4

Specific Fiscal Risks

The most significant economic risks have been identified in Chapter 3. The Statement of Specific Fiscal Risks is a requirement of the Public Finance Act 1989 and sets out all pending government decisions and other circumstances known to the Government at the finalisation of the fiscal forecasts that may have a material effect on the fiscal and economic outlook, but are not certain enough in timing or amount to include in the fiscal forecasts. It is not possible to identify every possible risk and disclosure is also subject to legal requirements and materiality thresholds, which are described after the Statement of Specific Fiscal Risks.

Overview of Specific Fiscal Risks

Specific fiscal risks can be positive or negative and can affect revenue or spending. The links between external events and spending are indirect because new policies that change spending and revenue usually require a decision by the Government and approval from Parliament. The approach taken in this chapter is to disclose those pending policy decisions and key areas of uncertainty that may have a material effect on the fiscal outlook. The specific fiscal risks are categorised into:

- **Pending policy decisions affecting revenue:** Changes to tax policy or ACC levies could reduce or increase government income.
- **Pending policy decisions affecting expenses:** Costs of policy proposals could increase or decrease expenses depending on decisions taken, and they are risks to the extent that they cannot be managed within baselines or budget allowances.
- **Pending capital decisions:** Capital investment decisions are risks to the extent that they cannot be managed within balance sheets or budget allowances.
- **Matters dependent on external factors:** The liability of the Government for costs is sometimes dependent on external factors such as the outcome of negotiations or international obligations.

Some key examples of the risks disclosed in this chapter are outlined below:

- government decisions relating to the recommendations of the Welfare Working Group and the redesign of business processes at Inland Revenue
- specific policies that may have flow-on costs that are not accounted for within allocated funding, such as early childhood education funding, but are not likely enough to include in the forecasts

- explicit guarantees that give assurance to the public and businesses about the Crown's planned response to specific events are recognised as risks; the largest current guarantee relates to the Extended Deposit Guarantees Scheme with a total value of $1.3 billion, and
- generic cross-government risks such as the renegotiation of collective employment agreements that could have material costs and flow-on effects to remuneration in other sectors.

General cost pressures, such as those associated with an ageing population, are not recognised as specific fiscal risks.

The new risks that have been added since the *Budget Update* include:

- how the Government will respond to the Waitangi Tribunal report on the Wai 262 claim
- a change in the legal interpretation of when work-related gradual process disease and infection claims should be recognised may have an impact on the fiscal position, and
- the response to the *Rena* cargo ship grounding on Astrolabe reef.

The costs of individual natural disasters, and other major events, are not recognised as specific fiscal risks in advance as they usually occur infrequently and their timing cannot be predicted. Once a disaster does occur, a number of choices arise about how to respond and when potential liabilities are recognised. Specific risks are disclosed at this point based on the range of possible responses.

In Budget 2011 the Government established the Canterbury Earthquake Recovery Fund (CERF). The CERF is $5.5 billion and this is an estimate of the core Crown's costs of earthquake recovery. There are a large number of earthquake-related risks that, if they occur, may exhaust the capacity of the CERF. These risks include government commitments where the final cost is not yet known and policy options where decisions have not yet been taken. The risks have been aggregated and are not quantified because it is unclear which risks will be realised and what the scale of these risks would be.

In addition to the obligations and policy choices for the Government, the disasters in Canterbury and elsewhere have placed pressure on private sector insurers. As a result, the cost of insurance premiums is likely to increase over the next five years with potential flow-on effects to the Crown. The potential Earthquake Commission impact has now been recognised as a separate risk.

The final part of the chapter contains a current list of contingent liabilities, which are likely costs that the Crown will have to face if a particular event occurs. Typically, contingent liabilities consist of guarantees and indemnities, legal disputes and claims on uncalled capital. The largest quantified contingent liabilities are to international financial organisations and mostly relate to uncalled capital and promissory notes.

Statement of Specific Fiscal Risks

Summary Table

The matters listed below are disclosed as specific fiscal risks because they meet the rules for disclosure outlined at the end of the chapter. Full descriptions of the risks listed below are set out in the next section.

