Guide to the Budget Documents

A number of documents are released on Budget day. The purpose of these documents is to provide information about the wider fiscal and economic picture and the Government's spending intentions for the year ahead. The Budget documents are as follows:

**Executive Summary**
The Executive Summary is the overview of all the Budget information and contains the main points for the media and general public. This section summarises the Government's spending decisions and key issues raised in the Budget Speech, the Fiscal Strategy Report, and the Budget Economic and Fiscal Update.

**Budget Speech**
The Budget Speech is the Minister of Finance's speech delivering the Budget Statement at the start of Parliament’s Budget debate. The Budget Statement generally focuses on the overall fiscal and economic position, the Government's policy priorities and how those priorities will be funded.

**Fiscal Strategy Report**
The Fiscal Strategy Report sets out the Government's fiscal strategy in areas such as the balance between operating revenues and expenses, and debt objectives. The 2012 report includes fiscal trends covering at least the next 10 years and the Government's long term fiscal objectives.

The Government must explain changes in, and/or inconsistencies between, the Fiscal Strategy Report, the Budget Policy Statement and the previous year's Fiscal Strategy Report.

**Budget Economic and Fiscal Update**
The Update includes Treasury's overall economic forecasts and the forecast financial statements of the Government, along with the implications of Government financial decisions and other information relevant to the fiscal and economic position.

**The Estimates of Appropriations**
The Estimates outline expenses and capital expenditure the Government plans to incur on specified areas within each Vote for the financial year about to start (the Budget year).

**Information Supporting the Estimates of Appropriations**
Information Supporting the Estimates is organised on the basis of sectors, with each Vote and its administering department allocated to one sector (only one department is in more than one sector). The Information Supporting the Estimates comprises sector overview information, together with statements of responsibility; performance information for appropriations in Votes covered by the sector; and statements of forecast service performance and forecast financial statements of departments included in the sector. The supporting information includes Statements of Intent of departments in the sector.

**The Supplementary Estimates of Appropriations and Supporting Information**
The Supplementary Estimates outlines the additional expenses and capital expenditure required for the financial year about to end. The Supporting Information provides reasons for the changes to appropriations during the year, related changes in performance information and certain additional performance information for new appropriations.

Internet
These documents will be made available on the New Zealand Treasury’s Internet site at http://www.treasury.govt.nz
Overview

Budget 2012 confirms the Government’s commitment to return the operating balance to surplus in 2014/15, get net debt down to more prudent levels and effectively manage the Crown’s balance sheet.

These objectives will be met while advancing the Government’s programme to build a more productive and competitive economy, deliver better public services and support the rebuilding of Christchurch.

In spite of significant headwinds, the New Zealand economy has grown in nine of the past 10 quarters. The outlook for the next four years is for a steady pace of expansion in activity. Growth will be underpinned by the rebuilding of Christchurch, historically-high terms of trade, and the strength of our key trading partners, including Australia and China.

The build-up in net government debt over recent years has been appropriate in order to absorb much of the shock of the recession, the global financial crisis and the Canterbury earthquakes. However, that build-up could only ever be temporary.

The Government has maintained spending but slowed its growth significantly. In Budget 2012, new spending over the forecast period is matched by a combination of savings and revenue initiatives.

As a result, the fiscal forecasts show a budget surplus in 2014/15, after which net debt will reduce as a proportion of gross domestic product (GDP). This means interest rates will stay lower for longer and the Government can rebuild its fiscal buffer against future shocks.

The Budget also reinforces the Government’s deliberate and active management of the Crown’s large balance sheet.
Economic Context

The New Zealand economy has been growing modestly but steadily, despite significant headwinds. The economy has expanded in nine of the past 10 quarters and a total of 60,000 more people are employed now than were employed two years ago.

This expansion in activity has been achieved in the face of weak world growth, the Canterbury earthquakes, a high New Zealand dollar and an increased level of household saving which is tempering economic growth in the short term.

Looking ahead, New Zealand faces a favourable set of circumstances and opportunities but is not immune from global risks.

The rebuilding of Christchurch will be a key driver of overall domestic activity and is expected to contribute around one percentage point to annual growth in each calendar year from 2012 to 2016.

Our two largest trading partners – Australia and China – are forecast to maintain reasonable growth rates, which will have a flow-on effect for New Zealand.

In addition, New Zealand’s merchandise terms of trade is expected to remain at historically high levels, even as it eases back off recent peaks.

Despite this favourable outlook, the Treasury’s latest economic forecasts show slightly weaker near-term growth than was presented in the 2012 Budget Policy Statement (BPS) earlier this year. This reflects weaker forecasts for growth amongst our trading partners, stemming mainly from the ongoing debt crisis in Europe.

Annual growth is now expected to be 2.6 per cent in the year to March 2013 and 3.4 per cent in the year to March 2014. However, the New Zealand economy is still expected to grow more strongly over the next two years than many other developed countries, including the United States, Canada, the United Kingdom, Japan, and the Euro area.

There are risks to these forecasts. Global growth could be weaker than expected, for example if European policymakers struggle to address the region’s underlying debt challenges. Further seismic activity in the Canterbury region could also push reconstruction activity back further.
Fiscal Strategy

Budget 2012 is about delivering on the Government’s four priorities, which are to:

- responsibly manage the Government’s finances
- build a more productive and competitive economy
- deliver better public services, within tight financial constraints, and
- support the rebuilding of Christchurch.

Responsibly managing the Government’s finances involves the fiscal goals of:

- returning the operating balance to surplus in 2014/15 and getting net debt down to prudent levels
- maintaining a broad-base, low-rate tax system that minimises economic distortions (Annex 2), and
- effectively managing the Crown’s balance sheet.

The Government has updated and strengthened its long-term debt objective. The objective is now to bring net debt down to no higher than 20 per cent of GDP by 2020.

If the economy was hit by a very severe negative shock the Government would look at whether sticking to the current fiscal strategy would harm the economy by forcing a sharp reduction in demand. However, outside that scenario, the Government remains firmly committed to its fiscal strategy, including achieving an operating surplus in 2014/15 and bringing net debt down to 20 per cent of GDP.

