

# 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
- [40] 18(c)(i) - that the making available of the information requested would be contrary to the provisions of a specified enactment

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## Treasury Report: Setting Short-Term Intentions and Long-Term Objectives for the Budget Policy Statement 2024

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<b>Date:</b>	Tuesday 27 February 2024	<b>Report No:</b>	T2024/312
		<b>File Number:</b>	MC-1-5-2-2024-M101968

### Action sought

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	Action sought	Deadline
Hon Nicola Willis <b>Minister of Finance</b>	Agree to your preferred short-term intentions and long-term objectives ahead of Budget Ministers 2.	Wednesday 6 March 2024

### Contact for telephone discussion (if required)

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Name	Position	Telephone	1st Contact	
Gabrielle Barratt	Senior Analyst, Macroeconomic and Fiscal Policy	[39]	N/A (mob)	✓
Luke Came	Team Leader, Macroeconomic and Fiscal Policy		N/A (mob)	

### Minister's Office actions (if required)

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<b>Return</b> the signed report to Treasury.
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Note any feedback on the quality of the report

**Enclosure:** No

# Treasury Report: Setting Short-Term Intentions and Long-Term Objectives for the Budget Policy Statement 2024

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## Executive Summary

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This report sets out options for setting short-term intentions (STIs) and long-term objectives (LTOs) to express your fiscal strategy in the Budget Policy Statement (BPS) 2024, as required by the Public Finance Act 1989.

The Treasury recommend a return to operating surplus as soon as practicable to support fiscal sustainability and macroeconomic stability. The fiscal strategy to achieve this surplus should be credible and achievable in the context of your Government's wider priorities and forecast uncertainty. The Treasury recommend the Government focus their fiscal strategy on:

- An operating balance STI target to reach an operating balance before gains and losses (OBEGAL) surplus by a particular year, with a LTO to run a 0 – 2% OBEGAL surplus on average over time.
- A net debt LTO of a ceiling of 30% of GDP (or 50% of GDP if New Zealand Super Fund is excluded from the net debt definition), and an STI of the Government's intended net debt trajectory.

Together these targets cover the stock and flow of the Crown's total financial position. There are a range of alternative or additional options for STIs and LTOs that could be adopted, which are outlined in this report. Some alternative options have notable operational risks or provide weaker constraints that mean you are less likely to achieve your fiscal objectives, including fiscal sustainability.

A concern you have noted regarding an OBEGAL target is the risk that the target is not met due to factors outside the Government's control. The Treasury recommend this risk is managed through:

- seeking Cabinet agreement to continue to progress targeted savings and revenue initiatives through future Budgets, and
- adjusting down Budget operating allowances if required, along with a credible plan to manage spending pressures within reduced allowances, and
- in a few limited cases where narrowly defined exit clauses are met, to consider departing from the OBEGAL STI, and
- over the long-term, utilising active balance sheet management strategies to manage OBEGAL volatility, including capital allocation and risk management decisions.

Following your direction on the recommendations in this report, the Treasury will reflect your preferred fiscal strategy options in the briefing material for the Budget Ministers 2 meeting. You will also receive further advice on Monday 4 March 2024 on calibrating your fiscal strategy. This advice will be informed by the latest preliminary economic and tax forecasts, and will include options to set Budget operating allowances as well as the recommended year to set an OBEGAL surplus target (should you agree to progress targeting a return by a specific date).

Following Cabinet's agreement to the fiscal strategy in mid-March 2024, it will be included alongside Budget operating and capital allowances in the publication of the BPS 2024 on Wednesday 27 March 2024.

## Recommended Action

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We recommend that you:

- a **note** Cabinet has agreed to a fiscal strategy that will focus on returning to surplus via a steadily improving OBEGAL trajectory [CAB-23-MIN-0490 refers],
- b **note** the Government is required by the Public Finance Act 1989 to set out its fiscal strategy through short-term intentions (STIs) and long-term objectives (LTOs) related to a set of fiscal variables at each Budget Policy Statement (BPS) and Fiscal Strategy Report,
- c **note** that the recommended operating balance before gains and losses (OBEGAL) and net debt LTOs provide buffers to respond to a wide range of economic shocks, and have been calibrated based on conservative assumptions,

