The Treasury

Budget 2024 Information Release

September 2024

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[31] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting collective and individual ministerial responsibility

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

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[36] 9(2)(h) - to maintain legal professional privilege

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

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Treasury Report: Budget Policy Statement 2024: Options for further advice on your fiscal strategy

Date:	21 December 2023	Report No:	T2023/2179
		File Number:	MC-1-5-4-1

Action sought

	Action sought	Deadline
Hon Nicola Willis **Minister of Finance**	**Note** that you are required to set your short-term intentions and long-term objectives for fiscal policy at the Budget Policy Statement; **Agree** to discuss your fiscal strategy and how you would like to communicate your short-term intentions and long-term objectives with officials; **Agree** to receive further advice on an expenditure target or rule and on modifying the net debt rule.	18 January 2024

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Rosalinda Pierce	Analyst, Macroeconomic and Fiscal Policy	[39]	[35]	✓
Luke Came	Team leader, Macroeconomic and Fiscal Policy			
Ben Gaukrodger	Manager, Macroeconomic and Fiscal Policy			

Minister's Office actions (if required)

Return the signed report to the Treasury.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Budget Policy Statement 2024: Options for further advice on your fiscal strategy

Executive Summary

New Zealand's fiscal strategy is set by the Government of the day and a successful fiscal strategy supports the Government to make trade-offs across the collective objectives of Cabinet. This will typically rely on balancing the Government's economic and policy objectives against fiscal constraints, while navigating external challenges. Your consideration of the fiscal strategy comes in the context of current structural deficits, elevated inflation and global economic headwinds that will continue to challenge the fiscal position over the forecast period. We provided initial advice on your fiscal strategy in T2023/1992, where we recommended returning the Operating Balance before Gains and Losses (OBEGAL) to surplus in 2026/27 at the latest.

The Government is required to specify its fiscal strategy as short-term intentions (STIs) and long-term objectives (LTOs) at each Budget Policy Statement (BPS) and Fiscal Strategy Report. This will set your fiscal strategy for the term of Government. This will also provide you an opportunity to decide if you want to communicate your fiscal strategy with different indicators and/or fiscal rules (which have previously been expressed as the LTOs) than those from Budget 2023.

Over 2021, the Treasury reviewed the headline fiscal indicators and in 2022 provided advice on setting new fiscal rules using the headline indicators. Treasury advised to adopt a new measure for net debt which includes the New Zealand Super Fund, Crown entity borrowings and advances, and recommended the adoption of two fiscal rules which were introduced at Budget 2022. These rules were also the LTOs for the operating balance and debt. The rules are:

- returning OBEGAL to surplus and aiming for surpluses of 0 – 2% of GDP thereafter which will mean that the Crown's day-to-day consumption and transfer payments are paid for out of operating revenues, thereby supporting intergenerational equity, and;
- a net debt ceiling of 30% of GDP (new net debt measure) that complements the OBEGAL target while allowing more fiscal space to fund high-quality capital investment and also ensures sufficient buffers to respond to economic shocks or natural disasters.

While we think the analysis and advice provided in 2022 remains sound, we see options to strengthen the fiscal rules and use of STIs to support the fiscal position and fiscal sustainability. Specifically, we recommend Treasury provides you advice on an expenditure rule or target if you are interested in this.

As noted above, you are required to state your STIs and LTOs for fiscal policy at the BPS. We seek a discussion with you to understand your objectives for the fiscal strategy (T2023/1992 refers), including how you intend to communicate these at the BPS, following which we can provide detailed advice on options for your fiscal rules. As the BPS is required to be published by 31 March, we will have a limited window in which to provide this advice.

Recommended Action

We recommend that you:

a **Note** that you are required to set your short-term intentions and long-term objectives for fiscal policy at the Budget Policy Statement;

b **Agree** to discuss your fiscal strategy and how you would like to communicate your short-term intentions and long-term objectives with officials;

Agree / Disagree

c **Note** that the current fiscal rules are the long-term objectives for the operating balance and debt;

d **Note** that there are options to strengthen the fiscal rules to support your fiscal strategy;

e **Agree** to receive follow-up advice on an expenditure rule or target;

Agree / Disagree

f **Indicate** your preferences for any further analysis and advice on fiscal indicators and/or rules as set out in Table 1;

Option	Rationale for consideration	Yes/no for advice
Adding a counter-cyclicality component to the operating rule	Fiscal policy has been pro-cyclical in recent years (contributing to inflationary pressures) and may be in future. The current fiscal rules are not explicit about aiming for counter-cyclicality.	
Modifying the calibration of the debt rule, such as considering a lower ceiling level, a debt target, or a directional rule like reducing debt over time	Since the adoption of the debt ceiling, there has been significant increases in debt, and the operating rule has not provided the constraint required to deliver surpluses in order to pay down debt. This suggests that a stronger approach to controlling debt may be warranted.	
Amending the headline stock indicator to exclude the NZSF (as prior to 2022)	The NZSF is predominantly equities, so its inclusion takes net debt away from the concept of a debt indicator, i.e. cash/fixed interest assets and liabilities. It increases the cyclical volatility of net debt, potentially incentivising procyclical fiscal policy.	
Supporting the headline indicators with more focus on other indicators for example the primary balance, gross debt, or net worth	There are other indicators that can help to provide a more comprehensive picture of the Government's financial position and how its fiscal policy choices are interacting with the balance sheet and economy.	

g **Note** that, depending on your level of interest, changes may need to be signalled at the Budget Policy Statement and implemented in Budget 2024 given the legislative requirement to publish the Budget Policy Statement by March 2024.

