THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Preparing a Budget Policy Statement

Date:	24 November 2008	**Report No:**	T2008/2187

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Note** our proposed approach to take with the 2009 *Budget Policy Statement*. **Discuss** this approach with Treasury officials.	Discussion with Treasury officials early in the week of 24-28 November 2008.

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Mark Sowden	Manager, Macro Policy	[deleted – privacy]		✓
Warwick Terry	Principal Advisor, Productivity and Innovation	[deleted – privacy]		For queries on the draft economic strategy

Minister of Finance's Office Actions (if required)

None.

Enclosure: **No**

24 November 2008

Treasury Report: Preparing a Budget Policy Statement

Executive Summary

You have indicated that you wish to publish a *Budget Policy Statement* (BPS) prior to Christmas, accompanied by an updated set of economic and fiscal forecasts.

This report sets out **our thinking about the approach to take with the BPS**. We are keen to engage with you on this approach to hear your views on it. Our suggested approach would involve the following components:

1. Broad strategic priorities:

    - Outlining an economic strategy that focuses on lifting productivity to drive medium-term growth; and

    - Signalling particular policy priorities that you would wish to advance through Budget 2009, such as personal tax reductions.

2. Fiscal strategy:

    - Acknowledging that the updated fiscal forecasts and projections are not consistent with the long-term objectives set out in the 2008 *Fiscal Strategy Report* (FSR);

    - Stating that the fiscal forecasts and projections as they stand are not acceptable, and that the government will be working to address this; and

    - Rather than revising the long-term objectives now, (a) stating that the long-term objectives will be revised in the 2009 FSR and (b) signalling a commitment to low levels of government debt in the medium term.

This approach would meet legislative reporting requirements. In our view, the approach would strike an appropriate balance in terms of being specific enough to give certainty to the public and markets about your intentions, while allowing you to take time to make sure that you get your fiscal objectives and fiscal strategy right.

This report also sets out some **broad approaches that you could take to address the projections of high government debt**. We would be keen to discuss these approaches with you, though decisions are not needed for the BPS. Briefly, the approaches include:

- Reducing the $1.75 billion allowances for new spending/revenue initiatives in future budgets;

- Identifying savings opportunities from within baselines through value for money reviews and using at least some of these to reduce debt (rather than to fund other spending);

- Using any savings from terminating low value programmes to reduce debt (Treasury has prepared a list of options should you wish to look at these programmes); and

- Looking to improvements in economic growth, which would bring in more tax revenue (which could be used to reduce debt) and improve the debt-to-GDP ratio.

Accompanying this, the report gives an illustrative sense of the scale of change that would be required to get debt projections back to more prudent levels.

From here, we would welcome a discussion with you to hear your views and take this work forward. We are also in the process of drafting a Cabinet paper on budget strategy and the BPS for you to take to Cabinet on Monday 8 December. We will have a draft of this Cabinet paper to you by Tuesday 2 December.

Recommended Action

We recommend that you:

a **note** that you have indicated that you wish to publish the 2009 BPS prior to Christmas;

b **note** that we have developed a proposed approach to take in the BPS that would meet legislative requirements, give broad signals about your priorities and your approach to fiscal strategy, and allow time for specifics of your fiscal strategy to be developed in the lead-up to the 2009 FSR;

c **indicate** whether you are comfortable with the following:

i. The way in which we have expressed a possible **economic strategy story** for the BPS on page 6;

Agree/disagree.

ii. The potential list of **policy priorities for Budget 2009** on page 7;

Agree/disagree.

iii. The proposed approach to discussing your **fiscal strategy** (acknowledging the inconsistency with the 2008 FSR long-term objectives; signalling that the objectives will be revised in the 2009 FSR; signalling a commitment to low levels of government debt in the medium term), as set out on pages 9-10;

Agree/disagree.

iv. Our advice to include **medium-term fiscal projections** (out to 2022/23) in the BPS;

Agree/disagree.

d **note** that, as discussed last week, we are working towards getting you a draft Cabinet paper on budget strategy and the BPS by 2 December, with the paper being discussed at Cabinet on 8 December;

e **note** that going forward you will have a range of options for addressing the projections of high government debt, which we would like to engage with you on; and f **discuss** this report with Treasury officials.