Specific fiscal risks as at 18 October	Status	Value of risk
Pending policy decisions affecting revenue		
ACC – Levies	Changed	Unquantified
Finance – Mixed Ownership Model	Unchanged	Unquantified
Revenue – Apportionment Rules for Mixed-Use Assets	Changed	Unquantified
Revenue – Income-Sharing Tax Credits	Unchanged	$500 million per annum
Revenue – Potential Tax Policy Changes	Changed	Unquantified
Revenue – Salary Trade-Offs	Changed	Unquantified
Services funded by Third Party Revenue	Changed	Unquantified
Pending policy decisions affecting expenses		
Climate Change – Review of the Emissions Trading Scheme	Changed	Up to $585 million operating expenses
Education – Early Childhood Education Funding	Changed	Unquantified
Education – Upward Adjustment for School Operating Funding	Unchanged	Unquantified
Government Response to Wai 262	New	Unquantified
Housing – Reform of Social Housing	Changed	Unquantified
Revenue – KiwiSaver Auto-Enrolment	New	$350 to $550 million operating expenses
Revenue – Transformation and Technology Renewal	Changed	Unquantified
Reviews of Public Services	Unchanged	Unquantified
Social Development – Welfare Working Group Recommendations	Changed	Unquantified
State Sector Employment Agreements	Unchanged	Unquantified
Pending capital decisions		
Agriculture and Forestry – Investment in Water Infrastructure	Changed	Unquantified
Departmental Capital Intentions	Unchanged	Unquantified
Finance – Crown Overseas Properties	Unchanged	$150 million capital expenditure
Transport – Support for New Zealand Railways Corporation	Changed	Unquantified

Specific fiscal risks as at 18 October	Status	Value of risk
Matters dependent on external factors		
ACC – Non-Earners' Account	Changed	Unquantified
ACC – Work-related Gradual Process Disease and Infection	New	Unquantified
ACC, Education, Health, Social Development – Caregiver Employment Conditions	Changed	Unquantified
Canterbury Earthquake – AMI Support Package	Changed	Unquantified
Canterbury Earthquake – EQC	New	Unquantified
Canterbury Earthquake – Exceeding the CERF	Changed	Unquantified
Climate Change – Finance for Developing Countries	Unchanged	Unquantified
Climate Change – International Climate Change Obligations	Unchanged	Unquantified
Climate Change – Kyoto Protocol Obligations	Unchanged	Unquantified
Communications – Potential Impairment in Value of Broadband Investment	Changed	Unquantified
Defence Force – Asset Valuations	New	Unquantified
Defence Force – Future Operationally Deployed Forces Activity	Changed	$10 to $30 million operating expenses per annum
Energy – Crown Revenue from Petroleum Royalties	Unchanged	Unquantified
Finance – Entities in Receivership under Crown Retail Deposit Guarantee Scheme	Unchanged	Unquantified
Finance – Extended Crown Retail Deposit Guarantee Scheme	Changed	Unquantified
Finance – Government Commitments to International Financial Institutions	Changed	Unquantified
Health – Payment of Family Caregivers	Unchanged	Unquantified
Revenue – Cash Held in Tax Pools	Unchanged	Unquantified
Transport – Response to the MV Rena Grounding	New	Unquantified
Treaty Negotiations – Treaty Settlement Forecast	Unchanged	Unquantified
Treaty Negotiations – Relativity Clause	Unchanged	Unquantified

Statement of Specific Fiscal Risks

Pending policy decisions affecting revenue

ACC – Levies (Changed, Unquantified)

Changes in tax settings, economic factors and ACC's financial performance affect ACC's expenses and levy income. If ACC's performance as a result of any of these factors is different from what is forecast, ACC may increase or decrease levies. An increase or decrease in levies has a flow-on impact on total Crown revenue with a corresponding impact on the operating balance before gains and losses.

Finance – Mixed Ownership Model (Unchanged, Unquantified)

The Government is considering applying the type of Mixed Ownership Model that is currently used for Air New Zealand to Genesis Energy, Meridian Energy, Mighty River Power and Solid Energy, and further reducing the Crown's shareholding in Air New Zealand. The final amount and timing of any cash proceeds, the flow-on effects for future dividend streams and any implementation costs are uncertain.

Revenue – Apportionment Rules for Mixed-Use Assets (Changed, Unquantified)

An issues paper has been released on the apportionment rules that apply to tax deductions for assets which are used to earn income and which are also partly used for private purposes. Any changes to those rules will have a positive impact on tax revenue.

Revenue – Income-Sharing Tax Credits (Unchanged, Quantified)

The Government has introduced legislation to establish an income-sharing tax credit. If passed as introduced, the legislation will allow couples with children under the age of 18 to pool their earnings for income tax purposes if they meet certain criteria. If implemented, the changes will reduce tax revenues by $500 million per annum once the scheme is fully operational. The Finance and Expenditure Committee has reported back recommending that the significant fiscal cost of the package be addressed before the Bill proceeds further.