Ben Gaukrodger
Manager, Macroeconomic and Fiscal Policy

Hon Nicola Willis
Minister of Finance

_____/_____/_______

Treasury Report: Budget Policy Statement 2024: Options for further advice on your fiscal strategy

Purpose of Report

1. You are required to set the Government's short-term intentions (STIs) and long-term objectives (LTOs) for fiscal policy at the Budget Policy Statement 2024 (BPS). We are seeking your direction on what analysis and advice you would like to inform your choices for the BPS.

2. To help inform any direction, this report summarises the analysis and advice from Treasury's 2021/22 review of the fiscal indicators and fiscal rules which underpin the current STIs and LTOs.

Background

3. The fiscal strategy is the Government's plan to manage its revenue, expenses, and balance sheet position over time, typically through the expression of fiscal rules or targets. New Zealand's fiscal framework relies on the political commitment of each Government to its own fiscal strategy, rather than the internationally common approach of legislated or codified fiscal targets and rules. We view this approach as a strength as it has generally led to stronger commitments by each Government by allowing fiscal objectives to change through time, reflecting changing circumstances and political preferences.

4. Regardless of circumstance and preference, a successful fiscal strategy will help the Government to deliver on its objectives, support macroeconomic stability and resilience, and raise living standards for New Zealanders. This will typically rely on balancing the Government's economic and policy objectives against fiscal constraints, while navigating external challenges. Your consideration of the fiscal strategy comes in the context of current structural deficits, elevated inflation and global economic headwinds that will continue to challenge the fiscal position over the forecast period. We provided initial advice on your fiscal strategy in T2023/1992, where we recommended returning the Operating Balance before Gains and Losses (OBEGAL) to surplus by 2026/27 at the latest.

5. The Public Finance Act 1989 (PFA) requires that the Government's fiscal strategy is specified as long-term (defined as a period of no shorter than 10 consecutive financial years) objectives and short-term (defined as a period no shorter than the next two financial years) intentions for debt, the operating balance, operating revenues, operating expenses, and net worth at each BPS and Fiscal Strategy Report (FSR). The short-term intentions (STIs) and long-term objectives (LTOs) must be consistent with the principles of responsible fiscal management set out in the PFA.

6. The current STIs and LTOs (from the Budget 2023 FSR) are set out in Annex One. The PFA requires you to communicate any changes to the STIs and LTOs at the BPS. This will also provide an opportunity to decide if you want to communicate your fiscal strategy with different indicators and/or fiscal rules than those from Budget 2023. The LTOs for the operating balance and the level of total debt are also known as the fiscal rules for the operating balance and net debt. This means that the objectives for these variables currently guide the fiscal strategy.

Purpose of fiscal rules

7. Fiscal rules can help to operationalise your fiscal strategy and manage the multiple objectives for fiscal policy that underlie the principles of responsible fiscal management in the PFA by providing anchors for decision making. This supports the Government to make trade-offs across the collective objectives of Cabinet within fiscal constraints.

8. Good fiscal rules should support:

   a **Sustainability** – compliance with the rules should ensure that the government's revenue and expenses are balanced over time and debt is maintained at prudent levels without the need for significant policy changes.

   b **Stability** – following the rules should not increase (and might even decrease) economic volatility. Fiscal rules promote economic stability when they are flexible enough to allow the budget balance to fluctuate over the economic cycle, support monetary policy, and let fiscal policy respond to major shocks (e.g. spending to support recovery after a natural disaster or during a recession).

   c **Simplicity** – the rules should also be readily understood by policymakers and the public, and ultimately support government accountability.

   d **Operational** – it should be possible to translate the rules into clear guidance in the annual Budget process. Fiscal aggregates targeted by the rule should be largely under the control of the policymaker.

   e **Credibility** – a rule should be in place and adhered to for a sustained period to build credibility.

   f **Ease of monitoring** – compliance with the rule should be easy to verify (this relates to the qualities of a good fiscal indicator discussed below).

9. There is no specific formula for a good fiscal rule as fiscal rules can be designed with varying levels of flexibility and constraint in order to trade-off relative preferences across the objectives outlined at a-f above. More importantly, fiscal rules will set the parameters for all fiscal management decisions, how you choose to design fiscal rules will be a key determinant of how the Government goes about achieving its fiscal, economic and broader objectives over this term of government. For example, fiscal rules that create a real fiscal constraint will necessitate savings and reprioritisation in order to deliver government priorities, which themselves may have to be phased and prioritised over the term.