Agree/disagree.

Mark Sowden
Manager, Macro Policy
for Secretary to the Treasury

Hon Bill English
Minister of Finance

Treasury Report: Preparing a Budget Policy Statement

Purpose of Report

1. You have publicly indicated that you intend to publish the BPS prior to Christmas. This is achievable. This report discusses the preparation of the BPS and sets out some of the issues you and your colleagues will need to consider.

Legislative Requirements

2. The Public Finance Act 1989, or "PFA", specifies principles of responsible fiscal management[1] and sets reporting requirements in relation to these principles. These reporting requirements include the BPS and the FSR. The FSR sets out the government's fiscal strategy and explains how that strategy accords with the principles of responsible fiscal management. The BPS sets out the broad strategic priorities for the forthcoming Budget.

3. The upcoming BPS must be published before 31 March 2009. It needs to state:

   - the **broad strategic priorities for Budget 2009**, including the overarching policy goals that will guide Budget decisions, and the areas of policy focus;

   - **how the Budget accords with the short-term intentions** in the most recent FSR or amended short-term intentions set out in the BPS (the short-term intentions indicate the government's intentions over the forecast horizon for each of the fiscal variables specified as long-term objectives);

   - **any changes to long-term objectives** from those outlined in the most recent FSR and explain how the changes objectives accord with the principles of responsible fiscal management; and

   - **any changes to short-term intentions** from those in the most recent FSR and explain how the changed intentions accord with the principles of responsible fiscal management and the long-term objectives.

4. The following two sections discuss how you could meet these legislative requirements.

Setting out Priorities for Budget 2009 and Beyond in the BPS

Setting the BPS within a broader economic strategy

5. The BPS is one of two important pre-Christmas opportunities to signal your broader economic strategy. The other is the *Speech from the Throne*. Setting an economic strategy early would have important expectation effects in the public service and amongst other stakeholders, including those in the private sector. Maintaining a tightly focused economic strategy would help to filter and channel public service ideas and efforts into areas that matter most for growth.

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[1] These principles are set out in Annex 1 of this report.

6. Accordingly, based on your publicly-stated priorities, we have drafted a **possible economic strategy story for the BPS** which would then flow through to your fiscal intentions. This is set out in the box below. We would like to discuss this with you, including how the strategy's elements could provide a credible platform for raising New Zealand's medium-term economic performance.

Possible economic strategy story for the BPS

We are currently in a challenging global economic position...

- Current financial crisis and its impact on New Zealand's growth prospects.

...but we must not lose sight of our main medium-term economic challenge

- Productivity and competitiveness context, i.e. poor, especially recently, compared with OECD.
- Need to ensure any short-term fiscal response matches medium-term growth priorities.
- Importance of raising productivity growth to drive per capita income growth.

To grow faster, our firms need more investment, stronger international connections, and we need to attract and retain skills

- Narrative on underpinnings of overall low productivity observation.
- Capital intensity situation or other empirical observations backing up the story about how we need to lift.
- Innovation in the private sector needs to lift to increase the profitable absorption and application of ideas.

So we need a tax system that better supports productivity growth...

- Our first step will be to begin a process of lowering personal income taxes.
- Over time we will look to lower and harmonise tax rates on personal income and investment.

...and we will begin lifting our investment in infrastructure to shift the flow of goods, people, and ideas for NZ up a gear

- Broadband has the potential to shorten economic distance for our firms.
- Key bottlenecks in other infrastructure that will be alleviated by further planned investment in Budget 2009.
- Short-term regulatory reform will include addressing the RMA to support this investment.

In the medium term our economic strategy will focus on reform to lift investment, private sector R&D, and skills to raise our productivity growth...