Revenue – Potential Tax Policy Changes (Changed, Unquantified)

The tax policy work programme announced by the Government includes a number of items which are under consideration, including:

- the tax treatment of charitable giving
- the imputation system
- amortisation of capital-raising costs
- the international tax review
- the GST treatment of cross-border business activities
- the tax treatment of hybrid instruments
- the dividend review, and
- the review of specified minerals rules.

The Government aggregates the revenue impacts of most tax policy changes, and measures on the work programme are expected to be revenue-neutral or positive in aggregate.

Revenue – Salary Trade-Offs (Changed, Unquantified)

The Government is reviewing the tax treatment of employee benefits traded off for salary, including the treatment of car parks. Any changes are expected to result in an increase in tax revenues.

Services funded by Third Party Revenue (Changed, Unquantified)

A wide range of government activities are funded through third party fees and charges. Demand for these services can vary, which has a direct effect on revenue. There is a risk that changes will be required to the way services are delivered, which could result in costs to the Crown.

Pending policy decisions affecting expenses

Climate Change – Review of the Emissions Trading Scheme (Changed, Quantified)

A statutory review of the ETS was published on 15 September 2011, which included recommendations to change the ETS settings with an estimated fiscal cost of up to $585 million between 2013 and 2020, calculated at a $25 carbon price. These estimates are subject to change, based on emissions forecasts and the carbon price. There are other recommendations that have not yet been quantified fully by officials, as well as potential savings that could be used to achieve a fiscally neutral outcome.

Education – Early Childhood Education Funding (Changed, Unquantified)

Rising demand for Early Childhood Education (ECE) services and increased costs associated with inflation have the potential to raise the costs of Government subsidies to ECE services.

Education – Upward Adjustment for School Operating Funding (Unchanged, Unquantified)

The Government has increased school operating grants in Budget 2011 to help meet increased costs associated with inflation. A risk remains that similar cost pressures will need to be addressed in future years.

Government Response to Wai 262 (New, Unquantified)

The Waitangi Tribunal released its report on the Wai 262 claim on 2 July 2011. The report focuses on the protection of Māori culture and identity, with a particular focus on mātauranga Māori and associated taonga. The Tribunal's recommendations are directed towards a number of Government agencies individually, as groups and across sectors. The Government is currently considering the Tribunal's report and recommendations to fully understand their implications (including any fiscal implications).

Housing – Reform of Social Housing (Changed, Unquantified)

The Government has decided to change the policy settings for social housing. This includes increasing third party providers of social housing, increasing the effectiveness of financial assistance and focusing Housing New Zealand Corporation on providing social housing to those with the greatest housing need. Plans for implementation remain under development, but potentially represent a significant fiscal risk to the Crown. However, there may be offsetting financial benefits to the Crown if significant gains in efficiency are achieved.

Revenue – KiwiSaver Auto-Enrolment (New, Quantified)

In Budget 2011 the Government announced its intention to consult on the design of a one-off KiwiSaver auto-enrolment exercise to increase the number of KiwiSaver members. The Government has recently announced that it intends to proceed with auto-enrolment in 2014/15 subject to returning to surplus as planned. Depending on the timing, design features and take-up rate, an auto-enrolment exercise is likely to entail a one-off cost for kick-start payments to new members and ongoing additional costs for the Member Tax Credit. These costs could be in the order of $350 to $550 million over the first four years after the auto-enrolment took place.

Revenue – Transformation and Technology Renewal (Changed, Unquantified)

Inland Revenue is exploring options that will fundamentally change the way it manages its processes and data, in order to deliver smarter, modern services for less. Technology renewal is a key enabler to support Inland Revenue's future business model and focuses on sustaining current systems (ie, minimising known risks within existing technology), through to significant business process and technology changes. Any changes could impact tax revenue collections and/or have material administrative costs to implement.

Reviews of Public Services (Unchanged, Unquantified)

The Government has initiated a series of reviews to improve the effectiveness and efficiency of public services. Reviews may recommend, or result in, changes to service delivery and/or free up resources for reprioritisation within Votes or be used to meet pressures in other areas.

Social Development – Welfare Working Group Recommendations (Changed, Unquantified)

The Government is considering its response to the recommendations of the Welfare Working Group. Many of the recommendations would result in large upfront costs if adopted. The Government will make policy and funding decisions over the next year.

State Sector Employment Agreements (Unchanged, Unquantified)

A number of large collective agreements are due to be renegotiated in the short-to-medium term. As well as direct fiscal implications from any changes to remuneration, the renegotiation of these agreements can have flow-on effects to remuneration in other sectors. The Government has signalled an expectation of restraint given the current economic environment.