### *Operating fiscal targets and rules*

- d **note** that Treasury recommends a return to operating surplus as soon as practicable to support fiscal sustainability and macroeconomic stability, while being credible and achievable in the context of the Government's wider priorities and uncertain forecasts,
- e **agree** to use OBEGAL (operating balance excluding gains and losses) as the fiscal indicator for your operating balance LTOs and STIs (**Treasury recommendation**),

*Agree/disagree.*

### *Operating LTOs*

- f **agree** to an operating balance LTO to run an OBEGAL surplus of between 0 – 2% on average (**Treasury recommendation**),

*Agree/disagree.*

- g **agree** to an additional operating expenditure LTO to reduce total Crown operating expenditure,

*Agree/disagree.*

- i. if recommendation g is agreed, **indicate** your preferred calibration of the operating expenditure LTO:
  - i. to constrain or stabilise core Crown expenditure (31.4% of GDP),
  - ii. to achieve a material reduction in core Crown expenditure (30.6% of GDP),
  - iii. to achieve a significant reduction in core Crown expenditure (28% of GDP),

### *Operating STIs*

- h **agree** to an STI:
  - i. to reach an OBEGAL surplus by a particular date (with the precise year to be determined when preliminary economic and tax forecasts are available) (**Treasury recommendation**), OR

*Agree/disagree.*

- ii. to reach an OBEGAL surplus by a steadily improving OBEGAL track, without specifying a date, OR

*Agree/disagree.*

- iii. to set an operating expenditure limit (**not recommended for 2024**),

*Agree/disagree.*

- i **indicate** if you would like to receive further advice on establishing an operating expenditure limit by the 2025 BPS,

- j **agree** that the BPS 2024 should specify the following limited and defined circumstances where suspension or deferral of the operating STI for returning to operating surplus will be considered:

- i. a significant decline in revenue due to factors outside of the control of the Government, such as a large change to the economic forecasts,
- ii. revisions to the economic outlook imply a material likelihood of constraints on the ability of monetary policy to stabilise the economy,
- iii. a significant economic shock, such as a natural disaster, results in a temporary increase in Government expenditure,

*Agree/disagree.*

- k **note** that the Treasury will monitor these criteria alongside updates to the economic and fiscal outlook and adjust its fiscal strategy advice accordingly,

*Agree/disagree.*

#### *Revenue fiscal targets and rules*

- l **agree** to an STI for revenue that commits to directing any upside forecast revenue surprises to OBEGAL to support the return to surplus and the operating balance LTO,

*Agree/disagree.*

#### *Net debt fiscal targets and rules*

- m **agree** that the definition of the net debt fiscal indicator:

- i. remains the same, including the New Zealand Superfund (NZSF), OR

*Agree/disagree.*

- ii. is amended to exclude the NZSF,

*Agree/disagree.*

#### *Net debt LTO*

- n **agree** to a net debt LTO:

- i. of a net debt ceiling, to keep net debt at levels equivalent to less than 30% of GDP based on the current net debt indicator (or less than 50% of GDP if it is

amended to exclude NZSF), subject to significant economic shocks (**Treasury recommendation**),

*Agree/disagree.*

- ii. of a net debt range, to keep net debt at levels equivalent to a range with an upper limit of 30% of GDP based on the current net debt indicator (or an upper limit of 50% if it is amended to exclude NZSF), subject to significant economic shocks,

*Agree/disagree.*

#### *Net debt STI*

- o **agree** to a net debt STI to put net debt on a downward trajectory,

*Agree/disagree.*

#### *Next steps*

- p **note** the Treasury will reflect your preferred fiscal strategy options in material for the Budget Ministers 2 meeting scheduled for Monday 11 March 2024,
- q **note** the Treasury will provide further advice based on your directions in this report on Monday 4 March 2024, including:
  - i. the appropriate treatment of ACC regarding the OBEGAL fiscal indicator,
  - ii. if you progress an OBEGAL target, the recommended quantum and timing of targeted savings and revenue raising options,
  - iii. if you progress an OBEGAL target year, the year the Treasury recommends selecting,
  - iv. if you progress a net debt ceiling, options for the number of the lower end of the range,
- r **note** following decisions at Budget Ministers 2, the Treasury will draft a paper for Cabinet's agreement to your preferred fiscal strategy, ahead of publication of the BPS 2024 on Wednesday 27 March 2024.