- Clear, consistent strategy driving budgets over the next three years, with the objective of raising productivity.
- Tackling barriers will take time; results will emerge over the medium to long term as a product of multiple actions across policy areas.

...to create a more business-friendly environment in New Zealand so we compete more successfully in the global economy

- Regulatory reforms and budget initiatives (e.g. more infrastructure) both necessary and complementary.
- Discussion of other policy areas that will need to be looked at over the medium term.

Particular policy priorities for Budget 2009

7. As well as signalling overarching policy goals, the BPS needs to set out the particular areas of policy focus for the forthcoming Budget. These can be expressed at a high level, or in detail, depending on your preferences.

8. This is an opportunity to communicate to the public your policy priorities for Budget 2009. It is also an opportunity to set expectations and aid prioritisation decisions that you will be taking with your colleagues over coming months.

9. We have drawn on material from your policy statements in the election campaign to pull together the following list of potential policy priorities for Budget 2009. We would like to test this first cut with you, and then work to narrow this list down and also add more specificity to particular items.

First cut at policy priorities for Budget 2009

Security and opportunity:

- Safety and security for all New Zealanders;
- An unrelenting focus on work (including reductions in personal taxation);
- Genuine support for people in need;
- An education system that helps every New Zealander climb the ladder of opportunity;
- A justice system that is tough on crime, with victims at its heart; and
- Services that are better, delivered sooner, and are more convenient.

A strong and growing economy:

- Removing and simplifying red tape;
- Reducing waste and bureaucracy;
- Getting more from existing spending;
- Smarter use of the private sector;
- Infrastructure that creates a platform for growth; and
- Preserving a balance between environmental objectives and economic growth.

Addressing the Fiscal Strategy Requirements of the BPS

The importance of fiscal strategy

10. A clear fiscal strategy can help achieve the government's wider social and economic goals, such as employment and growth. Focusing fiscal policy on the long term increases predictability and stability of fiscal policy settings, including tax rates and the provision of government services and transfer payments. This enhances private sector confidence and the ability to make long-term saving and investment decisions. In the present circumstances, a clear fiscal strategy can help provide the certainty and confidence that international investors and rating agencies are looking for.

11. A long-term focus to fiscal policy allows the Government to look through short-term variations in the fiscal position and so reduce the need to change policy settings in a way that exacerbates fluctuations in employment and output over the economic cycle. A long-term focus also encourages consideration of intergenerational fairness issues.

The previous government's fiscal strategy

12. The previous government's fiscal strategy involved strengthening the fiscal position to help manage future spending demands, particularly those arising from an ageing population. This was given effect through "pre-funding", i.e. building up assets in the New Zealand Superannuation (NZS) Fund, and maintaining government debt at prudent levels.[2]

13. This fiscal strategy was translated into the long-term fiscal objectives of keeping gross sovereign-issued debt (GSID excluding settlement cash) broadly stable at around 20% of GDP, and running operating surpluses on average over the economic cycle, sufficient to meet the contributions to the NZS Fund.

14. The PFA requires the long-term fiscal objectives to relate to a period of 10 or more years. The fiscal strategy has sought to meet the long-term fiscal objectives over a 10-year rolling horizon (so in this sense the objectives might be better described as "medium-term" objectives). This acknowledges that should the pressures on expenditure become more acute, future expenditure growth in some areas would need to slow in order to maintain debt at prudent levels and ensure that New Zealanders are no excessively taxed.

15. The long-term fiscal objectives and short-term fiscal intentions from the 2008 FSR are contained in Annex 2. The table of long-term fiscal objectives includes a second column that explains how the objectives are to be achieved in terms of the particular fiscal indicators most closely related to fiscal decision-making. Annex 3 sets out the evolution of the long-term debt objective since the first FSR was published in 1994.

Changes to the fiscal strategy and long-term objectives

16. We are looking forward to hearing your views on fiscal strategy and ensuring that we have understood your views correctly. At a high level, we understand from public comments made during the election campaign and from recent conversations with you that you intend to continue the general approach of strengthening the fiscal position to help manage future spending demands, by maintaining low levels of debt and accumulating NZS Fund assets.

