crown entities in most years.

Influences on Net Worth and Debt

Table 3.4 – Balance sheet indicators

Key balance sheet indicators (% of GDP)	**2001 Actual**	**2002 Forecast**	**2003 Forecast**	**2004 Forecast**	**2005 Forecast**	**2006 Forecast**
Gross debt						
Current presentation	32.2%	30.2%	28.6%	29.2%	28.8%	28.4%
Future presentation of Core Crown	29.6%	28.9%	28.4%	29.0%	28.6%	28.2%
Future presentation of Total Crown	30.4%	31.3%	30.5%	30.2%	29.4%	28.3%
Gross sovereign-issued debt (no change)	32.2%	30.2%	28.6%	29.2%	28.8%	28.4%
Net Crown debt						
Current presentation	17.5%	16.8%	16.8%	16.8%	16.2%	15.5%
Future presentation	14.9%	15.5%	16.5%	16.6%	16.0%	15.3%
Net worth (no change)	10.0%	11.8%	13.2%	14.9%	17.2%	19.4%

Source: The Treasury

Operating surpluses increase net worth and generate cash…

Net worth increases by $16.3 billion from $11.5 billion to $27.8 billion between 2000/01 and 2005/06. This increase reflects the level of operating balances over the forecast period of around $16.2 billion.

Table 3.5 shows how the forecast operating surpluses flow through to the Statement of Financial Position over the five-year forecast period.

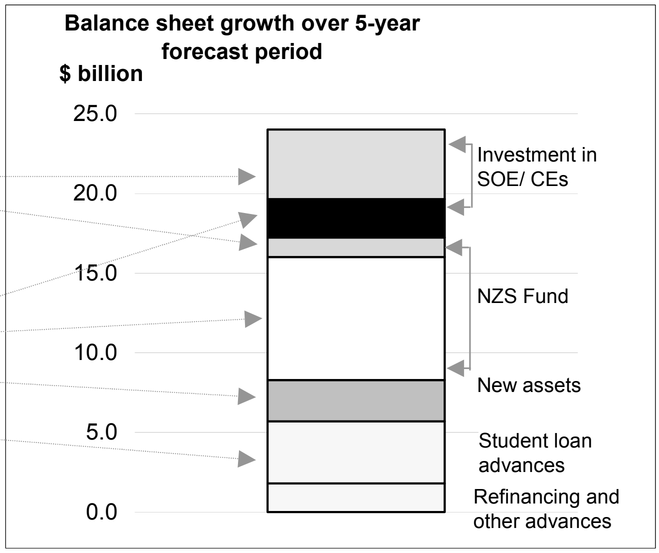
Some portions of the operating surplus are non-cash in nature, including:

- depreciation of $5.2 billion, for which a broadly equivalent amount of cash is earmarked for maintaining existing physical asset levels; offset by
- SOE and Crown entity net surpluses of $4.4 billion, which are retained by the SOEs and Crown entities and increase the Crown's investment in these entities
- NZS Fund returns (after tax) of $1.2 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 ($15.8 billion). The Crown can use this cash to either invest in assets or repay debt.

Table 3.5 – Impact of operating surpluses on the balance sheet from 2001/02 to 2005/06

	$ billion
Total operating balances	16.2
Add	
Depreciation	5.2
Less	
Retained net SOE/CE surplus	(4.4)
Retained NZS Fund returns	(1.2)
Other	(0.0)
Operating cash flows	15.8
Invested in	
SOE/CE net capital injections	(2.4)
NZS Fund contributions	(7.7)
Increase asset base	(2.6)
Maintain existing asset base	(5.2)
Advances	(6.1)
Other	-
Requiring finance	(8.3)



Source: The Treasury

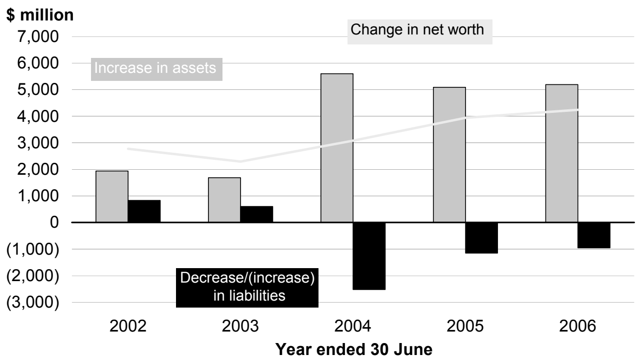
The forecast financing requirement is $8.3 billion, $2.4 billion lower than forecast in the *December Update.* This decrease is primarily due to improved operating cash flows (owing to higher operating balances) partially offset by increased debt financing requirements for hospitals.

…though investment claims outweigh available cash surpluses

The Crown invests $24.1 billion cash, $8.3 billion more than its operating cash flows over the forecast period, including[12]:

- maintaining and improving the existing asset base ($7.8 billion), providing injections ($2.4 billion) to DHBs and Air New Zealand, for example, and investing in the NZS Fund ($7.7 billion)
- funding advances ($6.1 billion). The advances comprise student loans of $3.9 billion with the remaining $2.2 billion relating to refinancing Crown entity private sector debt (DHBs and Housing New Zealand Corporation) and other miscellaneous advance activity.

Figure 3.10 – Assets and liabilities



Source: The Treasury

12 The capital provisions are allocated across purchases of assets, SOE/Crown entity capital injections, and advances (see Tables 3.12 and 3.13 on page 92).

To fund the difference of $8.3 billion between operating cash flows and investment programme requirements, existing levels of marketable securities and deposits (MSDs) will be run down by $4.8 billion and new debt of $3.9 billion will be required.

The increase in net debt over the forecast period is $2.3 billion, lower than the total funding requirement of $8.3 billion mentioned above. Net debt is not influenced by movements in advances (mainly student loans and refinancing Crown entity debt) or foreign exchange revaluations of overseas debt (which is fully hedged by movements in foreign currency denominated financial assets).

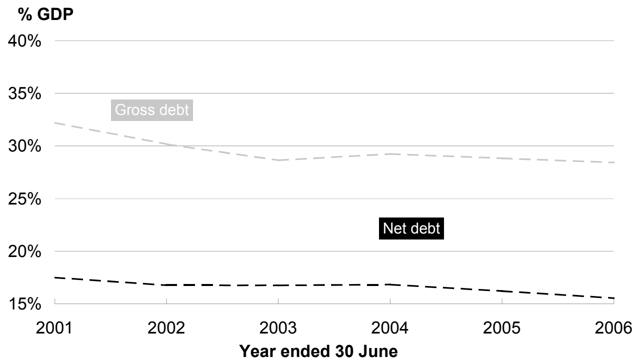
Gross debt as a percentage of GDP is consistent with the Government's long-term objective

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

The Government's long-term debt objective is established at a gross sovereign-issued debt constraint of 30% of GDP. The associated net debt indicator is 20% of GDP.

Over the period, gross debt falls as a percentage of GDP from around 32% at 30 June 2001 to 30.2% in 2001/02. Thereafter it averages around 29%, and is 28.4% by 2005/06.

Figure 3.11 – Gross and net debt as % of GDP



Source: The Treasury

For the same period, net debt averages 17% of GDP, before lowering in the last two years to 15.5% by 2005/06.

Net debt and gross debt rise slightly in the middle of the forecast period primarily owing to the timing of investments. The 2003/04 year is expected to be higher relative to other years owing to the timing of large defence purchases and higher Crown entity debt refinancing requirements.

