BUDGET
2018

Fiscal Strategy Report

Foundations for the Future

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Minister of Finance

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Guide to the Budget Documents

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

Budget at a Glance

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

Budget Speech

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

Summary of Budget Initiatives

The *Summary of Budget Initiatives* lists and describes the new initiatives included in Budget 2018.

Fiscal Strategy Report

The *Fiscal Strategy Report* sets out the Government's fiscal strategy in areas such as the balance between operating revenues and expenses, and its debt objectives. The report includes the Government's long-term fiscal objectives and short-term fiscal intentions plus fiscal trends covering at least the next 10 years. The Government must explain changes in the *Fiscal Strategy Report* from the *Budget Policy Statement*.

Budget Economic and Fiscal Update

The *Update* includes the Treasury's economic forecasts and the forecast financial statements of the Government incorporating the financial implications of Government decisions and other information relevant to the fiscal and economic outlook. The *Update* also discusses key risks to the economic and fiscal forecasts.

The Estimates of Appropriations

The *Estimates* outline, for the financial year about to start (the Budget year), expenses and capital expenditure the Government plans to incur on specified areas within each Vote, and capital injections it plans to make to individual departments. The *Estimates* are organised into 10 sector volumes, with each Vote allocated to one sector. Supporting information in the *Estimates* summarises the new policy initiatives and trend information for each Vote and provides information on what is intended to be achieved with each appropriation in a Vote and how performance against each appropriation will be assessed and reported on after the end of the Budget year.

Also released on Budget day:

The Supplementary Estimates of Appropriations

The *Supplementary Estimates* outline the additional expenses, capital expenditure and capital injections to departments required for the financial year about to end. Supporting information for each Vote provides reasons for the changes to appropriations during the year, related changes in performance information and full performance information for new appropriations.

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Fiscal Strategy Report

Executive Summary

The Government's priorities were set out in the *Budget Policy Statement* in December 2017. They are:

- Building quality public services for all New Zealanders and improving access to core services, such as health and education.
- Taking action on child poverty and homelessness.
- Supporting families to get ahead and sharing the wealth generated by our economy with a wide range of New Zealanders.
- Sustainable economic development and supporting the regions.
- Managing our natural resources and taking action against environmental challenges, such as climate change.

That document outlined the Government's ambitious plan to reduce child poverty, protect the environment, create decent jobs, and build more affordable houses. We committed to doing that while running sustainable surpluses and reducing net core Crown debt as a proportion of the economy.

Our plan builds on the investments made through the December mini-Budget and the 100-Day Plan. This Budget's focus is on rebuilding the foundations of our critical core public services so that New Zealanders receive the healthcare, education, housing and support for their communities that they expect and deserve. The Budget also encourages investment in our productive economy and our regions, through measures such as a research and development (R&D) tax incentive, the Provincial Growth Fund and the Green Investment Fund.

This is a first step – it will take more than one Budget to fix the nine years of underfunding of New Zealand's critical public services.

Budgets 2019 and 2020 will build on these foundations, transforming New Zealand's economy to be more productive, sustainable and inclusive.

We are looking to the future and taking responsibility on a number of intergenerational challenges facing New Zealand. The responsibility includes more than just policy choices – we are committed to fiscal responsibility to ensure that the New Zealand economy can withstand any unexpected shocks like natural disasters or global downturns.

The Treasury's *Budget Economic and Fiscal Update* shows the Government is meeting the Budget Responsibility Rules. These rules include running sustainable operating surpluses across the economic cycle, reducing net core Crown debt to 20 per cent of gross domestic product (GDP) within five years of taking office and keeping government expenditure as a per cent of GDP in line with historic trends.

New Zealand's fiscal and economic outlook continues to improve. The operating balance before gains and losses (OBEGAL) is forecast to reach a surplus of $7.3 billion in 2021/22. Net core Crown debt falls to 19.1 per cent of GDP in 2021/22. Unemployment declines towards 4 per cent, wages rise in real terms each year, and GDP growth is expected to average 3 per cent across the forecast period.

The Government's responsible approach to fiscal management, together with an improved economic outlook since the general election, means we have been able to increase the capital and operating allowances in Budget 2018. These will begin to address the social and infrastructure deficits facing New Zealand, while meeting the Budget Responsibility Rules. Budget 2018 provides for $2.8 billion per year of new operating spending and $3.8 billion of new capital investments.

Allowances for future Budgets have also been increased in light of continuing cost pressures across a range of portfolios. Budget 2018 forecasts a record $42 billion of net new capital spending over the next five years. This is over $10 billion more than planned by the previous Government at Budget 2017.

The Government's plan is fully funded within the allowances. It will ensure New Zealand transitions to an economy that is more productive, more sustainable, and more inclusive. It is a plan focused on improving the living standards and wellbeing of all New Zealanders, both now and into the future.

Economic and Fiscal Outlook

Our plan brings fresh energy to shift the drivers of growth to support a more productive, sustainable and inclusive economy…

New Zealand is a successful country when looking at some of our high level indicators. Our GDP growth has outstripped many peers since the global financial crisis, and is expected to continue at about 3 per cent on average over the next five years.

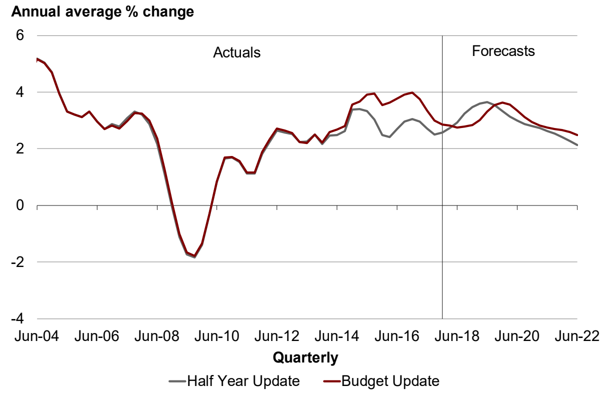
But we know that recent growth has been driven primarily by high net migration levels and low interest rates, which have supported consumption and property speculation, rather than investment in the productive economy.

While government debt remains low by international standards, household debt has increased to near-record levels at over 168 per cent of disposable income. Per capita GDP and productivity growth have been weak. Over the past 30 years, the share of the economy going to people earning wages and salaries has declined. In short, New Zealand's economy has been dominated by speculation rather than investment in our productive sectors.

The Coalition Government has a different plan for how our economy should grow. Similar to the *Half Year Economic and Fiscal Update* (*Half Year Update)* published in December 2017, the Treasury is forecasting a shift away from growth driven by population increases.

We are investing in skills, education, and research and development to lift labour productivity. We will train the workforce needed for a modern economy which will support all New Zealanders and ensure sustainable growth for future generations.

Figure 1 **–** Real GDP growth



Sources: The Treasury, Stats NZ

Note: Stats NZ has made significant historical revisions to real GDP since the *Half Year Update.*

The Families Package announced in the December mini-Budget supports families on middle and low incomes from the second half of 2018, boosting household spending. KiwiBuild contributes to an acceleration in residential investment for new houses, particularly in the second half of the forecast period.

These economic drivers see forecast unemployment fall to 4.1 per cent by late 2019, in line with the Government's target of reducing the unemployment rate to 4 per cent by the end of this parliamentary term. Wages are forecast to grow at over 3 per cent per year on average over the next five years, bringing average annual earnings to $71,000 by June 2022.

Headline inflation is expected to remain steady and stable, and track in line with the 2 per cent midpoint of the Reserve Bank's target band. Low interest rates are stimulatory in the short term but are forecast to begin rising slowly from the end of 2018 as the Official Cash Rate returns to a normal setting.

The Government's immigration policies will refocus the immigration system away from the recent model towards attracting the skill-mix and people New Zealand needs to become more productive.

The Treasury has increased the level of net migration that is assumed to be occurring in 2021/22 to 25,000 (up from 15,000 in the *Half Year Update*). This is still significantly lower than the recent peak of 72,400.

Table 1 – Summary of the Treasury's economic forecasts

Year ending 30 June	2017 Actual	2018 Forecast	2019 Forecast	2020 Forecast	2021 Forecast	2022 Forecast
Real GDP (annual average % change)	3.3	2.8	3.3	3.4	2.7	2.5
Real GDP per capita (annual average % change)	1.2	0.7	1.3	1.7	1.3	1.3
Consumers Price Index (annual % change)	1.7	1.4	1.5	1.8	1.9	2.0
Employment growth (annual average % change)	5.2	3.8	2.1	1.9	1.5	1.3
Unemployment rate (June quarter)	4.8	4.5	4.2	4.1	4.1	4.2
Wage growth (annual % change)	1.6	3.2	2.7	3.1	3.3	3.4
Current account (% of GDP)	-2.7	-2.6	-3.1	-3.0	-3.0	-3.1

Sources: The Treasury, Stats NZ

…allowing us to address the social infrastructure deficits that have worsened over recent years.