17. You have a choice about when to give effect to a new fiscal strategy by publishing a full set of long-term fiscal objectives: in the BPS or in the FSR. There are countervailing factors in considering the best time for change. A change in the BPS would provide clarity and certainty to the public and markets. A change in the FSR would allow you time to make sure you get the objectives right, and to build support with Cabinet colleagues and support parties if required. There are advantages from keeping the same long-term objectives through time, so in our view it is better to take the time and make sure they fully reflect the government's fiscal and economic strategy.

18. We understand that you prefer waiting until the 2009 FSR to publish a full set of long-term fiscal objectives, but using the BPS to signal the kind of changes that you have in mind. Absent a change, this would mean that the long-term fiscal objectives published in the 2008 FSR will remain as the current objectives.

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[2] Maintaining debt at prudent levels is part of the pre-funding approach because it is the government's total balance sheet that matters. Building up assets in the NZS Fund will not help to meet future pressures if it is being offset by increasing government debt.

Consistency with principles of fiscal responsibility, fiscal objectives and intentions

19. Given the updated economic forecasts and decisions on fiscal allowances and tax reductions, the fiscal forecasts will not be consistent with the long-term fiscal objectives set out in the 2008 FSR. The BPS will need to explain how this will be addressed.

20. Past practice has been that the short-term fiscal intentions, which describe the intentions for major fiscal indicators, are updated in every BPS and FSR to reflect changes to budget allowances and the overall fiscal forecasts. Given the extent of revisions to the fiscal forecasts since the FSR, in our view it will be necessary to update the short-term fiscal intentions in the BPS.

21. Because the updated fiscal forecasts will show the government running operating deficits, the short-term intentions could be interpreted as being inconsistent with the principles of responsible fiscal management. In particular, operating deficits could be considered to be in conflict with the PFA principle requiring that once a prudent debt level is achieved, that level is maintained by ensuring that, on average, over a reasonable period of time, operating expenses do not exceed operating revenue.

22. This would trigger additional requirements under the PFA, which allows the government to depart from the principles of responsible fiscal management if the departure is temporary and if the Minister states the reason for departure, the approach that will be taken to return to the principles and the timeframe involved.

23. The PFA does not specify what constitutes a "temporary departure" from the principles or a "reasonable period of time" over which to balance the operating budget. If the BPS concentrates solely on the short-term period (through to 2012/13), as opposed to medium-term projections (see paragraphs 24-28 below), the extent of departure from the principles will be less substantive. The intent of the PFA is to require an explanation as opposed to prescribing a threshold. Nonetheless, in the absence of a large change to the view of prudent debt, persistent operating deficits would likely be in conflict with the principles.

A suggested approach to take in the BPS

24. You can formulate a response in the BPS that meets the requirements of the PFA, but that stops short of fully specifying your new fiscal objectives. This response could outline the broad approach the government intends to take, the direction of change, and the broad timeframe that it considers appropriate for achieving the principles. Such an approach could cover the following points:

    i. The fiscal outlook has deteriorated relative to *Pre-election Update*;

    ii. There is considerable uncertainty about the economic outlook, given the international financial and economic crisis;

    iii. Fiscal stimulus is in the pipeline and automatic fiscal stabilisers are operating to help buffer the economic slowdown;

    iv. The fiscal stimulus in New Zealand is at the larger end of what is being carried out internationally and country-specific considerations beyond public debt positions are relevant (e.g. external imbalances and future fiscal challenges);

    v. Many countries are encountering a similar situation and are considering an appropriate response and in some cases this includes revisiting fiscal strategies and targets;

    vi. In the current circumstances a temporary departure from the long-term fiscal objectives is appropriate. However the medium-term projections suggest a path that is not acceptable in terms of risks, rising debt servicing costs and preparation for future fiscal pressures. The government will therefore evaluate and formulate a response leading up to the 2009 FSR; and

vii. The government continues to support pre-funding some future spending demands and is committed to low levels of debt in the medium term.