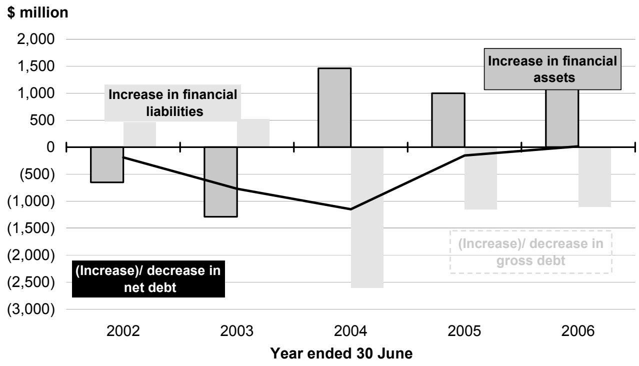
Influences on gross and net debt

Generally, nominal gross debt increases relatively faster than net debt owing to net student loan[13] capital requirements, which average around $780 million per year.

Additional factors causing the tracks to diverge over the forecast horizon include:

- the bulk of the existing housing and health sector[14] private sector debt refinancing, which takes place in 2001/02 ($625 million), 2002/03 ($285 million) and 2003/04 ($645 million), which only impacts on gross debt
- in 2001/02 and 2002/03, funding requirements are partially met through a decrease in holdings of MSDs, which only impact on net debt.

Figure 3.12 – Financial assets and financial liabilities



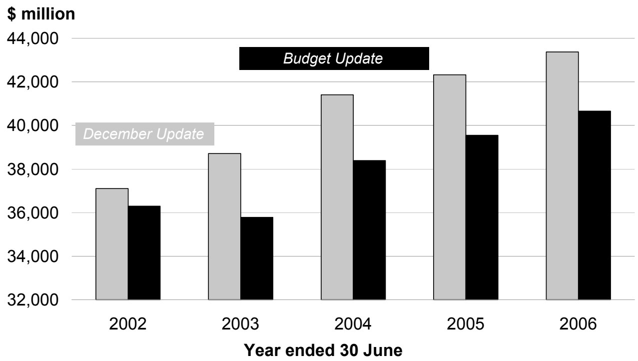
Source: The Treasury

Changes in debt relative to the December Update

Both gross and net debt decrease relative to the *December Update*. The key changes in funding requirements for the comparable period of 2001/02 to 2005/06 are:

- higher forecast cash generated from operating balances of $2.8 billion; partially offset by
- increases in investment activity ($200 million extra capital provision) and changes to forecasts of refinancing existing Crown entity debt (which only impacts on gross debt).

Figure 3.13 – Gross debt comparison



Source: The Treasury

Overall, the finance requirements are lower by $2.4 billion relative to the *December Update*.

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

14 The Crown has undertaken to refinance DHB and Housing New Zealand Corporation private sector debt with Crown-issued debt as it results in overall lower interest costs. This is a technical change that increases gross Crown-issued debt. Because it brings a financial asset onto the Crown's balance sheet, however, there is no impact on net debt.

Debt and the domestic bond programme

The 2001/02 domestic bond programme has been reduced by $350 million to $3.75 billion, as a result of forecast improvements in the Crown's cash flows. To accommodate this reduction the bond tender scheduled for 20 June 2002 has been cancelled.

The domestic bond programme for 2002/03 has been set at $3.4 billion. The bond programme finances the Crown's operating, investing and financing cash flows.

During 2002/03, the Crown will repay maturing domestic bonds of around $2.8 billion, finance operating and investing (excluding MSDs activity) cash flows of around $1.9 billion[15] and undertake other financing activity of around $1.2 billion.

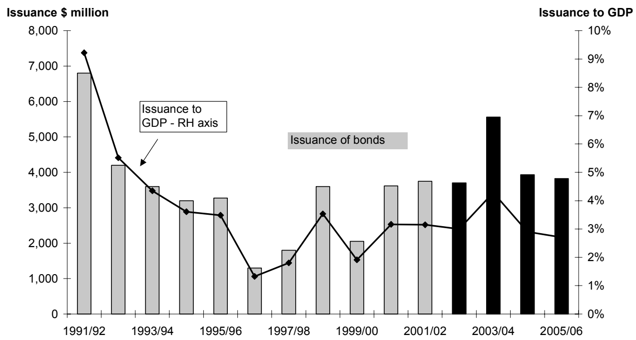
The overall funding requirement is reduced by around $2.5 billion from reductions in the Government's holdings of MSDs.

The domestic bond programme of $3.4 billion is substantially lower than the $5.1 billion forecast in the *December Update*. The change is largely a consequence of the forecast improvement in cash flows from operations, reducing the Government's financing requirement through to June 2003.

Forecast increases in the level of the domestic bond programme

The forecasts indicate a domestic bond programme of $5.6 billion is expected in 2003/04, which is somewhat larger than was experienced through most of the 1990s. This reflects the timing of planned capital spending, with the 2003/04 year expecting substantial acquisition of defence equipment and relatively higher refinancing requirements of existing Crown entity private sector debt.

Figure 3.14 – Domestic bond programme 1992 to 2006



Source: The Treasury

However, the nominal increases should be viewed in context with the relative size of the economy. Growth in the New Zealand economy means that the $5.6 billion debt programme is forecast (in 2003/04) to be much smaller relative to GDP (4.3%) than was the case in 1991/92 (9.2%) when the domestic debt programme amounted to $6.8 billion.

15 The $1.9 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.

Operating Balance Changes Since the *December Update*

Table 3.6 – Operating balance reconciliation (explains changes to the operating balance since the December Update)

($ million)	2001/02 Forecast	2002/03 Forecast	2003/04 Forecast	2004/05 Forecast	2005/06 Forecast
Operating Balance 2001 *December Update*	985	1,823	2,908	3,670	3,854
Budget decision impacts					
Revenue initiatives	50	280	296	302	306
Net expense initiatives	(43)	(594)	(790)	(752)	(761)
Drawdown from Government's operating provisions	87	220	271	273	263
Total Budget decision impacts	**94**	**(94)**	**(223)**	**(177)**	**(192)**
Other forecasting changes					
Tax revenue forecasting changes	507	804	433	343	325
Other revenue changes	97	45	80	95	79
Welfare benefit indexation increases	(3)	(39)	(118)	(104)	(54)
Welfare benefit forecasting increases	56	129	131	107	144
Valuation changes (GSF and ACC liability movements)	569	-	-	-	-
Education demographics	(51)	(124)	(150)	(177)	(203)
Finance expenses	42	(17)	83	93	69
Transport expenses	(3)	62	24	30	43
Change to SOEs and Crown entities (excluding ACC valuation change)	218	(105)	70	160	265
Other forecast changes	(125)	(276)	(160)	(103)	(88)
Total other forecasting changes	**1,307**	**479**	**393**	**444**	**580**
Operating Balance - 2002 *Budget Update*	2,386	2,208	3,078	3,937	4,242

Source: The Treasury

Explanations for key changes not covered elsewhere within this chapter include:

- Lower transport costs are due to a change in the forecast split between operating and capital spending on roading improvements (no overall cash impact as capital spending increases).
- Valuation changes mainly reflect an increase in average discount rates.