Pending capital decisions

Agriculture and Forestry – Investment in Water Infrastructure (Changed, Unquantified)

In Budget 2011 the Government established a funding programme to support potential irrigation development projects to an investment-ready stage. The Government intends to consider investing up to $400 million of equity for the construction and operation of water harvesting, storage and off-farm distribution infrastructure as part of Budget 2013. The proposal will provide detailed advice on the key investment principles and the provision of a clear separation in the Crown's role in supporting scheme development and investment decisions.

Departmental Capital Intentions (Unchanged, Unquantified)

The Government requires 15 capital-intensive agencies to identify their capital spending intentions over the next 10 years based on current policy settings and certain demographic and inflation assumptions. The difference between capital intentions and currently available funding is material but the Government expects that these intentions will be managed back through a range of measures such as prioritisation, changes to asset utilisation, alternative methods of service delivery and changes to policy settings. Departmental capital intentions are risks to the extent that they cannot be managed through these mechanisms or funded through existing funding sources.

Finance – Crown Overseas Properties (Unchanged, Quantified)

The Government holds New Zealand House in London on a long-term lease from the Crown Estate (UK). Depending on the Government's future intentions for this building, an upgrade may be required. Preliminary cost estimates for this upgrade total $150 million over the period 2012/13 to 2014/15.

Transport – Support for New Zealand Railways Corporation (Changed, Unquantified)

The Government has agreed in principle to support a 10-year strategy for the New Zealand Railways Corporation (NZRC, trading as KiwiRail Group) to achieve a commercially viable rail network. A total of $750 million in capital over the years to 2012/13 is forecast as the Crown contribution towards the strategy, but its disbursement will be dependent on the approval of suitable business cases and demonstrable progress towards objectives. Budgets 2010 and 2011 provided $500 million in capital towards the strategy. KiwiRail will be submitting a case for the third tranche of the $750 million as part of Budget 2012.

KiwiRail has signalled that completing the strategy will require $243 million in 2013 and $90 million in 2014. These costs are consistent with the $1.1 billion expected over the life of the plan, but are not yet funded.

KiwiRail also has $442 million in debt to the Crown maturing in the forecast period, all of which may need to be refinanced. In Budget 2011 $250 million was refinanced and $180 million falls due in 2012/13.

Matters dependent on external factors

ACC – Non-Earners' Account (Changed, Unquantified)

Changes in tax settings, economic factors and ACC's financial performance affect the Crown's liability for claims by non-earners. This is most evident in changes in discount rates that affect the Outstanding Claims Liability. If ACC's performance is different from what is forecast as a result of any of these factors, the amount required to cover the costs of non-earners' claims for that year may be more or less than needed, resulting in unplanned savings or costs to the Crown.

ACC – Work-related Gradual Process Disease and Infection (New, Unquantified)

The Department of Labour, in conjunction with the ACC, is seeking Crown Law advice to clarify the legal interpretation of when Work-related Gradual Process Disease and Infection claims should be recognised: at the date that someone first presents to a health provider with an injury (ACC's current interpretation) or the date that a person is first exposed to the injury-causing event. If the interpretation is the latter, ACC would need to recognise the additional liability.

ACC, Education, Health, Social Development – Caregiver Employment Conditions (Changed, Unquantified)

On 12 September 2011 the Government approved a negotiated settlement for sleepover providers whose service contracts are funded from Vote Health. The Government will contribute to the employers' payment of backpay and increased wages but the increased service cost to Health has only been partially funded. There is also a risk that this decision will have implications for other Crown-funded services, resulting in flow-on costs in ACC, Education and Social Development.

Canterbury Earthquake – AMI Support Package (Changed, Unquantified)

The net cost to the Crown of the AMI Support Package is currently estimated to be $335 million. The two main risks around this estimate are the ultimate cost of claims related to the Canterbury earthquakes (around which there is still considerable uncertainty) and the level of proceeds from the sale of the remaining good AMI business. Although the risks could be positive or negative, the reported claims liability estimates are based on the 75th percentile of the Appointed Actuary's estimated distribution of claims and therefore include a significant contingency against further deterioration.

Canterbury Earthquake – EQC (New, Unquantified)

The Crown faces increased risk relating to the Earthquake Commission's (EQC) disaster cover because the Natural Disaster Fund (NDF) is expected to be depleted after settling current Canterbury earthquake claims. The Government is liable to meet any deficiency in the EQC's assets required to fund future claims under section 16 of the Earthquake Commission Act 1993.