Luke Came  
**Team Leader, Macroeconomic and Fiscal Policy**

Hon Nicola Willis  
**Minister of Finance**

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# Treasury Report: Setting Short Term Intentions and Long Term Objectives for the Budget Policy Statement 2024

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## Purpose of Report

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1. This report provides advice on the options for communicating your fiscal strategy at the Budget Policy Statement 2024 in the form of new short-term intentions (STIs) and long-term objectives (LTOs) for fiscal policy. The recommendations draw on Treasury's review of fiscal indicators and the Government's fiscal rules undertaken in 2022.

## Background

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2. The Public Finance Act 1989 (PFA) requires you to specify your fiscal strategy at each Budget Policy Statement and Fiscal Strategy Report and explain how any changes to your fiscal strategy are consistent with the principles of responsible fiscal management. In particular, you are required to specify 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.
3. Setting the fiscal strategy will require you to balance 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. These factors will continue to challenge the fiscal position over the forecast and projection periods.
4. We also note recent downgrades to productivity growth assumptions, which are likely to lead to weaker GDP and revenue forecasts. Tax revenue is cumulatively \$12.7 billion lower in the five years to 2027/28 compared to the HYEPU 2023 forecast [T2024/341 refers]. Though preliminary fiscal forecasts are not yet available, the scale of this reduced tax revenue will negatively impact OBEGAL, which at HYEPU 2023 showed a technical surplus of \$0.1 billion forecast for 2026/27, and a small surplus of \$3.4 billion forecast for 2027/28.
5. The Treasury provided you with initial advice on your fiscal strategy in December 2023 [T2023/1992 refers], in which we recommended returning to operating surplus by 2026/27 at the latest.
6. Under the PFA, you are required to state your STIs and LTOs in relation to specific fiscal variables. To achieve this, we suggest the specific wording set out in Annex One. Through the process of drafting the BPS, we can work with you and your office to refine this wording to reflect your fiscal strategy as necessary and ensure it is compliant with the PFA requirements.



7. The STIs and LTOs should support medium-term fiscal sustainability, broader macroeconomic stability, and appropriate decision making to support the Government's near-term objectives. LTOs set out the Government's overall fiscal objectives, and the STIs set out how the Government intends to implement fiscal policy to achieve these over the short- to medium-term. Long-term fiscal sustainability objectives alone do not typically provide strong accountability, in part due to the relatively shorter timeframe for political cycles.
8. As discussed in previous advice, fiscal rules can help to operationalise your fiscal strategy and manage the multiple objectives for fiscal policy and support the Government to make trade-offs across its objectives [TR2023/2179 refers]. All options involve a trade-off between **flexibility** to respond as the economic and fiscal context changes, and fiscal **discipline**. Although there is no specific formula for a good fiscal rule, good rules should support:
  - **Sustainability:** supports long-term fiscal sustainability including through limiting deficit bias.
  - **Stability:** following the rules should not increase (and might even decrease) economic volatility, with enough flexibility to respond to shocks and the economic cycle to avoid pro-cyclical fiscal policy.
  - **Simplicity:** can be easily communicated and understood by the decision makers and the public.
  - **Accountability:** compliance with the rule should be easy to verify, enabling the Government to be held to account for adhering to the rules.
  - **Credibility:** are seen as credible and would not be easily abandoned after a shock.

### The Treasury recommend your fiscal strategy is anchored by targets for prudent levels of net debt and small operating surpluses

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9. The Treasury recommend that an operating balance before gains and losses (OBEGAL) target combined with a net debt target should form the basis of the Government's fiscal targets, expressed as both STIs and LTOs. Together these targets can cover the stock and flow of the Crown's total financial position.
10. 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.<sup>1</sup> 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.<sup>2</sup> An operating target is therefore important for fiscal sustainability.

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<sup>1</sup> 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).

<sup>2</sup> These cost drivers are described in detail in the Long-Term Fiscal Statement.