Fiscal Indicators – Comparison with *December Update*

Table 3.7 – Fiscal indicators – compares key fiscal information with the *December Update* (current presentation of forecasts)

($ million, year ended 30 June)	2001 Actual	2002 DEFU	2002 Budget	2003 DEFU	2003 Budget
Statement of Financial Performance					
Revenue					
Taxation revenue	36,738	37,571	38,377	38,978	40,141
Other revenue	2,754	2,719	2,795	2,553	2,811
Total Revenue	**39,492**	**40,290**	**41,172**	**41,531**	**42,952**
Ratio to GDP (%)	**34.6%**	**33.9%**	**34.2%**	**33.7%**	**34.4%**
Tax ratio to GDP (%)	**32.2%**	**31.6%**	**31.9%**	**31.6%**	**32.1%**
Expenses					
Functional expenses	35,750	37,186	36,781	37,775	38,618
Finance costs	2,483	2,345	2,303	2,322	2,339
Net foreign exchange gains	(47)	(18)	64	-	-
Forecast expense growth	-	90	-	450	230
Total Expenses	**38,186**	**39,603**	**39,148**	**40,547**	**41,187**
Ratio to GDP (%)	**33.5%**	**33.3%**	**32.5%**	**32.9%**	**33.0%**
Contribution of SOEs and CEs					
Surplus attributable to SOEs and CEs	424	634	1,015	1,089	984
Dividends and other distributions	(321)	(336)	(403)	(250)	(461)
Net Contribution of SOEs and CEs	**103**	**298**	**612**	**839**	**523**
Operating Balance	**1,409**	**985**	**2,636**	**1,823**	**2,288**
Ratio to GDP (%)	**1.2%**	**0.8%**	**2.2%**	**1.5%**	**1.8%**
Statement of Financial Position					
Assets (excluding NZS Fund assets)	65,081	65,934	66,421	67,817	66,816
NZS Fund assets	-	614	600	1,904	1,890
Liabilities	(53,618)	(54,106)	(52,783)	(55,456)	(52,180)
Crown Balance (net worth)	**11,463**	**12,442**	**14,238**	**14,265**	**16,526**
Ratio to GDP (%)	**10.0%**	**10.5%**	**11.8%**	**11.6%**	**13.2%**
Statement of Borrowings					
Crown Debt					
Gross debt	36,761	37,105	36,299	38,708	35,781
less financial assets	(16,790)	(15,402)	(16,137)	(15,406)	(14,846)
Net Crown Debt	**19,971**	**21,703**	**20,162**	**23,302**	**20,935**
Net Crown debt to GDP (%)	**17.5%**	**18.3%**	**16.8%**	**18.9%**	**16.8%**
Gross debt to GDP (%)	**32.2%**	**31.2%**	**30.2%**	**31.4%**	**28.6%**
Net debt repayment/(increase)	1,425	(1,732)	(1,031)	(1,599)	(773)
Nominal GDP	114,145	118,890	120,309	123,271	124,964

Source: The Treasury

Table 3.7 – Fiscal indicators (continued)

($ million, year ended 30 June)	2004 DEFU	2004 Budget	2005 DEFU	2005 Budget	2006 DEFU	2006 Budget
Statement of Financial Performance						
Revenue						
Taxation revenue	41,359	42,084	43,344	43,981	44,952	45,570
Other revenue	2,924	3,058	3,286	3,348	3,630	3,689
Total Revenue	**44,283**	**45,142**	**46,630**	**47,329**	**48,582**	**49,259**
Ratio to GDP (%)	**34.1%**	**34.4%**	**34.4%**	**34.5%**	**34.4%**	**34.4%**
Tax ratio to GDP (%)	**31.9%**	**32.1%**	**32.0%**	**32.1%**	**31.9%**	**31.9%**
Expenses						
Functional expenses	38,793	39,860	39,774	40,796	40,622	41,574
Finance costs	2,508	2,425	2,594	2,501	2,641	2,572
Net foreign exchange gains	-	-	-	-	-	-
Forecast expense growth	975	700	1,475	1,180	2,376	2,080
Total Expenses	**42,276**	**42,985**	**43,843**	**44,477**	**45,639**	**46,226**
Ratio to GDP (%)	**32.6%**	**32.7%**	**32.4%**	**32.4%**	**32.4%**	**32.3%**
Contribution of SOEs and CEs						
Surplus attributable to SOEs and CEs	1,214	1,284	1,248	1,408	1,295	1,560
Dividends and other distributions	(313)	(363)	(365)	(323)	(384)	(351)
Net Contribution of SOEs and CEs	**901**	**921**	**883**	**1,085**	**911**	**1,209**
Operating Balance	**2,908**	**3,078**	**3,670**	**3,937**	**3,854**	**4,242**
Ratio to GDP (%)	**2.2%**	**2.3%**	**2.7%**	**2.9%**	**2.7%**	**3.0%**
Statement of Financial Position						
Assets (excluding NZS Fund assets)	71,276	70,407	73,277	73,114	75,223	75,640
NZS Fund assets	3,914	3,898	6,379	6,277	9,091	8,944
Liabilities	(58,017)	(54,701)	(58,813)	(55,850)	(59,617)	(56,801)
Crown Balance (net worth)	**17,173**	**19,604**	**20,843**	**23,541**	**24,697**	**27,783**
Ratio to GDP (%)	**13.2%**	**14.9%**	**15.4%**	**17.2%**	**17.5%**	**19.4%**
Statement of Borrowings						
Crown Debt						
Gross debt	41,400	38,391	42,326	39,543	43,368	40,656
less financial assets	(16,773)	(16,304)	(17,628)	(17,299)	(18,502)	(18,426)
Net Crown Debt	**24,627**	**22,087**	**24,698**	**22,244**	**24,866**	**22,230**
Net Crown debt to GDP (%)	**19.0%**	**16.8%**	**18.2%**	**16.2%**	**17.6%**	**15.5%**
Gross debt to GDP (%)	**31.9%**	**29.2%**	**31.3%**	**28.8%**	**30.7%**	**28.4%**
Net debt repayment/(increase)	(1,325)	(1,152)	(71)	(157)	(168)	14
Nominal GDP	129,725	131,293	135,373	137,201	141,076	143,026

Source: The Treasury

Budget Policy Decisions

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

Fiscal provisions for the current term

The Government has allocated all but $230 million of the $6.1 billion three-year fiscal provision since the 2000 Budget. The remaining amount is set aside as a contingency to manage risks between the 2002 and 2003 Budgets. The table below provides a breakdown of the Government's three-year fiscal provision since 1999/2000 to 2002/03:

Table 3.8 – The Government's fiscal provisions

Fiscal provisions	**1999/2000**	**2000/01**	**2001/02**	**2002/03**	**Total**
($ million, GST inclusive)					
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 decisions	-	-	51	125	176
Budget 2002 decisions	-	-	(7)	715	707
2002 contingency provision	-	-	-	230	230
Total	**420**	**1,201**	**1,710**	**2,794**	**6,124**

Source: The Treasury

The 2001 *Budget Update* signalled an allocation of $815 million for Budget 2002. There was also a contingency of $300 million for decisions between the 2001 and 2002 Budgets (giving a total of $1,115 million available for new spending). At the time of the *December Update,* $176 million of the contingency had been committed, leaving $938 available for new spending. Budget 2002 commits $707 million of new spending over 2001/02 and 2002/03, and sets aside a contingency of $230 million for a total of $937 million.

Table 3.9 – Decisions within the $6.125 billion fiscal provision

Revenue initiatives	**1999/2000**	**2000/01**	**2001/02**	**2002/03**	**Total**
Tobacco excise increase	(20)	(110)	(78)	(82)	(290)
Improved IRD audit coverage	-	-	(78)	(183)	(261)
Cancellation of tariff reductions	-	(35)	(80)	(85)	(200)
Transport package - extra revenue	-	-	(50)	(175)	(225)
Multi-rate fringe benefit tax	-	80	65	65	210
Other revenue	-	(11)	(57)	(57)	(125)
Total revenue initiatives	**(20)**	**(76)**	**(278)**	**(517)**	**(891)**
Expense initiatives					
Health	32	158	315	779	1,284
Education	9	111	272	490	882
Increase in NZ Super rates	52	208	212	212	684
Student loan changes	32	92	103	110	337
Social Services	(2)	59	106	108	271
Police	27	64	74	106	271
Income-related rents	-	55	98	104	257
Environment/Conservation/Biosecurity	2	41	90	122	255
Changes to Housing NZ	30	79	70	70	249
Economic, Industry and Regional Development	-	37	65	111	214
Defence	-	24	62	80	166
Inland Revenue	-	36	52	77	165
Arts Culture and Heritage	55	16	22	44	137
Research Science and Technology	-	30	50	55	135
West Coast package	135	-	-	-	135
Cancellation of border charging	-	29	29	29	87
Corrections	-	14	32	40	86
Justice	5	22	19	22	68
Maori Affairs	14	19	15	15	63
Foreign Affairs/TradeNZ	-	18	16	24	58
Paid Parental Leave	-	-	1	39	40
Transport Package	-	-	50	178	228
Other initiatives	49	165	259	290	763
GSF diversification	-	-	(25)	(25)	(50)
2002 Contingency	-	-	-	230	230
Total initiatives	***440***	***1,277***	***1,988***	***3,310***	***7,015***
Total net impact on the provisions	**420**	**1,201**	**1,710**	**2,793**	**6,124**

