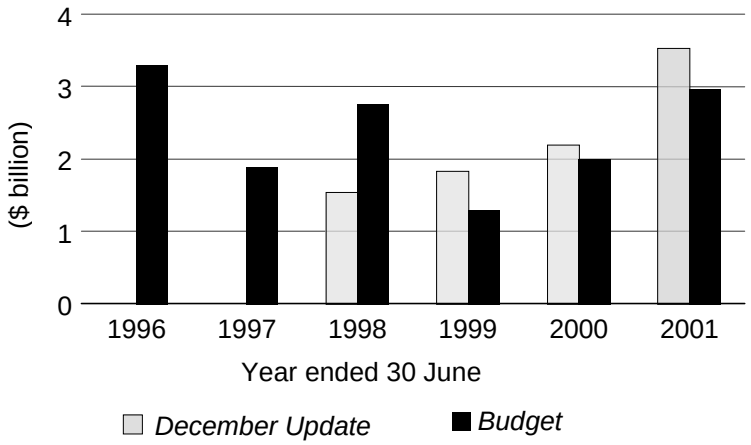
2

Fiscal Outlook

Key Features



- **Operating surpluses of 1.3% of GDP and rising are projected over the forecast period, net worth is projected to increase to around $17 billion and net Crown debt to fall to around 19% of GDP.**
- **Relative to the *December Update*, operating surpluses show an increase in 1997/98 of around $1.2 billion and a deterioration of around $500 million, $200 million and $600 million in 1998/99, 1999/2000 and 2000/01 respectively.**
- **Key changes since the *December Update* include the impact of positive one-off factors in 1997/98, lower tax projections and a reduction in spending intentions in 1998/99 and 1999/2000 and the inclusion of a provision for future initiatives in 2000/01.**
- **Crown entities contribute significantly to the operating surplus in all years with gross surpluses of around $900 million or more.**
- **Alternative scenarios indicate that operating surpluses will be maintained and net debt will reduce over time, even if the timing and speed of the economic pick-up were to differ from the economic forecast.**

Table 2.1 - Fiscal Outlook

	1996/97	1997/98 Forecast		1998/99 Forecast		1999/2000 Projection		2000/01 Projection	
($ million)	Actual	December Update	Estimated Actual	December Update	Budget	December Update	Budget	December Update	Budget
Statement of Financial Performance									
Revenue									
Total taxation revenue	31,916	33,551	33,590	34,551	33,698	35,922	35,616	37,252	37,473
Other revenue	2,862	2,430	2,457	2,516	2,559	2,625	2,613	2,700	2,733
Total Revenue	**34,778**	**35,981**	**36,047**	**37,067**	**36,257**	**38,547**	**38,229**	**39,952**	**40,206**
Ratio to GDP (%)	36.2%	36.3%	36.5%	35.1%	34.9%	34.8%	34.8%	34.5%	34.8%
Tax ratio to GDP (%)	33.3%	33.9%	34.0%	32.7%	32.5%	32.4%	32.4%	32.2%	32.4%
Expenses									
Functional expenses	29,869	32,043	31,568	32,367	32,878	32,806	33,229	33,183	33,593
Finance costs	3,072	2,777	2,758	2,626	2,564	2,660	2,695	2,449	2,597
Net foreign exchange losses/(gains)	12	(45)	(8)	..	..	..	..	..	..
Provision for future initiatives	..	180	..	820	290	1,600	1,090	1,600	1,090
Provision for 2000/01 initiatives	..	..	..	..	..	..	..	..	900
Contingency expense provision	..	100	..	200	100	200	100	200	100
Total Expenses	**32,953**	**35,055**	**34,318**	**36,013**	**35,832**	**37,266**	**37,114**	**37,432**	**38,280**
Ratio to GDP (%)	34.3%	35.4%	34.7%	34.1%	34.5%	33.6%	33.8%	32.4%	33.1%
Revenue less Expenses	**1,825**	**926**	**1,729**	**1,054**	**425**	**1,281**	**1,115**	**2,520**	**1,926**
Surplus attributable to SOEs and Crown entities	988	1,034	1,450	1,297	1,403	1,463	1,402	1,618	1,611
Dividends and other distributions	(905)	(422)	(401)	(518)	(523)	(553)	(496)	(603)	(553)
Operating Balance	**1,908**	**1,538**	**2,778**	**1,833**	**1,305**	**2,191**	**2,021**	**3,535**	**2,984**
Ratio to GDP (%)	2.0%	1.6%	2.8%	1.7%	1.3%	2.0%	1.8%	3.1%	2.6%
Statement of Financial Position									
Assets	57,968	59,396	61,493	60,886	62,976	62,226	64,374	62,989	66,243
Liabilities	50,498	50,330	51,078	49,987	51,256	49,136	50,633	46,364	49,518
Crown Balance	**7,470**	**9,066**	**10,415**	**10,899**	**11,720**	**13,090**	**13,741**	**16,625**	**16,725**
Ratio to GDP (%)	7.8%	9.1%	10.5%	10.3%	11.3%	11.8%	12.5%	14.4%	14.5%
Statement of Cash Flows									
Net cash flows from operations	2,720	1,350	1,749	1,785	1,208	1,998	1,886	3,155	2,453
Net cash flows from investing	2,431	(911)	(1,935)	(1,299)	(1,198)	(1,184)	(1,346)	(556)	(1,598)
Net cash flows from financing	(5,301)	(591)	(7)	(487)	..	(792)	(548)	(2,591)	(858)
Net Movements in Cash	**(150)**	**(152)**	**(193)**	**(1)**	**10**	**22**	**(8)**	**8**	**(3)**
Statement of Borrowings									
Crown Debt									
Gross debt	35,972	35,804	36,862	35,281	36,860	34,479	36,299	31,878	35,428
less financial assets	(10,648)	(11,062)	(12,500)	(11,023)	(12,288)	(11,121)	(12,674)	(11,072)	(13,224)
Net Crown Debt	**25,324**	**24,742**	**24,362**	**24,258**	**24,572**	**23,358**	**23,625**	**20,806**	**22,204**
Gross Debt to GDP (%)	37.5%	36.1%	37.3%	33.4%	35.5%	31.1%	33.0%	27.6%	30.6%
Net Crown Debt to GDP (%)	26.4%	25.0%	24.7%	23.0%	23.7%	21.1%	21.5%	18.0%	19.2%
Nominal GDP	95,953	99,116	98,758	105,618	103,825	110,854	109,959	115,666	115,696

Source: The Treasury

Full details of the fiscal forecasts are contained in the Generally Accepted Accounting Practice (GAAP) series tables at the back of this document.