Our plan introduces new ideas to tackle some of New Zealand's largest social and economic challenges, and starts to rebuild the foundations our economy and communities are built on. While some of the high level economic indicators have been positive in recent years, we have seen no discernible change in the rates of child poverty. New Zealand has experienced sustained high levels of youth unemployment and homelessness is at levels described by the Organisation of Economic Co-operation and Development (OECD) as the worst in the developed world, despite strong and rising GDP growth.

Many households on middle and low incomes are struggling to keep pace with an increasing cost of living, and too many struggle with housing costs. Our home ownership rates are the lowest in over 60 years and rents are rising. The New Zealand Health Survey showed that more than half a million New Zealanders did not go to a doctor because of the cost. Our public services have been placed under severe strain. Almost 20 per cent of the value of District Health Board (DHB) assets are in poor or very poor condition and our schools have an average age of 42 years, with approximately 40 per cent of them older than 50 years. Police stations have been closed around the country.

The Government is also facing significant pressure for infrastructure investment owing to population growth not being matched by essential supporting investment. Recent transport investment has been overly focused on a handful of expensive roading projects selected for political reasons benefiting only a small percentage of road users.

We have already filled the multi-billion dollar funding hole in Auckland's 10-year transport project and our transport plan increases investment across New Zealand in local and regional roads, road safety, rail and public transport.

Overall, we will invest $42 billion into net new capital and infrastructure over the next five years, over $10 billion more than planned by the previous Government at Budget 2017.

Our fiscal position will remain strong…

We are committed to managing the Government's own balance sheet so that we can start closing New Zealand's social and infrastructure deficits. This requires responsible fiscal management alongside our plan to grow the economy. The Government's books are in good shape and are tracking ahead of the Treasury's forecasts in the *Half Year Update* in December 2017. Stronger-than-expected revenue is being generated from higher business profits and stronger employment growth than expected before the election. This strength in revenue is now expected to persist for the remainder of the current year and into the forecast period.

A strong fiscal position is a pre-requisite for improving the wellbeing of New Zealanders. We must keep in mind that New Zealand faces risks domestically from natural disasters and biosecurity threats, and internationally from economic shocks, global insecurity, and changes in technology. This requires us to build a buffer into our accounts, which we are doing by running operating surpluses and reducing net core Crown debt as a share of the economy. Table 2 provides a summary of the Treasury's *Budget Economic and Fiscal Update* fiscal forecast.

Table 2 – Summary of the Treasury's fiscal forecasts

Year ending 30 June	2017 Actual	2018 Forecast	2019 Forecast	2020 Forecast	2021 Forecast	2022 Forecast
$billions						
Core Crown tax revenue	75.6	79.5	83.9	89.0	93.9	99.0
Core Crown expenses	76.3	81.7	86.7	90.1	94.7	98.1
Total Crown OBEGAL	4.1	3.1	3.7	5.4	5.7	7.3
Core Crown residual cash	2.6	(1.3)	(3.9)	(1.7)	(1.9)	0.7
Net core Crown debt	59.5	60.4	64.2	65.9	67.6	67.0
Net worth attributable to the Crown	110.5	117.6	124.5	133.3	142.9	154.7
% of GDP						
Core Crown tax revenue	27.6	27.3	27.5	27.8	28.1	28.3
Core Crown expenses	27.8	28.1	28.5	28.2	28.3	28.0
Total Crown OBEGAL	1.5	1.1	1.2	1.7	1.7	2.1
Core Crown residual cash	0.9	(0.4)	(1.3)	(0.5)	(0.6)	0.2
Net core Crown debt	21.7	20.8	21.1	20.6	20.2	19.1
Net worth attributable to the Crown	40.3	40.4	40.9	41.7	42.7	44.2

Source: The Treasury

… which allows us to increase Budget allowances to make essential investments while meeting the Budget Responsibility Rules.

A stronger fiscal position, our more responsible approach to debt repayment, reprioritisation of poorly targeted spending and cracking down on tax dodgers gives us the ability to begin addressing the social and infrastructure deficits New Zealand faces. The Government has chosen to increase the operating and capital allowances in this Budget to deal with the pressures New Zealand faces and to introduce our plan for more productive growth. The Budget 2018 operating allowance is now $2.8 billion per year and the capital allowance is $3.8 billion (an increase from the proposed allowances in the *Half Year Update* of $2.6 billion and $3.4 billion respectively). Over the next four years, this Government will invest $24 billion more than the previous Government had planned ($18 billion of operating and $6 billion of capital).

We are able to increase investment and fully fund our plan while maintaining our commitment to the Budget Responsibility Rules and the Public Finance Act 1989. We will make investments where they are needed, and we will be making a higher level of investment than the previous Government. We are doing this in a fiscally responsible way.

The Government's surplus is forecast to rise. Figure 2 shows OBEGAL is forecast to be $3.7 billion in 2018/19 (1.2 per cent of GDP), and to reach $7.3 billion (2.1 per cent of GDP) in 2021/22. This maintains the Budget Responsibility Rule commitment to deliver a sustainable surplus across an economic cycle, and shows that we are managing the Government's books responsibly.

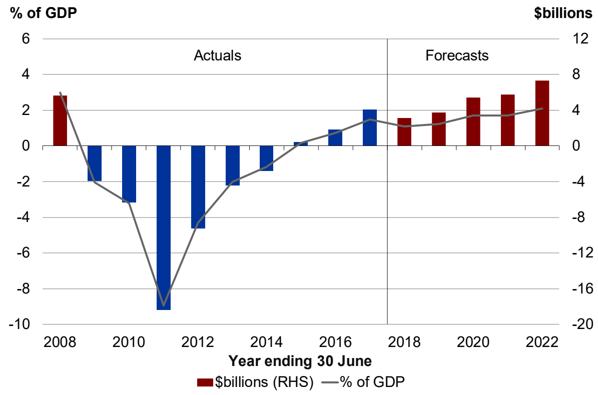
These OBEGAL surpluses, along with a growing economy, mean net core Crown debt falls as a per cent of GDP. The Treasury forecasts net core Crown debt will fall to 19.1 per cent of GDP in 2021/22, in line with the Budget Responsibility Rule for the Government to reduce net core Crown debt to 20 per cent within five years of taking office. This provides a buffer in case of unexpected events, like a natural disaster or global downturn (Figure 3).

Net core Crown debt in nominal dollar terms will rise over the next few years owing to the significant additional capital investment the Government has planned. This debt is being used responsibly to pay for the essential investments in schools, hospitals, housing, and infrastructure that are needed around the country.

Core Crown expenses are expected to remain around 28 per cent of GDP across the forecast period, below the recent historical average of 30 per cent of GDP (Figure 4). This is in line with the Budget Responsibility Rules.

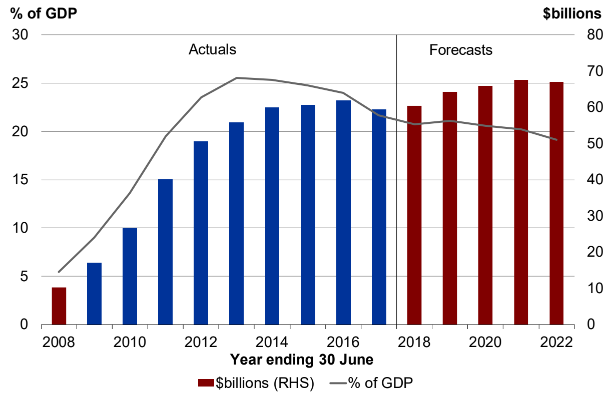
By taking a more responsible approach to debt reduction than the previous government, growing the productive economy with new policies designed to encourage innovation, and reversing the untargeted Budget 2017 tax cuts, we have opened up the room for additional investments while continuing to prudently manage the Government's books within the Budget Responsibility Rules.