Source: The Treasury

The $707 million allocated from the fiscal provisions as part of Budget 2002 is summarised in the following table:

Table 3.10 – Allocation of the remaining fiscal provision in the 2002 Budget

($ million, GST inclusive)	**2001/02**	**2002/03**	**Total[1]**	**2003/04**	**2004/05**	**2005/06**
Revenue initiatives						
Revenue initiatives	-	(105)	**(105)**	(118)	(120)	(120)
Transport package - extra revenue	(50)	(175)	**(225)**	(175)	(175)	(175)
Courts - extra revenue	-	-	**-**	(3)	(7)	(11)
Total revenue initiatives	(50)	(280)	**(330)**	(296)	(302)	(306)
Expenditure initiatives						
Health funding package	-	400	**400**	800	1,200	1,200
Other health spending	7	46	**53**	115	71	83
Education initiatives	7	111	**118**	189	174	176
Social Services initiatives	1	51	**51**	56	58	59
Social Services savings	(26)	(21)	**(47)**	(23)	(18)	(23)
Paid Parental Leave	1	39	**40**	41	41	41
Inland Revenue	3	28	**31**	38	40	40
Arts, Culture and Heritage	-	21	**21**	28	28	28
Environmental initiatives	1	18	**19**	23	26	32
Defence	3	23	**26**	22	19	19
Police	(8)	(3)	**(10)**	27	27	27
Research, Science and Technology	-	10	**10**	15	16	18
Courts	3	13	**16**	11	11	11
Foreign Affairs and Trade	-	12	**12**	12	12	12
Land Transport package	50	178	**228**	188	187	181
Security agencies	-	6	**6**	7	7	8
Food Safety	-	5	**5**	6	5	5
Labour	-	6	**6**	5	3	3
Corrections	-	2	**2**	2	6	6
Energy Efficiency	-	3	**3**	3	3	3
Other expenditure	-	47	**47**	24	33	30
Total expense initiatives	43	994	**1,037**	1,590	1,952	1,961
Net Impact on the provisions	**(7)**	**714**	**707**	**1,294**	**1,649**	**1,654**

Note 1: The "Total" column relates to the impact on the $6.125 billion fiscal provisions

Source: The Treasury

Capital Provisions

Table 3.11 outlines the full extent of capital spending over the current term of Government (1999/2000 to 2002/03).

Table 3.11 – The Government's capital provisions[16]

Capital provisions ($ million, GST inclusive)	1999/2000	2000/01	2001/02	2002/03
Capital provision - *December Update*	(69)	639	2,291	1,585
Budget 2000 decisions	(54)	827	576	568
December Update 2000 decisions	(15)	(58)	(4)	40
Receipts from spectrum sale	-	(135)		
Budget 2001 decisions	-	5	369	204
December Update 2001 decisions	-	-	76	27
Budget 2002 Decisions	-	-	1,151	407
Total decisions to date	(69)	639	2,168	1,246
Planned commitments pre-Budget 2002	-	-	123	339
Budget 2002 rephasing of commitments	-	-	(123)	(119)
Budget 2002 increase to forecast commitments	-	-	-	-
Forecast capital commitments	-	-	-	220
Total provision to 2002/03	**(69)**	**639**	**2,168**	**1,466**

Source: The Treasury

Since the *December Update*, the planned capital commitments have been revised. Underspends of $123 million in 2001/02 and $119 million in 2002/03 have been rephased to reflect timing of future capital demands.

16 Note that the remaining capital provision numbers do not exactly equal those contained in the fiscal forecasts owing to rounding.

Table 3.12 – Capital Spending over the current parliamentary term

Total capital spending in the current term ($ million)	**1999/2000**	**2000/01**	**2001/02**	**2002/03**	**Total**
Student loans	169	295	330	333	1,127
Air NZ (Note 1)	-	-	1,035	-	1,035
Health	(117)	73	235	379	570
Housing	-	208	143	202	553
Education	-	219	174	146	539
Corrections	-	55	70	84	209
Seed capital fund	-	-	100	-	100
Auckland rail	-	-	91	-	91
NZ Post - banking	-	-	78	-	78
Culture and Heritage	32	12	10	10	64
Parliamentary Services	-	6	11	9	26
Child, Youth and Family	-	-	-	23	23
Receipts from spectrum sale	-	(135)	-	-	(135)
Withdrawals from Crown entities	(120)	(120)	(150)	-	(390)
Other	(33)	26	41	60	94
Remaining capital provision	-	-	-	220	220
Total	**(69)**	**639**	**2,168**	**1,466**	**4,204**

Note 1 This consists of $885 million already provided and a further commitment by the Government to provide $150 million before June 2003 in a form that is appropriate for Air New Zealand's capital structure at the time required. Air NZ has indicated that it will not require the additional capital prior to 30 June 2002.

Source: The Treasury

Table 3.13 – Capital spending since the *December Update*

Budget 2002 decisions ($ million)	**2001/02**	**2002/03**	**2003/04**	**2004/05**	**2005/06**	**Total**
Education	25	148	5	6	6	191
Housing	-	42	46	51	39	178
Health	(16)	154	137	152	194	621
Justice	-	12	18	5	-	35
Partial moratorium on PTEs	-	(9)	(17)	(18)	(19)	(62)
Air NZ (Note 1)	1,035	-	-	-	-	1,035
Auckland Rail	91	-	-	-	-	91
Conservation	-	4	4	4	4	16
Other capital initiatives	16	56	1	-	-	73
Net Impact on the Capital Provisions	**1,151**	**407**	**194**	**200**	**224**	**2,177**

Note 1 This consists of $885 million already provided and a further commitment by the Government to provide $150 million before June 2003 in a form that is appropriate for Air New Zealand's capital structure at the time required. Air NZ has indicated that it will not require the additional capital prior to 30 June 2002.

Source: The Treasury

Forecast future new spending past 2002/03

In the next parliamentary term, the Government plans to revise the provisions framework to ensure the focus will be on the operating and debt tracks and their consistency with the fiscal objectives. This compares with the current focus on a set nominal limit for the electoral term.

Looking forward, the Government will balance the operating and capital components alongside NZS Fund contributions.

Under current operating balance projections, the Government could accommodate core operating expense growth of around 2.5% per year. This is consistent with making contributions to the NZS Fund as planned. The forecasts reflect amounts consistent with this approach.

In future years, the Government can accommodate capital investment of around $500 million to $600 million per year within the 30% gross debt objective.[17]

Note 5 of the forecasts contained in the GAAP tables (page 171) outlines the cumulative impact of the forecasts for future new spending.

17 This capital spending is in addition to purchases of physical assets to maintain the asset base, which averages around $1 billion per year over the next five years.

Air New Zealand: Impact on the 2002 Budget Forecasts

In January 2002 details of the Crown's recapitalisation package were finalised with Air New Zealand. The end result is an investment by the Crown of a total $892 million, resulting in an 82% stake in Air New Zealand. The Crown has also committed to provide up to $150 million in further funding before June 2003.