The deficiency in the EQC's assets as a result of the Canterbury earthquakes is estimated at $490 million and the core Crown's net debt has increased to allow for this shortfall. The estimated amount is based on a number of forecast assumptions, including:

- an actuarial estimate of the EQC's outstanding claims liability at 30 June 2011 (net of reinsurance recoveries)
- expected future levy income, and
- forecasts of ongoing operational costs, including reinsurance.

There is a high degree of uncertainty regarding the final cost of claims and reinsurance recoveries, which means the extent to which the EQC's assets are deficient is also highly uncertain. Measures to manage the risk associated with the deficiency in the short term, such as the purchase of additional reinsurance, may have a fiscal impact.

Future earthquakes or other natural disasters would increase the Crown's liability under section 16.

Given the significant impact of the Canterbury earthquakes on the Commission and its NDF the EQC may be reviewed, which could have a fiscal impact.

Canterbury Earthquake – Exceeding the CERF (Changed, Unquantified)

The Christchurch Earthquake Recovery Fund (CERF) was established in Budget 2011 to meet the Crown's costs of the Canterbury earthquakes. There are a number of pending decisions and possible eventualities that result in a risk that the CERF may be exceeded. These include:

- Land decisions – many properties are still classified as orange or white. Further decisions on land zoning and associated Government policies have yet to be made. These may increase costs to the Crown. There is also a risk that the forecast net cost to the Crown of current Crown offers is understated, mainly due to uncertainty about the extent of recoveries from insurance.
- Demolition and rockfall – the costs of demolition and mitigating rockfall risk are highly uncertain. The Crown may be required to provide a contribution towards costs not met by other parties.
- Infrastructure – not all damage to infrastructure has been fully assessed. There is a risk that the damage is greater than currently expected, which would increase the costs to the Crown.
- Contribution to Council costs – cost-sharing arrangements are yet to be finalised. There is a risk that the Crown share is greater than forecast, which would increase the costs to the Crown. This includes any potential Crown contribution towards the Central Business District Plan costs.

Climate Change – Finance for Developing Countries (Unchanged, Unquantified)

There is an international expectation that developed countries, including New Zealand, contribute finance to developing countries to support adaptation to, and mitigation of, the effects of climate change. Developed countries have committed to mobilising $US100 billion per year by 2020 to address the needs of developing countries. This would come from a wide variety of sources, both public and private.

Climate Change – International Climate Change Obligations (Unchanged, Unquantified)

The Government is currently taking part in international negotiations for a post-2012 international climate change agreement. Currently no rights or obligations are included in the fiscal forecasts for any post-2012 agreement because of the high levels of uncertainty. Any agreement could have significant financial implications, and will need to be recognised at the time.

Climate Change – Kyoto Protocol Obligations (Unchanged, Unquantified)

The fiscal impact of the Government's Kyoto Protocol obligations (2008 to 2012) is currently uncertain. An increase in New Zealand's net emissions or the future transfer of emission units offshore could reduce the net Kyoto position significantly. Increased allocation to emitters or increased participation by foresters under the ETS would negatively impact the Government's ETS position. The fiscal impact of any changes is dependent on the carbon price. The Government may also need to purchase emission units to meet its obligations, which would have a corresponding impact on net debt.

Communications – Potential Impairment in Value of Broadband Investment (Changed, Unquantified)

The Government has committed to capitalise Crown Fibre Holdings with $1.345 billion so that it can invest with private partners in a new network delivering "ultra fast" broadband services. Crown Fibre Holdings has entered into contracts with several partners. Given the nature of the investments made, it is possible that the full value of the investments will not be recovered. The fiscal forecasts include a provision for this impairment, but the final amount of the impairment may vary from this provision.

Defence Force – Asset Valuations (New, Unquantified)

The New Zealand Defence Force is undertaking a wide-ranging review and implementing actions to improve its business as a result of the recent Defence White Paper. The work is expected to test assumptions around asset valuations and operating norms, which may lead to changes to valuations and have an impact on the operating balance.

Defence Force – Future Operationally Deployed Forces Activity (Changed, Quantified)

New Zealand Defence Force personnel are deployed overseas on peace-keeping and United Nations missions. Deployments come with the risk of unforeseen events happening that could incur large costs – for example, the loss of a major military asset in a hostile environment. In addition, maintaining existing deployment levels would result in increased annual operating funding being required. The magnitude of both of these is estimated to be between $10 million and $30 million annually (but could potentially exceed this), subject to any decisions to change existing deployments.