Overview

This chapter discusses the Government's fiscal position, including revenue, expenses, State-owned enterprise (SOE) and Crown entity (CE) surpluses, and assets and liabilities. It focuses both on trends in the fiscal position over time and changes in the fiscal position since the 1997 *December Economic and Fiscal Update* (*December Update*).

The fiscal forecasts are based on existing spending and revenue decisions and are sensitive to underlying economic projections. The forecasts do not include any forecasts of asset revaluations or sales.

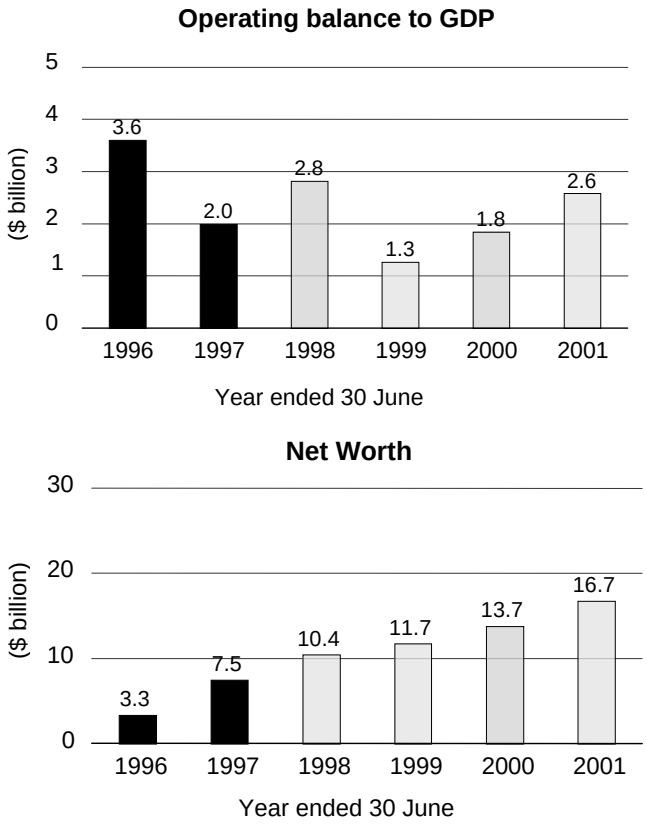
Figure 2.1 - Fiscal Projections

The fiscal forecasts show operating surpluses of 2.8% of GDP in 1997/98 falling to 1.3% in 1998/99, and then rising to 2.6% in 2000/01.

The operating surplus decline in 1998/99 relative to 1997/98, reflects slower nominal economic growth, tax and tariff reductions and the absence of one-off factors that boosted the 1997/98 surplus.

Beyond 1998/99 the surplus rises as economic growth accelerates and revenue grows at a faster rate than total expenses.

Net worth improves over the forecast period reaching $16.7 billion by 2000/01.



Source: The Treasury

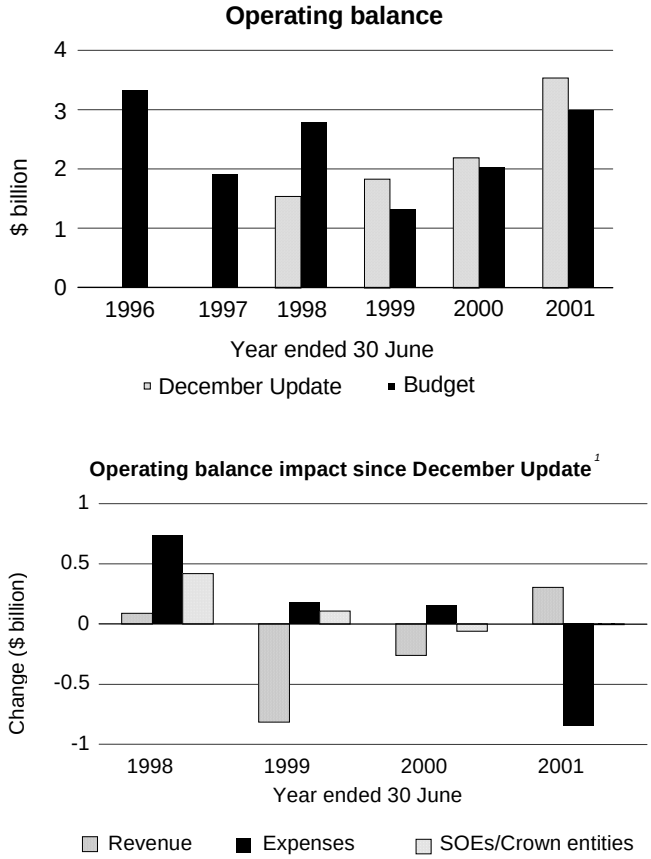
The fiscal forecasts do not include the recognition of the ARCIC unfunded liability which is due to occur at 30 June 1999. This will reduce net worth by around $8 billion. Recognition is likely to result in a reduction in the operating balance in 1999/2000 and 2000/01 (refer box on page 71).

Net Crown debt falls over the forecast period, to around $22 billion by 2000/01 (19.2% of GDP).

Major changes since the *December Update* include:

- taxation being revised down by around $850 million and $300 million in 1998/99 and 1999/2000 respectively, largely reflecting lower projected nominal economic growth and the removal of motor vehicle tariffs
- a $300 million reduction in Government spending intentions over 1998/99 and 1999/2000
- one-off factors boosting the operating surplus in 1997/98
- the inclusion of a $900 million technical provision for future initiatives in 2000/01 as signalled in the *Budget Policy Statement* which may consist of expense, revenue or SOE/Crown entity initiatives

Figure 2.2 - Changes since the *December Update*



Source: The Treasury

Note 1. A positive change indicates an improvement relative to the *December Update* - an increase in revenue or a decrease in expenses

- higher ARCIC surpluses of around $200 million and $150 million in 1997/98 and 1998/99.

Alternative scenarios indicate that operating surpluses will be maintained and net debt will reduce over time, even if the timing and speed of the pick-up were to differ from the economic forecast.