10. Fiscal rules have a more limited role to play in determining fiscal structure, driving prioritisation or determining value for money of yearly spending decisions. The optimal level of expenditure in any one Budget will be determined by a range of factors and will vary over time. A key example of this is capital investment: if fiscal rules are too binding on investment, revisions to forecasts of the fiscal aggregates can dictate the level of investment, rather than assessments of value for money and the impact on living standards. It is therefore important that fiscal rules are complemented by value-for-money tools.

11. Much of the academic literature recommends a combination of fiscal rules, often a long-term debt target and a short-term operational fiscal target for a flow variable, such as the budget balance. Any combination of rules needs to be calibrated in a consistent way.

The Treasury undertook a review of the fiscal rules and the headline fiscal indicators in 2021/22

We recommended focusing on the operating balance as the main fiscal rule

12. An operating balance target explicitly focuses on the flows of expenditure and revenue, on the assumption that if the flows are well maintained, then the stock of debt will also be managed sustainably. An operating rule should therefore ensure that on average over time, surpluses offset deficits.[1] Focusing on the operating balance supports:

    a **Fiscal sustainability over the medium-term**: Maintaining a balanced operating position over time creates a sustainable fiscal position, as operating expenses are paid for by operating revenue and debt is used only to fund net investment. Most of our long-term cost pressures such as health spending, an ageing population and climate change are expected to come through the operating budget.[2] An operating target is therefore important for fiscal sustainability.

    b **Intergenerational equity**: When operating expenses are paid for by operating revenue, the current generation pays for its own consumption which supports intergenerational equity. The Government could still borrow for investments where the cost can be spread across generations. Capital expenditure still impacts the operating balance over time, as both depreciation and finance costs are included in the operating balance.

We recommended maintaining OBEGAL as the headline indicator for the operating balance

13. OBEGAL has a broad institutional coverage, is accrual based, and excludes volatile market movements (such as revaluations). It is a total Crown measure, which means it includes the financial positions of Crown entities and State-Owned Enterprises including the Accident Compensation Commission. While this introduces some variation to the indicator, it is useful from an economic management perspective to consider the total Crown's fiscal position.

14. Although it does not provide for international comparability or stock/flow consistency (i.e. OBEGAL is not equal to the change in our debt metrics), we concluded that those were not strong enough reasons to move away from the use of OBEGAL. OBEGAL is the main long-term driver of changes in net debt as a share of GDP and is the indicator under the most direct control of the government of the day. Information about OBEGAL and the other flow indicators the Treasury publishes is included in Annex Two.

We recommended that the Government run small OBEGAL surpluses so to ensure the operating balance does not add to net core Crown debt as a share of GDP over time

15. We recommended ensuring the operating balance does not add to net debt-to-GDP over time. Generally, this means that net debt-to-GDP should not be increased for the day-to-day costs of providing public services, which helps to support intergenerational equity and fiscal sustainability as noted above.

16. Applying conservative assumptions, we estimated that ensuring the operating balance does not add to net core Crown debt as a share of GDP required an OBEGAL surplus of 0.6% of GDP on average per annum. Any OBEGAL rule should be sufficiently flexible to support the use of counter-cyclical fiscal policy, and we therefore recommended that the rule seeks to maintain average OBEGAL surpluses in the range of 0-2% over time. More detail on the calibration of the OBEGAL rule is included in Annex Three.

[1] Government can and should use fiscal policy to deliver its policy objectives, smooth the effects of the business cycle and respond to economic shocks. It is therefore appropriate to run operating deficits under certain conditions (e.g. during a severe economic downturn or to respond to a natural disaster).
[2] These cost drivers are described in detail in the Long-Term Fiscal Statement.

We recommended combining the OBEGAL rule with a net debt ceiling

17. A key benefit of a debt rule is that it can provide a backstop against deficit bias. One of the downsides of an operating balance rule is that previous deficits do not necessarily have to be offset by future surpluses. As net debt is a stock measure, at some point it would become binding if deficit bias materialised. The debt rule also acts as a check on investment spend, as the impact of capital expenditure on OBEGAL via depreciation and finance costs can occur well into the future.

18. We recommended that a net debt rule should be set so as to ensure that net debt is fiscally sustainable, but it also offers flexibility to respond to shocks and to undertake high-value capital expenditure. As long as GDP is growing, then debt can also increase which is justified as, with higher GDP, a greater level of debt can be serviced. This is also justifiable with regard to intergenerational equity as future generations will be better off through long-run productive economic growth.

19. For this reason, we did not recommend adopting a net debt target that would be excessively binding. This would reduce flexibility to respond to changing circumstances and potentially limit the Government's ability to invest in productive assets that help boost New Zealand's long-run economic growth.

20. Instead, we recommended adopting a net debt ceiling. The ceiling is intended to be the net debt level below which the Government would stay over the long term. While it is possible that debt may rise above the debt ceiling as a result of significant economic shocks, the intention would be that in such cases debt levels would be reduced back below the debt ceiling through adherence to the operating balance rule.

