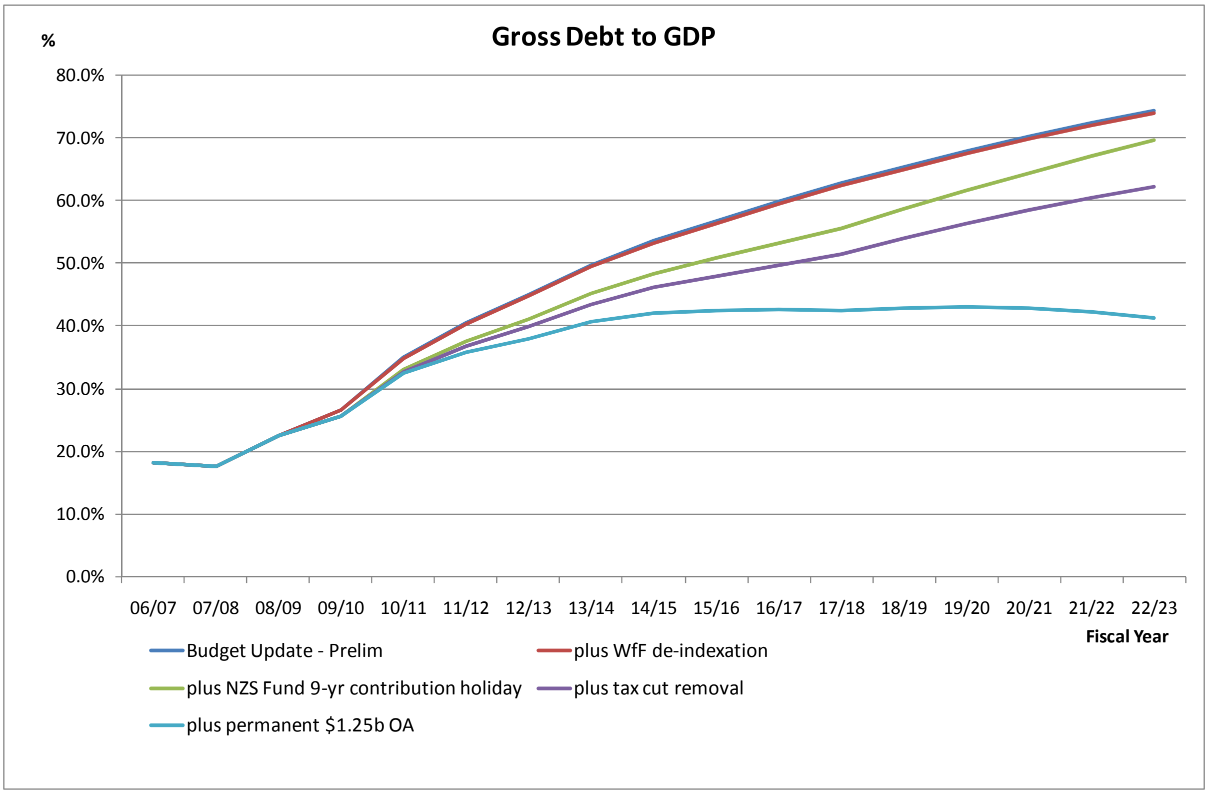
Consolidation package options

Option 1

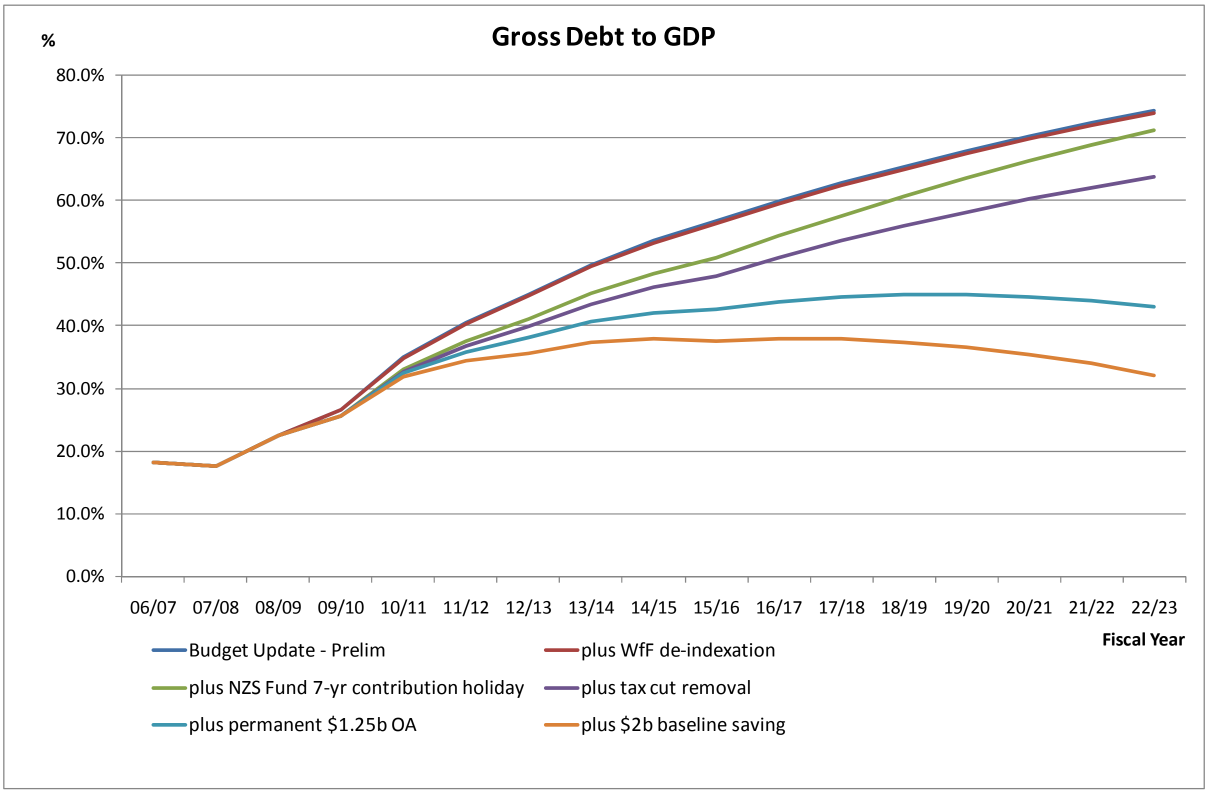


This shows the sequential impact on the preliminary gross debt to GDP track of:

- The removal of CPI indexation of the rates and thresholds of working for families, paid parental leave and childcare assistance.
- A nine-year contribution holiday from the NZS Fund, with the contributions made up by higher contributions in the future.
- The removal of the second and third tranches of the planned tax cuts in 2010 and 2011.
- A permanent change in the operating allowance from $1.75b to $1.25b from 2010/11, growing with inflation.

% of GDP in 2022/23	Prelim Budget Update	Changes to rates and thresholds	9-yr NZS Fund contribution holiday	Tax cut removal	Permanent OA reduction to $1.25b
Change in Gross debt	-	-0.3%	-4.4%	-7.5%	-20.8%
Gross debt	74.4%	74.1%	69.7%	62.2%	41.4%

Option 2



This shows the sequential impact on the preliminary gross debt to GDP track of:

- The removal of CPI indexation of the rates and thresholds of working for families, paid parental leave and childcare assistance.
- A seven-year contribution holiday from the NZS Fund, with the contributions made up by higher contributions in the future.
- The removal of the second and third tranches of the planned tax cuts in 2010 and 2011.
- A permanent change in the operating allowance from $1.75b to $1.25b from 2010/11, growing with inflation.
- A $1b baseline saving in 2010/11 and a further $0.5b baseline saving in 2011/12 and 2012/13 (the permanent removal of $2b from baselines).