Figure 2 – Total Crown operating balance before gains and losses (OBEGAL)



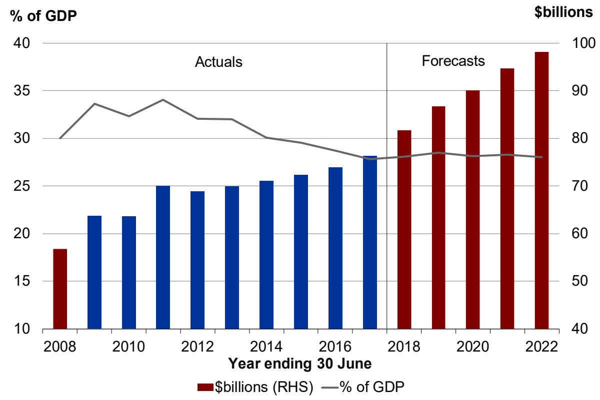
Source: The Treasury

Figure 3 – Net core Crown debt



Source: The Treasury

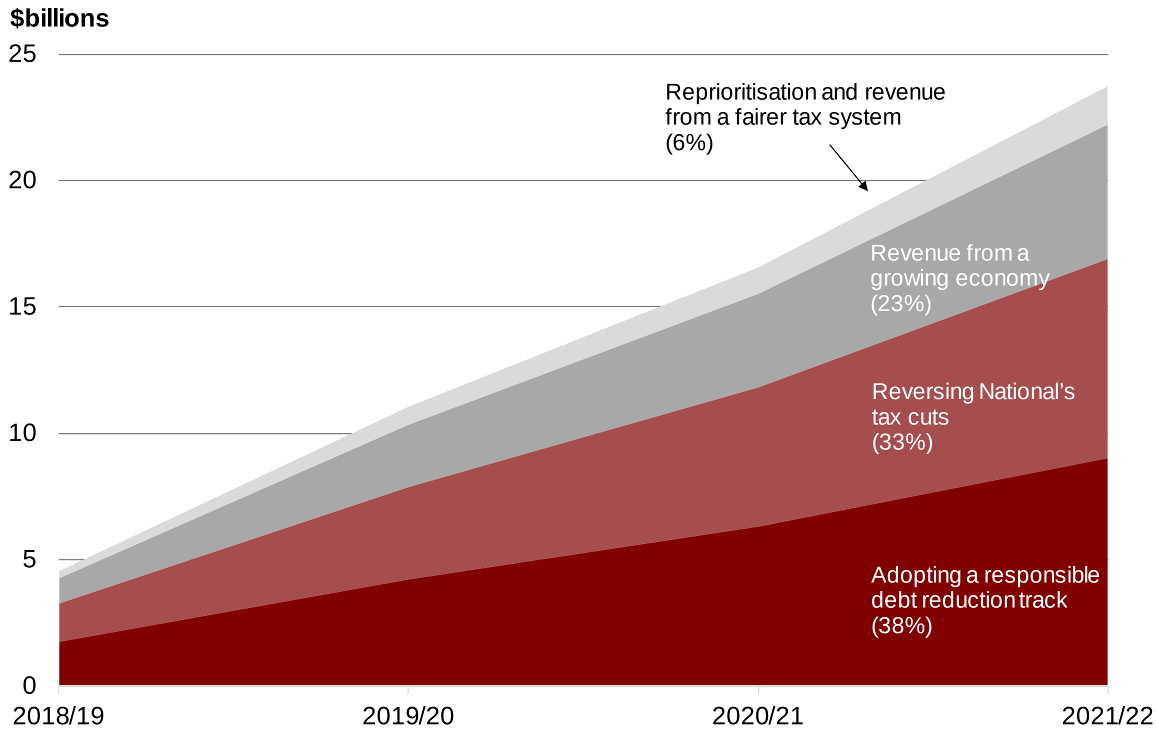
Figure 4 – Core Crown expenses



Source: The Treasury

Figure 5 below shows how we are financing our extra investments compared to the previous government.

Figure 5 – Additional Budget allowances and 100-Day Plan spending[1]



Source: The Treasury

Rebuilding critical public services and infrastructure will also require work over the coming Budgets.

This Budget builds on the investments made in the December mini-Budget and 100-Day Plan. It reflects this Government's strategy to make the significant investments needed to rebuild critical public services, meet the needs of a growing population, boost economic development in our regions, and support families to get ahead.

While we cannot make up for the underfunding of the past nine years in one Budget, we are making strong and important first steps. There are capacity constraints in the economy, and we need to take a phased approach to ensure good value for money. This Budget has been designed to ensure that our policies are deliverable, sustainable and fiscally responsible.

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1 Note: this chart shows sources of funding for the $24 billion of cumulative additional spending (beyond that planned by the previous Government) in the 100-Day Plan, Budget 2018 and future Budgets. The funding sources have been averaged across the forecast period.

- 'Revenue from a growing economy' refers to the increase in the forecast for tax revenue compared to the *Pre-election Update*.
- 'Reprioritisation and revenue from a fairer tax system' refers to funding freed up from reprioritisation and changes to the tax system such as loss ring-fencing.
- Reversing National's tax cuts that were proposed to come into force from 1 April 2018.
- 'Adopting a responsible debt reduction track' refers to the headroom created by having slightly higher net core Crown debt than planned by the previous Government.

This is the Coalition Government's first Budget. Through this, and in Budgets 2019 and 2020, we will be ensuring all the commitments in the Coalition Agreement, Confidence and Supply Agreement and Speech from the Throne are delivered and fully funded.

Budget 2019: Focus on Wellbeing

The *Budget Policy Statement 2018* confirmed this Government's intention to take a wellbeing approach to Budget 2019, which will support our commitment to put people's wellbeing and the environment at the heart of our policies. This includes reporting against a wider set of wellbeing indicators in future Budgets. For example, the Prime Minister's Child Poverty Reduction Bill will require each government to set targets on alleviating child poverty and report against those targets at every Budget.

Budget 2019, the Wellbeing Budget, will broaden the Budget's focus beyond economic and fiscal policy by using the Treasury's Living Standards Framework (LSF)[2] to inform the Government's investment priorities and funding decisions. The LSF is based on the OECD's wellbeing framework and combines measures of current wellbeing (across 12 domains) with indicators of intergenerational wellbeing, which are organised into four capitals – financial and physical, human, social and natural.

As part of the Confidence and Supply Agreement with the Green Party of Aotearoa New Zealand, the Government is developing a comprehensive set of environmental, social and economic sustainability indicators to measure our progress as a country. These will be used alongside the LSF to enable us to measure and report against a broader set of indicators to show a more rounded measure of success, as a country and as a Government.

Over the coming months, Ministers will set priorities that look across portfolios. Setting clear priorities for Budget 2019 will help us to align the information requirements and initiative assessment process so that they supports the successful delivery of the Wellbeing Budget.

The Wellbeing Budget represents an important step towards embedding wellbeing in New Zealand's public policy.

Details about the Wellbeing Budget will be announced later in the year, and detailed in the Government's *Budget Policy Statement* for 2019.

2 https://treasury.govt.nz/information-and-services/nz-economy/living-standards/our-living-standards-framework

Fiscal Strategy

The Government is meeting the Budget Responsibility Rules…

The Budget Responsibility Rules form the basis of our fiscal strategy. They are to:

1. Deliver a sustainable operating surplus across an economic cycle.
2. Reduce the level of net core Crown debt to 20 per cent of GDP within five years of taking office.
3. Prioritise investments to address the long-term financial and sustainability challenges facing New Zealand.
4. Take a prudent approach to ensure expenditure is phased, controlled and directed to maximise its benefits. The Government will maintain its expenditure to within the recent historical range of spending to GDP ratio.
5. Ensure a progressive taxation system that is fair, balanced and promotes the long-term sustainability and productivity of the economy.

The Public Finance Act 1989 (PFA) sets out the principles for responsible fiscal management and requires the Government to set its fiscal strategy in accordance with these principles (see Annex). The Budget Responsibility Rules are consistent with the PFA principles.

Delivering a sustainable operating surplus across an economic cycle meets the PFA requirement that, on average, total operating expenses do not to exceed operating revenues. Reducing the level of net core Crown debt to 20 per cent of GDP within five years of taking office meets the PFA requirement to maintain net debt at prudent levels, have regard for present and future generations and manage fiscal risks. We will continue to ensure that the New Zealand economy remains resilient to risks, both domestic and international.

Each of these Budget Responsibility Rules, and our progress so far in meeting them, is discussed further below:

The Government will deliver a sustainable operating surplus across an economic cycle. In recent years, the previous Government created surpluses by running down expenditure in key areas. This is not a sustainable surplus. A sustainable surplus is one that exists once policy objectives have been met, and is not artificially generated by underfunding key public services.