We recommended adopting a new net debt measure to include the New Zealand Super Fund, Crown entity borrowings, and advances

21. There are a range of debt indicators that could be used for the fiscal rule and a wide range of methodologies and measures are used internationally. In 2021/22, we recommended changing the headline debt indicator from net core Crown debt to a broader net debt indicator. The new net debt indicator included all the assets and liabilities in net core Crown debt and:

    a added Crown Entity (CE) borrowings (excluding Kiwibank) – mainly debts of Kāinga Ora and New Zealand Transport Agency;

    b netted off the fair value of advances – mainly Reserve Bank Funding for Lending (FLP) loans and student loans; and

    c netted off the value of the New Zealand Super Fund (NZSF).

22. Adding CE borrowings and netting of the fair value of advances brought the indicator more in line with international norms. Including the NZSF was a more finely balance judgement. From a fiscal policy perspective, there is a benefit to including NZSF because it better represents New Zealand's fiscal sustainability by recognising that assets build when the NZSF grows. The purpose of the NZSF is to support fiscal sustainability as the population ages. Therefore, it is beneficial to recognise its contribution to sustainability in the fiscal indicators.

23. At the time of the review, we considered that including the NZSF also provides a more internationally comparable measure of fiscal sustainability relative to countries that net off most of their superannuation funds (such as Australia), or do not have sizable superannuation funds (such as the UK and US).

We also highlighted the risks associated with including the NZSF:

a Including the NZSF introduces volatility into net debt due to the high equity component of the NZSF.

b The debt ceiling should be periodically reduced to avoid effectively spending the growth of the NZSF by borrowing against it, making the fiscal rule less enduring.

c Including the NZSF implies a willingness to liquidate it early to fund general spending.

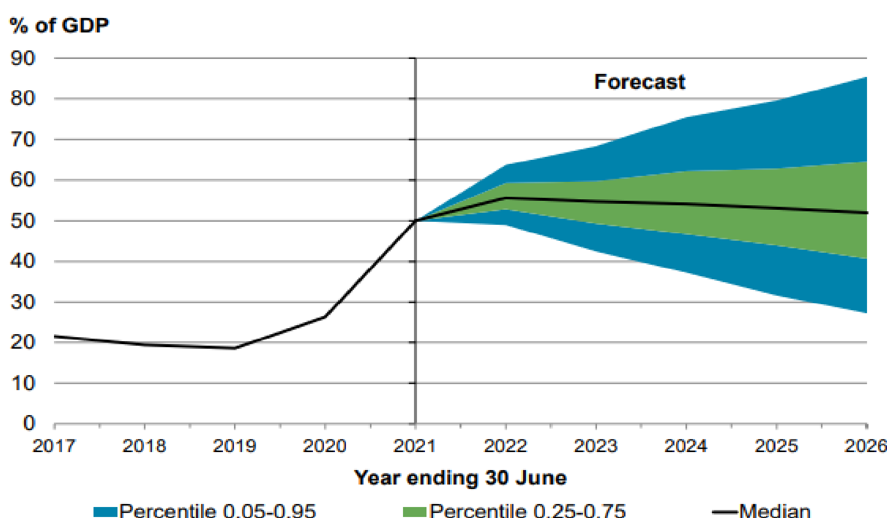
24. Overall, we concluded that including the NZSF improves international comparability and better represents New Zealand's long-term fiscal sustainability, and we considered the risks of including the NZSF could be managed through the lower debt ceiling and ongoing consideration of its impacts when formulating the fiscal strategy. However, recent shifts in international debt indicators since the adoption of the new net debt metric may have reduced the extent to which including the NZSF improves international comparability. For example, the Australian Government's fiscal strategy has moved away from a focus on net debt and towards a focus on gross debt. We can provide more advice on this if requested.

We recommended setting the net debt ceiling at 30% of GDP (new net debt measure)

25. To determine a net debt ceiling, we started by identifying the level of net debt (excluding the NZSF) as a percentage of GDP that we have very little tolerance of exceeding – a maximum tolerated debt level. Our analysis had very conservative assumptions of the interest rate exceeding nominal GDP growth (r-g) by three percentage points compared to the long-run average of +0.8 percentage points between 1991 and 2021.[3] Using this very conservative assumption implies a maximum tolerated debt level (excluding the NZSF) of 90% of GDP. All else equal, a higher assumed r-g, the lower the maximum level of sustainable debt.

26. We then subtracted a large buffer from this maximum tolerated debt level, which reflects an extreme but plausible shock. Our analysis suggested that starting from a net debt (excluding the NZSF) ceiling of c.50% of GDP, the likelihood is very low (at less than 5%) that net debt (excluding the NZSF) exceeds 90% of GDP in response to a shock (Figure 1). This buffer assumes a high degree of risk aversion and allows for the larger end of possible shocks, or multiple shocks in a short space of time.