Changes Since the *December Update*

Changes in the fiscal outlook from that reported in the *December Update* are outlined in the table below:

Table 2.2 - Changes in the Operating Balance Since the *December Update*[1]

($ million)	1997/98	1998/99	1999/2000	2000/01
Operating balance in 1997 *December Update*	**1,538**	**1,833**	**2,191**	**3,535**
Taxation changes[2]				
Policy initiatives[4]	(23)	143	173	155
Forecasting and other changes	62	(996)	(479)	66
	39	(853)	(306)	221
Expense changes[3]				
Policy initiatives[4]	(106)	(431)	(446)	(398)
Movement in provision for future initiatives[4]	180	380	360	510
Reduction in spending intentions[5]	..	150	150	..
Introduction of provision for 2000/01 initiatives	..	..	..	(900)
Reduction in contingency expense provision	100	100	100	100
Forecasting and other changes	563	(18)	(12)	(160)
	737	181	152	(848)
SOE/Crown entity surplus changes				
Policy initiatives[4]	(2)	(58)	(120)	(84)
Forecasting and other changes	418	164	59	77
Changes in other revenue, excluding SOE/CE dividends (eg interest income)	48	38	45	83
Total Change in Operating Balance	**1,240**	**(528)**	**(170)**	**(551)**
Operating Balance per 1998 Budget	**2,778**	**1,305**	**2,021**	**2,984**

Source: The Treasury

Notes:
1. Figures in parentheses represent a negative impact on the operating balance.
2. Changes in taxation revenue are set out in more detail in Chapter 3 (refer Table 3.4).
3. Changes in expenses are set out in more detail in Chapter 4 (refer Table 4.2).
4. The total impact of policy initiatives since the *December Update* largely offsets the movement in the provision for future initiatives. Differences arise because in the operating balance (and this table) the provision for future initiatives is grossed up for GST and rounded to the nearest $10 million.
5. The reduction in spending intentions decreases the provision for future initiatives in 1998/99 and 1999/2000.

1997/98

Compared with the *December Update*, the surplus is significantly higher in 1997/98 because of a number of one-off factors which do not carry over into the outyears, including:

- the reduction in the GSF unfunded pension liability caused by a change in valuation assumptions which decreases expenses by $387 million
- a correction in the forecast timing of ARCIC attendant care expenses which has boosted ARCIC's forecast surplus by around $200 million
- Treaty settlement expenses reduced by $132 million as the cost of settlements were lower than the provision included in the *December Update*, and the Whakatohea Treaty claim was reversed
- the settlement of the Equiticorp liability was lower than expected causing a reduction in expenses of $129 million.

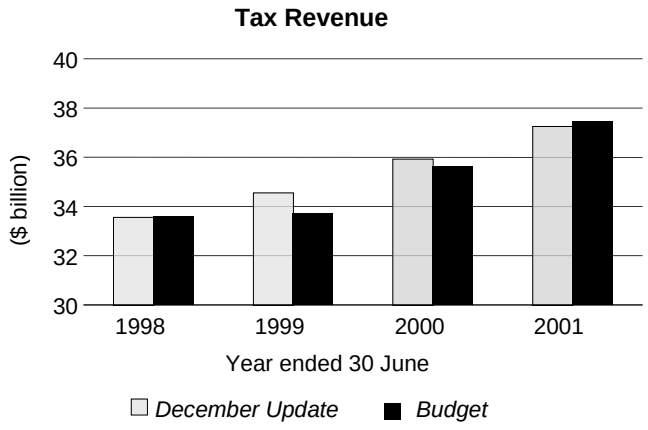
1998/99 and Beyond

Changes in the operating balance since the *December Update* are summarised in Table 2.2. Major features include:

Revenue

- Lower short-term nominal economic growth and the removal of tariffs on motor vehicles together reduce taxation in 1998/99 and 1999/2000 by $850 million and $300 million respectively.
- Much of the downward revision in short-term growth falls on businesses as subdued growth in domestic demand and continuing wage growth squeeze profits.

Figure 2.3 - Tax Revenue



Source: The Treasury

- As the economy picks up in 1999 and beyond tax revenue rebounds to be $220 million higher in 2000/01 than in the *December Update*.

- The removal of tariffs on passenger motor vehicles and light commercials, owing to the industry decisions to cease assembling motor vehicles in New Zealand, reduces customs duty by $260 million, $200 million and $255 million in 1998/99, 1999/2000 and 2000/01 respectively.

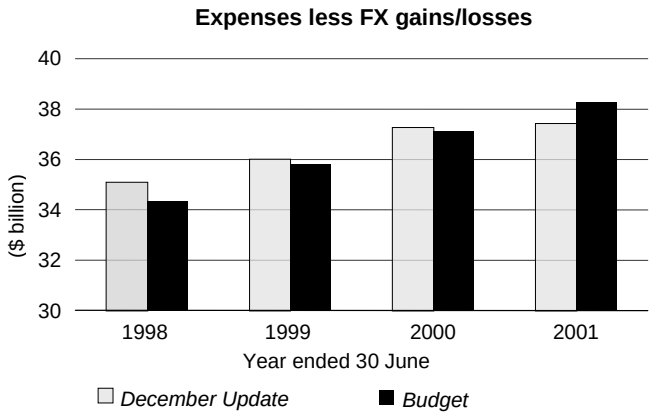
- The introduction of the $5 billion operating limit over the period from 1997/98 to 1999/2000 means policy decisions such as the increases in fuel and tobacco excise and the decision to remove alternative specific tariffs on motor vehicles have no impact on the Crown's operating surplus.

Expenses

Expenses are around $200 million lower in 1998/99 and around $150 million lower in 1999/2000.

- This largely reflects the Government's decision to reduce spending intentions by $150 million in each of these years.

Figure 2.4 - Expenses



Source: The Treasury

- The contingency expense provision has also reduced by $100 million in all years as a number of significant contingent liabilities have crystallised.

The inclusion of the $900 million technical provision for 2000/01 initiatives, as signalled in the *Budget Policy Statement*, causes expenses to increase in 2000/01.

Coalition Agreement's fiscal parameters

Schedule B to the National/New Zealand First 1996 Coalition Agreement set fiscal parameters for the Coalition Government for the period from 1997/98 to 1999/2000.

The fiscal parameters were up to $5 billion for additional expenses and the abolition of the superannuation surcharge over the period from 1997/98 to 1999/2000 and additional capital spending as provided in the 1996 *December Economic and Fiscal Update* capital contingency ($900 million over the period from 1997/98 to 1999/2000).

The Government has agreed to a general framework for the purposes of counting changes in the fiscal position against these fiscal limits. The key components of this approach are outlined below.

Operating items ($5 billion additional expense limit)

- All changes to the operating balance resulting from government decisions to introduce a new policy initiative or change the fiscal cost of existing initiatives will be counted against the Coalition's $5 billion expense limit over the period from 1997/98 to 1999/2000.
- All changes of this type that impact on the operating balance, except for tax reduction changes identified in Schedule B of the Coalition Agreement and additional finance costs, will be counted, whether they be expense, revenue or SOE or Crown entity surplus changes.
- Policy decisions will be counted according to their net impact on the fiscal aggregates. In particular, policy decisions will be counted exclusive of both GST and any income tax on transfer payments.
- In the event of selling an SOE or Crown entity, the impact of the cost of projected surpluses foregone less the reduction in finance costs will not count against the $5 billion expense limit.