Choice about whether to include medium-term fiscal projections

25. You have a choice about whether to include medium-term fiscal projections (covering the years 2013/14 to 2022/23) in either the BPS or the accompanying forecasts.

26. The PFA only requires medium-term fiscal projections to be published in the FSR. The PFA requires the FSR to explain the significant assumptions in the projections; the reasons for any differences from previous projections; the consistency of the projections with the long-term fiscal objectives; and the reasons for any departure of the projections from the objectives.

27. The Treasury included medium-term fiscal projections in the *Pre-election Update* to provide a fuller picture of the fiscal outlook. Previously, medium-term projections had been posted separately on the Treasury website at the time of the *Pre-election Update* publication.

28. The publication of medium-term fiscal projections in the *Pre-election Update,* together with the subsequent signalled worsening of the fiscal outlook, will have created an expectation of updated projections. In our view, including medium-term fiscal projections in the BPS would be beneficial in that they would help to convey the fiscal outlook and the broad extent of adjustments needed to return to particular fiscal goals.

29. However, it will be important to note, as was the case in the *Pre-election Update,* the sensitivity of the projections to the final forecast year starting point and the assumptions chosen. Decisions about the fiscal assumptions to be used in the projections are usually made as part of the FSR process. We intend to review the assumptions and projection methodology in the lead up to the 2009 FSR. As part of this process we have started preliminary discussions with external experts on the projection method and assumptions.

Addressing the Projections of Debt

30. While you do not need to specify your long-term fiscal objectives in the BPS – including stating what you see as a prudent level of government debt – we would find it helpful to start discussing this with you early. We would also like to give you a sense of the potential size of the task of reducing the projections of debt to more prudent levels. We will be looking to engage with you on this in coming months as work on the 2009 FSR gets underway.

A medium-term debt target

31. In terms of medium-term debt levels, we suggest that you ultimately target a level which balances your intentions on (i) pre-funding to meet the costs of the aging population and the need to keep low debt as a buffer against shocks, and (ii) the feasibility of the policy actions necessary to reach your target.

32. We consider a gross debt level of around 20% of GDP to be desirable should you wish to follow a pre-funding strategy. You have previously signalled you would consider a gross debt level of around 22%, which would still be consistent with a general principle of low debt as part of a pre-funding strategy and providing a buffer against unexpected events.

33. However, we also recognise that your comments indicating a 22% debt level were made in different economic and fiscal circumstances. For the FSR, you therefore need to consider whether a medium-term gross debt objective of around 22% is a feasible target given your priorities and the current economic and fiscal position.

34. As we engage with you in coming months, we would also like to consider the suite of fiscal aggregates that the government targets through its fiscal strategy. For instance, at this point in time we consider that, on balance, a net debt indicator would be preferable to the current gross debt indicator. We are also looking at whether a debt objective could be usefully supplemented by either an expenditure or a revenue objective, e.g. keeping government expenditure or revenue above/below a certain proportion of GDP. Clearly there would be linkages between the consideration of these matters and, for instance, the ACT Party's Taxpayer Rights Bill which seeks to set a cap on the growth of core Crown expenses.

Reducing projections of debt

35. We have identified four broad ways in which the government could look to address the projections of high government debt. These are:

    i. **Reducing the $1.75 billion allowances** for new spending/revenue initiatives in future budgets;

    ii. Identifying **savings opportunities from within baselines through value for money reviews** and using at least some of these to reduce debt (rather than using all of these savings to fund other priorities within the sector);

    iii. Using any **savings from terminating low value programmes** to reduce debt rather than using it to fund other priorities (Treasury has prepared a list of options should you wish to look at these programmes); and

    iv. Looking to **increases in economic growth**. This would help in several ways: it would bring in more tax revenue (which could be used to reduce debt); and it would improve the debt-to-GDP ratio by making the denominator larger. This route could be taken both from actively pursuing policies that improve economic growth, and as a source of debt reduction when you get "positive surprises" in terms of better-than-expected economic growth outturns or improvements in growth prospects.

