The Treasury

Budget 2022 Information Release

August 2022

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Debt indicator for use as a fiscal rule

Date:	28 February 2022	**Report No:**	T2022/306
		File Number:	MC-1-5-2-2022

Action sought

	Action sought	Deadline
Hon Grant Robertson **Minister of Finance**	**Consider** the analysis in this report and discuss with officials at Finance Priorities Meeting on Thursday 3 March 2022.	Friday 4 March

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Isabelle Hermes	Senior Analyst, Macroeconomic and Fiscal Policy	[39]	N/A (mob)	✓
Renee Philip	Manager, Macroeconomic and Fiscal Policy		N/A (mob)	

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Treasury Report: Debt indicator for use as a fiscal rule

Executive Summary

At the Finance Priorities Meeting on 24 February 2022, you asked us for information on a new option for the net debt indicator which would be more closely aligned with the IMF's Government Finance Statistics (GFS) methodology. In this report, we introduce this new option which would include cash and fixed interest assets of the New Zealand Super Fund (NZSF) and Crown entities, as well as providing further analysis to help you compare the different net debt indicator options.

We compare the options against the following criteria: international comparability, effectiveness in reflecting fiscal sustainability, fiscal management, ease of communication, and implementation. Which net debt indicator you will want to adopt will depend on how you balance these criteria.

Recommended action

We recommend that you:

a **Note** that if Treasury is to implement a new net debt metric for Budget 2022, we require a decision on the indicator by Friday 4 March 2022.

b **Agree** to discuss this report with officials at Finance Priorities Meeting on Thursday 3 March 2022**.**

Agree/disagree

c **Following discussion, indicate** which net debt indicator you wish to adopt for use as a fiscal rule:

Option 2: new net debt measure including the NZSF

Yes/No.

Option 3: new net debt measure including cash and fixed interest assets from both the NZSF and Crown entities

Yes/No.

Renee Philip
Manager, Macroeconomic and Fiscal Policy

Hon Grant Robertson
Minister of Finance

Treasury Report: Debt indicator for use as fiscal rule

Purpose of Report

1. This report introduces a new option for the net debt indicator which is more aligned with the IMF's GFS methodology (though not completely aligned). It also provides further analysis to support your decision on which debt indicator to use for announcing new fiscal rules at Budget 2022.

Background

2. In October 2021, we provided advice on updating the suite of fiscal indicators. You agreed to introduce a new net debt measure which includes Crown Entity borrowing and advances. This measure would be published with and without the New Zealand Super Fund (NZSF) (T2021/2416 refers). You also indicated that you would like to receive further advice on international comparability.

3. On 10 February 2022, you received advice on implementing new fiscal rules for Budget 2022 (T2022/37 refers). The report also provided recommendations on which debt indicator would be most suitable for use as a fiscal rule. When we discussed the report with you on 24 February, you asked us for information on a third option for the net debt indicator which would be more aligned with the IMF's GFS methodology.

4. In this report, we introduce this new net debt indicator option which would include cash and fixed interest assets from the NZSF and Crown entities, but not equities. We also provide further information to support the comparison of options. You also asked for further advice on the exact specification of the OBEGAL rule. We will provide further advice on this on 18 March.

Analysis

5. In this analysis we compare the following debt indicator options:
   - Option 1: new net debt measure excluding the entire NZSF
   - Option 2: new net debt measure including the entire NZSF
   - Option 3: new net debt measure including cash and fixed interest assets from the NZSF and Crown entities (ie part of the NZSF and other assets such as ACC).

6. All three of these options include Crown entity (CE) borrowings and advances. A detailed overview of what is included and excluded for each measure is provided in **Annex 1**.

7. As context, the level of each indicator in 2021 would be around 28% of GDP for Option 1, 11% of GDP for Option 2, and approximately 10-15% of GDP for Option 3 (based on our initial assessment). This compares to 30% of GDP for the old net core Crown debt indicator.

8. In Figure 1, we compare these three options against the following criteria:
   - **International comparability**: we consider both alignment with international standards and methodologies, as well as proximity to the IMF's GFS net debt figure (i.e. how similar the level of net debt would be compared to the actual IMF's GFS net debt figure for New Zealand). Refer to **Annex 2** for further information.

- **Effectiveness in reflecting fiscal sustainability:** we consider how well the measure represents New Zealand’s fiscal sustainability.
- **Fiscal management:** we consider the indicator’s suitability for use in fiscal management. A particular factor that we take into consideration is volatility.
- **Ease of communication:** Fiscal rules should be readily understood by policymakers and the public to support government accountability. We therefore consider how well the different indicator options support communication to the public, as well as potential communication challenges during the transition to the new indicator.
- **Implementation:** we consider the resourcing requirements for implementation and whether the options can be implemented by Budget 2022.