Capital items ($900 million additional capital spending limit)

- All new capital funding by the Crown will be counted against the Coalition Agreement's capital limit. This includes capital injections to departments and SOEs and Crown entities, purchase or development of capital assets by the Crown, and advances.
- Any new capital withdrawals, decisions to reduce existing baselines for purchase or development of capital assets by the Crown or reduce existing baselines for advances will represent a capital saving, increasing the amount available for new capital.

Forecasting changes

Forecasting changes that impact on the operating balance (for example, changes to debt servicing as a result of changes to interest rates) and demand-driven changes such as in student loan advances will not be counted against the Coalition Agreement's limits.

Operating Items ($5 Billion Limit)

The operating implications of 1998 Budget initiatives, decisions taken since the 1997 *December Update* and provisions for future initiatives, are summarised and reconciled to the Coalition Agreement's fiscal parameters as follows.

Table 2.3 - Operating Limit

($ million)	1997/98	1998/99	1999/2000	Three-year total
Operating Balance Impact ($5 billion limit)[1]				
1997 Budget Initiatives				
Revenue initiatives	21	140	190	351
Expense initiatives	585	647	699	1,931
Total 1997 Budget Initiatives	***606***	***787***	***889***	***2,282***
1997 *December Update* Initiatives				
Revenue initiatives	8	(70)	11	(51)
Expense initiatives	141	254	246	641
SOE/CE initiatives	(14)	(72)	(102)	(188)
Total *1997 December Update* Initiatives	***135***	***112***	***155***	***402***
Decisions taken since 1997 *December Update* [2]				
Revenue initiatives				
Motor vehicles alternative specific tariffs[3]	..	25	50	75
Motor vehicle duty refund	31	..	..	31
Fuels excise	(4)	(75)	(75)	(154)
Tobacco excise	(7)	(57)	(58)	(122)
Resident withholding tax	..	(13)	(72)	(85)
Other revenue initiatives	5	(8)	(2)	(5)
	25	(128)	(157)	(260)
Expense initiatives				
Education	50	216	270	536
Health	..	88	103	191
Law and order	4	65	81	150
Mäori television	..	15	15	30
Savings initiatives	..	(79)	(147)	(226)
Other expense initiatives	37	72	78	187
	91	377	400	868
SOE/Crown entity initiatives				
Electricity reforms	2	58	120	180
	2	58	120	180
Total initiatives since 1997 *December Update*	***118***	***307***	***363***	***788***
Provision for future initiatives[2]				
Provision for future 1998 Budget initiatives	..	261	339	600
Provision for 1999 Budget initiatives	..	..	628	628
	..	***261***	***967***	***1,228***
Total Operating Balance Impact	**859**	**1,467**	**2,374**	**4,700**
Reduction in Spending Intentions	..	150	150	***300***
Coalition Operating Limit				**5,000**

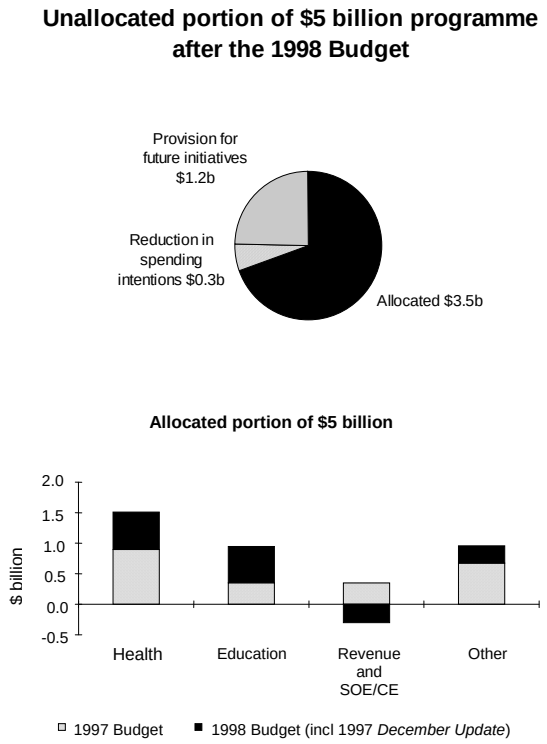
Source: The Treasury

Notes:
1. A positive sign represents a reduction in the operating balance.
2. Decisions taken since the Budget and the provision for future initiatives are reported here exclusive of GST. The provisions factored into the forecast financial statements are grossed up for GST and rounded to the nearest $10 million.
3. These costs relate only to the government decision to remove alternative specific tariffs on motor vehicles. The costs of removing motor vehicle tariffs does not count against the $5 billion operating limit as the decision was a consequence of a request by the motor vehicle industry.

The forecasts assume that spending will remain within the Coalition Agreement's $5 billion limit on policy initiatives. So far, $3.5 billion has been included in baselines, and $300 million has been redirected to the operating surplus. The remainder is included in a provision for future initiatives which stands at $1.2 billion.

The $3.5 billion allocated is largely reflected in increased health and education spending (around $1.5 billion and $1.0 billion respectively). Other significant initiatives include the surcharge abolition, the 1997 Housing package and the Law and Order package announced in the 1998 Budget.

Figure 2.5 - Coalition Package



Source: The Treasury

Since the *December Update*, there have been a number of fiscally positive initiatives that have enabled further spending in the Coalition period including:

- savings initiatives of $226 million (refer Table 2.4)
- overall revenue and SOE/Crown entity initiatives of $80 million (refer Table 2.3).

Table 2.4 - Savings Initiatives

($ million)	**1998/99**	**1999/2000**	**Total**
Savings Initiatives			
Social Welfare initiatives			
Aligning sickness and unemployment benefit	(9)	(19)	(28)
Limited emergency benefit eligibility for students	(13)	(14)	(27)
"At home" savings benefit rates for 18 and 19 year olds	(8)	(12)	(20)
Two year benefit stand down for migrants	(2)	(3)	(5)
	(32)	(48)	(80)
Research science and technology[1]	(9)	(27)	(36)
Border services cost recovery	..	(24)	(24)
Business development programme	(11)	(11)	(22)
Reduction in health bureaucracy	(9)	(11)	(20)
Elimination of separate government fire service levy	(9)	(10)	(19)
ODA assistance[1]	(5)	(10)	(15)
Other initiatives	(4)	(6)	(10)
Total Savings Initiatives	**(79)**	**(147)**	**(226)**

Source: The Treasury

Note: 1 Represents a reduced rate of increase in spending.