The Treasury forecasts show OBEGAL surpluses reaching $7.3 billion in 2021/22 (2.1 per cent of GDP), showing we are on track to meet this rule.

The Government will reduce the level of net core Crown debt to 20 per cent of GDP within five years of taking office. Reducing government debt will give future generations more options and help manage future risks or shocks like natural disasters or economic downturns.

The Treasury forecasts net core Crown debt to reduce to 19.1 per cent of GDP in 2021/22, providing a buffer against unexpected future events. This helps mitigate any deterioration in the economic or fiscal forecasts or the realisation of any fiscal risks.

The Government will prioritise investments to address the long-term financial and sustainability challenges facing New Zealand. Responsible investments that enhance the long-term wellbeing of New Zealanders will be prioritised – such as restarting contributions to the New Zealand Superannuation Fund (NZS Fund). In addition, we will invest in the infrastructure that supports our growing population, develops our regions' economic potential and reduces the long-term fiscal and economic risks of climate change.

Action taken in the 100-Day Plan and Budget 2018 make progress towards this goal. We have begun:

- Investment in regional infrastructure, particularly through the $1 billion per year Provincial Growth Fund.
- Contributions to the NZS Fund, which were restarted in December 2017, and are forecast to total $7.7 billion over the forecast period.
- Delivering a just transition to a more sustainable economy through initiatives such as the Green Investment Fund.
- Working towards the establishment of an Independent Climate Commission, and the Zero Carbon Act with a legislated emissions reduction target.

The Government will take a prudent approach to ensure expenditure is phased, controlled and directed to maximise its benefits. The Government will maintain its expenditure to within the recent historical range of spending to GDP ratio. On average for the past 20 years, core Crown spending has been around 30 per cent of GDP.

This Government will manage its expenditure carefully. The quality of public spending by government is vitally important in improving the wellbeing of all New Zealanders. We will take a responsible and balanced approach to the implementation of new policies, including the appropriate phasing of expenditure. We will scrutinise all current government expenditure to ensure it is best directed to improving productivity, sustainability, and opportunity for our economy and communities.

The Treasury forecasts that Government core Crown expenditure will peak at 28.5 per cent of GDP in 2018/19 – showing we are on track to meet this rule.

The Government will ensure a progressive taxation system that is fair, balanced and promotes the long-term sustainability and productivity of the economy. Taxation is an important tool for rebalancing the economy and setting New Zealand on a path to an economically and environmentally sustainable future. The Government believes that we need a better balance in our tax system to support our productive sector and ensure all taxpayers are paying their fair share.

The Treasury forecasts show that reversing the previous Government's unfocused tax cuts creates $8.4 billion of fiscal headroom over five years – this is enough to pay for the operating commitments set out in the 100-Day Plan, including the Families Package. Further, the Government has established the Tax Working Group to investigate possible changes to make our tax system fairer and more balanced. This meets the PFA requirement to ensure efficiency and fairness in the tax system.

Further details on the Government's specific short-term intentions and long-term objectives, as required by the PFA, can be found in the Annex.

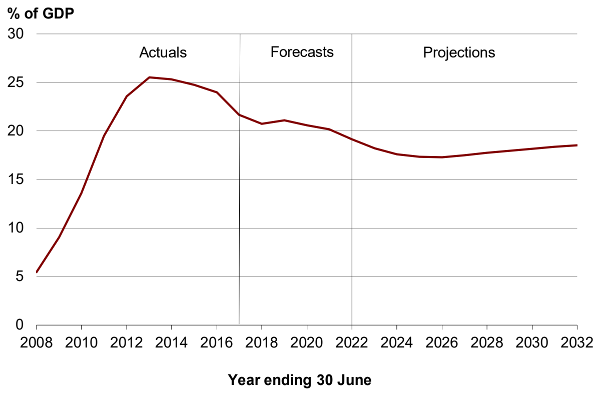
... because a strong fiscal position makes New Zealand more resilient.

Improving the Government's fiscal position makes New Zealand more resilient to future economic shocks and natural disasters, and helps us prepare for the costs associated with an ageing population, including higher superannuation and healthcare costs.

New Zealand has low government debt by international standards but is vulnerable to unexpected events, like earthquakes. The Budget Responsibility Rules ensure the Government makes responsible debt reductions, while also allowing for essential investment in the critical infrastructure and services to strengthen the economy and help us prepare for the future.

In addition to the fiscal forecasts that have been produced for the period 2017/18 to 2021/22, medium-term projections have been prepared through to 2031/32.

Figure 6 – Net core Crown debt projections



Source: The Treasury

Beyond 2021/22, projections show net core Crown debt as a share of GDP reaching a similar level in 2031/32 as the end of the forecast in 2021/22 (Figure 6). The projections assume a significant increase in capital allowances beyond 2021/22. These projections are consistent with the Budget Responsibility Rules. This is important because we face long-term fiscal challenges from an ageing population and the demand for public services. This is why we restarted contributions to the NZS Fund in our first 100 days. All governments should plan beyond the current term and take responsibility for future generations of New Zealanders.

Further details on fiscal projections, as required by the PFA, can be found in the Annex.

Allowances have been increased, remaining consistent with the Budget Responsibility Rules

Budget allowances show how much new investment and spending is available in each Budget for the Government to meet its fiscal priorities over the next four years. In the 2018 *Budget Policy Statement*, released in December last year, we signalled a proposed operating allowance of $2.6 billion per year and a capital allowance of $3.4 billion for this Budget, in addition to the investments already accounted for in the December mini-Budget as part of the 100-Day Plan. These were higher than the previous Government had allocated and were necessary to begin closing the social and infrastructure deficits faced by New Zealand.

We now have better information about the fiscal outlook and cost pressures than at the *Budget Policy Statement* in December. A strong economy and stronger fiscal position gives us choices. Given the clearer picture on the extent of the social and infrastructure deficits, the Government has chosen to further increase the operating allowance to $2.8 billion per year and the capital allowance to $3.8 billion for Budget 2018 (see Table 3).

We have also been able to increase the operating and capital allowances for future Budgets while meeting the Budget Responsibility Rules. Operating allowances for Budgets 2019, 2020 and 2021 will be increased to $2.4 billion per year and capital allowances will be increased to $3.7 billion in Budget 2019, $3.4 billion in Budget 2020 and $3.0 billion in Budget 2021 (before pre-commitments).

The Government is mindful of ensuring fiscal policy does not place undue pressure on monetary policy. A moderate fiscal impulse is broadly appropriate given the need for greater investment and the context of continuing subdued inflation, and historically low interest rates.

The total level of additional investment and expenditure is consistent with the Government's target of reducing net core Crown debt to 20 per cent of GDP within five years of taking office, and keeping expenditure around the long-run average of 30 per cent of GDP. The Government will use these allowances to prioritise responsible investments that enhance the long-term wellbeing of all New Zealanders and encourage productive, sustainable and inclusive growth.

Table 3 – Budget allowances

$billions	Budget 2018	Budget 2019	Budget 2020	Budget 2021
Operating allowances at *Budget Policy Statement*	2.600	1.875	1.875	1.875
Operating allowances at Budget 2018 (per year)	2.848	2.400	2.400	2.400
Capital allowances at *Budget Policy Statement*	3.400	3.400	3.100	2.700
Capital allowances at Budget 2018 (total)	3.804	3.700	3.400	3.000

Source: The Treasury

These allowances may change as the fiscal outlook develops and more information about the social and infrastructure deficits becomes available. In particular, as capital expenditure can be lumpy in nature the phasing of capital allowances will be kept under review to effectively manage demand.

Setting up an Independent Fiscal Institution

The Government will engage with the public on the creation of an Independent Fiscal Institution (IFI). The Budget Responsibility Rules include a commitment to establish "a body independent of Ministers of the Crown which will be responsible for determining if these rules are being met. The body will also have oversight of government economic and fiscal forecasts, shall provide an independent assessment of government forecasts to the public, and will cost policies of opposition parties".

IFIs have existed across the OECD for decades, and 26 of 35 OECD countries now have an IFI of some type. For example, the UK set up the Office for Budget Responsibility in 2010 and the Congressional Budget Office has been operating in the US since 1974.

A public discussion document will be released later this year to consider the roles that an IFI can play in promoting further fiscal transparency and accountability in New Zealand. Internationally there is no one-size fits all model. As Table 4 shows, the functions undertaken by IFIs vary considerably.