Figure 1: Comparison of the net debt indicator options

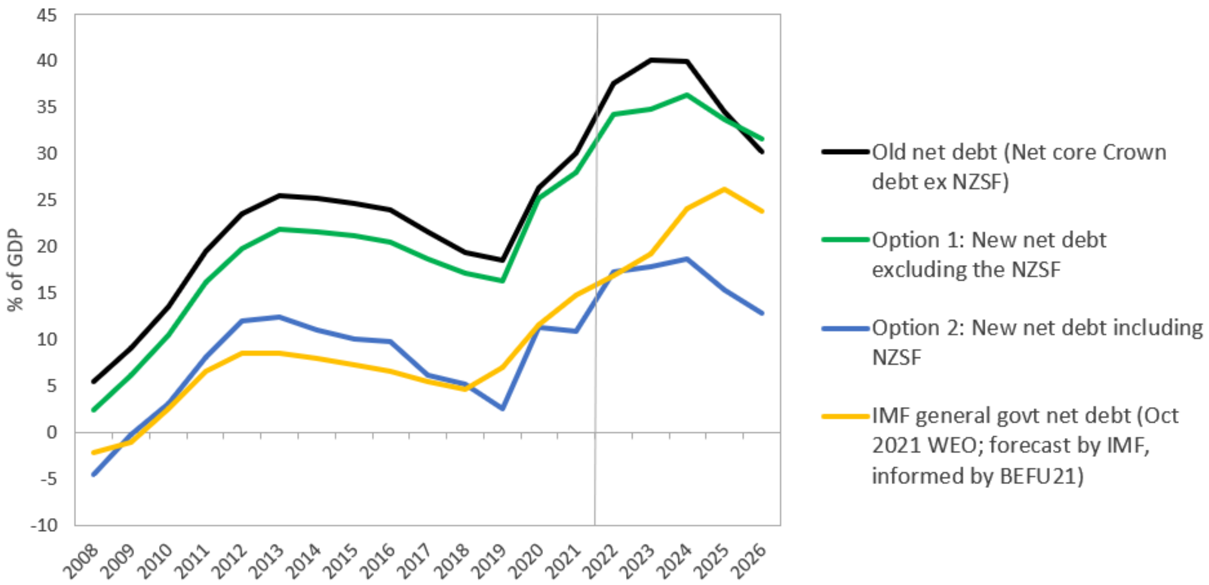
Criteria		Option 1: new net debt excl. NZSF option	Option 2: New net debt incl. NZSF option	Option 3: New net debt – cash and fixed interest assets option
International comparability	Alignment with international standards and the concept of net debt	Reasonably well aligned, but not in every respect (e.g. it doesn't net off all the NZSF and ACC fixed interest assets that GFS international practice would typically allow)	Nets off $52b of NZSF equities. GFS standards and most countries explicitly exclude equities from net debt. Australia is an outlier in including a sizable amount of them	Well aligned with GFS and international practice
	Proximity to the IMF's GFS net debt figure	Arguably overstates NZ debt by ~10-20ppt of GDP relative to IMF and average peer economy indicators	Broadly results in the same level of net debt as the IMF's GFS and average peer economy headline indicators	
Effectiveness in reflecting fiscal sustainability		Doesn't capture that growing the NZSF supports fiscal sustainability	Best reflects NZ's fiscal sustainability[1]	Doesn't recognise that ACC assets are held for an insurance liability which has already been incurred
Fiscal management	Volatility	No significant new volatility introduced	Inclusion of ~$52b of NZSF equities introduces significant pro-cyclical volatility (up to 10ppt of GDP in a repeat of the GFC)	Including more fixed interest assets has the potential to add some volatility to net debt, though less than adding equity assets. Volatility could also be impacted by decisions outside of Ministers' control (e.g. portfolio shifts by NZSF and ACC and CE balance sheet changes)
	Other fiscal management considerations	Some potential boundary issues (e.g. may incentivise not contributing to the NZSF or ACC funds in order to suppress reported net debt)	Risk of spending growth in NZSF if debt ceiling not lowered periodically (approx. 5ppt per decade) Some potential boundary issues (e.g. may incentivise shifting SOEs into NZSF ownership to suppress reported net debt)	Some potential boundary issues (e.g. may incentivise directing the NZSF or ACC to shift funds from equities to bonds to suppress reported net debt, such as through setting a lower risk appetite)
Communication		Easiest change to communicate as level and concepts in the measure are similar to the old net debt measure	10-20ppt Lower debt level - risks appearing as though the government intends to borrow against the NZSF and/or ACC, effectively spending them, which is not the government's intention. The change in indicator lowering reported net debt while moving to a higher debt ceiling under the proposed fiscal rules could also be difficult to communicate. These indicators have a more complex reconciliation to OBEGAL	
Implementation		Can be done for Budget		Will create resourcing pressures for Treasury. Likely to be possible to produce an indicator with data for the forecast and projection period for Budget, but not a full time series.[2] In the medium term we would need to consider aligning other measures, like residual cash, with the debt indicator

[1] This does not recognise that NZSF assets are held for forecast future New Zealand Super costs, however these liabilities have not yet been incurred. Internationally, it is uncommon to record liabilities such as this on the balance sheets.