- 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.
11. A key benefit of a debt rule is that it can provide a backstop against fiscal weaknesses in an operating balance rule. One of the downsides of an operating balance rule focused on future surpluses is that previous actual deficits are not addressed; an actual fiscal strategy where actual deficits are run so long as a future surplus is always forecast could therefore meet the operating balance rule. As net debt is a stock measure, at some point it would become binding if deficits continued to occur and added to net debt. 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.
12. 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 adopting 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 long-term objectives (LTOs) for the operating balance and debt. The rules are currently specified as follows:
- 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 ensuring sufficient buffers to respond to economic shocks or natural disasters.
13. While we think the analysis and advice provided in 2022 remains sound, there are different specifications for the LTOs and STIs that would also be consistent with the criteria for good fiscal rules. Different options to express your fiscal strategy are covered in this report.

***The Treasury recommend OBEGAL is used as the fiscal indicator for operating expenditure and balance LTOs and STIs***

14. As a measure of the Crown's operating balance, 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 flows of Crown entities and State-Owned Enterprises including the Accident Compensation Commission (ACC).<sup>3</sup> While this introduces some volatility to the indicator, it is useful from an economic management perspective to consider the total Crown's fiscal performance. An important advantage of OBEGAL is that it covers expenditure that the Government has levers and choices over (though some have constraints, e.g. Crown entities are operated at arms length from Ministers).
15. An alternative option to using OBEGAL is using the operating balance. The key difference is this would include valuation movements. Because these are more volatile and less within the Government's control, it is not as useful as OBEGAL for capturing how the Government's decisions are affecting the Crown's total fiscal position.

***The Treasury recommend the operating balance LTO is maintained as a 0 – 2% OBEGAL surplus on average over time***

16. Previous Treasury work has estimated that an OBEGAL surplus of 0.5% of GDP per annum would be sufficient to ensure that the operating balance does not contribute to net debt as a share of GDP over time. This calculation includes an adjustment to allow for buffers to be rebuilt following shocks that increase debt by 10% of GDP every decade, which is consistent with New Zealand's historical experience. The Treasury considers that the findings of this work still hold, though work is ongoing to better understand the pressure increasingly frequent climate change events could have on OBEGAL.
17. The Treasury recommend that this estimate is translated into the LTO as a range. The key trade-off with a range target is ensuring that the range is wide enough to provide the flexibility needed to manage cyclical and other fluctuations in OBEGAL, while not being so wide as to provide a lack of clarity about the Government's fiscal intentions.
18. The Treasury recommend that you maintain the current objective of a 0 – 2% OBEGAL surplus on average over time, as this strikes an appropriate balance between clarity and flexibility. An alternative more flexible LTO could exclude reference to a range and merely state there is an objective to maintain an OBEGAL surplus over time. However, the Treasury do not recommend this option. It would provide little guidance on your fiscal strategy beyond the legal requirement under the principles of responsible fiscal management (to ensure that, on average, over a reasonable period of time, total operating expenses do not exceed total operating revenues).

***An additional operating expenditure LTO could help support your fiscal objectives of sustainability and right-sizing government spending***

19. An additional operating LTO option you may want to consider is a new long-term objective to reduce operating expenses. This could support communication and

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<sup>3</sup> The Treasury will provide further advice about the appropriate treatment of ACC within the OBEGAL indicator for fiscal strategy purposes on Monday 4 March 2024.

progress of your priority to “embed across government an approach to fiscal sustainability that effectively manages expenditure, restore fiscal discipline and right-size the government’s footprint.”