Table 4 – International examples of Independent Fiscal Institutions

Country	Established	High-level functions undertaken
Australia (Parliamentary Budget Office)	2012	• Role in policy costings, including election platforms • Analysis of long-term fiscal sustainability • Directly support legislature in budget analysis
Canada (Parliamentary Budget Office)	2008	• Role in policy costings, including election platforms • Preparation of alternative economic and fiscal forecasts • Analysis of long-term fiscal sustainability • Directly support legislature in budget analysis
Ireland (Irish Fiscal Advisory Council)	2011	• Assessment of economic and fiscal forecasts • Role in monitoring compliance with fiscal rules
United Kingdom (Office for Budget Responsibility)	2010	• Preparation of economic and fiscal forecasts • Role in monitoring compliance with fiscal rules • Analysis of long-term fiscal sustainability • Scrutiny of government policy costings
United States (Congressional Budget Office)	1974	• Role in policy costings • Preparation of alternative economic and fiscal forecasts • Analysis of long-term fiscal sustainability • Directly support legislature in budget analysis

Source: OECD Independent Fiscal Institutions Database (2017), http://www.oecd.org/gov/budgeting/OECD-Independent-Fiscal-Institutions-Database.xlsx

Budget and 100-Day Plan Priorities

As outlined in the Coalition Agreement between the New Zealand Labour Party and the New Zealand First Party, and the Confidence and Supply Agreement between the New Zealand Labour Party and the Green Party of Aotearoa New Zealand, we will work to provide New Zealand with a transformational Government, committed to resolving the greatest long-term challenges for the country, including sustainable economic development, increased exports and decent jobs paying higher wages, a healthy environment, a fair society and good government. We will reduce inequality and poverty and improve the wellbeing of all New Zealanders and the environment we live in.

This Budget builds on the December mini-Budget and 100-Day Plan…

The Coalition Government has put child poverty at the heart of policy development and decision-making. Our investments in the 100-Day Plan have made significant progress on this.

We are ensuring that the benefits of a growing economy are shared by a wide range of New Zealanders. We have already made a significant investment towards this in the December mini-Budget through the Families Package. This will deliver an average of $75 a week to 384,000 middle and low income families, and is expected to reduce the number of children in poverty by 64,000 by the time it is fully rolled out in 2021. The package also includes a new Best Start payment to help families with children in their early years and a Winter Energy Payment to help superannuitants and beneficiaries heat their homes through the coldest months.

We are lifting wages and giving genuine opportunities for pay equity. We increased the minimum wage by 75 cents to $16.50 an hour on 1 April and have a plan to raise the minimum wage in steps over the next three years to $20 an hour in 2020, taking effect in 2021.

We established KiwiBuild as part of the 100-Day Plan. This is a bold and ambitious programme which will deliver 100,000 affordable homes for first home buyers over the next 10 years. Our post-secondary fees-free education and training policy will boost our economy's skill base and productivity.

…and delivers on our Budget priorities.

Rebuilding critical public services. We are committed to properly funding critical public services, in particular health, education, our police, and family violence and justice services. New Zealanders should be able to access doctors and modern hospitals when they need to, our children deserve the best education in the world, and we have a responsibility to keep our communities safe by ensuring there are enough police on our streets to prevent crime. The Government also has a responsibility to rehabilitate offenders so they can reintegrate into the community without posing any threat.

Budget 2018 delivers an additional $3.2 billion for health operating expenditure, $750 million for health capital projects, and an additional $100 million in capital for DHB deficit support. This represents a more than 40 per cent increase in new operating funding, and a five-fold increase in new capital investment for health capital projects compared to Budget 2017. It provides investment in core services including maternity services, disability support, air ambulances and bowel screening.

In education, Budget 2018 provides a more than 40 per cent increase in operating funding compared to Budget 2017. It includes investment in early childhood education support to make up for previous underfunding and support for students with the highest and most complex learning needs through a boost to the Ongoing Resourcing Scheme and other learning support initiatives.

We are also providing significant funding for the Police striving towards adding 1,800 more officers, with a strong focus on community policing and combating organised crime.

Promoting economic development and supporting the regions. It is essential that the regions of New Zealand thrive again for the people who live there and to take pressure off some of our major urban centres. Long-term under-investment and inter-generational poverty are undermining areas of the country that have enormous economic potential.

The Provincial Growth Fund totals $1 billion in its first year, and will invest in regional economic development opportunities. The $1 billion is made up of $684 million of operating expenditure ($536 million new and $148 million existing) and $316 million of capital expenditure ($236 million new and $80 million existing).

Budget 2018 also includes funding for an R&D tax incentive to encourage business expenditure on innovation, and a National Research Information System to ensure investments maximise benefits for New Zealand.

We are backing New Zealand's ability to secure high-quality progressive trade agreements by increasing funding to the Ministry of Foreign Affairs and Trade. Our ability to export our goods and services is central to our ability to lift living standards and make the essential investments we need in our critical public services at home.

Taking action on child poverty, housing and homelessness. Through the 100-Day Plan and the Families Package, we made serious steps towards ensuring that every New Zealand child gets the benefits of growing up in a warm dry home, supported by families that have the resources they need, with schools that are high quality, and in communities that are strong. That goal of being the best country in the world to be a child is one that we carry with us throughout the work we do.

The Government will expand the Housing First initiative to support those who are chronically homeless, increase public housing by over 6,000 homes over four years, and provide funding for the Tamaki Redevelopment Company to support the regeneration of the area and increase the number of social and affordable homes. Funding is also provided to implement the Healthy Homes Guarantee Act 2017 so that renters live in healthy homes. We will also provide insulation grants for eligible low-income home owners.

Budget 2018 also includes funding to extend free GP visits to under-14s, provide extra support for children on the Orphan's Benefit and Unsupported Child's Benefit, and set up a new Child Poverty Unit to implement the requirements set out in the Child Poverty Reduction Bill.

Enhancing and protecting our natural resources. Climate change is the greatest challenge facing the world and has the potential to undermine our primary industries. But our response to it is also an opportunity to develop new high wage jobs. The Government's commitment is to sustainable development that provides a just transition to a low carbon economy.

Budget 2018 provides $100 million of funding for the Green Investment Fund. This fund aims to stimulate up to $1 billion of new investment in low-carbon industries. This will contribute both to New Zealand's climate targets and to the sustainability of our economy. Budget 2018 significantly increases funding for conservation and biodiversity, including strengthening the Department of Conservation's policy capability, eradicating predators, and protecting New Zealand's unique biodiversity.

Enriching New Zealand's culture and identity. This Budget will also contribute to developing our national identity through investment in Māori Development, Arts, Culture and Heritage, Defence, and Internal Affairs.

This includes funding to support the new Crown Māori relations portfolio and funding to develop and test programmes that are focused on improving outcomes for rangatahi (18- to 25-year-olds, in particular Māori) who are not in education, employment or training (NEETs).

Budget 2018 provides significant investment to celebrate our history, culture and identity – including the 125th anniversary of women's suffrage and Armistice Day commemorations. It also include funding for the Ministry for Culture and Heritage to build policy capability, and to implement initial recommendations from the Ministerial Advisory Group on Public Media.

We are investing in the New Zealand Defence Force and Budget 2018 will ensure we can continue making meaningful contributions to global security and peacekeeping efforts, and respond effectively to events like natural disasters at home and abroad.

Delivering the Coalition and Confidence and Supply Agreements

This Budget continues the work of the Government in delivering the policies set out within the Coalition Agreement between the New Zealand First Party and the New Zealand Labour Party, and the Confidence and Supply Agreement between the New Zealand Labour Party and the Green Party of Aotearoa New Zealand.

Building upon the policies and programmes in the 100-Day Plan, Budget 2018 will enable the implementation of a significant part of these agreements. Illustrative examples include the following initiatives:

- Re-establishing a New Zealand Forestry Service
- Free Doctors' Visits for all under 14 year-olds
- Expanding the Limited Service Volunteer Programme
- Introducing an Independent Climate Commission
- Significantly increasing funding for the Department of Conservation
- Reforming the taxation treatment of expenditure on Horse Racing Bloodstock
- Delivering the Provincial Growth Fund and supporting the planting of One Billion new trees
- Delivering a Green Investment Fund
- Implementation of a grant scheme for insulation and heating retrofits
- Establishing an Integrated Therapies Mental Health Pilot for all 18-25 year olds
- Providing additional resources for New Zealand's Biosecurity System
- Providing assistance to the agricultural sector to shift to more sustainable land uses, by providing further resources to the Sustainable Farming Fund.