36. In terms of increasing economic growth, we would note a couple of points. First, while increased economic growth would unambiguously improve the fiscal outlook, the fiscal gains it would deliver are tempered by linkages between government spending and economic growth. Some of these are automatic, such as NZS being indexed to average wage rates. Others are less automatic: for instance, if wages are increasing throughout the economy, the government will face pressure to pass these on to workers such as teachers and nurses. This would place pressure on the $1.75 billion allowances for future spending, which are modelled as rising by 2% per annum. (The alternative would be to look to the public sector to deliver sustained productivity gains so that the same level of services could be delivered by fewer staff. This has not proven to be easy to achieve in the past.)

37. Second, achieving a sustained increase in trend economic growth is no easy task. Treasury's medium-term fiscal model (for the years 2013/14 to 2022/23) assumes real GDP growth of 2.5% per annum. This modelling approach was adopted in 1999. There is no doubt that policies can be used to increase this rate of growth. However we would need to see strong evidence that such growth benefits could be delivered before we would look to build an increase in trend growth into our model.

38. To give you a sense of the size of changes that would be needed to bring debt back to more prudent levels, we have run some scenarios through our medium-term fiscal model. The results of these scenarios are set out below. We would be happy to discuss these with you, and/or to run further scenarios for you. The scenarios should be taken as illustrative, rather than representing any particular target or approach that we would favour.

Change	**To get gross debt back to the following by 2022/23**	
	25% of GDP	**30% of GDP**
A permanent reduction in spending (by reducing operating allowances and/or finding savings)	↓ all future $1.75 billion operating allowances by $0.3 billion	↓ all future $1.75 billion operating allowances by $0.2 billion
A "big hit" reduction in spending through Budgets 2009 and 2010 (by reducing operating allowances and/or finding savings)	↓ the $1.75 billion operating allowances for Budgets 2009 and 2010 by $1.1 billion	↓ the $1.75 billion operating allowances for Budgets 2009 and 2010 by $0.75 billion
A slightly later "big hit" reduction in spending through Budgets 2010 and 2011 (by reducing operating allowances and/or finding savings)	↓ the $1.75 billion operating allowances for Budgets 2010 and 2011 by $1.2 billion	↓ the $1.75 billion operating allowances for Budgets 2010 and 2011 by $0.8 billion

39. The scenarios above are, of course, based on a range of assumptions. In particular, we would highlight that these scenarios are based on the economic and fiscal forecasts presented to you in the week following the general election. Subsequent events will see a worsening of our final economic and fiscal forecasts; as a consequence the projections of debt will be higher and **the changes needed to bring debt back to particular levels will be larger**.

40. In our view, addressing debt will need to involve all four of the options identified in paragraph 34 above. The relative emphasis between these will be informed by your views on the following items, which we would like to discuss with you:

   i. Are you thinking about baselines when you are considering the $1.75 billion operating allowance? The allowance is a *net* amount of new spending. For instance, if baseline savings of $250 million per annum were identified, this could be spent on other priorities, and you would get $2 billion of new spending from your $1.75 billion allowance. From the perspective of advancing your priorities, this would be preferable to getting only $1.75 billion of new spending. (It would however miss an opportunity to reduce debt by banking the savings.)

   ii. Do you consider that you can deliver your economic and fiscal priorities within the $1.75 billion operating allowance and the capital allowance? (We consider this is achievable, and will provide separate advice on how this could be done.)

iii. How much of Treasury's "potential savings list' would you be interested in pursuing, on the grounds that it represents low value expenditure and it is not necessary for delivering on your priorities? (We have prepared a separate note covering how you might treat savings identified as part of implementing your tax package, and key choices around KiwiSaver and the R&D tax credit, which will help inform consideration of your fiscal strategy and tax package.)

iv. How much money do you expect to generate from your planned value for money reviews for Budgets 2010 and 2011? How do you want to balance the incentives on chief executives (i.e. letting them keep savings they identify to fund other priorities) with the desire to pay down debt?