[2] Projections relate to the period beyond the five-year forecast period and are based on long-run economic and fiscal assumptions. The projections for the new indicator would be approximations. A time series would include historical actuals.

9. Figure 2 compares Options 1 and 2 against the current net debt metric (excluding crown entity borrowings, advances and the NZSF) and the IMF's GFS measure. We currently do not have sufficient data available to show a time series for Option 3, but we would expect the measure to track around 15 percentage points of GDP lower than the old net core Crown debt indicator.

Figure 2: Net debt indicators



10. You have previously indicated that you are inclined to use a measure that includes the NZSF. The following discussion therefore focuses on Options 2 and 3:

a If you place most value on adopting a net debt indicator which most accurately reflects the government's fiscal sustainability while also being relatively close to the IMF's GFS measure in terms of the level of net debt, then you should use the net debt measure which includes the NZSF (Option 2). However, this measure would be more volatile[3], less consistent with international standards and has communication risks as it may appear as if the governments intends to borrow against the NZSF, effectively spending it (which is not the government's intention). Either Option 2 or 3 would be 15-20% of GDP lower than the old net core Crown debt indicator. By coincidence, this is approximately the amount of additional headroom you would currently have below our recommended net debt ceiling. You would therefore be announcing a debt ceiling of approximately 30% of GDP, which is roughly the level of the old net debt measure now.

b If you place the most weight on international comparability and wish to avoid introducing significant new volatility in the indicator, then you should adopt the net debt indicator which includes cash and fixed interest assets of the NZSF and Crown Entities (Option 3). However, note that this bears similar communication risks to Option 2 with the added complexity that it may appear as if the government intends to borrow against ACC's funds. While NZSF assets are held to help fund expected future NZ Super costs, ACC assets are held to offset an already-incurred insurance liability (which is not counted in the indicator as it is not a debt instrument). Including ACC assets in the net debt calculation whilst not including the liability could bring into question the credibility of the indicator. It

3 Volatility will matter less if the focus of the fiscal rules is on an operating target as the main fiscal management tool, coupled with a long-term debt ceiling instead of a short-term debt target.

would also be the most resource-intensive option for Treasury to implement by Budget, as there will be substantive work required to identify NZSF and Crown Entity interest bearing assets. Given time and resourcing constraints, it is likely that we will only be able to produce five-year forecasts and ten-year projections of the indicator for Budget, not a full time series showing actual historical data.

11. We note that it is not possible to implement the full IMF GFS methodology due to differences in accounting measurement and it would have undesirable qualities, e.g. treating Kāinga Ora as a commercial entity.

Next Steps

12. We will provide further advice on the specification of the OBEGAL and net debt rule in March 2022. This advice will also cover the short-term intentions and long-term objectives. We will provide separate advice on the specification of the debt servicing indicator.

Annex 1 – Components of the net debt indicators

Item	What it is and approximate amount in 2021	Old net debt – net core Crown debt (for reference)	New net debt Option 1: exclude NZSF	New net debt Option 2: include NZSF	New net debt Option 3: include cash & fixed interest	IMF GFS general govt. net debt (for reference)
	Level in 2021 (% GDP) ->	**30.1%**	**28.0%**	**10.8%**	**Approx. 10-15%**	**14.8%**
Liabilities & assets in old net debt	Gross sovereign (core Crown) issued debt ($131b) net of core Crown financial assets aside from advances and NZSF ($29b)	In	In	In	In	In
Crown entity borrowings	~$9 billion – majority by Kāinga Ora	Out	In	In	In	Mostly in (Kāinga Ora is out as the IMF categorises it as a commercial entity)[4]
Core Crown advances	~$19b in 2021 ($3b FLP, $11b student loans, $5b other). This is forecast to grow to ~38b in 2023, largely due to the FLP growing to ~$22b	Not netted off	Netted off	Netted off	Netted off	Netted off
NZSF	NZSF has a net worth of ~$57b. This consists of ~$10b fixed interest assets, $52b equity and other assets, and ~$5b of liabilities[5]	Not netted off	Not netted off	Netted off	Fixed interest & cash assets netted off	Fixed interest & cash assets netted off
Crown entity assets	~$68b, of which ~$54b is ACC. Approximately $30b of ACC's assets are in fixed interest and cash, with the rest mostly in equities.	Not netted off	Not netted off	Not netted off	Fixed interest & cash assets netted off	Fixed interest & cash assets netted off
Central bank	Setting aside FLP impacts (which are addressed by netting off advances), inclusion of the RBNZ reduces net debt by approx $5-$10b.[6]	In	In	In	In	Out
Local government	Net debt of approx $14b in 2021	Out	Out	Out	Out	In
Accounts payable and receivable	Accounts receivable approx. $27bn in 2021, and accounts payable approx. $18b in 2021 for the Total Crown.	Out	Out	Out	Out	In