Provision for Future Initiatives

The forecasts incorporate provisions for future initiatives of $261 million in 1998/99 and $967 million in 1999/2000 (GST exclusive).

These represent both provision for 1998 Budget initiatives which have yet to be fully developed, and provision for extra spending in the 1999 Budget. The 1999/2000 provision ($967 million) is also included in 2000/01, reflecting the fact that additional spending in 1999/2000 will generally roll into 2000/01 baselines.

The provision for 1998 Budget initiatives has reduced since the *December Update*, reflecting decisions taken since then that are now included in departmental baselines and factored into the specific revenue and expense forecasts.

Capital Items ($900 Million Limit)

The capital implications of 1997 and 1998 Budget initiatives are summarised and reconciled to the Coalition Agreement's $900 million capital limit as follows.

Table 2.5 - Capital Limit

($ million)	**1997/98**	**1998/99**	**1999/2000**	**Three-year total**
Capital spending ($900 million limit)				
Decisions taken up to the 1997 *December Update*				
Capital changes in 1997 Budget	266	200	186	652
Capital changes in 1997 *December Update*	(483)	167	60	(256)
	(217)	367	246	396
Changes since the 1997 *December Update*				
Housing NZ - change in capital withdrawals	238	..	..	238
Education	3	195	1	199
Corrections	25	36	12	73
Court Buildings	10	10	..	20
New driver licensing system	4	14	(3)	15
Police communication system	..	10	..	10
Other	4	2	6	12
	284	267	16	567
Total Capital Spending	**67**	**634**	**262**	**963**

Source: The Treasury

As shown in the above table, forecast capital spending exceeds the Coalition Agreement's capital limit by $63 million. Principal changes since the 1997 *December Update* are a reduction in capital withdrawals from Housing New Zealand, and increased purchases of property for educational purposes.

The Government intends to seek capital withdrawals from SOEs and Crown entities to increase the amount available to meet future capital demands. The present limit on capital expenditure will be reviewed prior to the 1999 Budget, taking into account potential demands for capital and the extent of capital withdrawals realised.

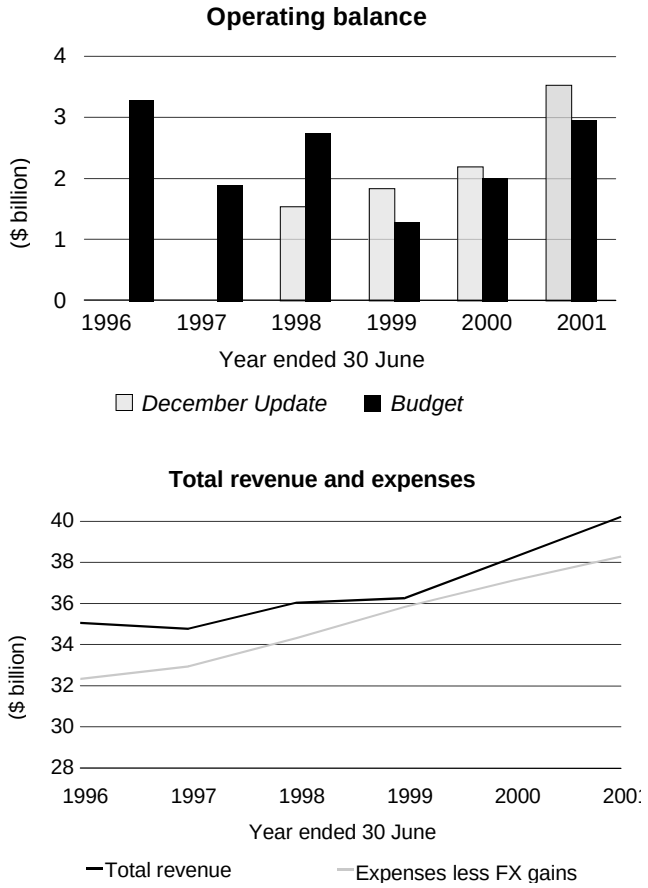
Operating Balance Trends

The operating balance track - comprising revenue, expenses and SOE/Crown entity surpluses - shows surpluses of $2.8 billion in 1997/98 declining to $1.3 billion in 1998/99 and then increasing to $2.0 billion and $3.0 billion in 1999/2000 and 2000/01 respectively.

The surplus increases in 1997/98 relative to 1996/97 reflecting a number of one-off unanticipated changes as well as increased taxation growth. These changes are partly offset by the Coalition Agreement's additional spending in 1997/98 and the settlement of the Ngai Tahu claim.

Operating surpluses then moderate relative to 1997/98 (taking away the one-off factors outlined above), as revenue growth slows owing to tax-rate reductions from 1 July 1998 and lower projected nominal growth in the economy.

Figure 2.6 - Operating Balance Trends



Source: The Treasury

The surpluses in the outyears improve owing to taxation growth exceeding expense growth and an improving performance by a number of Crown entities.

Revenue

Revenue grows over the forecast period, increasing by 11.5%, from $36.0 billion in 1997/98 to $40.2 billion in 2000/01. Tax revenue grows by $3.9 billion (11.6%) over that period, but declines as a percentage of GDP in all years reflecting the second round of tax reductions, abolition of the superannuation surcharge and the current round of tariff reductions (including the decision to remove motor vehicle tariffs).

Underlying tax revenue, after taking away tax and tariff reductions and policy decisions, is projected to grow in line with nominal economic growth, averaging 5.3% per annum over the next three years.

Expenses

Total expenses are projected to rise steadily, increasing by 11.5%, from $34.3 billion in 1997/98 to $38.3 billion in 2000/01. This trend is largely driven by increases in social welfare, education and health expenditure. These key expense categories account for over 70% of total expenses. The provision for future initiatives also trends upwards over the forecast period, reflecting decisions to be made in the 1999 Budget. Other spending is relatively constant, although finance costs continue to fall over the period owing to ongoing cash surpluses and corresponding reductions in debt.

Expenses in 2000/01 include a separate provision for future initiatives beyond the three-year $5 billion package. This provision is a technical assumption and is based on patterns in the cost of new initiatives over the period 1994/95 to 1999/2000. The provision, whilst included in expenses, may consist of expense, revenue or SOE/Crown entity initiatives.

Contribution from SOEs and Crown entities

The gross surplus of SOEs and Crown entities contributes significantly to the operating balance, increasing by 11.1% over the forecast period to reach $1.6 billion by 2000/01.