Alongside the announcements in Budget 2018, this government is moving forward on a number of other Coalition Agreement and Confidence and Supply Agreement commitments. Examples include:

- Re-entering Pike River Mine
- Overhauling the welfare system, led by a Welfare Expert Advisory Group
- Developing a comprehensive set of environmental, social and economic new sustainability indicators
- Reprioritising the National Land Transport Fund toward investment in rail infrastructure, in cities and regions, and in cycling and walking
- Reviewing and reforming the Reserve Bank of New Zealand Act
- Strengthening the Overseas Investment Act
- Developing a 30 year Strategic Plan for Education
- Lifting the Minimum Wage to $16.50 an hour as part of delivering a Minimum Wage of $20 an hour by 2020, with the final increases taking effect in April 2021.

Further announcements on the development and delivery of Coalition and Confidence and Supply Agreements will be made in future Budgets. The Government is committed to delivering all of the policies and programmes set out within those agreements, and has the fiscal room to fund them through the operating and capital allowances.

Economic Strategy

The Government's plan will promote a more productive, more sustainable and more inclusive economy – one where we work smarter, make better use of our resources, ensure everyone has an opportunity to participate and the benefits of growth are spread across society. To deliver on the Government's vision, New Zealand is facing a major economic transformation. Successfully achieving a just transition to a low emission economy, and responding to the opportunities posed by technological changes, will require real shifts in the composition of our economy and the outcomes it generates. Government will support this change to ensure that the prosperity generated from success is shared broadly by all New Zealanders.

Lifting productivity is crucial for growing wages and improving wellbeing.

Our plan will deliver higher wages for New Zealanders, both now and in future. We are making sure the overall economic policy settings are right to support essential improvements in productivity. That means supporting an economy where New Zealanders' savings are investing in firms' capital needs, where capital is directed to productive uses, and where firms face the right incentives to innovate and add more value to the goods and services they produce.

A sustainable economy will support better wellbeing for New Zealanders now and in the future.

We know we need to work towards an economy that protects and promotes our environment while supporting our communities through a just transition to a net zero emissions economy. The Government sees an opportunity for New Zealand to be innovative and at the leading edge of change, responding to a world hungry for clean, high technology solutions.

But we see sustainability as broader than just environmental. It is also about planning ahead to ensure future generations are well-placed to be able to deal with and afford the long-term challenges we face. The Budget Responsibility Rules ensure that we manage the Government's finances sustainably by promoting resilience and focusing on longer-term outcomes. We will ensure our workforce is prepared to adapt to and benefit from the future of work, and to respond to disruptive technologies.

This Government is committed to shaping an inclusive economy with a fair share of prosperity for all New Zealanders.

The Government wants an economy that offers opportunity to all and harnesses peoples' talents while rewarding everyone fairly. The OECD has identified that inequality in income and wealth tend to compound over a lifetime. This can manifest in poorer health and education outcomes in children in a self-reinforcing cycle.

We see that too many people are missing out, despite the fact they are working hard, or want to work. This Government will prioritise initiatives that encourage our youth into employment, education or training, provide access to quality housing, partner with Māori and Pasifika, and support fair pay and conditions for workers.

We are setting up a tripartite Future of Work Forum to model the collaborative approach we will take to address the challenges facing workers and businesses. We are complementing this by requesting the Productivity Commission to provide insight into some of the key productivity challenges facing the New Zealand economy.

Productivity Commission and Future of Work Forum

The focus of Budget 2018 is rebuilding the foundations of our core public services so that New Zealanders receive the healthcare, education, housing and support for their communities that they expect and deserve. The Budget also moves to invest in the productive economy, in our regions and in R&D. We are setting the Productivity Commission's next two inquiry topics to complement this, and setting up a tripartite Future of Work Forum.

The Productivity Commission's next two inquiries cover:

- **Technological change, disruption and the future of work.** This inquiry will address a range of issues to better prepare policy makers and businesses for the potential challenges of rapid technological change and disruption. It will investigate how government policy can best support the adoption of technological change while at the same time ensuring social support and education/skills systems and regulatory settings are able to equitably manage rapid technological change.
- **Local government funding and financing**. This inquiry will examine the adequacy and efficiency of the existing local government funding and financing frameworks. It would make recommendations on whether additional revenue-raising tools are needed for local authorities and what changes, if any, are needed in central government's approach to funding and financing local government. The scope of this inquiry could cover a number of potential areas, including tourism costs, transport funding for roads, infrastructure support for new growth, and examining rates affordability for households.

Terms of reference will be referred to the Productivity Commission to enable the inquiries to begin in 2018/19.

A focus for this Government is working more collaboratively with stakeholders in shaping government policy. To enable greater collaboration, we are establishing a tripartite Future of Work Forum between the Government, the New Zealand Council of Trade Unions and Business New Zealand.

The purpose of the Forum will be to help shape the Government's work supporting New Zealand workers and businesses to confidently face the rapidly changing nature of work. The Forum will sit alongside other Government work already underway, such as the Tax Working Group and the Welfare Expert Advisory Group.

Strategy for Managing Revenue and Expenses

A prudent approach will be taken to ensure expenditure is phased, controlled, and directed to maximise its benefits.

The Government continues the fiscal management approach of fixed nominal baselines with Budget allowances for new funding that has been in place since 2003. The policy of fixed nominal baselines means that funding for most departments does not automatically increase every year to adjust for inflation. Budget allowances are the pool of new funding available each Budget (for both operating and capital expenditure) to fund cost increases and new initiatives.

Budget allocations will be tightly focused on our key priorities. The Government is committed to properly funding critical public services – in particular health, education, housing and police – and not artificially generating surpluses through underfunding.

The Government is actively focusing on reprioritising expenditure that is not aligned with its priorities or is of low value. This Budget includes the reprioritisation of $698 million in 2017/18 and over the next four years of low-value activities and those that are not aligned to this Government's priorities.

Future Budgets will continue the focus on reprioritisation, with deep dives into large and complex areas to ensure current spending provides value for money. We will identify options for redeploying funding to ensure that spending better reflects the Government's priority of improving the wellbeing of all New Zealanders.

We will ensure a progressive tax system that is fair, balanced and promotes the long-term sustainability and productivity of the economy.

The primary function of the tax system is to raise revenue to fund government expenditure. However, it should do this in a way that supports this Government's overall economic and fiscal goals.

The Government has established the Tax Working Group to consider whether improvements can be made to the structure, fairness and balance of the tax system.[3] The Group's Terms of Reference include an exploration of a wide-ranging set of issues that interact with the tax system, such as the changing nature of work and the role of taxes in improving environmental outcomes.

After the Group provides its final recommendations in February 2019, the Government will focus on considering its recommendations and making changes that will improve the structure, fairness and balance of the tax system. As promised before the election, any significant changes legislated for from the Group's final report will not come into force until the 2021 tax year, after the next election.

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[3] *Tax Working Group's Terms of Reference*, November 2017, https://taxworkinggroup.govt.nz/resources/terms-reference-tax-working-group

The Government has the following objectives for the tax system:

- A system that is efficient, fair, simple, coherent and collects the tax that is due, on time and in full.
- A progressive tax and transfer system for individuals and families.
- A system that promotes the long-term sustainability and productivity of the economy.
- A system that supports a sustainable revenue base to fund government operating expenditure around its historical level of 30 per cent of GDP.
- A system that treats all income and assets in a fair, balanced and efficient manner.

The Government is committed to raising revenue in ways that meet these objectives. We support a sustainable broad-base low-rate framework for the tax system. This ensures that taxes are fair and efficient, and that they do not impede economic growth. It also helps keep compliance costs low and minimises opportunities for avoidance and evasion.

The Government believes that the tax system can help in delivering positive environmental and ecological outcomes, especially over the longer term.

The Government will ensure that people and businesses pay their fair share of tax. This includes multi-national companies. We will continue to advance work at national and international levels to crack down on those who do not meet their obligations.

Another objective of the Government is to continually improve public confidence in the tax system and Inland Revenue. The system should help people meet their obligations, be fair, and inspire confidence. The Government will ensure that tax policy development is inclusive, consultative and transparent.