Figure 1: Fan chart for net debt with 3% interest rate differential and initial net debt level at 50% of GDP



[3] We deem an r-g of +3% to be a very conservative assumption because r-g averaged +0.8% in the period of 1991 – 2021. At PREFU 2023, r-g was expected to average -0.2% over the forecast and projection periods which is higher than the -0.8% average at HYEFU 2021. As r-g increases, the primary surplus needed to reduce gross debt is higher (or to put it differently a given OBEGAL target is harder to achieve as interest costs are taking up a larger share of expenses).

27. We recommended adopting the net debt measure which includes the NZSF as the fiscal rule but setting the debt ceiling at 30% of GDP rather than 50% of GDP (the 20 percentage point difference approximately represents the value of the NZSF). This is because we recommended not implicitly borrowing against the NZSF and relying on using its assets and returns to pay for debt servicing in a crisis. In a crisis the NZSF is likely to have fallen considerably in value and borrowing against it and using it to pay for debt servicing would be inconsistent with the objectives of the fund.

This advice led to new LTOs being set at Budget 2022

28. At Budget 2022, the LTOs for the operating balance and debt were amended and communicated as the new 'fiscal rules'. These are:
    - a returning the operating balance before gains and losses (OBEGAL) to a surplus and aiming for surpluses of 0-2% of GDP thereafter which will mean that the Crown's day-to-day consumption and transfer payments are paid for out of operating revenues, and;
    - b a net debt ceiling of 30% of GDP (new debt measure) that complements the OBEGAL target while allowing more fiscal space to fund high-quality capital investment and also ensures sufficient buffer to respond to economic shocks or natural disasters.

29. These fiscal rules moved New Zealand towards a 'golden rule' approach to fiscal policy, whereby day-to-day operating expenses should be funded out of operating revenues, and debt is used to respond to shocks and for productive investment.

There is scope to change rules to support fiscal sustainability

30. As fiscal rules are set by the Government of the day, you have the opportunity to change the indicators and rules summarised above to reflect the fiscal context and your fiscal strategy. As set out in T2023/1992, we recommend that your fiscal strategy focuses on returning to surplus in 2026/27 at the latest. We consider that fiscal rules to achieve operating surpluses and maintain prudent levels of debt are broadly appropriate to support this and note that fiscal rules of this nature have been adopted by successive governments.

31. While we think the analysis and advice provided in 2022 was sound, we acknowledge that OBEGAL has been in deficit since 2020 and is forecast to remain so until 2026/27. Net debt has increased from 17.2% of GDP in 2021/22 to a forecast peak of 23.3% of GDP in 2024/25.

32. We consider this largely reflects the economic conditions since the rules were adopted and how the rules were operationalised, rather than the 'golden rule approach' itself.

33. We therefore recommend considering options to further strengthen the existing two fiscal rules. We see two broad opportunities to enhance the ability of the fiscal rules to support your fiscal strategy and fiscal sustainability: improving the communication and use of STIs and adopting an expenditure target/rule.

Communication and the use of short-term intentions

34. In recent years, the STIs have been communicated as forecasts rather than genuine intentions for the variable. This has meant that the STIs have frequently changed at each BPS and FSR. We think it would be beneficial for communicating and implementing your fiscal strategy if the STIs were clearly articulated in a way that remains consistent over the term of Government (supported by the forecasts), so that the Government could be held accountable to these, while complying with the PFA requirement to state the intentions "explicitly, by use of ratios, ranges or other means". The 2017 FSR is a good example of this.

Expenditure rule

35. In 2022, we advised that an operating balance rule would be preferable to an expenditure or revenue rule, as the balance between revenue and expenditure is most important for fiscal sustainability. However, since its adoption in 2022, the return to surplus has been delayed multiple times and fiscal policy has been pro-cyclical which has contributed to inflationary pressures.

36. Introducing an expenditure rule should assist with maintaining fiscal restraint following upside revenue surprises. Unlike an operating balance rule, the restraint provided by an expenditure rule would not be affected by upside revenue surprises. An expenditure rule could provide additional support for macroeconomic stability by reducing procyclicality in economic upswings by reducing the extent to which fiscal policy can loosen in response to upside revenue surprises. However, there is also a risk in that an expenditure rule may prevent fiscal policy from being used flexibly following a significant economic shock, if there is not a sufficient escape clause.

37. **We would like to understand your level of interest in an expenditure rule or target** (which could be communicated as your long-term objective or short-term intention for total expenses) as we think this could help to strengthen fiscal discipline. A summary of how other countries use expenditure rules in included in Annex Four.