Returning to Surplus and Reducing Debt Remains the Key Priority

Structural fiscal deficits¹ and rising debt are not sustainable, nor conducive to the medium- and long-term goals of rebalancing the economy towards tradable activity and lifting potential growth. Eliminating the fiscal deficit and reducing debt will help to:

- restore the fiscal buffer against future adverse events. Future surpluses will allow the Government to bolster the country’s resilience to future shocks. The longer the operating balance remains in deficit, the fewer options there are to deal with future economic shocks and longer-term fiscal pressures. Treasury projections show that delaying a return to surplus by two years, to 2016/17, would increase core Crown net debt by around 5.5 per cent of GDP ($16.7 billion) by 2019/20 (Figure 1).

¹ See the Fiscal Outlook chapter of the 2012 Budget Economic and Fiscal Update for the Treasury’s estimates of other indicators of the operating balance.
• **increase national saving and support higher investment.** Households and businesses are strengthening their financial position by paying off debt and increasing savings. The Government has been supporting the economy through the downturn, but now needs to help lift New Zealand’s national savings by returning to sustained fiscal surpluses. Disciplined spending and sustained surpluses will allow for lower interest rates and exchange rates than otherwise would be the case and is a policy mix more conducive to growth in the tradable sector.

• **reduce future borrowing and finance costs.** Maintaining a clear commitment to return to surplus and reduce debt will differentiate New Zealand from many other countries and ensures international markets will continue to lend to New Zealand at relatively low interest rates. Reducing the Crown’s finance costs also gives the Government flexibility to pursue more worthwhile and productive initiatives.

As discussed on page 9, budget deficits and increases in government debt over recent years have been appropriate in order to absorb much of the shock of the recession, the global financial crisis and the Canterbury earthquakes. Between 2009 and 2011, the fiscal impulse was equivalent to around six per cent of GDP (Figure 2).

However, that fiscal stimulus, and the resulting build-up in debt, could only ever be temporary. Since Budget 2009, the Government has been charting a course to tighten spending, return to surplus, cap the increase in public debt as a share of GDP and bring this debt down to more prudent levels.

Developments over the past year have threatened to delay the return to surplus. Global growth has been lower than expected, further seismic activity in Canterbury has delayed rebuilding, and costs in a number of areas – including the Accident Compensation Corporation (ACC) and the Earthquake Commission (EQC) – have been higher than previously expected.

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2 The fiscal impulse indicator is based on the annual change in a cash-based version of the Government’s cyclically-adjusted budget balance. Further information on the methodology can be found in New Zealand Treasury Working Paper 02/30 http://www.treasury.govt.nz/publications/research-policy/wp/2002/02-30/
The Government is taking the opportunity to deliver a “zero Budget”, where new spending over the forecast period is matched by a combination of savings and revenue initiatives (Table 1).

As a result, the fiscal forecasts continue to show a budget surplus being achieved in 2014/15. Fiscal policy is expected to be contractionary over the forecast period (Figure 2).

The forecast new operating allowances for future Budgets remain as they were in the BPS. The allowances in Budgets 2013 and 2014 are $800 million and $1.19 billion respectively, rising after 2014 by two per cent in each Budget.

**Table 1 – Summary of Budget 2012 new initiatives**

<table>
<thead>
<tr>
<th></th>
<th>2011/12</th>
<th>2012/13</th>
<th>2013/14</th>
<th>2014/15</th>
<th>2015/16</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>New spending</td>
<td>15</td>
<td>1,102</td>
<td>1,082</td>
<td>1,126</td>
<td>1,092</td>
<td>4,417</td>
</tr>
<tr>
<td>less Savings (including revenue initiatives)</td>
<td>703</td>
<td>757</td>
<td>811</td>
<td>1,071</td>
<td>1,049</td>
<td>4,391</td>
</tr>
<tr>
<td><strong>Net increase / (decrease)</strong></td>
<td><strong>(688)</strong></td>
<td><strong>345</strong></td>
<td><strong>272</strong></td>
<td><strong>55</strong></td>
<td><strong>43</strong></td>
<td><strong>27</strong></td>
</tr>
</tbody>
</table>

Note: Numbers may not add exactly to the stated totals owing to rounding

To limit borrowing, the Government also remains committed to spending no new money on capital projects in this and the next four Budgets. New capital investments will be funded from capital freed up from the Crown’s balance sheet – including through partial asset sales – rather than from additional borrowing.

The fiscal forecasts show net Core Crown debt peaking at 28.7 per cent in 2013/14.

**Delivering Better Public Services within Tight Financial Constraints**

A better-performing State sector is central to the Government’s plans over the next three years. The Government wants to see better results and improved services from the State sector, as well as reduced costs and more efficiency.

As shown in Figure 3, new operating allowances are a small fraction of total core Crown expenses compared to the base of existing spending, much of which is in areas such as health, education and welfare. The Government is committed to controlling fluctuations and reducing pressures across all areas of existing spending, while continuing to improve public services.

Budget 2012 identifies savings of $3 billion, which are being used to fund higher priority areas of spending. This builds on the past three Budgets which
collectively committed to savings of $9 billion over five years, which were also re-invested in public services.

Government departments have prepared four-year budget plans based on an indication of their future funding. In most cases that means no extra money. In addition, government agencies together have been asked to find almost $1 billion in savings over three years.

This has driven a number of changes in behaviour in the State sector. Government agencies have, for example, been jointly purchasing supplies such as vehicles, office supplies, air travel and legal services. Agencies have also been working together to share corporate services, like finance and human resources.

At the same time, the Government is focusing very strongly on achieving better results. Earlier this year the Prime Minister announced 10 key results for the public sector to achieve over the next three to five years. The results fall within five themes: reducing long-term welfare dependency; supporting vulnerable children; boosting skills and employment; reducing crime; and improving interaction with government. Measurable and stretching targets will sit underneath each result.

This focus on results is part of a wider programme of public sector reform – the Better Public Services project – which includes:

- government agencies working more closely together, sharing functions and services and developing joint systems
- more contestability in service provision and use of alternative providers
- greater use of technology and a shift to digital channels, so New Zealanders can more easily access public services
- agencies collecting, using and publishing better performance information, and
- a greater responsiveness to the needs and expectations of New Zealanders.

**Investing in the Future**

The Government intends to offer the public shares in four State-owned enterprises (SOEs) – Mighty River Power, Meridian, Genesis Energy, and Solid Energy – as well as reducing its shareholding in Air New Zealand. The Crown will continue to hold at least 51 per cent of the shares in each company.