Goodwill Component of Acquisition Price

As was mentioned in the 2001 *December Update*, the fair value of assets and liabilities of Air New Zealand need to be consolidated onto the Crown's balance sheet with the acquisition of Air New Zealand.

The deemed acquisition date of Air New Zealand is 1 January 2002. The following table outlines the fair value of the net assets and liabilities of Air New Zealand as at 1 January 2002, calculated at 82% ownership. The difference between the fair value of $423 million and the purchase price of $892 million is goodwill on acquisition of $469 million. Goodwill on acquisition represents the amount by which the Crown's share of the value of the business exceeds the value of the individual assets and liabilities.

Balance sheet ($ million)	Air New Zealand accounts as at 31 Dec 2001 including Crown recapitalisation	Fair value adjustments	**Air New Zealand fair value of assets and liabilities**
Assets	4,083	(502)	**3,581**
Liabilities	(3,065)	-	**(3,065)**
Net assets	1,018	(502)	**516**
Crown's share @ 82%			**423**
Purchase price ($885 million injection and $7 million shares from capitalised interest on original $300 million advance)			**892**
Difference between purchase price and share of the "fair value" of Air New Zealand net assets - goodwill			**469**

The Crown is required to recognise the individual assets and liabilities of Air New Zealand at fair value (market value) at a specific point in time. This is normal acquisition accounting that is common in the private sector. The fair value adjustment made to the balance sheet of Air New Zealand (on consolidation in the Crown financial statements) reflects the market value of the aircraft fleet as at 1 January 2002. It does not mean that the balance sheet of Air New Zealand is overstated. Air New Zealand is required under FRS 3: Accounting for Property, Plant and Equipment to value its aircraft at the lower of carrying value or recoverable amount, the latter being defined as the higher of market value or value-in-use. Accordingly, Air New Zealand considers disclosure of the carrying amount of its aircraft to be appropriate.

The goodwill component of the investment is disclosed within the Crown balance sheet as part of the intangible assets classification. The rest of the investment is contained within the net investment of SOEs and Crown entities. Goodwill will be amortised over a 10-year period. This results in a $23 million (non-cash) expense in 2001/02 and $47 million in each subsequent year until goodwill is fully expensed.

The forecasts also incorporate the forecast financial performance of Air New Zealand over the forecast period.

New Zealand Superannuation Fund Contributions

Section 42 (2) of the New Zealand Superannuation Act 2001 requires that the Treasury must include in the *Budget Economic and Fiscal Update*:

- the amount of the required annual capital contribution for the financial year
- a statement of the assumptions and judgements on which the calculations are based.

Required annual contribution

The required annual contribution to the New Zealand Superannuation Fund for the year ending 30 June 2003 is $1.666 billion.

The contribution to the Fund is calculated over a 40-year rolling horizon to ensure Superannuation entitlements over the next 40 years could be met, if the contribution rate were to be held constant at that level for 40 years.

In the first three years of the Fund's operation the Government plans to build towards making the full capital contribution as calculated by the formula set out in the NZS Fund Act. This transition period will prevent undue pressure being placed on the fiscal position while structural surpluses are raised to the required levels.

$ billion (June year end)	**2002**	**2003**	**2004**	**2005**	**2006**
Required contribution	N/A	1.666	1.850	2.011	2.117
Actual contribution	0.600	1.200	1.800	2.011	2.117

Statement of assumptions

The underlying assumptions in calculating the contribution are the:

- GDP series to 2046
- New Zealand Superannuation series to 2046
- opening Fund balance ($600 million as at 1 July 2002)
- expected net after-tax annual return of the Fund (7.5%).

The GDP series was projected following the assumptions stated in the annex to the *Fiscal Strategy Report*. In calculating the required capital contribution to the NZS Fund the following explicit assumptions were made:

	2002 Budget	**2001 *December Update***	**2001 Budget**
Expected nominal bond rate	6.2%	6.2%	6.5%
Equity premium	5.0%	5.0%	-
Portfolio composition (equities)	70.0%	70.0%	-
Management fees	0.3%	0.3%	-
Expected return before tax	9.4%	9.4%	9.0%
Tax	20.0%	20.0%	33.0%
Expected return after tax	7.52%	7.52%	6.0%

There are no changes to the assumptions from the *December Update.* The Treasury website contains further information on the rate of return and calculation methods. These papers can be found at: www.treasury.govt.nz/release/super/default.asp

The Fund is subject to New Zealand tax as if it were a body corporate. The current marginal rate of tax on assessable income is 33%. However, depending on the portfolio composition and investment style, a significant proportion of the returns might not be subject to tax. In particular, capital gains on equities, particularly if held as passive investments, attract less tax than bonds. For the purpose of this calculation, an average rate of 20% is assumed.

Sensitivity

The forecasts of capital contributions for 2004/05 and 2005/06 exhibit sensitivities to the various assumptions made above as follows:[18]

Variable	**Marginal change** (%age points)	**Effect on net return after tax** (%age points)	**Effect on capital contribution ($ billion)**	
			2004/05	**2005/06**
Nominal bond rate	+1%	+0.80%	–0.176	–0.190
Equity premium	+1%	+0.56%	–0.125	–0.135
Portfolio composition (equities)	+5%	+0.20%	–0.046	–0.050
Management fees	+0.1%	-0.08%	+0.019	+0.020
Tax	+5%	-0.47%	+0.111	+0.119

These sensitivities are well within the bounds of reasonable forecasting accuracy three to four years ahead.

18 The effects shown in this table are the marginal effects (that is, all else held equal). This overstates the effects for some variables that are interdependent. For example, a portfolio with a higher weighting in equities would be likely to have a lower average tax rate.

Full line-by-line consolidation

Current Obligations on the Crown

The Public Finance Act 1989 and Fiscal Responsibility Act 1994 require the government to produce actual and forecast financial statements in accordance with generally accepted accounting practice (GAAP). This ensures that the financial statements and forecasts of the Crown are prepared on a basis familiar to readers of private sector financial statements – providing a transparent and independently established set of principles on which to measure a government's financial activity.

GAAP is Changing

GAAP is refined over time in line with international and New Zealand-specific accounting developments. While the Crown will continue to prepare consolidated financial statements the form of that consolidation will be changing to comply with forthcoming changes to GAAP.

GAAP will soon require the full line-by-line consolidation of SOEs and Crown entities (currently the accounts only consolidate the net surplus in the operating balance and net investment/net worth in the balance sheet). In addition, there are some adjustments that will impact on "core Crown" (defined below) results owing to changes to the treatment of GST on Crown spending and the treatment of the Government Superannuation Fund (GSF).

The following table outlines the presentation and how that is changing. It defines the key terms that are used throughout the Budget documents. A second table outlines how line-by-line consolidation impacts on the key fiscal indicators.

Current presentation of consolidation	**Future presentation of consolidation**
The current presentation shows: • Crown expenses and revenues with net SOE and Crown entity results • Crown assets, liabilities, net Crown debt, gross Crown debt and net worth. The Crown balance sheet only includes a net investment in SOEs and Crown entities.	The future presentation will show the three institutional forms of: • **"core Crown"** (existing information on revenues and expenses less GST on Crown expenses plus inclusion of full GSF numbers) • **SOE** revenues, expenses, assets, liabilities • **Crown entity** revenues, expenses, assets, liabilities. The sum of these three segments (less internal transactions) is the "**total Crown**". The **core Crown** is different from the current presentation owing to the removal of GST on Crown expenses and the inclusion of the full accounts of the GSF. These changes are explained in more detail in the next section.

While the presentation is changing it is important to note that the net results for the Crown will be materially the same (ie, operating balance and net worth), although the composition and total of items such as revenues, expenses, assets and liabilities will change.