[4] GFS general government net debt includes all entities at a central, regional and local level that perform non-market and redistribution functions. For New Zealand, this broadly covers core Crown+Crown entities and local government, and excludes SOEs. However, the IMF classifies Kāinga Ora as a 'commercial entity' due to the historical institutional arrangements with Housing New Zealand. We do not consider Kāinga Ora to be a commercial entity as it primarily performs social policy functions funded by central government, so consider it to best be treated as central government rather than a commercial entity, and should be included in the government debt indicator. It is possible that the IMF excludes some other CEs, or includes some other SOEs, based on their judgement about which entities are commercial vs non-market – we have not had time to fully investigate this.

[5] Debt liabilities of the NZSF (predominantly derivatives in loss) are included in all five of the options in this table.

[6] This arises from the net result of (1) inclusion of RBNZ equity reducing net debt, (2) currency on issue reducing net debt as it is not counted as a liability, but provides funding for offsetting assets that are netted off against debt and (3) LSAP valuation effects increasing net debt.

Annex 2: International comparison of net debt methods and levels

Jurisdiction	National headline debt measure	Level of debt in 2021 (% of GDP, actual or estimate)			Possible reasons why the national headline debt measure is above or below the IMF GFS net debt measure[7]
		National headline debt measure[8]	IMF GFS net debt (Dec 2021)	Difference between headline and GFS net debt	
New Zealand	Net core Crown debt (excluding the NZSF)	30.1%	14.8%	+15.2%	Excluding the NZSF makes debt appear higher. This effect outweighs the inclusion of the RBNZ (which lowers debt) and the exclusion of local government debt.
	Net core Crown debt (including the NZSF)	12.2%		-2.6%	Exclusion of local government debt and inclusion of the RBNZ (which lowers debt)
Euro area	General government gross debt[9] (Maastricht definition)	97.7%	82.8%	+14.9%	Headline measure is gross debt so nothing is netted off.
Canada	Federal debt (a net debt measure)[10]	47.6%	34.9%	+12.7%	The headline measure includes a wide range of assets and liabilities, and the main superannuation funds are not netted off, but provincial and local government debt is excluded.
United States	Debt held by the public (a federal gross debt measure) [11]	102.3%	101.9%	+0.4%	Headline measure is gross debt so nothing is netted off, but states and local government are also not included
Australia	Federal net debt[12]	28.6%	38.1%	-9.5%	About 70% of the superannuation fund (including a significant amount of equities) is netted off and the measure excludes state and local government debt.
UK	Public Sector Net Debt excluding the Bank of England[13]	82.7%	97.2%	-14.5%	Not yet confirmed – potentially accounting measurement differences

Sources: NZ Treasury, IMF, Eurostat, Canadian Department of Finance, Congressional Budget Office, The Commonwealth of Australia, Office for National Statistics

[7] Note that these are only potential reasons we have identified – a full reconciliation of each country's headline indicator to GFS is beyond the scope of this report.
[8] The time periods for the national headline debt measures vary from March 2021 to December 2021, depending on each organisation's reporting cycle.
[9] Source of the Euro area's headline debt: https://ec.europa.eu/eurostat/documents/2995521/14176362/2-21012022-AP-EN.pdf/4785530c-a1dc-5d07-1e94-acb29d9986a7#:~:text=At%20the%20end%20of%20the,from%2090.9%25%20to%2090.1%25.
[10] Source of Canada's headline debt: https://www.canada.ca/content/dam/fin/publications/afr-rfa/2021/afr-rfa-2020-21-eng.pdf
[11] Source of the United States' headline debt: https://www.cbo.gov/system/files/2021-02/56970-Outlook.pdf
[12] Source of Australia's headline debt: https://budget.gov.au/2021-22/content/myefo/download/myefo-2021-22.pdf, page 64
[13] Source of the UK's headline debt: https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/december2021