This share offer will free up capital so the Government can invest in more public assets and new infrastructure without having to borrow to do so. The “Government’s partial share sales” box on page 7 shows how this programme of partial sales is reflected in the Treasury’s fiscal forecasts.

The Government has established the Future Investment Fund to receive all proceeds from the share offers – expected to be between $5 billion and $7 billion. The Fund will re-invest these proceeds in other public assets like schools and hospitals over the next few Budgets. In particular, the Government has earmarked $1 billion of the Fund for modernising and transforming New Zealand’s schools.
Budget 2012 allocates $559 million to capital projects from the Fund. Provision has also been made in the fiscal forecasts for a further $3 billion to be allocated from the Fund over the next three Budgets.

The Fund makes it clear that the partial sale of shares in the SOEs does not result in any net loss of public assets, but simply changes the mix of those assets.

### Government's partial share sales

The Government intends to sell up to 49 per cent of its shareholdings in the SOEs Mighty River Power, Meridian, Genesis Energy, and Solid Energy and reduce the Crown’s current shareholding in Air New Zealand.

Mighty River Power is the first company being prepared for partial share sales, via an Initial Public Offering, which is expected to commence in the third quarter of 2012, subject to market conditions.

Table 2 below outlines the forecast fiscal impacts of the Government’s partial sale of shares in these five companies. These assumptions are similar to those reported in the BPS, but the assumptions and accounting treatment have been slightly revised in accordance with International Accounting Standards.

#### Table 2 – Estimated fiscal impact of extending the partial share sales

<table>
<thead>
<tr>
<th>Year ending 30 June</th>
<th>2013 Forecast</th>
<th>2014 Forecast</th>
<th>2015 Forecast</th>
<th>2016 Forecast</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash/Debt impact</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Forecast cash proceeds</td>
<td>1,500</td>
<td>1,500</td>
<td>1,500</td>
<td>1,500</td>
<td>6,000</td>
</tr>
<tr>
<td>Forecast forgone dividends</td>
<td>(50)</td>
<td>(90)</td>
<td>(140)</td>
<td>(180)</td>
<td>(460)</td>
</tr>
<tr>
<td>Estimated finance cost savings</td>
<td>55</td>
<td>91</td>
<td>173</td>
<td>256</td>
<td>575</td>
</tr>
<tr>
<td>Reduction in net debt</td>
<td>1,505</td>
<td>1,501</td>
<td>1,533</td>
<td>1,576</td>
<td>6,115</td>
</tr>
<tr>
<td><strong>Accrual impact</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Forecast forgone profits</td>
<td>(90)</td>
<td>(180)</td>
<td>(270)</td>
<td>(360)</td>
<td>(900)</td>
</tr>
<tr>
<td>Estimated finance cost savings</td>
<td>55</td>
<td>91</td>
<td>173</td>
<td>256</td>
<td>575</td>
</tr>
<tr>
<td>Net decrease in the operating balance before gains and losses (OBEAGL)</td>
<td>(35)</td>
<td>(89)</td>
<td>(97)</td>
<td>(104)</td>
<td>(325)</td>
</tr>
<tr>
<td>Forecast gain on disposal recorded in taxpayer funds</td>
<td>200</td>
<td>200</td>
<td>200</td>
<td>200</td>
<td>800</td>
</tr>
<tr>
<td>Increase in net worth attributable to the Crown</td>
<td>165</td>
<td>111</td>
<td>103</td>
<td>96</td>
<td>475</td>
</tr>
</tbody>
</table>

Estimated finance costs are based on average bond yields.

Profits include dividends paid in cash to shareholders and earnings that are retained by the company.

Source: The Treasury

The estimated fiscal impact of the partial share sales is:

- a $6.1 billion reduction in net debt. Proceeds will reduce the Crown's borrowing requirement. Forgone dividends increase net debt but are offset by estimated finance cost savings
- a $325 million reduction in the operating balance before gains and losses (OBEAGL). Profits attributable to minority shareholders (forgone profits) reduce the surplus. This is offset somewhat by a reduction in finance costs resulting from the reduced net debt, and
- a $475 million increase in net worth attributable to the Crown over the forecast horizon. Gains on disposal are forecast, reflecting an expectation that sale prices will be greater than the proportion of the companies’ carrying value divested by the Government.
Managing the Crown's Balance Sheet

The Government has been moving to more consistent and deliberate management of the Crown's balance sheet – that is, what it owns and what it owes. This will ensure that public assets are used as efficiently and effectively as possible, and that public services can continue to be provided to desired levels in the future.


Numerous steps have been, and will continue to be, taken to give effect to this strategy including:

- **rebuilding the Crown's balance sheet buffer against future adverse events.** The Crown's balance sheet has played a crucial role in supporting New Zealand through the events of recent years, but that necessarily makes it less able to deal with future shocks. The Government's fiscal strategy focuses on quickly rebuilding its fiscal buffer through a return to surplus in 2014/15 and a subsequent reduction in net debt as a percentage of GDP.

- **reducing the Crown's risk exposures.** In cushioning New Zealanders from the worst impacts of recession, the global financial crisis and the Canterbury earthquakes, the Crown took ownership of a number of risky assets and liabilities, through initiatives such as the Retail Deposit Guarantee Scheme (RDGS), introduced in 2008, and its support for AMI Insurance. The Government is actively managing its balance sheet to reduce these risks.

- **prioritising capital to its highest value use.** Establishing the Future Investment Fund allows the Government to reallocate its capital from lower-priority areas to investments that will enhance the efficiency and effectiveness of the State sector and improve New Zealand's infrastructure.

- **sharpening incentives on State agencies to use existing Crown capital well.** Through a number of mechanisms the Government is encouraging State sector agencies to use capital more efficiently. This is being reinforced through the Better Public Services project, which places strong emphasis on agencies collaborating on capital investment decisions and driving efficiency improvements through better transparency, and

- **introducing private sector capital and disciplines.** The Government intends to participate in PPPs where appropriate to introduce private sector expertise and risk-sharing. PPPs have been announced for the new prison at Wiri and two schools at Hobsonville. The Better Public Services project also emphasises more contestability in service provision and greater use of alternative service providers.
Assessment of Past Fiscal Strategy

The fiscal position has deteriorated sharply in response to one-off shocks

When the National-led Government presented its first Budget in 2009, it did so against the backdrop of a sharp recession that had started in early 2008, and the impact of the worst global financial crisis since the 1930s.