Other options for fiscal rules

38. Other options that we could provide advice on, depending on your level of interest, include but are not limited to:

Table 1: Other options for further advice

Option	Rationale for consideration	Yes/no for advice
Adding a counter-cyclicality component to the operating rule	Fiscal policy has been pro-cyclical in recent years (contributing to inflationary pressures), and may be in future. The current fiscal rules are not explicit about aiming for counter-cyclicality.	
Modifying the calibration of the debt rule, such as considering a lower ceiling level, a debt target, or a directional rule like reducing debt over time	Since the adoption of the debt ceiling, there has been significant increases in debt, and the operating rule has not provided the constraint required to deliver surpluses in order to pay down debt. This suggests that a stronger approach to controlling debt may be warranted.	
Amending the headline stock indicator to exclude the NZSF (as prior to 2022)	The NZSF is predominantly equities, so its inclusion takes net debt away from the concept of a debt indicator, i.e. cash/fixed interest assets and liabilities. It increases the cyclical volatility of net debt, potentially incentivising procyclical fiscal policy.	
Supporting the headline indicators with more focus on other indicators for example the primary balance, gross debt, or net worth	There are other indicators that can help to provide a more comprehensive picture of the Government's financial position and how its fiscal policy choices are interacting with the balance sheet and economy.	

Next steps

39. We are seeking a meeting to discuss your interests and get direction from you on:

    a your overall fiscal strategy;

    b what advice you would like on amending the short-term intentions and long-term objectives for fiscal policy at the BPS, and

    c whether you would like further advice and analysis on options to review or revise the current stock and flow headline indicators and the current fiscal rules.

40. We will provide advice based on the outcome of this discussion.

41. As the BPS is required to be published by 31 March, we will have a limited window in which to provide this advice. If you are interested in more comprehensive amendments to the fiscal indicators and rules, this may need to be signalled at the BPS and implemented later. Specifically, any changes that require the creation of new fiscal indicators will likely require a longer timeframe to implement beyond Budget 2024.

42. [33]

Annex One: Short-term intentions and long-term objectives at Budget 2023

Variable (s26J of PFA)	Short-term intention for fiscal policy	Long-term objective for fiscal policy
Debt	Maintain total debt at prudent levels. Maintain net debt at below 30 percent of GDP based on new net debt measure including the New Zealand Super Fund, subject to significant shocks. Gross debt is forecast to be 44.2 percent of GDP at the end of the forecast period. Net debt is forecast to peak at 22 percent of GDP in 2023/24 and reduce over the forecast period to 18.4 percent of GDP in 2026/27	Maintain total debt at prudent levels. Maintain net debt at below 30 percent of GDP based on new net debt measure including the New Zealand Super Fund, subject to significant shocks.
Operating balance	Our intention is to return to an operating surplus (before gains and losses) by 2025/26, subject to economic and fiscal conditions. The operating balance (before gains and losses) is forecast to be 0.1 percent of GDP in 2025/26. The operating balance is forecast to be 1.5 percent of GDP in 2025/26.	Once the operating balance (before gains and losses) has returned to a surplus, our long-term objective is to maintain an average surplus in the range of 0 percent to 2 percent of GDP, subject to economic and fiscal conditions. This will ensure that, on average, over a reasonable period of time that total operating expenses do not exceed total operating revenue.
Expenses	Our intention is to ensure expenses are consistent with the operating balance objective. Core Crown expenses are forecast to be 32 percent of GDP in 2025/26. Total Crown expenses are forecast to be 40 percent of GDP in 2025/26.	The Government will ensure operating expenses support a responsible and proportionate role for the Government in maintaining a productive, sustainable and inclusive economy, consistent with the debt and operating balance objectives.
Revenue	Our intention is to ensure revenue is consistent with the operating balance objective. Total Crown revenues are forecast to be 40.2 percent of GDP in 2025/26. Core Crown revenues are forecast to be 32.9 percent of GDP in 2025/26. Core Crown tax revenues are forecast to be 30.4 percent of GDP in 2025/26.	The Government will ensure a progressive taxation system that is fair, balanced and promotes the long-term sustainability and productivity of the economy, consistent with the debt and operating balance objectives.
Net worth	Our intention is to maintain net worth consistent with the operating balance objective. Total net worth attributable to the Crown is forecast to be 38.8 percent of GDP in 2025/26. Total Crown net worth is forecast to be 40.6 percent of GDP in 2025/26.	The Government will use the Crown's net worth to maintain a productive, sustainable and inclusive economy, consistent with the debt and operating balance objectives.

Annex Two: Definitions of different flow indicators published by the Treasury

Balances

Total Crown OBEGAL – Represents total Crown revenue less total Crown expenses excluding minority interest share. OBEGAL can provide a more useful measure of underlying stewardship than the operating balance as short-term market fluctuations are not included in the calculation.

Total Crown operating balance – Represents OBEGAL plus gains and less losses. The operating balance includes gains and losses not reported directly as a movement against net worth. The impact of gains and losses on the operating balance can be subject to short-term market volatility and revaluations of long-term liabilities.

Cyclically adjusted balance (CAB) – The Treasury's CAB is an estimate of OBEGAL adjusted for fluctuations of actual GDP around potential GDP. The CAB aims to provide a picture of the underlying fiscal position by excluding the impacts of the economic cycle.

Structural balance – The Treasury's structural balance removes from the CAB significant expenditure or revenue associated with one-off events. In doing this, the structural balance aims to provide a better picture of fiscal sustainability than the CAB.