41. Once we have had an initial engagement with you on this and got a sense of the approach that you would be interested in taking, we will start to develop a more detailed approach to reducing the debt projections.

Annex 1: The Principles of Responsible Fiscal Management

Under section 26G of the Public Finance Act 1989, the government must pursue its policy objectives in accordance with the following principles of responsible fiscal management:

a reducing total debt to prudent levels so as to provide a buffer against factors that may impact adversely on the level of total debt in the future by ensuring that, until those levels have been achieved, total operating expenses in each financial year are less than total operating revenues in the same financial year;

b once prudent levels of total debt have been achieved, maintaining those levels by ensuring that, on average, over a reasonable period of time, total operating expenses do not exceed total operating revenues;

c achieving and maintaining levels of total net worth that provide a buffer against factors that may impact adversely on total net worth in the future;

d managing prudently the fiscal risks facing the Government; and

e pursuing policies that are consistent with a reasonable degree of predictability about the level and stability of tax rates for future years.

Annex 2: Long-term Fiscal Objectives and Short-term Fiscal Intentions from the 2008 Fiscal Strategy Report

Table A1: Long-term Objectives from the 2008 FSR

<table>
<tr><th>Long-term fiscal objectives</th><th>To achieve the objectives, the Government’s high-level focus is on:</th></tr>
<tr><td>Operating balance
Operating surpluses on average over the economic cycle sufficient to meet the requirements for contributions to the NZS Fund and ensure consistency with the debt objective.</td><td rowspan="3">• Operating surpluses during the build-up phase of the NZS Fund. Our focus is on maintaining the OBEGAL excluding NZS Fund revenue at a level sufficient, on average, to meet the requirements for contributions to the NZS Fund.
• Our focus in meeting this objective is on core Crown revenues and expenses, maintaining tax-to-GDP and core Crown expenses-to-GDP around current levels.
• As set out in our revenue strategy, we will ensure tax policy decisions are consistent with the overall fiscal strategy including the Government’s long-term revenue objective.
• SOEs and Crown entities contributing to surpluses, consistent with their legislation and Government policy.</td></tr>
<tr><td>Revenue
Ensure sufficient revenue to meet the operating balance objective.</td></tr>
<tr><td>Expenses
Ensure expenses are consistent with the operating balance objective.</td></tr>
<tr><td>Debt
Manage total debt at prudent levels. Gross sovereign-issued debt broadly stable at around 20% of GDP over the next 10 years.</td><td>• Gross sovereign-issued debt-to-GDP will be broadly stable over the period ahead of the major demographic changes associated with population ageing.
• The Government is effectively targeting a level of gross sovereign-issued debt excluding the increase in debt on the Reserve Bank balance sheet as a result of the change in the liquidity management regime.
• SOEs will have debt structures that reflect best commercial practice. Changes in the level of debt will reflect specific circumstances.</td></tr>
<tr><td>Net worth
Increase net worth consistent with the operating balance objective.</td><td>• The NZS Fund will continue to accumulate assets through its retained earnings and Crown contributions.
• Consistent with the net worth objective, there will also be a focus on quality investment.</td></tr>
</table>

Table A2: Short-term Intentions from the 2008 FSR

Operating balance

Based on operating amounts for the 2008 Budget, and indicative amounts for the 2009 and 2010 Budgets, the OBEGAL excluding NZS Fund retained revenue is forecast to be 0.7% of GDP in 2008/09, decreasing to 0.1% of GDP by 2011/12. This remains consistent with the long-term objective for the operating balance.

Debt

Total debt (including Reserve Bank Settlement Cash) is forecast to be 25.9% of GDP in 2011/12.

Gross sovereign-issued debt including Settlement Cash is forecast to be 19.6% of GDP in 2011/12. Excluding Settlement Cash, gross sovereign-issued debt is forecast to be 16.8% of GDP in 2011/12.

The Government will set forecast new operating and capital spending amounts over the next three years that are consistent with the long-term objective for debt.