The Government’s challenge was to provide support to the economy when it was most needed, and cushion New Zealanders from the effects of the recession, but to do so within a clear framework which would deliver a prudent fiscal position in the medium term.

The Government’s plan was to support the economy in the near term by running operating deficits, then reduce these deficits by slowing growth in government expenditure as the economy recovered. The Government also signalled its intention to invest in the productive capacity of the economy and increase its focus on the Crown’s balance sheet.

Since Budget 2009, New Zealand has also experienced the Canterbury earthquakes, a slower-than-expected global recovery and the impact of the RDGS. These events led to an even greater deterioration in the fiscal position than had previously been anticipated.

The Government could have responded by sharply reducing expenditure or increasing taxes. However, this would have risked damaging the economy at a time when the recovery was still fragile. The Government chose to run a larger deficit and absorb much of the impact on its own balance sheet to enable the economy to get back on track.

The OBEGAL deficit deteriorated to $18.4 billion (9.2 per cent of GDP) in the year to June 2011 (Figure 4), and core Crown operating expenses increased to 35.2 per cent in the same fiscal year, the highest share of GDP since the early 1990s. At the same time, core Crown revenue declined to 28.7 per cent of GDP (Figure 5). The one-off effects of the Canterbury earthquakes and the RDGS added around $9.25 billion (4.6 per cent of GDP) to the OBEGAL deficit in 2010/11.

3 Forecasts from 2009 have been re-based as a share of GDP reflecting historical revisions to nominal GDP.
But the fiscal outlook has improved considerably

Projections of the future fiscal position have improved significantly over time. Budget 2009 projected core Crown net debt to be more than 30 per cent of GDP in the early 2020s (Figure 6), driven by annual budget deficits through to 2018/19.

Policy decisions have reduced core Crown expense growth and lowered projected debt levels. Early decisions to improve the fiscal position have a large impact in future years owing to the compounding effects of lower interest costs and lower debt levels.

The operating balance is now forecast to return to surplus by 2014/15, net debt is projected to decline as a proportion of GDP from 2014/15, and net worth is projected to have recovered to pre-crisis levels by the mid-2020s.

Over its four Budgets, the Government’s spending in the final year of the forecast period on discretionary operating and revenue initiatives has totalled only around $750 million. This has been achieved by:

- reprioritising spending from lower-value to higher-value activities
- reining back on policies that had significant cost escalations built into them
- ensuring that major programmes of tax changes were broadly fiscally neutral
- driving more efficiency in the State sector
- better targeting government financial assistance, and
- broadening the tax base and clamping down on tax avoidance.

At the same time, the Government has continued to invest in major infrastructure projects. In Budget 2009 the Government announced its plan to spend $7.5 billion on new capital initiatives over the next five years.

In the past, New Zealand’s public sector investment in infrastructure has tended to be lumpy and subject to significant swings, particularly in the face of recessions and other fiscal pressures. The Government has focused on prioritising new capital investment to areas that lead to productive infrastructure and better delivery of public services.
Strengthening the Fiscal Responsibility Provisions of the Public Finance Act 1989

The fiscal responsibility provisions in the Public Finance Act 1989 (PFA) have served New Zealand well by focusing on prudent levels of public debt. However, the current provisions have little power to curb increases in spending once this debt objective has been achieved, and to ensure governments consider the impacts of fiscal policy on future generations.

To address these concerns, the Government is proposing a number of changes to the fiscal responsibility provisions of the PFA, which will be introduced later this year and should come into effect from the 2013 Fiscal Strategy Report (FSR). The proposed changes will require governments to:

- consider the impact of fiscal policy on the economic cycle
- set out their priorities for revenue, spending and the balance sheet
- take into account the impact of fiscal policy decisions on future generations, and
- report on the successes and failures of past fiscal policy.

Some of the proposed PFA amendments simply codify existing good practice to ensure it continues in the future. This includes the publication of a revenue strategy (Annex 1) and an investment statement.

Other amendments have been implemented into this FSR ahead of being a legislative requirement. This includes an assessment of the National-led Government’s fiscal performance during its first term in office (pages 9 and 10).

This Budget, the Government is also committing itself to a spending limit. The spending limit restricts growth in core government expenses (excluding Unemployment Benefits, debt-financing costs, asset impairments, and natural disasters) to no higher than the rate of inflation and population growth.

The spending limit sets out an upper bound on spending. The Government’s current fiscal strategy will result in core Crown expenditure being considerably below the spending limit for at least the next 10 years (illustrated in the “Short-term Fiscal Intentions and Long-term Fiscal Objectives” section).

The Government is consulting with other political parties about the possible introduction of a more formal spending rule.
Short-term Fiscal Intentions and Long-term Fiscal Objectives

The PFA requires that the FSR states the Government’s long-term fiscal objectives, for 10 years or more, for operating expenses, operating revenues, the balance between operating expenses and revenues, the level of debt and the level of net worth. The Government is also required to indicate short-term fiscal intentions for those variables for at least three financial years. The Government’s short-term fiscal intentions and long-term fiscal objectives are consistent with the principles of responsible fiscal management, as set out in section 26G(1) of the PFA. These intentions and objectives are formally laid out in Annex 2.

**Short-term fiscal intentions**

The Government’s intention is to return the total Crown OBEGAL to a surplus no later than 2014/15. Current forecasts set out in the 2012 Budget Economic and Fiscal Update show this being achieved.

The deficit peaked at $18.4 billion or 9.2 per cent of GDP in 2010/11. It is forecast to more than halve to $8.4 billion or 4.1 per cent of GDP in 2011/12. This improvement is driven by a six percentage point reduction in total Crown expenses as a portion of GDP, reflecting the unwinding of many of the one-off earthquake expenses incurred in 2010/11.

Further out, the path back to surplus is driven by a combination of a recovery in revenues as a share of GDP and a reduction in expenses as a share of GDP.

Table 3 shows the nominal growth in core Crown expenses over the next four years, including its forecast track relative to the Government’s new spending limit.