Revenue and expenses

Total Crown revenue and expenses – The Total Crown includes the Core Crown (a reporting segment consisting of the Crown, departments, Offices of Parliament, the NZ Super Fund, and the Reserve Bank) plus Crown entities and SOEs and other entities controlled by the Government Reporting Entity. Approximately three-quarters of the Crown's revenue comes from tax revenue, while sales of goods and services is the second-largest component of total Crown revenue, making up around 15%. Other sovereign revenue (e.g. fines and levies) contributes around 6% of total Crown revenue, which consists mainly of Accident Compensation Corporation levies and Emissions Trading Scheme revenue.

Core Crown tax revenue – Tax revenue collected by the Government.

Core Crown revenue – Consists primarily of tax revenue collected by the Government but also includes investment income, sales of goods and services and other revenue of the core Crown.

Core Crown expenses – The day-to-day spending (e.g. public servants' salaries, welfare benefit payments, finance costs and maintaining national defence etc.) that does not include capital expenditure on the construction or purchase of physical assets by the core Crown. This is an accrual measure of expenses and includes non-cash items such as depreciation on physical assets.

Cash position

Core Crown residual cash – The level of money the Government has available to repay debt or, alternatively, needs to borrow in any given year. Residual cash is alternatively termed 'Cash available/ (shortfall to be funded)'. Residual cash is equal to net core Crown cash flow from operations excluding NZ Super Fund activity less core Crown capital payments (e.g. purchase of assets, loans to others).

Total fiscal impulse – The total fiscal impulse shows whether the stance of fiscal policy is expansionary or contractionary relative to the previous year. The Treasury's total fiscal impulse measure is calculated as the change in the fiscal balance as a percentage of nominal potential GDP. The fiscal balance is residual cash adjusted for some expenditure items that do not directly affect domestic demand.

Annex Three: Calibration of the OBEGAL rule

To calibrate the operating balance rule, we took the following approach:

a **Calculate the average required operating balance, such that it does not contribute to a rise in net debt-to-GDP.** This approximates to the growth rate of nominal GDP multiplied by debt-to-GDP.[4] We assume a long-run growth rate of nominal GDP of 4.5% and a starting debt stock of approximately 30% of GDP. The operating balance can therefore be -1.35% of GDP so as not to contribute to net debt-to-GDP.

b **Convert this measure into an OBEGAL balance.** Given that OBEGAL excludes gains and losses, there is a question as to whether the Government should target a different level of OBEGAL than the required operating balance. Gains and losses vary but on average over a long period of time we tend to expect gains, primarily from the NZSF. However, targeting a lower level of OBEGAL on the assumption that this will be offset by returns on the NZSF, would mean that we were effectively using those returns to pay for operating expenses, rather than saving them. This, combined with the uncertainty of gains and losses, suggests we should not make an adjustment.

c **Add in an allowance for contributions to the NZSF.** NZSF contributions are not operating expenses and are therefore not included in OBEGAL. If the Government intends to contribute to the NZSF out of revenues, as opposed to out of debt – then the required OBEGAL surplus is higher. We add in 0.45% of GDP. We have not added in any further adjustment for pre-funding of long-term costs, beyond the contribution to the NZSF.

d **Add in an allowance for shocks.** This is perhaps the most uncertain variable. We assumed that significant economic shocks will occur approximately every decade and will require a temporary rising of debt-to-GDP. The size of those shocks has varied over time but we assume that an average shock will add approximately 15 percentage points to net debt to GDP. This requires that the operating balance be larger than it otherwise would by 1.5 percentage points of GDP per annum to keep debt-to-GDP stable over time. This implicitly assumes that deficits resulting from economic shocks will be smaller than they otherwise would be, due to the stronger starting OBEGAL position.

The result of this is a required OBEGAL surplus of 0.6% of GDP. However, we did not recommend adopting a specific point target due to the volatility in the OBEGAL indicator. Any OBEGAL rule should be sufficiently flexible to support the use of counter-cyclical fiscal policy, we therefore recommended that the rule seeks to maintain average OBEGAL surpluses in the range of 0 – 2% over time.

[4] As finance costs are included in OBEGAL, we do not need to further account for them or interest rates when calibrating the rule. However, higher finance costs will make it more difficult to achieve a given OBEGAL objective.