Energy – Crown Revenue from Petroleum Royalties (Unchanged, Unquantified)

The Crown Revenue from Petroleum Royalties is very dependent upon the US dollar value per barrel of oil and the exchange rate. Movements up or down in either of these variables could result in a significant decrease or increase in the Crown revenue. The overall impact for the Crown could therefore be negative or positive. In addition, the Government is currently reviewing the regulatory, royalty and taxation arrangements for petroleum as part of the Petroleum Action Plan. Although the outcomes of this review are still uncertain, any changes to policies in this area could have a significant impact on future revenue from petroleum royalties.

Finance – Entities in Receivership under Crown Retail Deposit Guarantee Scheme (Unchanged, Unquantified)

Eight entities that were guaranteed under the original Deposit Guarantee Scheme and one that was guaranteed under the extended scheme are now in receivership. The Crown recognises its obligations under the schemes as liabilities and its rights of recovery from the receivers as assets. While the reported assets represent the receivers' best prudent estimates of likely recoveries from the receiverships, the eventual return to the Crown is uncertain and dependent upon the value that can be realised from these entities' assets.

Finance – Extended Crown Retail Deposit Guarantee Scheme (Changed, Unquantified)

There are three financial institutions participating in the extended Retail Deposit Guarantee Scheme, which ends on 31 December 2011. These entities have deposits totalling $1.3 billion covered by the guarantee and are listed on the Treasury website. This is the maximum exposure and does not include any offset resulting from the recovery of the remaining assets of financial institutions in the event the guarantee is called upon. The entities participating in the extended scheme are currently assessed as unlikely to default and therefore no provision is considered necessary in relation to the amount guaranteed by the Crown under the extended guarantee. While this represents a best estimate of the expected outcome, a range of outcomes is possible if entities default, including eventual loss to the Crown.

Finance – Government Commitments to International Financial Institutions (Changed, Unquantified)

The forecast level of government commitments to international financial institutions is subject to change, depending on the Government's response to any changed financial plans on the part of these institutions. The risk of government commitments to the International Monetary Fund being called has increased due to the Global Financial Crisis and recent world events, including in the Euro area.

Health – Payment of Family Caregivers (Unchanged, Unquantified)

The Human Rights Tribunal and High Court have ruled that the Ministry of Health's policy of not employing family members to provide care to disabled relatives is in breach of section 19 of the New Zealand Bill of Rights. Leave has been granted to appeal to the Court of Appeal.

Revenue – Cash Held in Tax Pools (Unchanged, Unquantified)

Funds held in tax pools are recognised as an asset to the Crown. There is a risk that funds held in these pools, over and above a customer's provisional tax liability, may be withdrawn, resulting in an unquantified cash loss to the Crown.

Transport – Response to the MV Rena Grounding (New, Unquantified)

On Wednesday 5 October the cargo ship *MV Rena* was grounded on the Astrolabe Reef. The grounding resulted in New Zealand's largest marine oil spill. The *Rena* has a number of containers with hazardous substances in them. Some containers have fallen into the sea and more may also fall. Maritime New Zealand (MNZ) must maintain a reserve to fund an initial response to an oil pollution event and at 30 June 2011 this stood at $3.5 million. The fiscal forecasts also include an additional $12.1 million that the Government has approved for MNZ to fund the clean-up. Under the Maritime Transport Act 1994, some costs of a clean-up can be sought from the polluter. The total cost of the clean-up, salvage response and the contribution of the polluter are not yet known, and therefore additional funding may be required.

Treaty Negotiations – Treaty Settlement Forecast (Unchanged, Unquantified)

The fiscal forecasts include provision for the cost of future Treaty settlements. There is a risk that the timing and amount of the settlements could be different from what is forecast. It is not possible to reliably estimate the value of this difference.

Treaty Negotiations – Relativity Clause (Unchanged, Unquantified)

The Deeds of Settlement negotiated with Waikato-Tainui and Ngāi Tahu include a relativity mechanism. The mechanism provides that, where the total redress amount for all historical Treaty settlements exceeds $1 billion in 1994 present-value terms, the Crown is liable to make payments to maintain the real value of Ngāi Tahu's and Waikato-Tainui's settlements as a proportion of all Treaty settlements. The agreed relativity proportions are 17% for Waikato-Tainui and approximately 16% for Ngāi Tahu. There is a risk that the timing and the amount of the expense for the relativity payments may differ from that included in the fiscal forecasts.