In nominal terms, core Crown expenses are forecast to increase by $6.8 billion over the next five years. However, the Government is committed to ensuring that operating expenses grow more slowly than the economy as a whole, and within the bounds of the spending limit. This will see core Crown expenses as a percentage of GDP fall to 30.2 per cent of GDP by 2015/16 – the lowest level since 2004/05.
Table 3 – Cumulative growth in core Crown expenses

<table>
<thead>
<tr>
<th>Year ended 30 June</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>$billion Forecast</td>
<td>Forecast</td>
<td>Forecast</td>
<td>Forecast</td>
<td>Forecast</td>
<td>Forecast</td>
</tr>
</tbody>
</table>

### Movements in expenditure

#### New spending
- **Budget 2011 decisions**: 0.4 (0.1) (0.4) (0.3) (0.3)
- **Budget 2012 decisions**: (0.7) 0.5 0.6 0.4 0.6
- **Budget 2013 allowance**: - - 0.8 0.8 0.8
- **Budget 2014 allowance**: - - - 1.2 1.2
- **Budget 2015 allowance**: - - - - 1.2

#### Forecast changes
- **New Zealand Superannuation costs**: 0.8 1.4 2.0 2.8 3.5
- **Other social assistance**: (0.1) - (0.1) (0.1) 0.1
- **Emissions Trading Scheme**: (0.2) (0.6) (0.6) (0.4) (0.2)
- **Debt impairments**: 0.2 0.5 0.6 0.4 0.5

#### Other movements
- **Finance costs**: 0.5 0.7 0.9 1.2 1.2
- **Weathertight homes**: (0.8) (0.6) (0.6) (0.6) (0.6)
- **Earthquake expenses**: (0.9) 0.6 (1.2) (1.4) (1.5)
- **Other movements**: (0.1) 0.8 0.4 0.4 0.3

#### Increase/(decrease) in core Crown expenses
- (0.9) 3.2 2.4 4.4 6.8

#### 2011 Core Crown expenses
- 70.5 70.5 70.5 70.5 70.5

#### Core Crown expenses
- 69.6 73.7 72.9 74.9 77.3
- Core Crown expenses (% of GDP) 33.5 33.8 31.5 30.7 30.2

#### Core Crown spending limit
- 63.5 66.9 68.8 71.3 73.6

#### Core Crown expenses covered by spending limit
- 63.5 65.3 66.0 68.2 70.6

#### Difference
- - (1.6) (2.8) (3.1) (3.0)

1. The spending limit excludes Unemployment Benefits, debt financing costs, asset impairments, and natural disasters

Source: The Treasury

On the capital side, the Crown’s net worth is forecast to initially weaken before stabilising towards the end of the forecast period. The Government’s capital priorities will result in changes in the composition of the Crown balance sheet (Figure 8).

The Government’s Social Portfolio is expected to grow the most in net value, by $12.2 billion over the next five years, consistent with the Government’s prioritisation of capital towards the highest-value social and infrastructure areas. The Government intends to manage the Social Portfolio in a manner consistent with delivering value-for-money public services, as well as concentrating new investments in areas where ownership risks cannot cost-effectively be carried by the private or not-for-profit sectors.

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4 The Crown’s balance sheet consists of three portfolios. The “Social Portfolio” consists of the assets and liabilities held primarily to provide public services or to protect assets for future generations; the “Financial Portfolio” reflects assets and liabilities held by the Crown to finance or pre-fund government expenditure; while the Crown’s “Commercial Portfolio” consists of the portfolio of companies held with purely commercial objectives. For more details, see the Investment Statement of the Government of New Zealand 2010 on the Treasury website (www.treasury.govt.nz).
The Government’s Commercial Portfolio is expected to grow by $2 billion over the next five years.

The Government’s Financial Portfolio is the only portfolio expected to experience a decline in net value, from -$47.2 billion to -$63.1 billion. This underscores the importance of the Government’s commitment to rebuilding the Crown’s financial buffer and holding and accumulating financial assets, where appropriate, against future adverse events.

**Long-term fiscal objectives**

The fiscal projections in Figures 9 to 13 assume a continuation of current government policy settings, including operating and capital spending, until the end of the projection period.5

The Government is committed to its long-term debt objective to ensure net debt remains consistently below 35 per cent of GDP. To further underline its commitment to returning net debt to prudent levels, the Government has amended the long-term objective to ensure that net debt is brought back to a level no higher than 20 per cent of GDP by 2020 (from the previous “...the early 2020s”). This will ensure that future governments and generations have better choices over fiscal policy.

Core Crown net debt is forecast to peak at 28.7 per cent of GDP in 2013/14, slightly lower and earlier than in the 2011 Pre-election Economic and Fiscal Update (Figure 9). Net debt is currently projected to be 21 per cent of GDP in 2020 – slightly higher than the Government’s long-term objective.

However, net debt remains on a downward trajectory throughout the projection period and reaches two per cent of GDP by 2025/26.

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5 See Annex 3 for more details.
Net worth is expected to start building up from 2013/14 (Figure 10).

Contributions to the New Zealand Superannuation Fund are projected to resume in 2017/18, the same as forecast in the 2011 Pre-election Economic and Fiscal Update. This will assist in meeting some, but not all, of the future fiscal pressures from population ageing.

Figure 11 shows the projected paths for core Crown revenue and expenses. Revenue is projected to increase as a proportion of GDP until 2020/21, at which point tax ratios are assumed to remain broadly stable.

Ongoing expenditure restraint is essential for New Zealand’s long-term fiscal sustainability and to put the country back on a sustainable growth path, with economic growth led by the private sector. The long-term objective for operating expenses is consistent with the objectives of running sufficient surpluses to return debt to prudent levels.\(^6\) The Government will restrain the growth in government spending so that, over time, core Crown expenses are reduced to below 30 per cent of GDP. This objective has been changed since the BPS to ensure consistency with the Government’s spending limit (Figure 12).

Total Crown OBEGAL is projected to continue increasing as a share of GDP throughout the projection period, reaching more than four per cent of GDP in the mid-2020s (Figure 13).

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\(^6\) The long-term fiscal objectives in Annex 2 explain how operating expenses have to correspond to an operating surplus sufficient to meet the Government’s net capital requirements, including contributions to the NZS Fund, and ensure consistency with the debt objective.
Comparison with longer-term fiscal projections

The fiscal projections in Figures 9 to 13 extend to June 2026, which is a decade beyond the final forecast year and is the period of time typically covered in fiscal strategy reports.

In the longer term, however, demographic factors increasingly come into play. An ageing population will place increasing and significant upward pressure on core Crown expenses such as New Zealand Superannuation and health.