Impact on presentation of fiscal indicators	
Current key fiscal indicators	**Future key fiscal indicators**
Crown revenue (revenue collected by departments)	• Core Crown revenue (Crown revenue less GST paid by Crown) • Total Crown revenue (core Crown + SOEs + Crown entities less internal transactions)
Crown expenses	• Core Crown expenses (Crown expenses less GST) • Total Crown expenses (core Crown + SOE + Crown entity expenses less internal transactions)
Operating balance	• Operating balance (no change)
Gross Crown debt	• Gross sovereign-issued debt (essentially the same as gross Crown debt)[19] • Core Crown gross debt (gross Crown debt less cross-holdings with NZS Fund and GSF) • Total Crown gross debt (core Crown gross debt + debt of SOEs and Crown entities less cross-holdings)
Net Crown debt	• Net Crown debt (same as current presentation less cross-holdings with NZS Fund and GSF)
Net worth	• Net worth (no change)

As noted in the 2002 *Fiscal Strategy Report*, full consolidation does not alter the Government's fiscal policy approach. The box on page 28 outlines how the presentation of long-term objectives changes, but it is important to note that the underlying focus does not. The focus is a mixture of core Crown and total Crown, reflecting the institutional arrangements by which the Crown is organised, and those elements over which the Government chooses to have day-to-day control, as well as the whole-of-government position.

As part of the transition to full consolidation, the GAAP tables are presented on the existing approach (refer pages 141 to 175) and also on a fully consolidated basis (refer pages 176 to 192). The fully consolidated basis contains disclosure of the "core Crown", SOEs and Crown entities segments to provide relevant information for fiscal objectives and indicators. The manner in which the fully consolidated information is presented will mean that, going forward, no information within the current presentation will be lost.

19 Sovereign-issued debt is debt issued by the New Zealand Debt Management Office (NZDMO) and will also be defined to include the Reserve Bank given it is integral to the debt management of the Crown; it will exclude debt issued by SOEs and Crown entities and any sovereign-guaranteed debt of SOEs and Crown entities. Gross sovereign-issued debt includes any New Zealand Government stock held by the GSF and NZS Fund. This is essentially the same as the current presentation of gross Crown debt.

Illustration of Changes

The following table outlines how the Crown financial statements differ from the current presentation. It highlights the changes to the headline fiscal indicators. The table has been prepared to show the Crown indicators as they are currently calculated (ie, as shown in the 2001 Crown financial statements, which is the core Crown plus equity accounting the SOEs and Crown entities) – column (A), to the new core Crown – column (B) and then to total Crown (full consolidation) – column (C). The last column is the overall change from the status quo to full consolidation.

Table 3.14 – Illustration of full consolidation on presentation of key fiscal indicators

Core Crown comparison and total Crown aggregates as a percentage of GDP as at 30 June 2001

Table may not add owing to rounding	Crown as currently disclosed (A)	Changes to core Crown only (GST removed, GSF added in)	New core Crown (B)	Changes from new core Crown to total Crown	Total Crown (full consolidation) (C)	Change between current Crown and total Crown
Revenue	**34.6%**	(1.3%)	**33.3%**	**7.6%**	**40.9%**	6.3%
Tax revenue	32.1%	(1.4%)	30.7%	1.5%	32.2%	0.1%
Expenses	**33.4%**	(1.3%)	**32.1%**	**7.5%**	**39.6%**	6.2%
Net SOEs and Crown entities	**0.1%**	(0.1%)	N/A	N/A	N/A	(0.1%)
Operating balance	**1.2%**	(0.1%)	**1.1%**	**0.1%**	**1.2%**	0.0%
Physical assets	23.8%	0.0%	23.8%	16.4%	40.2%	16.4%
Financial assets	14.7%	0.5%	15.2%	4.2%	19.4%	4.7%
Other assets	18.5%	(6.4%)	12.1%	(4.1%)	7.9%	(10.6%)
Total assets	57.0%	(6.0%)	51.0%	16.5%	67.5%	10.5%
Gross debt	**32.2%**	(2.6%)	**29.6%**	**0.7%**	**30.3%**	(1.8%)
Other liabilities	14.8%	3.1%	17.9%	9.3%	27.1%	12.4%
Total liabilities	46.9%	0.5%	47.5%	10.0%	57.5%	10.5%
Net worth	**10.0%**	(6.5%)	**3.5%**	**6.5%**	**10.0%**	(0.0%)
Gross sovereign-issued debt	**32.2%**	0.0%	**32.2%**	**0.0%**	**32.2%**	0.0%
Net Crown debt	**17.5%**	(2.6%)	**14.9%**	**N/A**	**N/A**	N/A
Net Crown debt (+ assets of NZSF&GSF)	**17.5%**	(3.0%)	**14.4%**	**(3.5%)**	**11.0%**	(6.5%)

The core Crown

The key change between the current presentation of Crown revenues and expenses and the new "core Crown" (that is, excluding SOEs and Crown entities) is that the GST on Crown spending will be removed (reducing reported tax revenues and expenses with no change to the operating balance). When preparing consolidated financial statements, transactions between entities within the group are removed. From an external viewpoint, GST is a tax paid by the Crown to itself – an internal transaction for the purposes of financial reporting. This change has the impact of lowering the presented revenue- and expense-to-GDP tracks by around 1.3%.

A second impact of the difference between the current presentation and the new "core Crown" relates to the treatment of the net liability of the GSF. At present only the net unfunded liability of the GSF is disclosed as a liability. The new consolidation requirements mean that the Crown is required to disclose the full activity of the GSF within the Crown financial statements. The material impact is on the balance sheet where the existing GSF financial assets of around $3.5 billion are added in and the total liability is also shown (an increase to pension liabilities of $3.5 billion)[20]. There is no overall impact on net worth but it does alter the net Crown debt indicator.

20 While GAAP requires the inclusion of GSF in the Crown financial statements, the financial assets of the GSF can only be used for the payment of GSF benefits, ie, they are restricted in nature (in much the same way that the assets of the NZS Fund are restricted). As such, the net assets of GSF are also excluded when calculating the net Crown debt indicator.

Total Crown – full line-by-line consolidation

The key change of full line-by-line consolidation is to include within the consolidated Crown results the line-by-line results of SOEs and Crown entities (ie, gross-up revenue, expenses, assets and liabilities). Between the current Crown financial statements and fully consolidated results there is no material change to the total operating balance and net worth. Key movements to the components of the operating balance and net worth include:

- overall gross revenues and expenses increase from the inclusion of SOE and Crown entity third party revenue (eg, ACC levies, sales of goods and services by the SOEs, Lotteries income, etc). The increase in sovereign revenue is mainly due to the inclusion of ACC levies, offset by the removal of GST revenue
- the major expense category that increases is Other Economic (many of the SOE expenses), Social Welfare (ACC payments) and Education (expenses funded from third party revenue of schools and tertiary education institutions). The following table indicates at a summary level where the expenses of the material SOEs and Crown entities are allocated. Page 182 shows function classifications of core Crown and consolidated Crown

Functional classification	**Allocation of material SOEs and Crown entities**
Social security and welfare	ACC payments, Public Trust
Health	DHBs, Crown Financing Agency (RHMU)
Education	Schools, Skill NZ, Tertiary education institutes
Core government services	Human Rights Commission, Privacy Commissioner
Law and order	Law Commission, Legal Service Agency, NZ Fire Service
Defence	None
Transport and communication	Airways, Air New Zealand, NZ Post, TVNZ, Land Transport Safety Authority, Transfund, Transit
Economic and industrial services	Genesis Power, Meridian Energy, Mighty River Power, Transpower, Solid Energy, Earthquake Commission (EQC), Foundation for Research, Science and Technology, Industry NZ, NZ Trade Development Board, NZ Tourism Board
Primary services	Landcorp, Timberlands, Agriquality NZ, Asure NZ, CRIs
Heritage, culture and recreation	Arts Council, NZ on Air, Hillary Commission, Te Papa, Radio NZ
Housing and community development	Housing NZ Corporation, Quotable Value NZ
Finance costs	Interest costs of entities with debt

- physical assets increase significantly owing to the Housing New Zealand Corporation housing portfolio, the electricity distribution and generation assets of Transpower, Meridian Energy, Mighty River Power and Genesis Power and, from 2001/02, the assets of Air New Zealand. Other assets reduce as the net investment in SOEs and Crown entities is removed
- borrowings alter by the inclusion of the debt of SOEs and Crown entities less any cross-holdings of Government stock held by ACC, EQC and other Crown entities (as it reduces further the debt of the core Crown)
- other liabilities increase largely from the inclusion of the ACC outstanding claims obligation.