20. An expenditure objective may help provide an important signal about the Government’s commitment to expenditure control and reinforce the credibility of the Government’s recommended operating balance objective goals to return to and maintain operating surpluses. With significant challenges facing the fiscal position, adopting an expenditure objective could signal a strong commitment to improving the fiscal position over the medium term.
21. Core Crown expenses, which represent the day-to-day operating spending of the Government reached a multi-decade high of 34.6% of GDP in 2021/2022, having averaged 30.6% of GDP between 1996/97 and 2022/23. Pronounced peaks and troughs in core Crown expenditure reflect political preferences, shocks, and the economic cycle. Total Crown expenses have followed a similar trend to core Crown.
22. If you agree to adopt a numerical long-term objective for operating expenses, the numerical figure will be a political decision. The below illustrates the spectrum of choices you have here:
  - a To communicate an objective to constrain or stabilise the recent growth in government expenditure, you could commit to reducing expenditure in line with the HYEPU forecasts for core Crown expenses to decline to 31.4% of GDP in 2027/28.
  - b To communicate an objective to materially reduce the current level of government expenditure, you could commit to reducing core Crown expenses over time towards their long-run average of 30.6% of GDP. Achieving this objective over the medium-term would require forecast and projected operating allowances to be much lower than the current level.
  - c To significantly reduce the current level of government expenditure, you could commit to reducing core Crown expenses over time towards their historic low of 28% of GDP. This would require a fundamental change in the role of government in New Zealand.
23. The Treasury does not have a recommendation on the ‘right size’ of Government, beyond that any size of the state should be a sustainable size (that is, operating expenses should be funded from operating revenues over time). Significant and sustainable reductions in Government expenditure over the medium-to-long-term would require structural reforms such as stopping major existing programmes or restricting entitlements, given the outlook for rising expenditure associated with an ageing population.

***The Treasury recommends an operating balance STI of returning to OBEGAL surplus by a specific year***

24. The Treasury recommends an **OBEGAL surplus target year** to provide an effective constraint for fiscal sustainability. A target year is simple to communicate and provides a clear direction of the Government’s short-term fiscal strategy. If calibrated to provide a meaningful constraint, such an objective would contribute to narrowing the current account deficit, support monetary policy to lower inflation, and incentivise Government decisions on savings and reprioritisation. Moreover, making early consolidation progress would help address structural expense pressures and increase flexibility should a further shock hit the economy.

25. Alternatively, you could aim to **return to surplus via a steadily improving OBEGAL trajectory**, but without a specific target year. This STI would reflect the current high-level fiscal strategy agreed by Cabinet in December 2023, “focus on returning to surplus via a steadily improving OBEGAL trajectory” [CAB-23-MIN-0490].
26. While this option would provide a relatively high degree of flexibility, including to manage OBEGAL volatility, it would be a lessening of fiscal discipline relative to STIs of recent Governments, and provide a weaker commitment to medium-term sustainability. In particular, without a clear commitment on the timeframe for returning to operating surplus, the intent of the LTO for OBEGAL could be undermined by repeatedly pushing out the timeframe for returning to surplus.
27. A concern you have noted regarding an OBEGAL target is the risk that the target is not met due to factors outside the Government’s short-term control, such as forecast revisions or changes in the performance of State-Owned Enterprises and Crown Entities. An example is recent preliminary economic and tax forecasts, where tax revenue is cumulatively \$12.7 billion lower in the five years to 2027/28 compared to the HYEPU forecast [T2024/341 refers]. The Treasury recommend this risk is managed through:
  - a seeking Cabinet agreement to continue to progress targeted savings and revenue initiatives through future Budgets, and
  - b adjusting down Budget operating allowances if required, along with a credible plan to manage spending pressures within reduced allowances, and
  - c in a few limited cases where narrowly defined exit clauses are met, to consider departing from the OBEGAL STI. The proposed exit clauses are discussed later in this report, and
  - d over the long-run, utilising active balance sheet management strategies to manage OBEGAL volatility, including capital allocation and risk management decisions.
28. Another option is an operating expenditure STI expressed as an **operating expenditure limit**. Expenditure limits are increasingly common in advanced economies as a short-term fiscal rule to support a trajectory towards medium-term balanced-budget and net debt objectives. They typically take the form of a cap on nominal or real spending growth, and often exclude counter-cyclical expenditure like unemployment payments.
29. This option in place of an OBEGAL STI is better suited to addressing your concern that an OBEGAL surplus target may not be met due to factors outside the Government’s control. It can support fiscal management and control by increasing transparency and scrutiny of expenditure outside the allowance framework. However, there are important disadvantages compared to an OBEGAL surplus target.
30. Operating expenditure limits put relatively less focus on the Crown’s total fiscal position, or the full scope of options available to the Government to achieve medium-term fiscal sustainability (e.g. revenue changes). They can also introduce complexity to the Budget process through the interaction with the Budget allowance framework, which is a de facto expenditure limit.
31. **The Treasury recommends against adopting an operating expenditure limit in the 2024 BPS**. Besides the notable weaknesses compared to an OBEGAL STI, there are

significant operational risks in designing and implementing an expenditure limit in a few weeks (e.g., inadvertent severe constraints on future expenditure).