Contributions from Crown entities improve, after adjusting for one-off factors in 1997/98 and 1998/99, throughout the forecast period reaching just over $1 billion in 2000/01. This improvement is driven by increased surpluses in a number of entities, in particular ARCIC and Housing New Zealand.

SOE surpluses are relatively stable over the period from 1997/98, contributing around $500 million per year. Economic growth and an improving general performance are partly offset by the impact of the electricity reforms which reduces ECNZ and Contact Energy surpluses in 1998/99 and beyond.

Sensitivity of the Fiscal Position to Economic Changes

Both the revenue and expenditure forecasts are dependent on a number of assumptions. The revenue forecasts are driven largely by the economic outlook, but also include a number of key judgments about the impact of changes to tax policies.

The uncertainty surrounding the tax forecasts is one of the largest possible sources of variation in the forecasts. Annual tax revenue is currently around $34 billion, so a forecast error of 1% has an impact of over $300 million on the fiscal position.

Social spending components of the expenditure forecasts are sensitive to economic influences such as the employment rate and demographic factors such as the age and gender composition of the population, as well as its distribution and overall size. Changes in the proportion of those eligible for benefits or services who actually take up their entitlement can also lead to forecast revisions.

The assumptions underlying the economic forecasts are set out in Chapter 1. The following table provides an indication of the sensitivity of the fiscal forecasts to changes in economic activity using simple “rules of thumb”.

Table 2.6 - Sensitivity Analysis

($ million)	**1998/99**	**1999/2000**	**2000/01**
1% higher nominal GDP growth per annum			
Revenues	+335	+710	+1,125
Expenses (debt servicing only)	+10	+50	+115
Impact on the operating balance	+345	+760	+1,240
10% reduction in Unemployment Benefit costs			
Revenue	-20	-20	-20
Expenses	+150	+150	+155
Impact on the operating balance	+130	+130	+135
Revenue impact of a 1% increase in the growth rate of			
Wages and salaries	+135	+285	+460
Taxable business profits	+60	+160	+260
One percentage point lower interest rates			
Revenues	-45	-50	-65
Expenses	+105	+135	+175
Impact on the operating balance	+60	+85	+110

Source: The Treasury

Note: A positive sign indicates an improvement in the fiscal position.

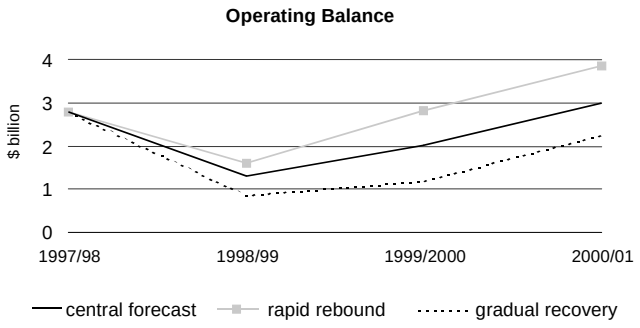
Minor changes in growth are likely to have a small impact on the fiscal position. Assuming that revenue grows at the same rate as GDP, changes in nominal GDP growth of around 1% will result in revenue changing by around $300 million to $350 million per annum.

However, some revenue components, including individual and company tax, may show a higher variability to economic growth. The impact on the fiscal position could therefore be greater for large changes in GDP. For example, while nominal GDP grew by 26% between 1991/92 and 1995/96, individual income tax grew by over 30% and company tax revenue by more than 70%.

The discussion in Chapter 1 identified two alternative economic scenarios - a gradual economic recovery and a rapid rebound. Alternative economic scenarios would lead to different fiscal outcomes, largely owing to changes in nominal GDP, which is a key driver of tax revenue. The estimated operating balance for each scenario (assuming that revenue grows broadly in line with nominal GDP as in the ready reckoner detailed on page 66) is shown in Figure 2.7.

Figure 2.7 - Scenario Analysis

Under the Rapid Rebound scenario the operating balance is higher than the Central Forecast by around $300 million in 1998/99, $800 million in 1999/2000 and $875 million in 2000/01.



Source: The Treasury

The Gradual Recovery scenario lowers the projected operating balance by around $450 million in 1998/99, $850 million in 1999/2000 and $725 million in 2000/01.

These scenarios should be considered as illustrative of what the fiscal position could look like under alternative economic scenarios reflecting the uncertainties surrounding the timing and speed of pick-up. They should not be regarded as “best-case” or “worst-case” since extreme, but unlikely, events could lead to altogether different outcomes.

Table 2.7 - Operating Surplus (under alternative scenarios)

($ billion)	**1997/98**	**1998/99**	**1999/2000**	**2000/01**
Central Forecast	2.8	1.3	2.0	3.0
Rapid Rebound	2.8	1.6	2.8	3.9
Gradual Recovery	2.8	0.9	1.2	2.3

Table 2.8 - Net Crown Debt (under alternative scenarios)

(% of GDP)	**1997/98**	**1998/99**	**1999/2000**	**2000/01**
Central Forecast	24.7	23.7	21.5	19.2
Rapid Rebound	24.7	23.2	20.1	17.2
Gradual Recovery	24.7	24.4	23.1	21.2

The cyclically adjusted balance

The cyclically adjusted balance tries to remove the impact of purely cyclical factors on the fiscal position by providing a picture of the fiscal position if the rate of GDP growth is consistent with a steady trend. Since it removes temporary economic fluctuations, changes in the cyclically adjusted balance generally reflect changes in policy.

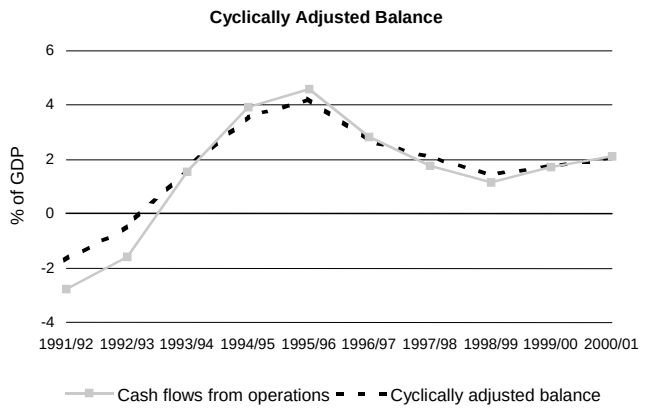
The crucial step in deriving the cyclically adjusted balance is to identify potential or trend output against which cyclical fluctuations can be measured. Estimating the trend rate of growth is a difficult judgment. Our estimates of the cyclically adjusted balance incorporate a view of the trend rate of growth in the range of 3% to 3.5%.