To help understand the impact of these longer-term cost pressures, the Treasury uses a different methodology that assumes government expenses are driven by the expected demand for public services, rather than a continuation of current government fiscal policy.

A key message from the longer-term projections is that fiscal decisions made in the near to medium term can substantially alter the longer-term fiscal outlook.

This does not mean that the longer-term fiscal challenge from an ageing population has been solved. But the Government’s commitment to prudent fiscal management, as well as an improvement in economic forecasts since the depths of the global financial crisis, has improved the longer-term fiscal projections hugely since 2009 (Figure 14).

The Treasury is required by legislation to publish a statement on the long-term fiscal position, at least every four years, that looks at least 40 years into the future.

The last Long-term Fiscal Statement was published in October 20097 and a full update is scheduled to be released in early 2013. The next Statement will play a key role in meeting the proposed new fiscal responsibility principle of the PFA that will require governments to take into account the impact of fiscal policy decisions on future generations.

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Annex 1

Revenue Strategy

*Government’s objectives for the tax system*

The Government is committed to building a stronger economy and increasing productivity.

The tax system should be as fair and efficient as possible in raising the revenue required to meet the Government’s needs. The Government supports a broad-base, low-rate tax system that minimises economic distortions.

The Government considers these goals are best supported by a tax system that:

- maintains revenue flows to pay for valued public services and reduce debt
- responds to New Zealand’s medium-term needs in a planned and coherent way
- biases economic decisions as little as possible – which allows people to work, save, spend or invest in ways that they believe are best for them
- rewards effort and individuals’ investment in their own skills
- has low compliance costs and low administrative costs
- minimises opportunities for tax avoidance and evasion, and
- shares the tax burden as fairly as possible.

The Government’s strategy is to raise revenue in ways that meet these objectives.

*Relationship with economic and fiscal strategy*

This revenue strategy has been produced as part of the strategic phase of the generic tax policy process. It supports the Government’s economic and fiscal strategy. In particular, it is consistent with the Government’s commitment to return to operating surplus by 2014/15 in order to reduce government debt as a proportion of GDP, while providing the right incentives to achieve stronger and more sustainable economic growth. Meeting this commitment will require managing government expenditure carefully and protecting the revenue base.

The Government has implemented two rounds of personal tax cuts and is committed to further fiscally-neutral reductions in income tax rates as economic and fiscal conditions allow. Maintaining revenue flows is particularly important in the current economic environment. The Government will consider whether there are other desirable revenue-enhancing measures to help finance further reductions in tax rates.
**Tax policy work programme**

The tax policy work programme is designed to implement the Government’s revenue strategy. It will deliver tax policy:

- consistent with a broad-base, low-rate tax system that raises revenue in the most efficient manner
- appropriate for the current economic situation
- that is simple and certain, and
- that supports New Zealand as an internationally competitive economy.

The Government recognises that, over the longer term, the tax system will need to adapt to the effects of population ageing and increased international mobility of people, capital and businesses on the revenue base.

A tax policy work programme will continue to be released publicly.

**Government commitments**

The Government, through its confidence and supply agreement with United Future, is committed to the reinstatement of the Taxation (Income-Sharing Tax Credit) Bill in the Government’s reinstatement of legislation motion. This commitment has been met.
Annex 2

Long-term Fiscal Objectives and Short-term Fiscal Intentions

The Government’s long-term fiscal objectives are not materially different from those outlined in the BPS – as shown below in Table A1. There has been a change to the net debt objective to indicate the Government’s objective to reduce net debt to 20% of GDP by 2020 (as opposed to the previous “...by the early 2020s”). The operating expenses objective has also been changed to allow for core Crown expenses to be reduced to below 30% of GDP over time (previously “...around 30% of GDP”). This change ensures consistency with the Government’s spending limit. These long-term objectives are consistent with the principles of responsible fiscal management.

The Government’s short-term fiscal intentions have been revised since those in the BPS, consistent with the revisions to the fiscal forecasts (see Table A2). These revised fiscal intentions are consistent with the Government’s long-term fiscal objectives.

Table A1 – Long-term fiscal objectives

<table>
<thead>
<tr>
<th>Fiscal Strategy Report 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Debt</strong></td>
</tr>
<tr>
<td>Manage total debt at prudent levels. Over the short to medium term it is prudent to allow an increase in debt to deal with the current economic and fiscal shocks.</td>
</tr>
<tr>
<td>However, we need to ensure that this increase is eventually reversed and that we return to a level of debt that can act as a buffer against future shocks.</td>
</tr>
<tr>
<td>We will do this by ensuring that net debt remains consistently below 35% of GDP, and is then brought back to a level no higher than 20% of GDP by 2020. We will work towards achieving this earlier as conditions permit.</td>
</tr>
</tbody>
</table>

| **Operating balance**      |
| Return to an operating surplus sufficient to meet the Government’s net capital requirements, including contributions to the New Zealand Superannuation Fund, and ensure consistency with the debt objective. |

| **Operating expenses**     |
| To meet the operating balance objective, the Government will control the growth in government spending so that over time, core Crown expenses are reduced to below 30% of GDP. |

| **Operating revenues**     |
| Ensure sufficient operating revenue to meet the operating balance objective. |

| **Net worth**              |
| Ensure net worth remains at a level sufficient to act as a buffer to economic shocks. Over the medium term, net worth will continue to fall as the impact of the global financial crisis unfolds. Consistent with the debt and operating balance objectives, we will start building up net worth ahead of the full fiscal impact of the demographic change expected in the mid-2020s. |
### Table A2 – Short-term fiscal intentions