Strategy for Managing Assets and Liabilities

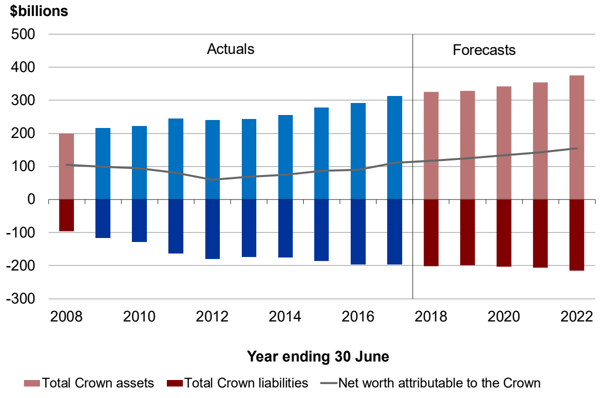
Assets and liabilities will be managed to improve wellbeing.

The most recent year-end results show the Crown currently owns $314 billion of assets and has $197 billion of liabilities. The difference between these numbers represents the Crown's net worth, which is forecast to grow from $111 billion in 2016/17 to $155 billion in 2021/22, or from around $23,000 to $30,000 per person in New Zealand.

The Treasury's 2018 *Investment Statement* found that social assets are ageing. The majority of schools and Housing New Zealand houses are more than 40 years old. A significant proportion of our health assets are in poor or very poor condition.

The Government is acutely aware of the infrastructure deficit in New Zealand and has a plan to address this. Capital investments will be a key focus of our Budgets, in particular, ensuring that infrastructure and services are in place to support improved wellbeing and that as a country we are actively planning for our future. In addition, we will work with local government and the private sector to design and deploy innovative mechanisms to finance and fund necessary infrastructure.

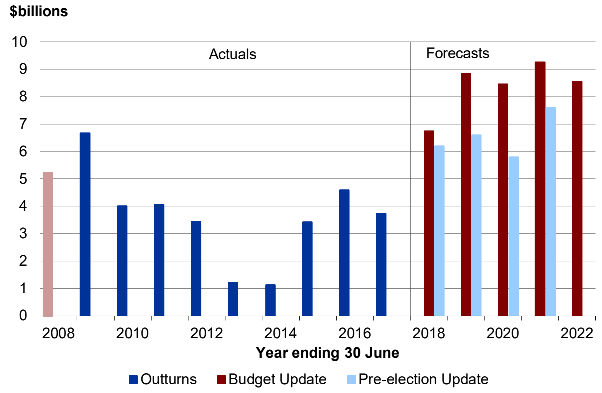
Figure 7 – Assets, liabilities and net worth



Source: The Treasury

The level of future capital spending is significantly higher than planned under the previous Government, with around $42 billion forecast to be spent on capital and infrastructure investments over the next five years (Figure 8).

Figure 8 – Net capital spending



Source: The Treasury

The Government is committed to driving value from these investments. We will make significant investments in regional infrastructure, particularly from the $1 billion per year Provincial Growth Fund, invest in housing infrastructure through KiwiBuild and our state house building programme, and transport infrastructure.

As in the previous government's *Fiscal Strategy Report 2017,* and the *Budget Policy Statement*, this Government will continue to recognise the importance of maintaining a sustainable New Zealand Government Bond (NZGB) market. Even if net core Crown debt falls below 20 per cent of GDP, the Government intends to maintain levels of NZGBs on issue at not less than 20 per cent of GDP over time. This supports ongoing government access to debt funding if needed, reduces volatility in the size of government borrowing programmes over time and provides wider capital market benefits.

Contributions to the NZS Fund will enhance the long-term wellbeing of New Zealanders.

The Government is prioritising responsible investments that enhance the long-term wellbeing of New Zealanders. Having restarted contributions to the NZS Fund as part of the 100-Day Plan, the Government intends to make regular contributions. These are projected to increase the size of the NZS Fund to $64 billion by 2022/23 and will help protect the Government's ability to pay superannuation at age 65. Maintaining a responsible fiscal position as well as restarting contributions to the NZS Fund will ensure future governments are in a position to meet future payments.

Table 5 – Contributions to the NZS Fund

Year ending 30 June	**2018**	**2019**	**2020**	**2021**	**2022**
$billions	**Forecast**	**Forecast**	**Forecast**	**Forecast**	**Forecast**
NZS Fund contributions - *prescribed by formula*	2.3	2.3	2.3	2.4	2.4
NZS Fund contributions - *Budget Update*	0.5	1.0	1.5	2.2	2.5

Source: The Treasury

As Table 5 shows, contributions to the NZS Fund will increase gradually over the next five years. This ensures that the Government can continue to meet its fiscal commitments, while responsibly investing for the future. This is a change from the previous Government's approach of not having made any payments since 2009. Estimates from the NZS Fund suggest that the Fund would have been more than $23 billion larger had contributions been maintained.

Infrastucture Investment Funding

The Government is acutely aware of an emerging infrastructure deficit in New Zealand which needs to be addressed. Capital investments will be a key focus of our Budgets, in particular ensuring that infrastructure and services are in place to support improved wellbeing, and that as a country we are actively planning for our future.

There are many different ways to fund infrastructure investment. We've put aside more than $42 billion over the next five years for direct net government capital investment, over $10 billion more than planned by the previous Government at Budget 2017.

To meet the infrastructure needs of New Zealand, we will also work with local government and the private sector to design and deploy innovative solutions and special purpose vehicles to further enhance new capital investment.

We aim to stimulate new investment in low carbon industries by 2020 through our $100 million Green Investment Fund, agreed as part of the Confidence and Supply agreement with the Green Party of Aotearoa New Zealand.

We recently announced a refreshed and fully costed Auckland Transport Alignment Project which will invest $28 billion over the next decade to unlock Auckland's growth potential. This will include funding from a range of sources, including the Auckland fuel tax and Crown Infrastructure Partners contributions.

In April, we released the draft Government Policy Statement on land transport 2018 (GPS 2018) which sets out the Government's priorities for expenditure from the National Land Transport Fund (NLTF) over the next 10 years. The NLTF spends around $4 billion each year in transport investments. The GPS sets out how funding is allocated between activities, such as road safety policing, state highways, local roads, public transport and other modes of transport. The final GPS 2018 is expected by 30 June 2018 following public engagement.

We will also extend the previous Government's move to give Housing New Zealand the ability to borrow directly from the market to help meet the growing need for state housing.

Conclusion

The Coalition Government, as demonstrated through this *Fiscal Strategy Report*, is fiscally responsible, is committed to policies that will create a productive, sustainable and inclusive economy, and will ensure that New Zealand is well-placed to handle any natural disasters or economic shocks.

Budget 2018 builds on the December mini-Budget and 100-Day Plan, taking the first steps in our plan for economic and social transformation that will deliver to New Zealanders an improved quality of life and better living standards for decades to come. The Government's approach will provide all New Zealanders with opportunity and security. There is a clear focus on sustainable economic development, supporting regional economies, increasing exports, lifting wages and reducing inequality.

Budget 2018 lays the foundations for the future of our economy and communities. A future that gives New Zealanders the confidence to meet new challenges, and seize the opportunities of our rapidly changing world.

Hon Grant Robertson
Minister of Finance

17 May 2018

Annex

Long-term Fiscal Objectives and Short-term Fiscal Intentions

The Government's long-term objectives relate to the next 10 years beginning in 2018/19. These long-term objectives are unchanged from those set out in the *Budget Policy Statement 2018*.

Table A1 – Long-term fiscal objectives

Fiscal Strategy Report 2018
Operating balance
The Government will deliver a sustainable operating surplus across an economic cycle.
Operating expenses
The Government will maintain its expenditure to within the recent historical range of spending as a ratio of GDP. The Government will take a prudent approach to ensure expenditure is phased, controlled, and directed to maximise its benefits, in particular prioritising investments to address the long-term financial and sustainability challenges facing New Zealand.
Operating revenues
The Government will ensure a progressive taxation system that is fair, balanced, and promotes the long-term sustainability and productivity of the economy.
Debt
Maintain total debt at prudent levels. The Government will reduce the level of net core Crown debt to 20 per cent of GDP within five years of taking office, and maintain it at prudent levels thereafter.
Net worth
The Government will strengthen net worth consistent with the debt and operating balance objectives.

The Government's short-term fiscal intentions (in Table A2 below) have not changed since the *Budget Policy Statement 2018,* except to update them based on the *Budget Economic and Fiscal Update* forecasts, including the impact of the Government's Budget allowances.