The following graph shows how the cyclically adjusted balance in New Zealand has moved in recent years. The cyclically adjusted balance presented here is derived from "Net Cash Flows from Operations". This is the cash flow measure of the operating balance. A reconciliation between the cash and accrual measures is included on page 164.

The extent to which the fiscal balance is above or below the cyclically adjusted balance gives an idea of how much of the surplus may be the result of cyclical economic changes.

The results show an underlying fiscal improvement through to 1995/96. Estimates suggest that a portion of the deterioration in the fiscal position in 1997/98 and 1998/99 is owing to cyclical factors (as the cyclically adjusted balance exceeds the fiscal balance).

Figure 2.8 - Cyclically Adjusted Balance



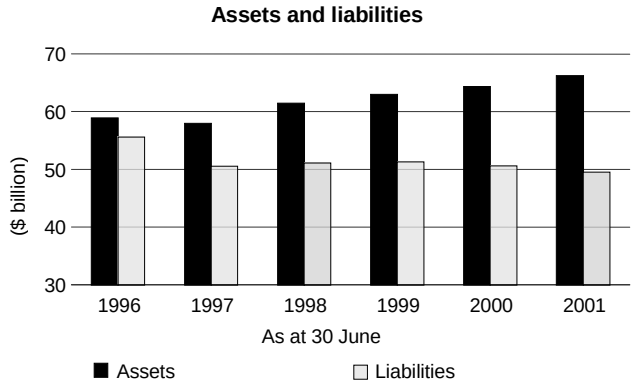
Source: The Treasury

Assets and Liabilities

Net worth grows steadily over the forecast period, reaching $16.7 billion in 2000/01. This trend largely results from the cumulative impact of ongoing operating surpluses over the forecast period.

The forecasts however do not include the recognition of the ARCIC unfunded liability which will reduce net worth by around $8 billion at 30 June 1999 (refer box on page 71).

Figure 2.9 - Net Worth

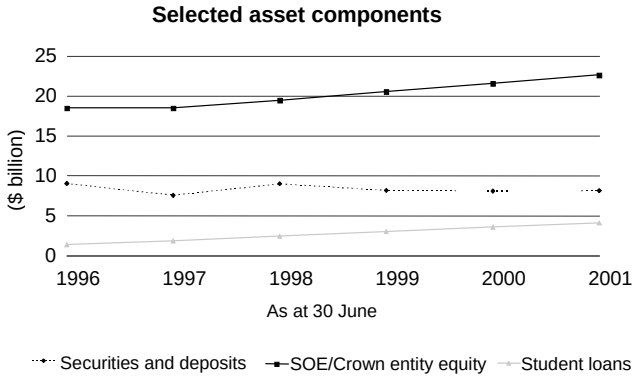


Source: The Treasury

Assets

- SOE/Crown entity equity grows over the forecast period, increasing by 16.3%, from $19.4 billion in 1997/98 to $22.6 billion in 2000/01 as surpluses are retained within SOE and Crown entity balance sheets.

Figure 2.10 - Asset Components



Source: The Treasury

- Total advances increase by 46.3% over the forecast period, from $3.4 billion in 1997/98 to $5.0 billion in 2000/01 reflecting an increase in student loans.

- Securities and deposits gradually decrease by 9.6% over the forecast period, from $9.0 billion in 1997/98 to $8.1 billion in 2000/01. The level of securities and deposits fall, as debt matures, toward a minimum prudent level of foreign-currency reserves. The increase in 1997/98 relative to 1996/97 is largely caused by exchange gains on foreign-currency assets.

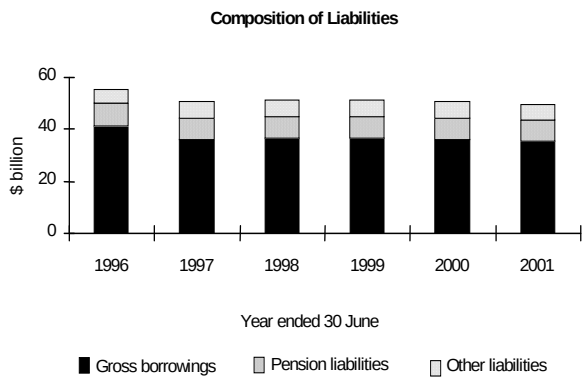
Liabilities

The two most significant components of the Crown's total liabilities are borrowings and the unfunded GSF pension liability.

Liabilities reduce slowly over the forecast period by 3.1% reaching $49.5 billion by 2000/01.

Figure 2.11 - Liabilities

- Gross borrowings fall by 3.9% over the forecast period, from $36.9 billion in 1997/98 to $35.4 billion in 2000/01.
- The gradual decline in borrowings over the forecast period reflects the application of cash surpluses to the repayment of debt.



Source: The Treasury

- Pension liabilities fall by around $250 million in 1997/98, reflecting a downwards revaluation adjustment in 1997/98, and then are forecast to remain relatively stable in the outyears.

Recognition of ARCIC outstanding claims obligation

ARCIC has an obligation to meet the future costs of accepted accident claims. To date this obligation has been disclosed in the notes to both ARCIC's and the Government's financial statements. At 30 June 1997 these outstanding claims obligations were estimated at $8,267 million.

After consultation with both ARCIC and the Auditor General it has been agreed that these outstanding claims obligations will be recorded on the Crown's balance sheet at 30 June 1999.

In addition to the recognition of the liability it will be necessary to adjust premium income so that the amount owed to ARCIC by premium payers, who currently pay in arrears, is also brought fully onto the balance sheet as an asset.

The initial recognition of the liability and asset will result in a net negative impact on the Crown's net worth of around $8 billion at 30 June 1999. This intended change in accounting policy will not affect cash flows or net Crown debt.

In subsequent years changes to the actuarial valuation of the liability will affect the Crown's operating surplus from 1999/2000. Indications are that there will be a significant negative impact on the Crown's operating surplus.

The impact of this intended change in accounting policy is *not* included in these forecasts. Once the 30 June 1998 valuation is finalised and there is greater clarity over the impact of government decisions on ARCIC, the impact will be included in the forecasts prepared for the 1998 *December Economic and Fiscal Update.*

Changes in Assets and Liabilities Since the *December Update*

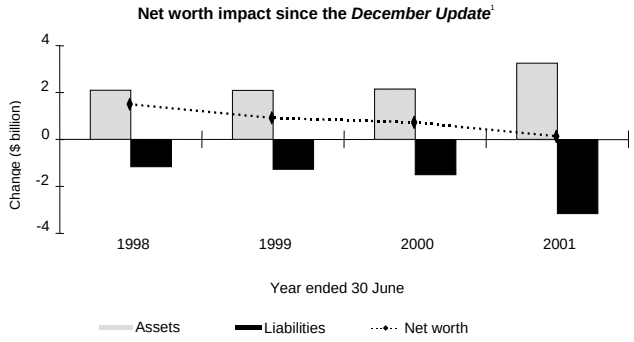
The Crown balance improves significantly in 1997/98 relative to the *December Update* because of the higher-than-expected surplus. The improvement declines gradually over the forecast period owing to the impact of lower projected surpluses in the outyears.