<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td><strong>Debt</strong></td>
<td></td>
</tr>
<tr>
<td>Gross sovereign-issued debt (including Reserve Bank settlement cash and Reserve Bank bills) is forecast to be 35.1% of GDP in 2015/16.</td>
<td>Gross sovereign-issued debt (including Reserve Bank settlement cash and Reserve Bank bills) is forecast to be 36.9% of GDP in 2015/16.</td>
</tr>
<tr>
<td>Core Crown net debt (excluding NZS Fund and advances) is forecast to be 27.7% of GDP in 2015/16.</td>
<td>Core Crown net debt (excluding NZS Fund and advances) is forecast to be 28.6% in 2015/16.</td>
</tr>
<tr>
<td><strong>Operating balance</strong></td>
<td></td>
</tr>
<tr>
<td>Our intention is to return the operating balance (before gains and losses) to surplus as soon as practical and no later than 2014/15, subject to any significant shocks.</td>
<td>Our intention is to return the operating balance (before gains and losses) to surplus as soon as practical and no later than 2014/15, subject to any significant shocks.</td>
</tr>
<tr>
<td>Based on the operating allowance for the 2012 Budget, the operating balance (before gains and losses) is forecast to be -3.6% of GDP in 2012/13. The operating balance (before gains and losses) is forecast to be 0.1% of GDP in 2014/15. This is consistent with the long-term objective for the operating balance.</td>
<td>Based on the operating allowance for the 2012 Budget, the operating balance (before gains and losses) is forecast to be -2.6% of GDP in 2012/13. The operating balance (before gains and losses) is forecast to be 0.2% of GDP in 2014/15. This is consistent with the long-term objective for the operating balance.</td>
</tr>
<tr>
<td>The operating balance is forecast to be -2.6% of GDP in 2012/13.</td>
<td>The operating balance is forecast to be -1.5% of GDP in 2012/13.</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
</tr>
<tr>
<td>Our intention is to support a return to fiscal surplus by restraining the growth in core Crown expenses – so that they are reduced to around 30% of GDP by 2015/16.</td>
<td>Our intention is to support a return to fiscal surplus by restraining the growth in core Crown expenses – so that they are reduced to around 30% of GDP by 2015/16.</td>
</tr>
<tr>
<td>Core Crown expenses are forecast to be 30.2% of GDP in 2015/16.</td>
<td>Core Crown expenses are forecast to be 30.3% of GDP in 2015/16.</td>
</tr>
<tr>
<td>Total Crown expenses are forecast to be 39.6% of GDP in 2015/16.</td>
<td>Total Crown expenses are forecast to be 39.8% of GDP in 2015/16.</td>
</tr>
<tr>
<td>This assumes a new operating allowance of $800 million for Budget 2013, increasing to $1.19 billion, in Budget 2014 and growing at 2% for Budgets thereafter (GST exclusive).</td>
<td>This assumes a new operating allowance of $800 million per annum for Budgets 2012 and 2013, then returning to $1.19 billion, growing at 2% for Budgets thereafter (GST exclusive).</td>
</tr>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
</tr>
<tr>
<td>Total Crown revenues are forecast to be 40.5% of GDP in 2015/16.</td>
<td>Total Crown revenues are forecast to be 40.9% of GDP in 2015/16.</td>
</tr>
<tr>
<td>Core Crown revenues are forecast to be 30.5% of GDP in 2015/16.</td>
<td>Core Crown revenues are forecast to be 30.5% of GDP in 2015/16.</td>
</tr>
<tr>
<td>Core Crown tax revenues are forecast to be 27.8% of GDP in 2015/16.</td>
<td>Core Crown tax revenues are forecast to be 27.8% of GDP in 2015/16.</td>
</tr>
<tr>
<td><strong>Net worth attributable to the Crown</strong></td>
<td></td>
</tr>
<tr>
<td>Total Crown net worth is forecast to be 28.6% of GDP in 2015/16. Core Crown net worth is forecast to be 8.8% of GDP in 2015/16.</td>
<td>Total Crown net worth is forecast to be 27.5% of GDP in 2015/16. Core Crown net worth is forecast to be 8.2% of GDP in 2015/16.</td>
</tr>
</tbody>
</table>
Annex 3

Projection Assumptions out to 2025/26

The economic and fiscal forecasts, from 2011/12 to 2015/16, are detailed in the 2012 Budget Economic and Fiscal Update. The projection period begins in 2016/17 and ends in 2025/26. These post-forecast fiscal projections are based on the long-run technical and policy assumptions outlined below. The projection model can be found on the Treasury website at http://www.treasury.govt.nz/government/fiscalstrategy/model.

Table A3.1 – Summary of economic and demographic assumptions*

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Labour force</td>
<td>0.9</td>
<td>0.8</td>
<td>1.1</td>
<td>1.2</td>
<td>1.2</td>
<td>1.0</td>
<td>1.0</td>
<td>0.9</td>
<td>0.5</td>
<td>0.5</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unemployment rate**</td>
<td>6.4</td>
<td>5.8</td>
<td>5.3</td>
<td>5.0</td>
<td>4.7</td>
<td>4.6</td>
<td>4.5</td>
<td>4.5</td>
<td>4.5</td>
<td>4.5</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Employment</td>
<td>1.1</td>
<td>1.4</td>
<td>1.6</td>
<td>1.5</td>
<td>1.4</td>
<td>1.1</td>
<td>1.1</td>
<td>0.9</td>
<td>0.5</td>
<td>0.5</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Labour productivity growth***</td>
<td>0.6</td>
<td>2.0</td>
<td>1.9</td>
<td>1.6</td>
<td>1.4</td>
<td>1.3</td>
<td>1.3</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real GDP</td>
<td>1.8</td>
<td>2.9</td>
<td>3.3</td>
<td>3.1</td>
<td>2.8</td>
<td>2.5</td>
<td>2.4</td>
<td>2.4</td>
<td>2.1</td>
<td>2.0</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Consumers price index (CPI) (annual % change)</td>
<td>1.2</td>
<td>2.7</td>
<td>2.3</td>
<td>2.4</td>
<td>2.4</td>
<td>2.2</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government 5-year bonds (average % rate)</td>
<td>3.6</td>
<td>3.8</td>
<td>4.2</td>
<td>4.8</td>
<td>5.0</td>
<td>5.1</td>
<td>5.2</td>
<td>5.3</td>
<td>5.4</td>
<td>5.5</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nominal average hourly wage</td>
<td>3.1</td>
<td>3.6</td>
<td>3.8</td>
<td>3.7</td>
<td>3.6</td>
<td>3.6</td>
<td>3.3</td>
<td>3.5</td>
<td>3.5</td>
<td>3.5</td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

* Annual average % change unless otherwise stated
** Unemployment as a percentage of the labour force (average for year ended June)
*** Hours worked measure

Sources: The Treasury, Statistics New Zealand

Transition of economic variables from the end of forecast

Given the difficulty in projecting cycles and shocks beyond the forecast horizon, the projections out to 2025/26 use trend or long-run averages for the growth rates or levels of key variables.