Annex Four: International approaches to expenditure rules

Jurisdiction	Description	Scope & key exclusions	Conditions, escape clauses & sanctions	Comment
Australia (current) *Primary source: Mid-Year Economic and Fiscal Update 2023*	"Limiting growth in spending until gross debt as a share of GDP is on a downwards trajectory, while growth prospects are sound and unemployment is low."	While not explicitly defined, adherence to the rule is demonstrated by improvements in the underlying cash balance (operating only) and low real growth in payments (operating and purchase of non-financial assets, e.g. roads), relative to pre-pandemic trends. Income support payments are excluded and expressly allowed to "respond in line with changes in the economy".	The expenditure rule applies "while [national economic] growth prospects are sound and unemployment is low". Compliance relies on transparency and public accountability under the Charter of Budget Honesty Act 1998 (similar to New Zealand's Public Finance Act 1989).	The "overarching goal" of the economic and fiscal strategy is to reduce gross debt as a share of the economy over time. The expenditure rule is the main way the gross debt objective is realised, by restraining spending broadly, including capital spending. However, to avoid spending restraint leading to counter-cyclical fiscal policy, the fiscal strategy "allow[s] tax receipts…to respond in line with changes to the economy", excludes income support payments (typically counter-cyclical) and provides a general escape clause for slower economic conditions. The fiscal strategy also explicitly directs upside tax revenue revisions to the Treasury.
Australia (2009-2013) *Primary source: Budget 2010-11*	"holding real growth in spending to 2 per cent a year once the economy is growing above trend until the budget returns to surplus" and "surpluses are at least 1 per cent of GDP"	Spending is defined as operating payments that contribute to the underlying cash balance.	The expenditure rule applies "once the economy is growing above trend" and until "surpluses are at least 1 per cent of GDP".	The stated objective of the fiscal strategy was fiscal sustainability, implemented through counter-cyclical fiscal policy as the economy was expected to grow strongly (i.e. by allowing tax revenue to increase as the economy recovers, while limiting expenditure growth).
UK (2014 – current) *Primary source: The welfare cap – House of Commons Library, 2023*	An expenditure cap is set for welfare spending. Treasury sets the cap.	The welfare cap covers around 50 percent of welfare spending, omitting pensions and Jobseekers Allowance payments, but includes tax credits, child benefit and disability benefit.	If there is a "significant negative shock to the UK economy" the Treasury may temporarily suspend the fiscal targets, including the welfare cap. If the OBR's formal assessment shows that the welfare cap is breached, the Secretary of State for Work and Pensions must explain to the House of Commons either: how government policy measures which will reduce welfare spending to within the level of the cap, or why a breach of the welfare cap is considered justified.	The welfare cap is one of three the UK's current three fiscal targets, alongside targets for net debt (declining as a share of GDP by the 5th year of the forecasts) and the budget deficit (not exceed 3% of GDP by the 5th year of the forecasts). As the welfare cap is set as a forecast (with a margin), it is primarily a means of improving scrutiny of welfare spending that can be difficult to control. The exclusions from the welfare cap, alongside escape clauses to explain why a breach is justified (e.g. due to an economic recession) avoid pro-cyclical fiscal policy arising due to the welfare cap. As the level of the welfare cap has changed several times, the OBR has questioned whether the cap has any meaningful impact on spending plans.
European Union (proposed) *Primary source: European Commission – proposed new economic governance rules*	European Union (EU) member states would be required to set 4-year expenditure targets as the "single operational indicator" for implementing the EU's two main fiscal rules of reducing debt below 60 percent of GDP and reducing budget deficits to below 3 percent of GDP.	The expenditure targets would be set based on net primary expenditure (expenditure net of discretionary revenue measures and excluding interest expenditure as well as cyclical unemployment expenditure). Members with debt above 60% of GDP or budget deficits above 3% of GDP would have "fiscal adjustment paths" to achieve the debt and deficit targets within 4 years (with possible extension to 7 years) and an improvement in the budget deficit of at least 0.5% per year.	An "excessive deficit procedure" would be applied to members with high debt and that fail to meet the agreed fiscal adjustment path. The member would be required to provide the European Council with a plan of corrective action, with fines issued for failure to comply with the plan. Deviations from the expenditure targets would be permitted due to a severe economic downturn in the EU (a "general escape clause") or for exceptional circumstances outside the control of the member ("unusual events clause"). The European Council would decide on the use of the escape clauses.	The EU's proposed fiscal and economic framework retains the previous focus on debt sustainability. However, the proposed framework is intended to be a simpler approach with stronger member-state buy-in by using expenditure targets (so members can decide how to prioritise spending within the target).
Finland (EU member) **(current)** *Primary sources: General government fiscal plan* *for 2024–2027 and the Spending Limits System Guide*	A net real expenditure limit is set to achieve a path towards the overarching medium-term objective of a structural budget deficit of 0.5% of GDP. The expenditure limit is a binding expenditure ceiling for the parliamentary term.	The expenditure limit excludes: expenditure that changes with the economic cycle (e.g. expenditure on unemployment security, housing allowance, basic social assistance and pay security), but includes the impact of policy changes to these areas an adjustment for forecast price and cost changes for the remaining term of the expenditure limit (to maintain the real value of the expenditure limit) debt interest expenditure is also excluded. The expenditure limit sets a ceiling for approximately 85% of central government budget expenditure.	As an EU member, Finland is subject to the excessive deficit procedure, as noted above. In addition, transparency about performance against the limit, and public accountability, encourage compliance. The EU's general escape clause and an unusual events clause permits temporarily departs from the adjustment path towards the medium-term objective of structural budget deficits of -0.5% of GDP.	The effectiveness of the expenditure limit on achieving the medium-term objective of a structural balance is dependent on how tightly the limit is set. In the latest update, the newly set expenditure limits for the new Finnish Government is not forecast to achieve a structural balance -0.5% of GDP within the forecast period (2023-2027).