32. An operating expenditure limit could be considered as a **supplementary** option to an OBEGAL STI, instead of an alternative. This would avoid the disadvantages associated with no fiscal rules or targets focused on OBEGAL, but still carries significant operational risks in the near-term. If you are interested in an operating expenditure limit as an additional fiscal target, the Treasury recommend you defer including it in the 2024 BPS for the operational risk reasons outlined above. Instead, we recommend that you consider further advice from the Treasury in June 2024 on the benefits and risks, with a view to deciding whether to proceed with the design and incorporate decisions on an expenditure limit for the 2025 BPS.

### ***Selecting a target year and savings/revenue target for the recommended OBEGAL STI***

33. If you agree with Treasury's recommendation to adopt an OBEGAL surplus target year, the Treasury will provide advice on Monday 4 March 2024 on setting an appropriate surplus target year that is realistically achievable whilst providing a meaningful constraint on Budget decision making to support fiscal sustainability. This advice will also cover a suitable quantum and timing of total targeted savings and revenue raisers to aim for in future Budgets. The advice will be informed by the Treasury's latest economic and fiscal forecasts and should be robust to moderate changes to the forecast outlook.

### ***The Treasury recommend pairing an OBEGAL STI with defined exit clauses to support commitment to the fiscal strategy barring significant negative developments***

34. Where there are significant negative changes in the economic and fiscal outlook outside of the Government's control, the Treasury recommends that you retain flexibility to consider departing from your fiscal strategy. To ensure this flexibility is balanced against achieving your fiscal objectives, demonstrating commitment to fiscal discipline, and delivering your fiscal strategy, the Treasury recommend the BPS specifies exit clauses. These clauses would set out the circumstances where you expect it would be appropriate for the Government to review the OBEGAL STI, such as suspending the target in the STI or adjusting the target date of surplus.
35. The Treasury recommend the STI for OBEGAL sets out your expectation that there will be consideration of whether to suspend or defer the surplus point target in the following circumstances:
  - a A significant decline in revenue due to factors outside of the control of the Government, such as a large change to the economic forecasts.
  - b Revisions to the economic outlook which imply a material likelihood of constraints on the ability of monetary policy to stabilise the economy.
  - c A significant economic shock, such as a natural disaster, results in a temporary increase in Government expenditure.
36. In order to support a clear and transparent process for adjusting the surplus point target in response to new information, the Treasury intends to monitor whether these criteria are met alongside updates to the economic and fiscal forecasts. If the criteria are judged to be met, we will provide you with advice on the trade-offs involved in deciding whether to suspend or defer the target. Although the Government is ultimately accountable for whether it adheres to its STIs and LTOs, the Treasury's advice would provide analysis that supports you in deciding whether to amend your fiscal strategy.

37. Overall, the recommended approach to monitoring and review of the surplus point target should result in the STI for OBEGAL providing a stronger public commitment to medium-term sustainability than the previous formulation, which was subject to “economic and fiscal conditions”. The recommended approach would send a strong signal of your desire for fiscal restraint in coming Budgets by defining the specific circumstances where you expect to receive advice that considers recalibration of the target.
38. If you agree to the recommended approach of monitoring and review, the Treasury can provide further advice in the next report on the fiscal strategy. This advice would cover further details on the process for Treasury monitoring whether the triggers for reviewing the point target have been met, and any additional scenarios that could warrant a review (for example, if there are large and temporary changes to the OBEGAL forecast caused by Crown entity deficits).

## Recommendations and alternative options for revenue STIs

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### ***The Treasury recommends you adopt a revenue STI to direct upside surprises towards reducing net debt***

39. Given the macroeconomic and fiscal sustainability benefits of returning to surplus as soon as possible, it would be desirable to bring forwards the target date if there is a significant improvement in the fiscal outlook. The Treasury recommend that you commit to this approach by specifying an STI for revenue that sets out your intention that any upside forecast revenue surprises will return to the centre to support the operating balance objective. This will strengthen the commitment to medium-term sustainability resulting from the surplus point target, reinforce your commitment to stated operating allowances, and support any long-term objective to reduce excessive Government expenditure.