% of GDP in 2022/23	Prelim Budget Update	Changes to rates and thresholds	7-yr NZS Fund contribution holiday	Tax cut removal	Permanent OA reduction to $1.25b	Baseline saving of $2b
Change in Gross debt	-	-0.3%	-2.8%	-7.5%	-20.9%	-10.7%
Gross debt	74.4%	74.1%	71.3%	63.8%	42.9%	32.2%

Details of components

Working for Families/paid parental leave/childcare assistance

Removal of CPI indexation of the rates and thresholds for Working for families, paid parental leave and childcare assistance provides the following savings:

Fiscal Year ($m)	2009/10	2010/11	2011/12	2012/13
Working for families		53	217	245
Paid parental leave	4	9	12	14
Childcare assistance	1	6	11	14
TOTAL	**5**	**68**	**240**	**273**

Beyond the forecast period (from 13/14 to 22/23) these welfare payments grow with inflation, suggesting a re-indexation to the CPI in this period.

NZS Fund contribution holiday

In this option contributions to the New Zealand Superannuation Fund are suspended for 9 or 7 years from 2009/10, starting again in 2017/18 (option 1) or 2016/17 (option 2). The contributions are suspended while the fiscal position is in deficit, and begin again when the fiscal position returns to surpluses. The contribution holiday is shorter in option 2 because the baseline cuts cause the fiscal position to return to surpluses more quickly. The contributions from these starting points will be larger than previously, to make up for the time spent not contributing to the Fund. This is determined by the Fund's contribution rate formula.

The following example illustrates the difference in contributions now and after the 9-year contribution holiday. The average contribution size from 2003 to 2008 was **$2.1b**, and after the 9-year contribution holiday they are expected be averaging **$2.7b** per year (from 2018/19 to 2023/24).

A further NZS Fund option was modelled where **$250m** was contributed to the Fund for 9 or 7 years, instead of a contribution holiday. In this option the operating allowance was also decreased to **$1.1b**, growing with inflation. This option (for both the 9 and 7 year options) increased **gross debt to GDP by approximately 2.5%** by 2022/23.

Removal of the tax cuts in 2010 and 2011

Removal of the tax cuts in 2010 saves **$550m** ongoing.

Removal of the tax cuts in 2011 (combined with the previous year's savings) saves **$950m** ongoing (this ongoing saving will grow approximately in line with nominal GDP).

The gross debt numbers have also changed significantly since the last version of this document. This is because an assumption of **fiscal drag on source deductions** until 2018/19 is being used in all scenarios, including the base scenario. Fiscal drag occurs when wages increase, as this propels more people into higher tax brackets. If tax thresholds on incomes are not changed, this will increase the amount of source deductions collected at such a rate that the tax-to-GDP ratio will increase gradually over time. This assumption causes gross to debt to GDP to fall by approximately 7.4% by the end of the projection period in 2022/23, compared to previous versions of these projections.

Reduction in the operating allowance

Reducing the operating allowance from $1.75b, growing with inflation, to $1.25b growing with inflation, saves approximately **$500m** a year, ongoing. This $500m savings increases with inflation each year as shown below:

Fiscal Year $m	2010/11	2011/12	2012/13 ….	…. 2022/23
Previous operating allowance	1785	1821	1857 ….	…. 2264
Reduced operating allowance	1250	1275	1301 …	…. 1585
Savings	**535**	**546**	**557 ….**	**…. 679**

Baseline savings

Removing $2b from baselines (over three years) removes this amount permanently, i.e. at the end of the three years you are saving $2b each year into the future. This is currently modelled as a $1b saving in 2010/11 and a further $0.5b baseline saving in both 2011/12 and 2012/13, totalling $2b over the three years. Changing the phasing of these savings between the three years (2010/11 to 12/13) would not materially impact on the predicted savings, e.g. saving $0.5b in 2010/11, $1b in 2011/12 and $0.5b in 2012/13.

These savings could be achieved by cutting a program (or a package of programs) that cost $2b per year to run. Please see the attached note outlining potential areas of savings for more detail.