---

8 Note that the economic forecasts in the Budget Economic and Fiscal Update are based on a March year.
In previous forecast rounds the five-year forecast period was generally sufficient for the effects of current cycles and shocks to have worked their way through the economy. By the end of the forecast period key variables such as unemployment, the terms of trade and labour force participation have usually returned to trend growth rates or levels.

In recent forecast rounds, shocks to the economy, either on the demand or supply side, have caused key variables to remain above or below trend at the end of the forecast period. For example, in Budget 2010, some of the key economic variables were not predicted to fully converge to their long-term values at the end of the forecast period, owing to the persistent effects of the recession. Those variables were adjusted from their end-of-forecast values to the long-term averages, using a relevant rate of convergence for each variable.

In the Budget 2012 forecasts, the flow-on effect from the earthquake rebuild is assumed to continue into the early years of the projection period. Accordingly, real GDP growth is assumed to grow above the trend rate until 2018/19. Labour productivity growth is adjusted to reflect the faster real GDP growth track.

Four other economic variables have also been adjusted from their end-of-forecast values. These all contribute to the projection of nominal GDP, which is both a driver of a number of important fiscal variables, such as tax revenue, and the denominator in key fiscal ratios (ie, debt-to-GDP). These variables are:

- aggregate labour force numbers
- CPI inflation
- unemployment rate, and
- average hours worked.

From 2016/17 to 2018/19, labour productivity growth is modelled as a function of real GDP growth and labour force. From 2019/20 onwards, labour productivity growth is assumed to return to the estimated long-term value of 1.5% per annum.

For aggregate labour force numbers, the adjustment technique involves continuing to grow them at similar rates to those used at the end of the forecast period, with the Statistics New Zealand labour force projection growth rates taking over from 2019/20 onwards.

For the other three variables – CPI inflation, unemployment rate and average hours worked – a long-term average is determined, together with a convergence path. The long-term averages are based on historical data, making allowance for factors that could alter their future values, such as the Policy Targets Agreement with CPI inflation.

By 2020/21, all these variables have returned to their trend rates or levels.
Comparison with longer-term fiscal projections

By contrast, the Treasury’s longer-term fiscal projections out to 2049/50 (page 16) are driven solely by cost pressures reflecting the expected demand for public services. An explanation of the approach behind these projections can be found in the Treasury’s 2009 *Long-Term Fiscal Statement*.

**Table A3.2 – Summary of fiscal projection assumptions out to 2025/26**

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tax revenue</strong></td>
<td>Linked to growth in nominal GDP. Source deductions (mainly PAYE tax on salary and wages) is grown using employment growth and nominal average hourly wage growth for the first five years of the projection period. The latter is multiplied by a fiscal drag elasticity of 1.35. After the first five years of the projection period source deductions are returned to a long-term stable value of 11.2% of GDP. The three other major tax categories, Corporate tax, Hypothecated Transport taxes and Other taxes (dominated by GST), are gradually returned, from their end-of-forecast values, to long-term constant ratios to GDP. This transitional adjustment is to ensure that tax revenue projections are based on ratios to GDP that are neither higher nor lower than would be expected when the economy is performing at its potential. All tax categories change at a rate of 0.2% of GDP per annum, with final ratios-to-GDP of 4.5% for Corporate tax, 1.3% for Hypothecated Transport taxes and 11.7% for Other taxes. The long-term ratios are based on historical data, taking into account tax rate and policy changes that could affect these. Once the long-term ratios are reached the tax types remain at them in later projected years.</td>
</tr>
<tr>
<td><strong>New Zealand Superannuation (NZS)</strong></td>
<td>Demographically adjusted and linked to net wage growth, via the “66% wage floor”. The latter refers to the net (after-tax) weekly New Zealand Superannuation rate for a couple being constrained to lie between 66% and 72.5% of net average weekly earnings. As tax on average weekly earnings, being a part of overall PAYE, increases owing to fiscal drag, the net average weekly earnings do not grow as quickly as the gross earnings.</td>
</tr>
<tr>
<td><strong>Other benefits</strong></td>
<td>Demographically adjusted and linked to inflation.</td>
</tr>
<tr>
<td><strong>Health</strong></td>
<td>Held constant at the end-of-forecast values, because their growth is assumed to come from a share of the projected Operating Allowance annual increment.</td>
</tr>
<tr>
<td><strong>Education</strong></td>
<td>As with Health, except for the student allowances and student loan write-off components. The former grows as “Other Benefits” do, while the latter grows in line with Ministry of Education projections.</td>
</tr>
<tr>
<td><strong>Other expenditure</strong></td>
<td>Held constant at the end-of-forecast values, because their growth is assumed to come from a share of the projected Operating Allowance annual increment. Two exceptions are KiwiSaver expenses, which grow in line with projections from the Inland Revenue Department, and Emission Trading Scheme (ETS) expenses. For the latter, see the ETS section in this table.</td>
</tr>
<tr>
<td><strong>Finance costs</strong></td>
<td>A function of debt levels and interest rates.</td>
</tr>
</tbody>
</table>

### Operating allowance
$1.24 billion in 2016/17, which is equivalent to the Budget 2010 Operating Allowance of $1.1 billion, growing at 2% per year in intervening years. Operating Allowances for subsequent projected years grow at 2% per year from this value.

### Capital allowance
$0.918 billion in 2016/17. This is based on a track of $0.9 billion in Budget 2016 as the starting point, grown at 2% per annum.

### Surplus NZDMO financial assets
Nil.

### NZS Fund
Contributions to the Fund suspended until 2016/17. Contributions begin again in 2017/18, and are consistent with the New Zealand Superannuation and Retirement Income Act 2001.

### Emission Trading Scheme (ETS)
The fiscal impact of the ETS depends on several highly uncertain factors, most notably future carbon prices and New Zealand's emissions targets from future international climate change agreements. The ETS has been modelled as having no net fiscal impact in the projection period (expenses equal revenues), as the net impact of the ETS and future international obligations is highly uncertain. Any net revenue (the value of credits received after free allocation of credits to participating industries) is assumed to be required to meet future international obligations, or alternatively used for fiscally equivalent, unspecified tax reductions or spending increases.

### Future emissions liabilities
The Kyoto liability included in fiscal forecasts reflects the Government's obligation for Commitment Period 1, which is for the period 2008 to 2012. Projections beyond 2015/16 do not incorporate a quantitative estimate of any net emissions liability that may eventuate from New Zealand’s obligations under future international climate change agreements.