## Recommendations and alternative options for net debt LTOs and STIs

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### ***You could choose to amend the current net debt definition by excluding the New Zealand Superfund***

40. In 2022, the Treasury 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).
41. The Treasury considers there is benefit in maintaining both Crown entity borrowings and advances in the net debt indicator.
  - a. Including Crown entity borrowings more accurately reflects the liabilities of the Crown. It also avoids the incentive to engage in more expensive borrowing on Crown entity balance sheets that would fall outside the net debt indicator but does not realistically shift risk away from the core Crown.

- b The motivation for including advances was largely driven by the Reserve Bank's Funding for Lending Programme. Without netting off the fair value of the asset, this would have driven a large increase in net debt in a way that was not indicative of the sustainability of the Crown's fiscal position. A similar argument applies to student loans. Including these advances bring the net debt measure into better alignment with international comparators.
42. There are different pros and cons regarding including or excluding the NZSF in the net debt definition:
- a Including the NZSF better represents New Zealand's long-term fiscal sustainability. Initially, including the NZSF improved international comparability. However, since 2022 international movements in fiscal indicators has reduced this (e.g. the Australian Government's fiscal strategy has moved away from a focus on net debt and towards a focus on gross debt). The International Monetary Fund (IMF) also publish internationally comparable fiscal indicators on net debt. Disadvantages include increased volatility of the fiscal indicator, and the need for periodic amendment to reduce the debt ceiling so the growth of the NZSF is not spent through increased room for net debt.
  - b Excluding NZSF reduces volatility, and does not require periodic amendment. While less internationally comparable than including NZSF, this relative disadvantage has narrowed since 2022. As Treasury already publishes a net debt measure that excludes NZSF, this option can be operationalised ahead of the 2024 BPS.
43. For transparency reasons, the Treasury recommend you continue to publish net debt information both including and excluding NZSF in your Fiscal Strategy Report. The decision on which definition you will use to describe net debt would therefore be about which definition best aligns with the values and objectives of your fiscal strategy, and that you would like to focus communication of your fiscal strategy on.

***The Treasury recommend retaining the net debt LTO of a ceiling of 30% of GDP***

44. Based on a recent review of headline fiscal indicators, the Treasury still considers that a ceiling of 30% net debt to GDP is prudent. The 2022 modelling used to guide the recommended ceiling conservatively allowed for debt levels increasing by up to 40% of GDP in response to severe economic shocks. The modelling also assumed adverse changes to interest rates and economic growth that are far in excess of outcomes seen in recent decades.
45. As a result, assuming a moderate-high willingness by the Government to run primary surpluses after shocks, the Treasury is confident that the 30% debt ceiling provides a sufficient buffer for the Government to borrow to respond to severe economic shocks and support productive long-term capital assets. This conclusion still holds despite recent increases in long-term interest rates.
46. While this LTO is useful for creating a maximum upper bound for the long-term, it does not communicate an ideal level of net debt. As discussed below, the Treasury recommend you adopt a net debt STI that acts as a further fiscal control and communicates your intention to put net debt on a downward trajectory over the forecast period. However, over the long-term, there is significant uncertainty about the ideal level of debt. For example, the long-term projections for debt depend heavily on the Government's assessment of the level of borrowing required to support investments in essential infrastructure that helps boost productivity growth.



47. For this reason, we recommend against a specific point target as a net debt LTO, as this may become overly binding if the fiscal forecasts and / or projections change. Moreover, depending on the specific point target chosen and the timeframe this could imply a need for significant reductions in expenditure and/or a material rise in tax revenue in order to achieve the Government's goal.
48. An alternative approach, which could better reflect uncertainty about the ideal level of net debt, would be to specify a range for the LTO for net debt – for example, a range of a number below 30% of GDP and 30%. However, a range that incorporated a realistic degree of uncertainty could result in very wide bands that have little information value. For example, the PREFU projections showed net debt falling to below 10% of GDP, and there may be scenarios where an even lower level of net debt would be feasible and desirable. We can provide follow-up advice on possible calibrations for a LTO for net debt specified as a range if you would like to consider this option further.