Expenses

Total Crown expenses are forecast to be 42.4% of GDP in 2011/12.

Core Crown expenses are forecast to average 32.9% over the forecast period and be 33.0% of GDP in 2011/12.

This assumes new operating expense amounts of $1.75 billion per annum for the 2009 Budget, $1.79 billion per annum for the 2010 Budget and $1.82 billion per annum for the 2011 Budget (GST exclusive).

Revenues

Total Crown revenues are forecast to be 42.5% of GDP in 2011/12. Within this, core Crown revenues are forecast to be 32.7% of GDP in 2011/12.

Budget 2008 introduces personal tax reductions. As a result, core Crown tax-to-GDP is forecast to decline from 31.5% in 2007/08 to 29.6% in 2011/12.

Net worth

Total Crown net worth is forecast to be 52.5% of GDP in 2011/12. Core Crown net worth is forecast to be 28.4% of GDP in 2011/12.

Annex 3: Evolution of the Long-term Debt Objective

1. The **FSR 1994** set an objective for **net debt** to be **between 20% and 30% of GDP** in order to reduce Crown debt to prudent levels, to provide a buffer against future adverse events, and to further strengthen the fiscal position prior to the increasing fiscal impact of an ageing population from 2011 onwards.

2. The **BPS 1995** changed the long-term debt objective to **net debt below 20% of GDP**. The lower bound of the range was removed recognising economic benefits from debt reduction.

3. The **FSR 1996** modified the net debt objective **steadily reduce net debt to 20% of GDP**, then further lower debt at a rate consistent with the operating balance objective. Once net debt had been reduced to 20% of GDP, the objective was to gradually reduce the operating surplus through a balanced mix of increased priority expenditure and tax reductions. In the longer term, the government would seek to maintain at least fiscal balance over the economic cycle.

4. The **BPS 1997** introduced the objective for gross debt. The new objective was to steadily reduce the level of gross Crown debt to 30% of GDP, consistent with reducing net Crown debt to 20% of GDP and then further lowering gross and net Crown debt at a rate consistent with the operating balance.

5. The **FSR 1998** modified the objectives so that the government would **reduce gross Crown debt to 25% of GDP**, consistent with reducing **net Crown debt to 15% of GDP**. Gross and net Crown debt would then be lowered at a rate consistent with the operating balance objective.

6. *The changes to objectives after 1999 reflect the evolution of the NZS Fund, accounting changes and the choice between net or gross debt. Overall, the pre-funding aspect of the fiscal strategy was strengthened through time.*

7. The initial set of long-term objectives in the **BPS 2000** emphasised the shift to a strategy of running operating surpluses to prefund the costs associated with an ageing population. Both gross and net debt were included and expressed as ceilings: **gross debt below 30% of GDP** and **net debt below 20% of GDP**.

8. The **FSR 2001** clarified the cyclical aspects of the operating and debt objectives. The role of pre-funding through asset accumulation was also made clearer. The expense objective was recast to give a sense of how pre-funding would see time-varying expenses.

9. The **BPS 2002** removed net debt from the debt objective but not from the suite of fiscal indicators considered.

10. The **FSR 2002** introduced a new set of objectives that allowed for the shift to line-by-line consolidation and the distinction between “total” and “core”. The expense objective was simplified and its numerical anchor was removed. **Gross sovereign-issued debt (GSID) replaced gross debt** as GSID does not eliminate cross-holdings of the NZSF and GSF.

11. The **FSR 2004** introduced a new debt objective which incorporated a downward trend together with a timeframe: **gross debt trending down over time and below 20% of GDP before 2015** in accordance with the forthcoming amendments to the PFA.

12. The **FSR 2006** introduced a new debt objective that shifted the focus away from reducing debt further towards ensuring that **gross debt** remains anchored **around 20% of GDP** over the next 10 years.

13. The **FSR 2007** outlined the government’s intention to look through the increase in GSID resulting from changes to the Reserve Bank’s liquidity management regime.