Risks Removed Since the 2011 BEFU

The following risks have been removed since the *Budget Economic and Fiscal Update*:

Expired risks	**Reason**
Defence Force - Sale of Skyhawks and Aermacchi Trainers	Decision taken to dispose of Skyhawks and Aermacchi Trainers element does not meet materiality threshold
Housing - Weathertight Homes	No longer material
Justice - Legal Aid	Some decisions taken, no longer material
Revenue - Child Support	No longer material
Revenue - Student Loans Redesign	Decision taken
Social Development – ServiceLink	Project scaled back, no longer material
State Services – KiwiSaver Contribution	Decision taken, risk now managed within departments

Criteria and Rules for Inclusion in the Fiscal Forecasts or Disclosure as Specific Fiscal Risks

The Public Finance Act requires that the Statement of Specific Fiscal Risks sets out all government decisions, contingent liabilities or contractual obligations known to the Government and subject to specific requirements that may have a material effect on the economic or fiscal outlook.[14]

The criteria and rules set out below are used to determine if government decisions or other circumstances should be incorporated into the fiscal forecasts, disclosed as specific fiscal risks or, in some circumstances, excluded from disclosure.

Criteria for Including Matters in the Fiscal Forecasts

Matters are incorporated into the fiscal forecasts provided they meet the following criteria:

- The matter can be quantified for particular years with reasonable certainty.
- A decision has been taken, or a decision has not yet been taken but it is reasonably probable[15] the matter will be approved, or it is reasonably probable the situation will occur.

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[14] The Statement of Specific Fiscal Risks is a requirement set out in sections 26Q and 26U of the Public Finance Act 1989.

[15] For these purposes "reasonably probable" is taken to mean that the matter is more likely than not to be approved within the forecast period (by considering, for example, whether there is a better than 50% chance of the matter occurring or being approved).

Additionally, any other matters may be incorporated into the forecasts if the Secretary to the Treasury considers, using his best professional judgement, that the matters may have a material effect on the fiscal and economic outlook and are certain enough to include in the fiscal forecasts.

Rules for the Disclosure of Specific Fiscal Risks

Matters are disclosed as specific fiscal risks if:

- the likely cost is more than $100 million over five years, and either
- a decision has not yet been taken but it is reasonably possible[16] (but not probable) that the matter will be approved or the situation will occur, or
- it is reasonably probable that the matter will be approved or the situation will occur, but the matter cannot be quantified or assigned to particular years with reasonable certainty.

Additionally, any other matters may be disclosed as specific fiscal risks if the Secretary to the Treasury considers, using his best professional judgement, that the matters may have a material effect (more than $100 million over five years) on the fiscal and economic outlook but are not certain enough to include in the fiscal forecasts.

Exclusions from Disclosure

Matters are excluded from disclosure as specific fiscal risks if they fail to meet the materiality criterion (ie, are less than $100 million over five years), or if they are unlikely[17] to be approved or occur within the forecasting period.

Additionally, the Minister of Finance may determine that a matter be included in the fiscal forecasts or a specific fiscal risk not be disclosed, if such disclosure would be likely to:

- prejudice the substantial economic interests of New Zealand
- prejudice the security or defence of New Zealand or international relations of the Government
- compromise the Crown in a material way in negotiation, litigation or commercial activity, or
- result in a material loss of value to the Crown.

If possible, the Minister of Finance should avoid withholding the matter either by making a decision on it before the forecasts are finalised, or by disclosing it as an unquantified risk.

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16 For these purposes "reasonably possible" is taken to mean that the matter <u>might</u> be approved within the forecast period (by considering, for example, whether there is a 20% to 50% chance of the matter occurring or being approved).

17 For these purposes "unlikely" is taken to mean that the matter <u>will probably not</u> be approved within the forecast period (by considering, for example, whether there is a less than 20% chance of the matter occurring or being approved).

Contingent Liabilities

Contingent liabilities are:

- costs that the Crown will have to face if a particular event occurs, or
- present liabilities that are unable to be measured with sufficient reliability to be recorded in the financial statements (unquantifiable liabilities).

Typically, contingent liabilities consist of guarantees and indemnities, legal disputes and claims, and uncalled capital. The contingent liabilities facing the Crown are a mixture of operating and balance sheet risks, and they can vary greatly in magnitude and likelihood of realisation. In general, if a contingent liability were realised, or the amount becomes sufficiently reliable to record as a liability, it would reduce the operating balance and net worth and increase gross sovereign-issued debt. However, in the case of contingencies for uncalled capital, the negative impact would be restricted to gross sovereign-issued debt.

Where contingent liabilities have arisen as a consequence of legal action being taken against the Crown, the amount shown is the amount claimed and thus the maximum potential cost. It does not represent either an admission that the claim is valid or an estimation of the amount of any award against the Crown.