The indicator of gross sovereign-issued debt is unchanged as a result of changing the presentation of the Crown financial statements. This is because gross sovereign-issued debt does not remove any cross-holdings of Government stock.

The increase in revenues and expenses is not as simple as adding existing Crown spending to all spending of SOEs and Crown entities. For example, a lot of the expenses of the core Crown go towards the provision of funding to Crown entities, for example health funding to hospitals. In a set of fully consolidated financial statements, the health expenses of the Crown are replaced with the expenses of the DHBs, so that the same expenses are not counted twice. The following table illustrates how the components of the consolidated Crown operating statement "add up" to the total Crown numbers for the 2001/02 year (pages 188 to 192 show the situation for each of the forecast years).

Forecast Statement of Financial Performance (institutional form)
for the year ended 30 June 2002

($ million)	Core Crown 2002 $m	Crown entities 2002 $m	State-owned enterprises 2002 $m	Inter-segment eliminations 2002 $m	Total Crown 2002 $m
Revenue					
Taxation revenue	36,430	-	-	(225)	36,205
Other sovereign levied income	493	2,000	-	(14)	2,479
Sales of goods and services	687	3,270	6,583	(873)	9,667
Investment income	1,303	571	31	(722)	1,183
Other revenues	613	12,252	377	(11,598)	1,644
Total revenue	**39,526**	**18,093**	**6,991**	**(13,432)**	**51,178**
Expenses by functional classification					
Social security and welfare	14,210	2,223	-	(449)	15,984
Health	7,019	5,409	-	(4,943)	7,485
Education	6,499	6,052	-	(4,366)	8,185
Other functional classifications	7,534	3,584	6,355	(2,960)	14,513
Forecast for future new spending	-	-	-	-	-
Finance costs and FX losses/(gains)	2,240	205	241	(311)	2,375
Total expenses	**37,502**	**17,473**	**6,596**	**(13,029)**	**48,542**
Operating balance	**2,024**	**620**	**395**	**(403)**	**2,636**

Table 3.15 – Components of the total Crown

Outstanding Issues

While the fully consolidated Crown forecasts shown with the Budget 2002 forecasts provide an illustration of the impending changes, there are two issues still to be worked through prior to the first audited set of Crown financial statements under line-by-line for the 30 June 2003 financial year. These issues may impact on the final form of the fully consolidated Crown forecasts and Crown financial statements. The two issues are:

- the issue of whether to consolidate tertiary education institutes (TEIs) in the Crown financial statements is not clear-cut. The Treasury and the Ministry of Education are currently working through the issue. In the interim the forecasts are continuing with the status quo of consolidating TEIs (they are currently equity accounted as agreed by the Finance and Expenditure Select Committee as part of the original decisions taken on implementing accrual accounting back in the early 1990s). Not consolidating the TEIs would have a material impact on the forecasts and Crown financial statements as TEIs currently represent an investment in excess of $2 billion

- at present the Crown financial statements record as a net liability the guarantee the Crown has provided to the DBP Annuitants Scheme. The Treasury and the Audit Office have yet to finalise a view on whether components of the National Provident Fund (if any) should be consolidated. Any change from the status quo would result in an increase to assets and liabilities. Such a change would be unlikely to be material.

Ten-Year Summary Information

To provide a summary of key indicators, the following table outlines a 10-year time series (five-year history and the forecasts). The Treasury is in the process of compiling the time series back to the start of accrual accounting in the Crown financial statements (early 1990s).

Table 3.16 – Summary of key fiscal indicators

Summary indicators (% of GDP)	1997 Actual	1998 Actual	1999 Actual	2000 Actual	2001 Actual	2002 Forecast	2003 Forecast	2004 Forecast	2005 Forecast	2006 Forecast
Revenue										
Current presentation	35.5%	35.7%	35.7%	34.1%	34.6%	34.2%	34.4%	34.4%	34.5%	34.4%
Future presentation of Core Crown	34.2%	34.3%	33.8%	32.3%	33.3%	32.9%	33.1%	33.0%	33.1%	33.1%
Future presentation of Total Crown	41.5%	42.1%	42.1%	39.7%	40.9%	42.5%	43.3%	43.3%	43.4%	43.2%
Expenses										
Current presentation	33.6%	34.3%	35.2%	33.8%	33.5%	32.5%	33.0%	32.7%	32.4%	32.3%
Future presentation of Core Crown	32.4%	32.9%	33.8%	32.3%	32.2%	31.2%	31.7%	31.4%	31.0%	30.9%
Future presentation of Total Crown	39.5%	40.0%	40.3%	38.3%	39.7%	40.3%	41.4%	41.0%	40.5%	40.3%
Operating balance										
Current presentation	1.9%	2.5%	1.7%	1.4%	1.2%	2.2%	1.8%	2.3%	2.9%	3.0%
Future presentation	1.9%	2.1%	1.7%	1.4%	1.2%	2.2%	1.8%	2.3%	2.9%	3.0%
OBERAC (no changes)	1.9%	2.2%	0.2%	0.8%	1.8%	1.9%	1.8%	2.3%	2.9%	3.0%
Gross debt										
Current presentation	36.7%	38.0%	36.1%	33.7%	32.2%	30.2%	28.6%	29.2%	28.8%	28.4%
Future presentation of Core Crown	35.0%	36.1%	33.8%	31.6%	29.6%	28.9%	28.4%	29.0%	28.6%	28.2%
Future presentation of Total Crown	37.8%	38.2%	35.2%	32.4%	30.4%	31.3%	30.5%	30.2%	29.4%	28.3%
Gross sovereign-issued debt (no change)	36.7%	38.0%	36.1%	33.7%	32.2%	30.2%	28.6%	29.2%	28.8%	28.4%
Net Crown debt										
Current presentation	25.9%	24.1%	21.3%	20.0%	17.5%	16.8%	16.8%	16.8%	16.2%	15.5%
Future presentation	24.1%	22.2%	19.1%	17.9%	14.9%	15.5%	16.5%	16.6%	16.0%	15.3%
Net worth (no change)	7.6%	9.9%	5.9%	8.0%	10.0%	11.8%	13.2%	14.9%	17.2%	19.4%
Nominal GDP ($ million)	97,933	99,790	101,761	107,064	114,145	120,309	124,964	131,293	137,201	143,026

Key interpretational points include:

- the operating balance is generally the same under the current approach and full line-by-line consolidation. There is one point of difference in the historical series. The assets of Transpower are revalued each year and devaluations currently flow through Transpower's operating result. This had been absorbed through an asset revaluation reserve in the Crown financial statements. Because Transpower's assets are a separate class of asset within the new Crown financial statements, the Crown will adopt the same treatment as Transpower in the future. The operating balance has been altered in the above historical series

- OBERAC is not impacted by the change in treatment to Transpower's annual revaluation of assets. Net worth also remains the same because while the Transpower revaluation did not impact on the Crown's operating balance it still did reduce net worth

- gross debt and net debt of the new core Crown differ from the current presentation because of the change in treatment of the GSF. Because the GSF is in the process of diversifying its Government stock holdings into other financial assets, the size of the adjustment is much smaller from 2003/04 forward. At that stage the GSF is expected to have diversified out of much of its current Government stock portfolio, making the cross-holdings with the GSF much smaller.