***The Treasury recommend you adopt a net debt STI to communicate your aims for the net debt trajectory***

49. The Treasury recommend you adopt a net debt STI that the Government intends to return to operating surplus and put net debt on a downward trajectory in the short-term. This would add to the net debt LTO to communicate your fiscal objectives regarding net debt, while still retaining a long-term upper limit.
50. In setting this STI, the Treasury recommend against setting a specific net debt target quantum. As discussed in the recent report on options to increase the multi-year capital allowance (MYCA) [T2024/327 refers], there are still outstanding decisions on reprioritisation and scope of capital-intensive policy aims, and agency checks of capital policy costings are still underway.
51. If you would like a net debt STI to include a total net debt quantum, the Treasury recommend further defining the net debt STI at the 2025 BPS. At this point you will have more information and decisions on policies that could significantly affect pressure on net debt (e.g., the outcome of the Budget 2024 reprioritisation process, and the Independent review of Kāinga Ora).

## Next steps

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52. On Monday 4 March 2024 you will receive advice covering the outstanding issues indicated above (ACC, the quantum and timing of savings and revenue raising options, the recommended target year to return to OBEGAL surplus), Treasury's recommended operating allowance for Budget 2024, and any follow up advice that you may commission from this report.
53. You are meeting with Budget Ministers on Monday 11 March 2024 to discuss Treasury's advice on the Budget package and your fiscal strategy. We will need your decisions on this report and the forthcoming Monday 4 March 2024 report by Wednesday 6 March 2024, so that these decisions can be reflected in Budget Ministers 2 material and agreed by Budget Ministers on Monday 11 March 2024.

## Annex 1 – Suggested short-term intentions and long-term objectives for BPS 2024

<b>Fiscal variable as specified in section 26J of the PFA</b>	Short-term intentions (STIs)	Long-term objectives (LTOs)
<b><i>Level of total debt</i></b>	The Government's intention is to put net debt on a downward trajectory [excluding/including the New Zealand Super Fund], and ensure that debt does not exceed 50 / 30% of GDP as long as there are not significant economic shocks.	Maintain total debt at prudent levels, being below 50 / 30 percent of GDP based on the net debt measure [excluding/including] the New Zealand Super Fund, subject to significant economic shocks.
<b><i>The operating balance</i></b>	<p>The Government's intention is to return the operating balance (before gains and losses) to surplus by [to be confirmed]. The Government will consider whether to suspend or defer the point target is expected in the following circumstances:</p> <ul style="list-style-type: none"> <li>- A significant decline in revenue due to factors outside of the control of the Government, such as a large change to the economic forecasts.</li> <li>- Revisions to the economic outlook which imply a material likelihood of constraints on the ability of monetary policy to stabilise the economy.</li> <li>- A significant economic shock, such as a natural disaster, results in a temporary increase in Government expenditure.</li> </ul>	The Government's intention is to return the operating balance (before gains and losses) to a surplus and maintain surpluses in the range of 0 – 2% of GDP on average over time. This will ensure that, on average, over a reasonable period of time, operating expenses are being funded from operating revenues and not from debt.
<b><i>Total operating revenue</i></b>	The Government's intention is to ensure total operating revenues are consistent with the operating balance objective, and to direct any upside revenue surprises to the Treasury to support the operating balance objective.	The Government will ensure the level of operating revenues is consistent with the operating balance objective and supports long-term productive economic growth.
<b><i>Total operating expenses</i></b>	The Government's intention is to ensure total operating expenses are consistent with the operating	The Government's intention is to ensure total operating expenses are consistent with the operating balance

	balance objective and reduce in line with the savings identified through our Fiscal Sustainability Programme.	objective, and reduce towards their long-run average as a proportion of GDP (as measured by core Crown expenses returning to their long run average level of 30-31% of GDP)] to support a more appropriate role for the Government in the economy.
<b><i>Level of total net worth</i></b>	The Government's intention is to maintain net worth above 40% of GDP.	The Government will ensure net worth remains at a level sufficient to act as a buffer to economic shocks and will use the Crown's net worth to manage a strong economy that delivers for all New Zealanders.