Only contingent liabilities involving amounts of over $10 million are separately disclosed. Contingent liabilities less than $10 million are included in the “other quantifiable contingent liabilities” total. Comparatives have been adjusted where appropriate to align with the disclosure of new “material” contingent liabilities. The total amount of prior years’ contingent liabilities remains unchanged.

Contingent liabilities have been stated as at 30 June 2011, being the latest set of published contingent liabilities.

Details of each of the following contingent liabilities can be accessed from the Treasury website at http://www.treasury.govt.nz/budget/forecasts/prefu2011.

Quantifiable Contingent Liabilities

Guarantees and indemnities	Status[18]	($ million)
Air New Zealand – letters of credit and performance bonds	Unchanged	34
Cook Islands – Asian Development Bank loans	Unchanged	12
Indemnification of receivers and managers – Terralink Limited	Unchanged	10
Ministry of Transport – funding guarantee	Unchanged	10
Other guarantees and indemnities	Unchanged	12
		78
Uncalled capital		
Asian Development Bank	Unchanged	2,995
Bank for International Settlements	Unchanged	23
European Bank for Reconstruction and Development	Unchanged	12
International Bank for Reconstruction and Development	Unchanged	991
Other uncalled capital	Unchanged	12
		4,033
Legal proceedings and disputes		
Health – legal claims	Unchanged	18
Tax disputes	Unchanged	281
Other legal proceedings and disputes	Unchanged	32
		331
Other quantifiable contingent liabilities		
Air New Zealand partnership	Unchanged	77
Crown Health Financing Agency	Unchanged	24
Inland Revenue Department – unclaimed monies	Unchanged	55
International finance organisations	Unchanged	1,254
Kyoto Protocol units	Unchanged	997
New Zealand Export Credit Office – export guarantees	Unchanged	132
NZTA – Auckland City Council	Unchanged	10
Reserve Bank – demonetised currency	Unchanged	23
Other quantifiable contingent liabilities	Unchanged	127
		2,699
Total quantifiable contingent liabilities		**7,141**

18 Relative to reporting in the *Financial Statements of the New Zealand Government for the year ending 30 June 2011*.

Unquantifiable Contingent Liabilities

Guarantees and indemnities	Status
Air New Zealand	Unchanged
Airways Corporation of New Zealand	Unchanged
AsureQuality Limited	Unchanged
At Work Insurance Limited	Unchanged
Bona Vacantia property	Unchanged
Building Industry Authority	Unchanged
Civil Defence Emergency Management – New Zealand Local Authorities	Unchanged
Contact Energy Limited	Unchanged
Deposit Guarantee Schemes	Unchanged
Electricity Corporation of New Zealand Limited	Unchanged
Genesis Energy – financial guarantees	Unchanged
Genesis Energy – letters of credit and performance bonds	Unchanged
Housing New Zealand Corporation	Unchanged
Indemnities against acts of war and terrorism	Unchanged
Justices of the Peace, Community Magistrates and Disputes Tribunal Referees	Unchanged
Landcorp Farming Limited	Unchanged
Maui Partners	Unchanged
Meridian Energy – letters of credit and performance bonds	Unchanged
National Provident Fund	Unchanged
New Zealand Railways Corporation	Unchanged
Persons exercising investigating powers	Unchanged
Public Trust	Unchanged
Reserve Bank of New Zealand	Unchanged
Synfuels-Waitara Outfall Indemnity	Unchanged
Tainui Corporation	Unchanged
Canterbury Earthquakes:	
Earthquake Commission	Unchanged
Land Zones	Unchanged
Civil Defence Emergency Management – Canterbury Local Authorities	Unchanged
Properties acquired under the Canterbury Red Zone Support Package	Unchanged

Unquantifiable Contingent Liabilities (continued)

Other unquantifiable contingent liabilities	
Abuse claims	Unchanged
Accident Compensation Corporation litigations	Unchanged
Air New Zealand litigation	Unchanged
Environmental liabilities	Unchanged
Family caregivers	Unchanged
Kordia Group Limited	Unchanged
Maui Contracts	Unchanged
Rugby World Cup 2011	Unchanged
Television New Zealand	Unchanged
Treaty of Waitangi claims	Unchanged
Treaty of Waitangi claims – settlement relativity payments	Unchanged
Westpac New Zealand Limited	Unchanged

Contingent assets	
Legal proceedings and tax disputes	Unchanged
Suspensory loans to integrated schools	Unchanged