Although net worth does not change significantly over the forecast period, there are offsetting increases in assets and liabilities of $3.3 billion and $3.2 billion respectively by 2000/01.

By 2000/01, marketable securities and deposits are $2.1 billion higher than the *December Update*.

- This increase is primarily due to exchange gains on foreign-assets in 1997/98 and a correction of a corresponding downwards reduction in financial assets and liabilities in the *December Update*.

Figure 2.12 - Changes in Assets and Liabilities[1]



Source: The Treasury

Note: 1 A positive change indicates an improvement relative to the *December Update,* ie, an increase in assets or a decrease in liabilities.

The investment in SOEs and Crown entities is greater than the *December Update* in each year. This increase largely reflects the improving cumulative performance from a number of Crown entities.

The major component of liabilities, gross borrowings, significantly increases throughout the forecast period, increasing by around $3.5 billion in 2000/01. This reflects:

- a slower rate of debt repayment owing to lower projected surpluses over the forecast period
- exchange losses on foreign-currency liabilities recognised in the 1997/98 financial year
- a correction of a corresponding downwards reduction of financial assets and liabilities in the *December Update*.

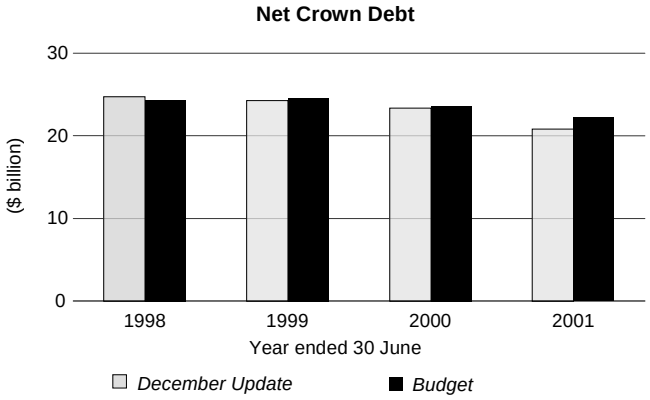
The GSF pension liability is lower in all periods by at least $400 million, reflecting the downwards revision of the liability in 1997/98.

Net Crown Debt

From 1997/98 to 2000/01 Net Crown Debt decreases by 8.9% reaching $22.2 billion at the end of the forecast period.

Relative to the *December Update*, the reduction in net Crown debt in 1997/98 of around $400 million is significantly less than the improvement in the operating surplus. This is because a number of the factors that improve the operating surplus, such as the GSF revaluation and the increase in ARCIC's surplus, have no cash impact over the short term.

Figure 2.13 - Net Crown Debt



Source: The Treasury

Net Crown debt in 1998/99 and 1999/2000 is moderately higher as the improvement in 1997/98 is more or less offset by lower cash surpluses in these years.

There is a significant increase relative to the *December Update* in 2000/01 because of the inclusion of $900 million for 2000/01 operating initiatives and an additional provision for capital initiatives of $300 million.

Table 2.9 - Summary of Movements in Net Crown Debt

	1996/97	1997/98 Forecast		1998/99 Forecast		1999/2000 Projection		2000/01 Projection	
($ million)	**Actual**	**DEFU**	**Budget**	**DEFU**	**Budget**	**DEFU**	**Budget**	**DEFU**	**Budget**
Opening Net Crown Debt	**28,637**	**25,324**	**25,324**	**24,742**	**24,362**	**24,258**	**24,572**	**23,358**	**23,625**
Closing Net Crown Debt	**25,324**	**24,742**	**24,362**	**24,258**	**24,572**	**23,358**	**23,625**	**20,806**	**22,204**
Annual reduction/(increase)	3,313	582	962	484	(210)	900	947	2,552	1,421
Represented by:									
Cash items									
Net cash flows from operations	2,720	1,350	1,749	1,785	1,208	1,998	1,886	3,155	2,453
Net purchase of physical assets	(900)	(1,317)	(1,203)	(1,008)	(1,268)	(888)	(927)	(832)	(864)
Contingency capital provision	..	(60)	..	(220)	..	(230)	..	..	(300)
Sale/(purchase) of investments with a net debt impact	1,434	279	45	(218)	(231)	(92)	(119)	104	16
RHMU swap cash flows	(11)	124	120	(7)	(7)	(4)	(4)	(2)	(2)
Issue of circulating currency	66	41	84	..	..	..	..	..	..
Total cash flow movement	*3,309*	*417*	*795*	*332*	*(298)*	*784*	*836*	*2,425*	*1,303*
Non-cash items									
Foreign-exchange gains/(losses)	(12)	45	8	..	..	..	..	..	..
Non-cash movements in advances (including accrued interest and provisions)	84	71	71	88	86	105	100	115	108
Other (including amortisation of discounts and premiums)	(68)	49	88	64	2	11	11	12	10
Total non-cash movement	*4*	*165*	*167*	*152*	*88*	*116*	*111*	*127*	*118*
Total Reduction	**3,313**	**582**	**962**	**484**	**(210)**	**900**	**947**	**2,552**	**1,421**

Source: The Treasury

Stop press

Government decisions with a fiscal impact of greater than $10 million in any one forecast year since the cut-off date for incorporating government decisions into the fiscal forecasts are set out below:

- The Government has agreed to move to a new system of funding the costs of tuition for tertiary students at approved courses. This decision is estimated to cost $27 million in 1998/99, $87 million in 1999/2000 and $136 million in 2000/01. The overall level of expenses will not increase as these amounts will be funded from the provision for future initiatives.

- The Government's 1995 package for the reform of the wholesale electricity market included the proposed sale by ECNZ of eight small hydro power stations. On 29 April 1998 ECNZ announced that it had accepted a bid from an Alpine Energy Limited/TrustPower Limited consortium for Coleridge Power Station. A condition of the sale is that the Ngai Tahu Claims Settlement Bill is enacted by a certain date. The gain on sale will improve the Crown's operating surplus. The gain is expected to be around $70 million and is likely to be recorded in the 1998/99 financial year.