Explanation of Key Fiscal Indicators

Total revenue and expenses – effects of line-by-line consolidation

Total revenue

Total revenue (% of GDP)	**2001 Actual**	**2002 Forecast**	**2003 Forecast**	**2004 Forecast**	**2005 Forecast**	**2006 Forecast**
Current presentation	34.6%	34.2%	34.4%	34.4%	34.5%	34.4%
Future presentation of Core Crown	33.3%	32.9%	33.1%	33.0%	33.1%	33.1%
Future presentation of Total Crown	40.9%	42.5%	43.3%	43.3%	43.4%	43.2%

Total expenses

Total expenses (% of GDP)	**2001 Actual**	**2002 Forecast**	**2003 Forecast**	**2004 Forecast**	**2005 Forecast**	**2006 Forecast**
Current presentation	33.5%	32.5%	33.0%	32.7%	32.4%	32.3%
Future presentation of Core Crown	32.2%	31.2%	31.7%	31.4%	31.0%	30.9%
Future presentation of Total Crown	39.7%	40.3%	41.4%	41.0%	40.5%	40.3%

Over the forest period, the revenue-to-GDP ratio is reasonably stable, while the expense-to-GDP ratio is slowly declining. These trends are not changed (from 2003/04 onwards) as a result of the change to line-by-line consolidation, although there is a level change to the relevant indicators:

- The "core Crown" revenues and expenses decrease around 1.3% from the current presentation, mainly reflecting the removal of GST from Crown revenues.

- The "total Crown" revenues increase by around 10.2% on average, and "total Crown" expenses increase by around 9.4% on average. These increases reflect the inclusion of expenses of SOEs and Crown entities funded from sources (ie, revenue) other than Crown funding, less internal flows between the entities consolidated. The majority of the increase is due to the revenues/expenses of SOEs, ACC and the education sector. The level shift between from 2000/01 and 2001/02 forward is due mainly to the inclusion of Air New Zealand from 1 January 2002.

Because of the nature of the SOEs (including Air New Zealand) and those Crown entities that generate their own revenue (for example ACC levies, housing rentals, New Zealand Lotteries Commission sales, CRIs, tertiary fees, etc), the nominal revenue growth broadly mirrors the nominal GDP growth. As such the revenue-to-GDP trend of the total Crown is driven mainly from the trend in "core Crown" revenue forecasts.

The inclusion of SOE and Crown entity expenses does not represent an increase in government spending. It is simply the effect of fully recognising the underlying entities' expenses (and revenue) rather than including only their net results.

Tax revenue – effects of line-by-line consolidation

Taxation and total sovereign revenue (% of GDP)	**2001 Actual**	**2002 Forecast**	**2003 Forecast**	**2004 Forecast**	**2005 Forecast**	**2006 Forecast**
Taxation revenue						
Current presentation	32.2%	31.9%	32.1%	32.1%	32.1%	31.9%
Future presentation of Core Crown	30.7%	30.3%	30.5%	30.4%	30.4%	30.2%
Future presentation of Total Crown	30.4%	30.1%	30.3%	30.1%	30.1%	29.9%
Total sovereign revenue (taxation plus other fees, fines and levies)						
Current presentation	32.5%	32.3%	32.5%	32.4%	32.4%	32.2%
Future presentation of Total Crown	32.4%	32.2%	32.3%	32.1%	32.0%	31.8%

Two tax types are affected by line-by-line consolidation: GST and net company tax:

- The Government, via departments, SOEs and Crown entities, pays a significant amount of GST to itself, so all of this is now eliminated. This accounts for the decrease between the current presentation and the new “core Crown”.
- Company income tax paid by SOEs and several Crown entities is eliminated at the “total Crown” level and accounts for the decrease in the tax-to-GDP track between “core Crown” and “total Crown”.

If total sovereign revenue is considered (that is, tax revenue plus other sovereign-generated fees, fines and levies such as ACC levies), then the change between the current presentation and full consolidation is minimal. This is because the removal of GST, and SOE and Crown entity company income tax is broadly offset by the inclusion of Crown entity levies (eg, ACC levies, Fire Service levies, etc).

SOE and Crown entity surpluses – effects of line-by-line consolidation

Gross SOE and Crown entity surpluses ($ million)	**2001 Actual**	**2002 Forecast**	**2003 Forecast**	**2004 Forecast**	**2005 Forecast**	**2006 Forecast**
Current presentation						
Gross surplus of SOEs and Crown entities	424	1,015	984	1,284	1,408	1,560
Less dividends	(321)	(403)	(461)	(363)	(323)	(351)
Net surplus of SOEs and Crown entities	103	612	523	921	1,085	1,209
Future presentation						
Gross revenues	20,164	25,084	26,859	28,105	28,971	29,845
Gross expenses	19,740	24,069	25,875	26,821	27,563	28,285
Gross surplus of SOEs and Crown entities	424	1,015	984	1,284	1,408	1,560

Bringing SOEs and Crown entities fully into the Crown’s accounts is the biggest change under line-by-line consolidation. Their actual revenues and expenses replace the net surpluses of SOEs and Crown entities. This has no effect on the overall operating balance since the removal of the net surpluses from the accounts is matched by the changes to revenue and expenses.

The revenues and expenses of SOEs and Crown entities include revenue received in the form of Crown funding. The two largest sectors that receive Crown funding are the health and education sectors. The growth in revenues and expenses of SOEs and Crown entities reflects both the growth due to the nominal economy and increased funding provided by the core Crown to Crown entities (reflected in core Crown expense growth).

Net worth and debt – effects of line-by-line consolidation

The components of the balance sheet under line-by-line consolidation do change significantly, though there is no overall change to net worth as assets and liabilities increase by equal amounts.

Key indicators in terms of change from the existing presentation are shown in the following table:

Key balance sheet indicators (% of GDP)	**2001 Actual**	**2002 Forecast**	**2003 Forecast**	**2004 Forecast**	**2005 Forecast**	**2006 Forecast**
Gross debt						
Current presentation	32.2%	30.2%	28.6%	29.2%	28.8%	28.4%
Future presentation of Core Crown	29.6%	28.9%	28.4%	29.0%	28.6%	28.2%
Future presentation of Total Crown	30.4%	31.3%	30.5%	30.2%	29.4%	28.3%
Gross sovereign-issued debt (no change)	32.2%	30.2%	28.6%	29.2%	28.8%	28.4%
Net Crown debt						
Current presentation	17.5%	16.8%	16.8%	16.8%	16.2%	15.5%
Future presentation	14.9%	15.5%	16.5%	16.6%	16.0%	15.3%
Net worth (no change)	10.0%	11.8%	13.2%	14.9%	17.2%	19.4%

Broadly, there is currently little change in the presented debt results. This reflects the current debt positions and cross-holdings of Government stock:

- The new core Crown debt indicator changes because of the impact of the GSF. Even though the assets of the GSF are excluded from net debt (for the same reasons as the assets of the NZS Fund, ie, restricted in their purpose) the removal of cross-holdings of Government stock impacts on the level of gross debt. This impact is muted across the forecast period as the GSF diversifies out of Government stock (resulting in a smaller adjustment across the latter half of the forecast period).
- Total Crown debt indicators are impacted by the inclusion of the financial assets and debt of SOEs and Crown entities less internal-cross holdings.
- Gross sovereign-issued debt is an indicator that does not eliminate cross-holdings of Government stock and so is the same amount irrespective of consolidation approach.
- Net worth does not alter between the current presentation and fully consolidated Crown presentation.