The short-term intentions and long-term objectives are consistent with each other, for example they both include a commitment to achieve net core Crown debt of 20 per cent of GDP within five years of taking office. The short-term intentions and long-term objectives are consistent with the principles of responsible fiscal management as set out in the Public Finance Act 1989. That is, they aim to:

- reduce total debt to prudent levels and achieve and maintain levels of total net worth so as to provide a buffer against adverse economic shocks
- ensure that, on average, total operating expenses do not exceed total operating revenues
- have regard to efficiency and fairness, including the predictability and stability of tax rates
- take into account the impact of fiscal policy on monetary policy
- prudently manage the fiscal risks facing government
- have regard for present and future generations, and
- ensure the Crown's resources are managed effectively and efficiently.

More detailed information about the principles of responsible fiscal management can be found at: https://treasury.govt.nz/publications/introduction-new-zealands-fiscal-policy-framework-html

Table A2 – Short-term fiscal intentions

Fiscal Strategy Report 2018	Budget Policy Statement 2018
Debt	***Debt***
Our intention is to reduce the level of net core Crown debt to 20 per cent of GDP within five years of taking office (subject to any significant shocks to the economy). Gross sovereign-issued debt (including Reserve Bank settlement cash and Reserve Bank bills) is forecast to be 27.3 per cent of GDP in 2021/22. Net core Crown debt (excluding NZS Fund and advances) is forecast to be 20.6 per cent of GDP in 2019/20, 20.2 per cent of GDP in 2020/21 and 19.1 per cent in 2021/22. This assumes new capital allowances of $3.8 billion in Budget 2018, $3.7 billion in Budget 2019, $3.4 billion in Budget 2020, and $3.0 billion in Budget 2021.	Our intention is to reduce the level of net core Crown debt to 20 per cent of GDP within five years of taking office (subject to any significant shocks to the economy). Gross sovereign-issued debt (including Reserve Bank settlement cash and Reserve Bank bills) is forecast to be 27.1 per cent of GDP in 2021/22. Net core Crown debt (excluding NZS Fund and advances) is forecast to be 21.9 per cent of GDP in 2019/20, 20.8 per cent of GDP in 2020/21 and 19.3 per cent in 2021/22. This assumes new capital allowances of $3.4 billion in Budgets 2018 and 2019, $3.1 billion in Budget 2020, and $2.7 billion in Budget 2021.
Operating balance	***Operating balance***
Our intention is to deliver operating surpluses (before gains and losses) to ensure net debt falls to 20 per cent of GDP within five years of taking office. The operating balance (before gains and losses) is forecast to be 1.1 per cent of GDP in 2017/18, rising to 1.7 per cent of GDP in 2019/20 and 2.1 per cent of GDP in 2021/22. This is consistent with the long-term objective for the operating balance. The operating balance is forecast to be 3.3 per cent of GDP in 2021/22.	Our intention is to deliver operating surpluses (before gains and losses) to ensure net debt falls to 20 per cent of GDP within five years of taking office. The operating balance (before gains and losses) is forecast to be 0.9 per cent of GDP in 2017/18, rising to 1.6 per cent of GDP in 2019/20 and 2.5 per cent of GDP in 2021/22. This is consistent with the long-term objective for the operating balance. The operating balance is forecast to be 3.8 per cent of GDP in 2021/22.
Expenses	***Expenses***
Our intention is to ensure expenses are consistent with the operating balance objective. Core Crown expenses are forecast to be 28.1 per cent of GDP in 2017/18 and 28.0 per cent of GDP in 2021/22. Total Crown expenses are forecast to be 36.2 per cent of GDP in 2021/22. This assumes new operating allowances of $2.8 billion per year in Budget 2018 and $2.4 billion per year in Budget 2019, 2020 and 2021.	Our intention is to ensure expenses are consistent with the operating balance objective. Core Crown expenses are forecast to fall from 28.5 per cent of GDP in 2017/18 to 27.6 per cent of GDP in 2021/22. Total Crown expenses are forecast to be 35.5 per cent of GDP in 2021/22. This assumes new operating allowances of $2.6 billion per year in Budget 2018 and $1.875 billion per year in each budget thereafter.
Revenues	***Revenues***
Our intention is to ensure sufficient revenue to meet the operating balance objective. Total Crown revenues are forecast to be 38.4 per cent of GDP in 2021/22. Core Crown revenues are forecast to be 30.4 per cent of GDP in 2021/22. Core Crown tax revenues are forecast to be 28.3 per cent of GDP in 2021/22.	Our intention is to ensure sufficient revenue to meet the operating balance objective. Total Crown revenues are forecast to be 38.2 per cent of GDP in 2021/22. Core Crown revenues are forecast to be 30.4 per cent of GDP in 2021/22. Core Crown tax revenues are forecast to be 28.3 per cent of GDP in 2021/22.

Fiscal Strategy Report 2018	Budget Policy Statement 2018
Net worth	***Net worth***
Our intention is to increase net worth consistent with the operating balance objective.	Our intention is to increase net worth consistent with the operating balance objective.
Total net worth attributable to the Crown is forecast to be 44.2 per cent of GDP in 2021/22.	Total net worth attributable to the Crown is forecast to be 44.7 per cent of GDP in 2021/22.
Total Crown net worth is forecast to be 45.8 per cent of GDP in 2021/22.	Total Crown net worth is forecast to be 46.4 per cent of GDP in 2021/22.

Fiscal Projections and Assumptions

Fiscal projections commence after the final forecast year (2021/22) and extend to 2031/32. The Fiscal Strategy Model (FSM) is used to develop the projections, with the forecast years acting as the projection base. The main changes to fiscal projections, since the *Fiscal Strategy Report 2017*, are changes to the assumptions for the operating and capital allowances across the projection horizon and a revision to the long-term stable tax-to-GDP ratios. The new allowance assumptions are consistent with the long-term objectives. Updated tax-to-GDP ratios reflect updated historical averages. Other changes to the FSM reflect updates to the economic and fiscal forecasts, including the outlook for nominal GDP.

These projections illustrate likely future progress towards achieving the Government's long-term objectives, including that net core Crown debt will be maintained at prudent levels, expenditure will be maintained within the recent historical range of spending as a ratio of GDP and that the Government will deliver sustainable operating surpluses across an economic cycle.

The full set of modelling assumptions is outlined on the Treasury website at https://treasury.govt.nz/information-and-services/financial-management-and-advice/fiscal-strategy/fiscal-strategy-model

Key assumptions include:

- Non-welfare spending growth is largely determined by operating allowances.
- For the projection period, starting with Budget 2022, operating allowances are assumed to be $2.2 billion per Budget and are assumed to grow at a rate of 4.5 per cent per year for subsequent Budgets.
- Capital allowances are assumed to be $9.5 billion in Budget 2022 and are assumed to grow at 4.5 per cent per year for subsequent Budgets.
- The long-term core Crown tax-to-GDP ratio is assumed to be 28.3 per cent.
- The economy is assumed to grow at trend growth rates with no economic cycles in the projections.

Table A3 – Summary of fiscal projections

Year ending 30 June	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	…	2032
% of GDP	**Forecasts**					**Projections**							
Core Crown revenue	29.5	29.9	30.1	30.2	30.4	30.1	30.3	30.3	30.3	30.4	30.4	…	30.5
Core Crown expenses	28.1	28.5	28.2	28.3	28.0	27.9	28.0	28.0	28.1	28.2	28.3	…	28.5
Total Crown revenue	37.8	38.1	38.3	38.4	38.4	38.3	38.4	38.5	38.5	38.6	38.6	…	38.7
Total Crown expenses	36.6	36.8	36.5	36.5	36.2	36.2	36.3	36.3	36.4	36.5	36.7	…	36.9
Total Crown OBEGAL[1]	1.1	1.2	1.7	1.7	2.1	1.9	2.0	2.0	2.0	1.9	1.8	…	1.7
Total Crown operating balance[2]	2.4	2.2	2.8	2.9	3.3	3.0	3.1	3.2	3.3	3.3	3.2	…	3.2
Gross sovereign-issued debt	32.6	29.3	28.6	27.0	27.3	26.2	25.5	25.1	25.0	25.2	25.4	…	26.2
Net core Crown debt[3]	20.8	21.1	20.6	20.2	19.1	18.2	17.6	17.3	17.3	17.5	17.7	…	18.5
Total Crown net worth	42.5	42.8	43.5	44.4	45.8	46.7	47.8	49.0	50.2	51.3	52.5	…	56.5
Net worth attributable to the Crown	40.4	40.9	41.7	42.7	44.2	45.1	46.3	47.5	48.7	49.9	51.1	…	55.3

Notes

1 Operating balance (before gains and losses).

2 Excludes minority interests.

3 Excludes the NZS Fund and advances.

Source: The Treasury